STAFF PAPER

September 2014

IFRS Interpretations Committee Meeting

IFRS IC January, May and July 2014

Project	Items for continuing consideration		
Paper topic	IAS 12 *Income Taxes* Measurement of current income tax on uncertain tax position		
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Introduction

1. The IFRS Interpretations Committee (the Interpretations Committee) received a request to clarify the recognition of a tax asset in the particular situation in which an entity makes a payment to tax authorities in respect of an uncertain tax position (UTP). The Interpretations Committee was asked to clarify whether IAS 12 *Income Taxes* or IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* should be applied to determine whether to recognise an asset in such a situation.

2. The Interpretations Committee discussed the issue in January, May and July 2014[1] and decided that it should consider separately the question of recognition and the question of measurement of income tax on UTPs. At its July meeting, the Interpretations Committee asked the staff to prepare a paper that would analyse the question of how to measure income tax on UTP. In particular, the Interpretations Committee asked the staff to analyse how detection risk and probability should be reflected in the measurement of tax assets and liabilities in such situations.

3. The objectives of this Agenda Paper are to:

   (a) provide background information on measurement of UTPs;

[1] Refer to the IFRIC Update for January 2014, May 2014 (Agenda Paper 5A) and July 2014 (Agenda Papers 3 and 3A).

(b) propose approaches to measurement of UTPs and make a staff recommendation; and

(c) ask the Interpretations Committee whether it agrees with the staff recommendation.

Background information

Existing guidance in IAS 12

4. Paragraph 46 of IAS 12 states that:

> Current tax liabilities (assets) for the current and prior periods shall be measured at the amount expected to be paid to (recovered from) the taxation authorities, using the tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

5. The Standard does not specify a measurement method. It also does not make an explicit reference to detection risk and unit of account.

Practices developed

Estimate and measurement method

6. The term 'amount expected to be paid' is not applied consistently across entities.

7. Several measurement methods are used in practice, most commonly by being aligned with 'best estimate' as labelled in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*) or US GAAP requirements as set out in UTPs (Topic 740-10-30-7 *Income Taxes Overall Initial Measurement* in the FASB *Accounting Standards Codification*®). They are:

(a) *Expected value* (the statistical mean[2]) measured using a probability-weighted average method, described in paragraph 39 of IAS 37;

(b) *Most likely estimate* (the statistical mode[2]) measured using an individual most likely outcome method, described in paragraph 40 of IAS 37; and

(c) Maximum amount that is more likely than not to occur estimate (a *'more-likely-than-not estimate',* similar to the statistical median[2]) measured using a method based on the largest amount that is greater than 50 per cent likely to being realised, which is required by US GAAP.

8. Example 1 in Appendix A illustrates the difference between these three measurement methods on the basis of a simplified fact pattern.

Detection risk

9. The term 'detection risk' in this context is the risk that the tax authority will detect an 'error' or misapplication of the taxation requirements and, accordingly, assess additional (less) tax. Detection risk of 100 per cent means that the tax authority will detect all such errors or misapplication. In other words, it is assumed that the authority will examine the amounts reported to it and has full knowledge of all relevant information.

10. The question arises as to what level of detection risk should be assumed. Should an entity assume 100 per cent detection risk or instead include some estimate of a 'likely' detection risk in determining the measurement of tax assets and liabilities, similarly to other risks and uncertainties. Example 2 in Appendix A illustrates the impact of detection risk assumption on measurement of UTPs.

Unit of account

11. In this context, the unit of account is the level at which tax assets and liabilities are aggregated or disaggregated for recognition and/or measurement purposes. We understand that in practice tax positions are either considered at the level of an individual position (income or deduction), or grouped at the level of a particular tax authority, jurisdiction or entity as a whole. In some cases the selection of the unit of account may affect the measurement of UTPs[3].

[2]Mean is an average. A probability-weighted average formula is usually applied to compute the mean.
Mode is the most common value among a group.
Median is the numerical value separating the higher half of a probability distribution from the lower half.

[3] As explained in paragraph 31 below, it does *not* affect measurement in the case in which expected value is applied. However, it *may* affect measurement in some cases in which a single-point estimate is applied.

IASB discussions in 2009: proposal in the Exposure Draft Income Tax *(ED/2009/2)*

Approach proposed in the ED/2009/2[4]

12. Paragraph 26 of the ED/2009/2 stated that (*emphasis* added):

> Uncertainty about whether the tax authorities will accept the amounts reported to them by the entity affects the amount of current tax and deferred tax. An entity shall measure current and deferred tax assets and liabilities using the *probability-weighted average amount of all the possible outcomes, assuming that the tax authorities will examine the amounts reported to them and have full knowledge of all relevant information*. Changes in the probability-weighted average amount of all possible outcomes shall be based on new information, not a new interpretation by the entity of previously available information.

13. Paragraph BC63 of the *Basis for Conclusions on ED/2009/2* explained that (an extract below):

> <…> the Board does not intend entities to seek out additional information for the purposes of applying this aspect [a probability-weighted average] of the proposed IFRS. Rather, it proposes only that entities do not ignore any known information that would have a material effect on the amounts recognised.

14. The proposal was aligned with the IASB thinking in *Proposed Amendments to IAS 37*[5], which required that no probability-based *recognition* threshold should be applied. Instead, the uncertainty was included in the *measurement*. The basis for reaching this conclusion is further explained in paragraph BC60 of the *Basis for Conclusions on ED/2009/2* (an extract below):

[4] Refer to the text of ED/2009/2 and the Basis for Conclusions on ED/2009/2.

[5] Refer to the text of *Proposed Amendments* issued in June 2005 and in January 2010.

> <…> the Board believes that the use of a probability-weighted average of all possible outcomes, without any probability-based recognition threshold, provides more relevant information than an approach that uses a probability-based recognition threshold. No possible outcomes are ignored in the measurement.

15. The IASB and FASB did not reach similar conclusions on the measurement method of UTPs. The boards noted that (an extract from paragraph BC61):

> <…> The boards observed, however, that the divergence arises from different approaches to uncertainty more generally in IFRSs and US GAAP. The boards are addressing these differences in the joint conceptual framework project and do not think they can be resolved in a convergence project on income tax.

16. Paragraph 26 of the ED/2009/2 required entities to assume that the tax authorities will examine the amounts reported to them and have full knowledge of all relevant information (a 100 per cent detection risk). The proposal was aligned with US GAAP requirements (Topic 740-10-30-7 *Income Taxes Overall Initial Measurement* in the FASB *Accounting Standards Codification*®).

17. The ED/2009/2 did not define 'unit of account'.

Feedback received on the ED/2009/2

18. The vast majority of respondents did not support the proposal to prescribe a probability-weighted average method as the single measurement method[6]. They argued that the IASB should not rely on the *Proposed Amendments to IAS 37* for which the due process had not been yet completed. Many respondents instead suggested the use of the most likely outcome method, because it is consistent with the existing requirements of IAS 37. Some respondents suggested aligning the IFRS requirements with US GAAP guidance.

[6] Refer to paragraphs 42 to 51 of the Comment letter analysis discussed in October 2009.

19. The main arguments against the probability-weighted average method were:

    (a) the outcome of applying probability-weighted average method would rarely equal the actual outcome, because all tax positions contain some level of uncertainty and many UTPs are binary in nature;

    (b) because of the nature of tax uncertainties, it would not often be possible to measure them reliably (eg tax cases relating to business combinations or transfer pricing). Consequently, it seems unreasonable to expect the high level of precision implied by this method; and

    (c) entities would need to perform significant additional work in analysing and assessing the information in order to demonstrate that they had fully considered all possible outcomes and that the judgements on those outcomes were supportable.

20. Despite the general disagreement with the proposed method, the expected value measurement was strongly supported by the user group that responded to the ED, by professionals who seemed to have an academic background and by the tax authority that responded. Most supporters expressed a view that the expected value approach was conceptually superior to single-point estimates (most likely and more-likely-than-not). Some of the proponents of the expected value measurement method suggested the introduction of a more simplified approach, eg a probability-weighted average method based on a limited number of outcomes (a minimum, most likely and maximum outcome[7]).

Status of the project

21. Taking into account the feedback received, the IASB decided not finalise the ED/2009/2, but instead to undertake some limited-scope amendments to IAS 12[8]. In March 2010, the IASB decided that it should not do further work on uncertain tax positions until it had completed the redeliberations on the *Proposed Amendments to IAS 37*. However, IAS 37 was not revisited. In 2012 work on *Liabilities*—amendments to IAS 37 was moved to the research programme, while

[7] Eg refer to comment letter 60 http://www.ifrs.org/Current-Projects/IASB-Projects/Income-Taxes/ED-march-09/Comment-Letters/Documents/CL60.pdf.

[8] Amendment *Deferred Tax: Recovery of Underlying Assets* was issued in December 2010.

the IASB refocused its efforts on reviewing the definition of a liability as part of the *Conceptual Framework* project. The IASB plans in 2015 to discuss how IAS 37 could be revised or replaced in the light of the likely revisions to the *Conceptual Framework*.

22. Accounting for income tax was also identified as a possible longer-term research project in the Feedback Statement resulting from the IASB agenda consultation 2011. Preliminary work on the research project is not expected to commence until after the 2015 agenda consultation.

IASB discussions in 2011: a cross-cutting issue on measurement of uncertainties

23. In February 2011, the IASB and FASB discussed staff papers dealing with measurement of uncertainties.[9] This issue was discussed as a cross-cutting issue within the context of *Revenue Recognition*, *Leases* and *Insurance Contracts* projects. The staff papers also envisaged that the analysis might be used in other projects, including a project on UTPs.

24. The objective of the staff papers was to provide the boards with analysis that would be helpful when they need to make decisions about measuring uncertain assets and liabilities.

25. The staff papers noted that an expected value might be viewed as the most relevant measurement if:

    (a) the objective is to measure the current value; or

    (b) outliers (extreme, relatively unlikely outcomes) are important for users, eg if the outliers are large outflows; or

    (c) other measures would be susceptible to 'cliff edges', eg if the distributions are likely to have two almost equally probable outcomes; or

    (d) specifying the unit of account is difficult.

[9] Refer to Agenda Papers 2, 2A and 2B: http://www.ifrs.org/Meetings/Pages/IASB-meeting-February-2011.aspx.

26. A more-likely-than-not estimate might be viewed as the most relevant measurement if:

    (a) the objective is to predict future cash flows; or

    (b) outliers are less important for users or more uncertain than central outcomes; or

    (c) the transactions do not recur frequently enough for their average outcomes to approximate to the long-run average; or

    (d) expected value is more difficult to measure.

27. A most likely estimate might be viewed as the most relevant measurement when it is assumed that the distribution of outcomes is approximately symmetrical about a single most likely outcome.

28. The staff papers also described three other measures that are mentioned in accounting literature. We do not provide details on these measures in this Agenda Paper because they are not common in practice.

IASB discussions in 2014: a discussion on measurement of uncertain cash flows within the context of the Conceptual Framework *project*

29. In July 2014, the IASB discussed different approaches to dealing with uncertain cash flows within the context of the *Conceptual Framework* project[10].

30. The IASB tentatively decided that the Exposure Draft of the *Conceptual Framework* should include some guidance on the different approaches to measurement of uncertain cash flows. In particular, Agenda Paper 10L noted that:

    (a) When measuring an asset or liability by reference to uncertain future cash flows, it is necessary to represent the range of possible cash flows by selecting a single amount (a central estimate).

[10] Refer to the IASB Update and to paragraphs 23 to 25 of the Agenda Paper 10L, in particular.

(b) Different central estimates provide different information. For example:

(i) expected values are used in estimating the value of a liability at the measurement date;

(ii) a more-likely-than-not estimate indicates that the probability of a subsequent outflow is no more than 50 per cent; and

(iii) a most likely estimate attempts to predict the ultimate outflow arising from a liability rather than the value of that liability at the measurement date.

(c) No one central estimate gives complete information about the range of possible outcomes. To provide complete information, disclosure of additional information may be needed.

31. The staff papers for the July meeting also noted that when expected value is used, measurement of uncertainty would not depend on the unit of account. This is because expected values are additive, ie the expected value of a portfolio equals the sum of the expected values of the items within the portfolio. However, measurement may be affected by the selected unit of account in some cases in which a single-point estimate is applied.[11]

IASB decisions in 2014: decisions taken on measurement of variable consideration in IFRS 15 Revenue from Contracts with Customers

32. In the 2010 Exposure Draft the boards (the IASB and the FASB) proposed that an entity should measure the transaction price of the variable consideration using a probability-weighted method. Many respondents to the 2010 Exposure Draft disagreed with this proposal[12] because they reasoned the probability-weighted method would:

(a) add complexity and be costly to apply; and

[11] This point is illustrated in Example 6 in Agenda Paper 2A discussed by the IASB in February 2011 (http://www.ifrs.org/Meetings/Pages/IASB-meeting-February-2011.aspx). It illustrates a particular situation when each item has the same possible outcomes. In this particular situation, measurement would depend on the unit of account applied.

[12] Refer to paragraphs BC196-BC197 of IFRS 15.

(b) impede the reporting of meaningful results in all circumstances because, for example, it could result in an entity determining the transaction price at an amount of consideration that the entity could never obtain under the contract.

33. After their deliberations, the boards decided to specify that an entity should estimate variable consideration using either the expected value or the most likely amount depending on which method the entity expects to better predict the amount of consideration. Paragraph 53 of IFRS 15 states that (an *emphasis* added):

> An entity shall estimate an amount of variable consideration by using either of the following methods, *depending on which method the entity expects to better predict the amount of consideration to which it will be entitled*:
>
> (a) *The expected value*—the expected value is the sum of probability-weighted amounts in a range of possible consideration amounts. An expected value may be an appropriate estimate of the amount of variable consideration if an entity has a large number of contracts with similar characteristics.
>
> (b) *The most likely amount*—the most likely amount is the single most likely amount in a range of possible consideration amounts (ie the single most likely outcome of the contract). The most likely amount may be an appropriate estimate of the amount of variable consideration if the contract has only two possible outcomes (for example, an entity either achieves a performance bonus or does not).

Staff analysis

(a) Estimate and measurement method

34. IAS 12 requires tax assets and liabilities to be measured at the *amount expected* to be paid to (recovered from) the taxation authorities. The Standard does not specify a measurement method.

35. We identified two alternative views on measurement methods. These views are:

    (a) *View (a)1*: requiring the measurement of UTPs at their expected value when the level of uncertainty is high. Other estimates can be applied when the level of uncertainty is not high.

    (b) *View (a)2*: permitting the measurement of UTPs at either of the following estimates:

        (i) expected value,

        (ii) most likely estimate, or

        (iii) more-likely-than-not estimate,

        depending on which estimate the entity expects to better depict the amount payable to (recoverable from) the taxation authorities.

36. We think that both views:

    (a) are consistent with the existing guidance in IFRS;

    (b) do not contradict the recent IASB discussions of measurement of uncertainties; and

    (c) take into account the concern about cost constraints raised by the respondents to the ED/2009/2. The concern is that it would be unduly onerous to apply the expected value when the level of uncertainty is low. This is because an entity would need to assess the probabilities of several expected outcomes and compute the expected value, even if one particular outcome is highly probable. Many respondents to the ED/2009/2 thought that using a single-point estimate (eg most likely estimate) would be more appropriate in such cases.

37. These views are based on the analysis of the proposals in the ED/2009/2 and on the recent discussions of similar issues by the IASB. We acknowledge that other views are possible.

View (a)1: measurement at expected value when the level of uncertainty is high

38. Under this view UTPs are measured at their expected value using a probability-weighted average method when the level of uncertainty is high. Limiting the scope of circumstances in which expected value is applied allows for other measurement methods to be used. Those methods are considered to be sufficiently reliable in the circumstances when the level of uncertainty is low.

39. The arguments in favour of this view are:

    (a) Under this view an entity would be able to apply other estimates when the level of uncertainty is low and measurement at expected value is unduly onerous.

    (b) The use of expected values together with suitable disclosures about risk and uncertainty is capable of providing complete, neutral and useful information. This is because:

        (i) Expected value ensures that measurement always reflects the uncertainty about future events. This will be the case even if a UTP has an 'all or nothing' outcome. Proponents of this view think that providing an estimate is a better approach than presenting a zero value.

        (ii) Expected value is less dependent on a single outcome than a single-point estimate would be. For that reason, it is a more neutral depiction of the financial position of an entity.

40. If this view is supported by the Interpretations Committee, it could develop guidance to require that:

    (a) UTPs should be measured at their expected value using a probability-weighted average amount of expected outcomes; and

(b) expected value should *not* be required to measure tax positions that contain only a low level of uncertainty[13].

41. If this view is taken, the Interpretations Committee would not need to define the unit of account for measurement purposes. This is because measurement using expected value would not depend on the unit of account, as noted in paragraph 31 above.

View (a)2: measurement at either of the three central estimates, depending on which estimate the entity expects to better depict the amount payable (recoverable)

42. Under this view UTPs are measured at one of the following three central estimates: expected value, most likely estimate or more-likely-than-not estimate. An entity would need to consider which estimate and measurement method it expects to better depict the amount payable (recoverable).

43. This view is similar to the approach taken by the boards (the IASB and the FASB), when they developed IFRS 15.[14] However, IFRS 15 allows a choice of two estimates (expected value and most likely estimate). View (a)2 also permits a more-likely-than-not estimate which is required for measurement of UTPs by US GAAP.

44. The arguments in favour of this view are:

(a) Under this view an entity would be able to apply a single-point estimate in cases in which measurement at expected value is unduly onerous.

(b) This approach would provide the framework for measurement of UTPs.

(c) Under this view measurement requirements in respect of income tax would be close to the general measurement requirements in respect of uncertainties in IAS 37.

(d) Some argue that even detailed guidance on measurement would not achieve comparability of information about UTPs across companies,

[13] We will bring a staff proposal for the scope of the project to a future meeting, if View (a)1 is supported by the Interpretations Committee.

[14] Refer to paragraphs 32-33 of this paper.

because of the managements' judgements involved and the complexity of tax laws. This point was made in the post-implementation review report on FIN 48[15].

45. If this view is supported by the Interpretations Committee, guidance on the following issues could be developed:

(a) circumstances in which particular central estimates are relevant; and

(b) unit of account for measurement purposes (subject to further staff analysis and discussion by the Interpretations Committee)[16].

Staff view

46. We support View (a)1 for the following reasons:

(a) We think it would improve financial reporting by providing a detailed guidance on the method to measure UTPs.

(b) For the reasons listed in paragraph 39 above, we think that expected value is a more appropriate measure to value uncertainties than single-point estimates.

47. We do not support view (a)2 for the following reasons:

(a) We do not think that this approach would significantly improve financial reporting, because it would still allow diverse methods to measure UTPs.

(b) Even if this view is taken, requirements on income tax uncertainties (within the scope of IAS 12) would not be fully aligned with general requirements on other uncertainties, eg uncertainties in respect of other taxes (within the scope of IAS 37). This is because of the different recognition requirements in the Standards.

[15] http://www.accountingfoundation.org/cs/ContentServer?site=Foundation&c=Document_C&pagename=Foundation/Document_C/FAFDocumentPage&cid=1176159654068.

[16] We will bring analysis of the issue to a future meeting, if the Interpretations Committee decides to develop guidance on the basis of View (a)2. The Interpretations Committee would not need to address this issue if expected value is applied for the reasons stated in paragraph 31 above.

48. Consequently, we propose to clarify that UTPs should be measured at their expected value using a probability-weighted average amount of expected outcomes (view (a)1).

49. Having said that, we acknowledge concerns in respect of expected value raised by the respondents to the ED/2009/2. Many respondents argued that nearly all tax positions contain some level of uncertainty. They thought that applying expected value could be unduly onerous in cases in which there is only a low level of uncertainty. We think that this concern could be addressed by:

    (a) limiting the scope of circumstances in which expected value would be required[17]; and

    (b) stating explicitly that a probability-weighted average method based on a limited number of outcomes could be applied. An entity could reduce the number of expected outcomes by identifying a sample that is representative of the complete distribution (eg minimum, most likely and maximum outcome).

50. We think that if guidance is developed taking into account the proposals above, costs to apply expected value would be justified by the benefits of reporting that information.

(b) Detection risk

51. IAS 12 does not make an explicit reference to detection risk. We identified two alternative views on how detection risk could be reflected in the measurement of UTPs.

View (b)1: assumed 100 per cent detection risk

52. Under this view an entity should assume that the tax authorities will examine the amounts reported to them and have full knowledge of all relevant information (assumed 100 per cent detection risk). This view was supported by the IASB when it developed the ED/2009/2 and is consistent with US GAAP requirements.

[17] If View 1(a) is taken by the Interpretations Committee, we will bring our proposal of the scope of the project to a future meeting.

53. The basis for this view is that income tax should be assessed based on the legally enforceable obligations, irrespective of the entity's expectation in respect of the detection risk. This is because:

    (a) IAS 12 requires an entity to measure tax assets and liabilities on the basis of *enacted or substantially enacted tax laws* (refer to paragraphs 5 and 46 of IAS 12).

    (b) The concept of detection is not consistent with the definition of a liability as a present obligation. Paragraph 4.15 of the *Conceptual Framework* describes an obligation as "a duty or responsibility to act or perform in a certain way".

View (b)2: detection risk is included in the measurement

54. The alternative view is to include an assessment of the detection risk in the measurement of tax assets and liabilities. Under this view, detection risk is taken into account in determining "the amount expected to be paid to (recovered from) the taxation authorities", similarly to other risks and uncertainties.

Staff view

55. We support View (b)1 because we think that it is consistent with the measurement requirements in IAS 12 and with the concept of liability.

56. Consequently, we propose to clarify that an entity should assume that the tax authorities will examine the amounts reported to them and have full knowledge of all relevant information.

Assessment against agenda criteria

57. Our assessment against the Interpretations Committee agenda criteria[18] is as follows:

[18] As presented in paragraphs 5.16, 5.17 and 5.21 of the *IFRS Foundation Due Process Handbook*.

Agenda criteria	
We should address issues:	
that have widespread effect and have, or are expected to have, a material effect on those affected.	The issue is widespread. We have not performed separate outreach in order to conclude whether the effect of applying different measurement methods could be material.
where financial reporting would be improved through the elimination, or reduction, of diverse reporting methods.	Yes, if View (a)1 is taken. The feedback we received indicates that there is a need for guidance. We acknowledge that if View (a)2 is taken, different measurement methods would still be allowed.
that can be resolved efficiently within the confines of existing IFRS and the *Conceptual Framework for Financial Reporting*.	Yes.
In addition:	
Is the issue sufficiently narrow in scope so that the Interpretations Committee can address this issue in an efficient manner, but not so narrow that it is not cost-effective for the Interpretations Committee to undertake the due process that would be required when making changes to IFRS?	Yes.
Will the solution that was developed by the Interpretations Committee be effective for a reasonable time period?	Yes.

Summary of staff recommendation

58. We think that it is within the Interpretations Committee's remit to develop guidance on measurement of UTPs that responds to the diversity in practice.

59. We propose to require that:

    (a) UTPs are measured at their expected value using a probability-weighted average amount of expected outcomes when the level of uncertainty is high (View (a)1). The number of outcomes taken into account could be reduced by identifying a sample that is representative of the complete distribution.

(b) An entity should assume that the tax authorities will examine the amounts reported to them and have full knowledge of all relevant information (View (b)1).

60. We recommend to develop guidance on measurement of UTPs because:

(a) We think that the identified diversity in practice in respect of the measurement of UTPs indicates that the existing guidance is not sufficiently clear.

(b) We understand that the IASB research project on *Income Tax* is not expected to commence until after the 2015 agenda consultation. Developing guidance on this particular issue would be an appropriate interim solution.

61. We also think that the Interpretations Committee could develop guidance on this issue, if the scope of the project is clearly defined. In particular, we propose to exclude tax positions that contain a low level of uncertainty from the scope of the project. If the Interpretations Committee agrees to proceed with the project, we will bring an analysis of the proposed scope of the project to a future meeting.

Questions for the Interpretations Committee

Questions for the Interpretations Committee
1. Does the Interpretations Committee agree with the staff proposal in paragraph 59? If not, what alternative do you recommend?
2. Does the Interpretations Committee agree to proceed with the project on measurement of UTPs?

Appendix A—
Illustrative examples

Example 1—Measurement methods

A1. Entity A included in its tax return deductions that might be challenged by the tax authorities. Entity A estimates the probability that tax authorities would accept that deduction as follows[19]:

	Estimated outcome, CU	Individual probability, %	Cumulative probability, %	Estimate of expected value, CU
Outcome 1	100	30%	100%	30
Outcome 2	**200**	25%	**70%**	50
Outcome 3	**600**	**35%**	45%	210
Outcome 4: deduction would be accepted in full	1,000	10%	10%	100
		100%		**390**

A2. Entity A assessed the amount of the deduction (benefit) using different measurement methods as follows:

(a) CU390 under a probability-weighted average method;

(b) CU600 under an individual most likely outcome method. This is the outcome with the highest individual probability: 35 per cent; and

(c) CU200 under a more-likely-than-not method. This is the maximum amount that has a cumulative probability greater than 50 per cent.

Example 2—Detection risk

A3. Example 1 above is based on the assumption that the tax authority would examine the amount reported to it and have full knowledge of all relevant information (a 100 per cent detection risk).

[19] In these examples monetary amounts are denominated in 'currency units' (CU).

A4. The second example uses the basic fact pattern described above, but it is based on the assumption that the detection risk is different from 100 per cent and that Entity A includes the detection risk in its assessment of the income tax on UTP.

A5. Entity A estimates the probability that the tax authority will *not* examine the amount reported to it as 40 per cent.

A6. Taking into account the detection risk, Entity A estimates the probability that the tax authorities would accept that deduction as follows :

	Estimated outcome, CU	Adjusted individual probability, %	Adjusted cumulative probability, %	Estimate of expected value, CU
Outcome 1	100	18% (60%*30%)	100%	18
Outcome 2	200	15% (60%*25%)	82%	30
Outcome 3	**600**	21% (60%*35%)	**67%**	126
Outcome 4: deduction would be accepted in full; or tax authorities would not examine the amounts reported to them	**1,000**	**46%** (60%*10% +40%)	46%	460
		100%		**634**

A7. The amount of the deduction (benefit) in this example would be equal to:

(a) CU634 (compared to 390 CU in Example 1) under a probability-weighted average method;

(b) CU1,000 (compared to 600 CU in Example 1) under an individual most likely outcome method. This is the outcome with the highest individual probability: 46 per cent; and

(c) CU600 (compared to 200 CU in Example 1) under more-likely-than-not method. This is the maximum amount that has a cumulative probability greater than 50 per cent.

A8. This example demonstrates that the amount of the deduction (benefit) would be higher if Entity A includes the detection risk in the measurement of the UTP.