IFRS Accounting

Staff paper

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Contacts	Nhlanhla Mungwe (nmungwe@ifrs.org) Siok Mun Leong (smleong@ifrs.org) Mariela Isern (misern@ifrs.org)

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Objective

1. This paper sets out staff analysis and recommendations on the proposals in the Exposure Draft *Regulatory Assets and Regulatory Liabilities* (Exposure Draft) dealing with the recognition and measurement of regulatory assets and regulatory liabilities arising from performance incentives that test an entity's performance over several periods (long-term performance incentives).

Staff recommendations

2. The staff recommend that the final Accounting Standard retains the proposal that an entity is required to estimate the amount of a long-term performance incentive and determine the portion of that estimated amount that relates to the reporting period using a reasonable and supportable basis.

Structure of the paper

3. This paper is structured as follows:

    (a) proposals in the Exposure Draft (paragraphs 5–7);

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(b) feedback received (paragraphs 8–10);

(c) the IASB's tentative decisions (paragraph 11);

(d) outreach (paragraphs 12–34); and

(e) staff analysis (paragraphs 35–64).

4. This paper includes two appendices:

(a) Appendix A describes the stakeholders we contacted to gather feedback on long-term performance incentives.

(b) Appendix B provides a comparison between the proposals in the Exposure Draft and the alternative approaches suggested by respondents.

Proposals in the Exposure Draft

5. The Exposure Draft proposed that:

(a) amounts relating to a performance incentive form part of or reduce the total allowed compensation for goods or services supplied in the period in which an entity's performance gives rise to the incentive (a bonus or a penalty—paragraph B17 of the Exposure Draft).

(b) if the performance criteria test an entity's performance over a time frame that is not yet complete, the entity would estimate the amount of the performance incentive using the 'most likely amount' method or the 'expected value' method and then determine the portion of that estimate that relates to the reporting period. That portion forms part of or reduces the total allowed compensation for goods or services supplied in the reporting period. An entity should use a reasonable and supportable basis in determining that portion and apply that basis consistently (paragraph B19 of the Exposure Draft).

6. Paragraph BC106 of the Basis for Conclusions accompanying the Exposure Draft says that in arriving at the proposal described in paragraph 5(b), the IASB rejected two alternatives:

(a) recognising a performance incentive only when the outcome is known (referred to as 'first alternative' in paragraph 7); or

(b) recognising a performance incentive only when a specified probability threshold is met (referred to as 'second alternative' in paragraph 7).

7. Paragraphs BC108–BC109 explain the reasons why the IASB rejected these two alternatives (**emphasis added**):

> BC108 In the **first alternative**, an entity would recognise a performance incentive only when the outcome is known. That alternative reflects a view that the entity has no right to a bonus or obligation for a penalty until it has met or failed to meet all the performance criteria. However, the Board concluded that supplying goods or services gives an entity an enforceable present right to the total allowed compensation for those goods or services, even if the amount of that total allowed compensation remains uncertain until the entity meets the performance criteria (and might even turn out to be nil).
>
> BC109 In the **second alternative**, an entity would recognise a performance incentive only when a specified probability threshold is met. That alternative might specify the same threshold for both a bonus and a penalty, or one threshold for a bonus and a different threshold for a penalty. One example of applying a probability threshold is the treatment of variable consideration in IFRS 15. In contrast, the proposals in the Exposure Draft do not use probability thresholds, except when it is uncertain whether a regulatory asset or regulatory liability exists (existence uncertainty). In the Board's view, uncertainty about the amount of total allowed compensation for goods or services already supplied (outcome uncertainty) does not create uncertainty about whether the entity's right to that amount of total allowed compensation exists (existence uncertainty). The Board also considers that including a

probability threshold would add unnecessary and unhelpful complexity to the model and would provide less timely information to users of financial statements.

Feedback received

8. Some respondents (mostly national standard-setters and preparers in Europe and Asia-Oceania and a few accounting firms) were concerned about the significant outcome and measurement uncertainties that arise from some long-term performance incentives.[1] Some long-term performance incentive schemes may give rise to either a regulatory asset if an entity meets the performance targets or a regulatory liability if the entity fails to meet those targets. Those respondents said that estimating the future cash flows in a range of possible outcomes, especially early in the performance period, would be very costly and subjective.

9. Consequently, some of these respondents suggested that:

   (a) an entity should recognise regulatory assets and regulatory liabilities arising from long-term performance incentives if they meet an 'existence' threshold and can be *reliably measured*, or the amount and timing of future cash flows *are known*.

   (b) the final Standard should include a constraint on the measurement of regulatory assets and regulatory liabilities arising from long-term performance incentives, similar to the constraint on estimates of variable consideration in IFRS 15 *Revenue from Contracts with Customers*.[2]

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[1] Paragraphs 6.61 and 2.19 of the *Conceptual Framework for Financial Reporting* (the *Conceptual Framework*) explain the concepts of outcome uncertainty and measurement uncertainty. The Appendix to the *Conceptual Framework* defines:

(a) outcome uncertainty as the uncertainty about the amount or timing of any inflow or outflow of economic benefits that will result from an asset or liability.

(b) measurement uncertainty as the uncertainty that arises when monetary amounts in financial reports cannot be observed directly and must instead be estimated.

[2] Paragraph 56 of IFRS 15.

(c) the IASB provides additional guidance about how an entity estimates the amount of the performance incentive and determines the portion of that estimated amount that relates to the reporting period.

10. An accounting firm and an accountancy body, while agreeing with the proposed 'more likely than not' recognition threshold, suggested that the Basis for Conclusions accompanying the final Standard explains why the measurement requirements do not contain a 'highly probable' constraint.

The IASB's tentative decisions

11. At its February 2023 meeting, the IASB tentatively decided:

(a) to reconfirm the proposed requirement that amounts relating to performance incentives should form part of or reduce the total allowed compensation for goods or services supplied in the period in which the entity's performance gives rise to the incentive. These amounts would include those that result from an entity's performance of construction work.

(b) to retain the proposal to require an entity to recognise a regulatory asset or a regulatory liability whose existence is uncertain if it is more likely than not that such an asset or liability exists.

(c) not to set a recognition threshold based on the probability of a flow of economic benefits.

(d) not to set a recognition threshold based on the level of measurement uncertainty, except for regulatory assets and regulatory liabilities whose measurement depends on a regulatory benchmark determined by a regulator after the financial statements are authorised for issue. The IASB tentatively decided that an entity should recognise these regulatory assets or regulatory liabilities when the regulator determines the benchmark.

(e) to consider the principles in paragraph 35(c) of IFRS 15 that relate to an entity's right to payment for performance completed to date in developing the final Standard. These principles would be used to set the requirements for

assessing the existence of enforceable present rights (obligations) relating to specific regulatory assets (regulatory liabilities) including those arising from long-term performance incentives.

Outreach

12. To better understand concerns raised by respondents about long-term performance incentives (paragraph 8), we contacted different types of stakeholders in different jurisdictions.[3]

13. Our outreach identified a few long-term performance incentives that according to stakeholders—mainly preparers—are subject to significant outcome and measurement uncertainties:

    (a) long-term performance incentives that test an entity's efficiency when incurring capital and operating expenditures. These incentives are common in a few jurisdictions in Asia-Oceania and the United Kingdom (paragraphs 16–21).

    (b) long-term performance incentives whose calculations depend on yearly average performances achieved during the performance period or on inputs related to the last year of the performance period. These incentives are common in Canada and Hong Kong (paragraphs 22–24).

14. The length of the performance period for both these types of schemes is five years and coincides with the regulatory period. In these performance schemes, the amounts (bonuses or penalties) arising from the performance of an entity over a performance period generally adjust the entity's allowed revenue for the next regulatory period.

15. We have also discussed these performance incentives with users of financial statements—mainly credit and equity analysts. We noted that these users value information about amounts arising from these long-term performance incentives differently:

[3] Appendix A describes the stakeholders we contacted.

(a) credit analysts tend to place less value on information about amounts arising from long-term performance incentives and instead focus on more significant and highly predictable components of an entity's allowed revenue—that is, regulatory returns, regulatory depreciation and operating expenditure allowances—that have a greater effect on an entity's underlying credit ratios.

(b) equity analysts tend to place more value on information about amounts arising from long-term performance incentives because these amounts may have a significant effect on an entity's valuation over the long term.

Capital and operating expenditures efficiency schemes

16. These schemes measure an entity's performance by comparing:

(a) a regulatory (capital or operating) expenditure allowance—the regulator generally approves the entity's expenditure allowance prior to the start of the regulatory period for each of the years within that period; and

(b) the entity's actual (capital or operating) expenditure.

17. An underspend arises when an entity's actual expenditure is lower than the regulatory expenditure allowance while an overspend arises when the entity's actual expenditure is higher than the regulatory expenditure allowance (see Table 1).[4]

Table 1 ***In CU***	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**
Regulatory allowance	100	100	100	100	100
Actual expenditure	95	95	98	120	105
Under / (Overspend)	5	5	2	(20)	(5)

18. These schemes generally require that an entity shares with customers:

(a) any underspend arising during a performance period by deducting part of the underspend from regulated rates charged in the next regulatory period; and

(b) any overspend arising during a performance period by adding part of the overspend to regulated rates charged in the next regulatory period.

[4] Monetary amounts are denominated in 'currency units' (CU).

In certain schemes in the United Kingdom, the amount of underspend or overspend that is shared with customers is partly adjusted to the allowed revenue amount for the next regulatory period and partly adjusted to the entity's regulatory capital base.[5]

19. In these schemes, an entity's performance in each year within a performance period can provide a good starting point for the entity to measure its performance for that year. Having said that:

    (a) an entity's business decisions in a particular year (for example, year 2) within a five-year performance period—for example, delaying a project—may impact:

        (i) the actual expenditures that the entity incurs in future years within the performance period; and

        (ii) the relative weight the entity attributes to the actual performance for the current year (year 2) and to the performance for future years.

    (b) the regulator assesses the underspend or overspend for the entire performance period and may make an adjustment to that total amount of under or overspend at the end of the regulatory period. This type of adjustments cannot be allocated to each individual year of the performance period (paragraph 31(b)). In addition, the significance of these adjustments vary. Consequently, these regulatory decisions could also have an impact on the relative weight the entity attributes to the actual performance for a particular year and to the performance for future years.

20. In some other cases, the design of the performance incentive may result in each year's performance not having the same weight in the calculation of the bonus or penalty for the entire performance period. For example, in some cases the performance achieved

[5] The regulatory capital bases of the entities subject to these performance incentive schemes probably have no direct relationship with the entities' property, plant and equipment. At its December 2022 meeting (Agenda Paper 9C), the IASB tentatively decided that an entity is neither required nor permitted to recognise a regulatory asset or a regulatory liability relating to a performance incentive included in its regulatory capital base when the entity's regulatory capital base and its property, plant and equipment have no direct relationship.

in the later years of the performance period will be given higher weights in the calculation of the bonus or penalty.

21. The significance of these performance incentives can also vary. For example,

(a) a preparer in the energy industry in Australia said that the capital and operating expenditures incentives arising from a previous regulatory period represented about 6% of its allowed revenue for the current regulatory period. A regulator in Australia said that on average the incentives could represent up to 2% of an entity’s allowed revenue for a regulatory period. In contrast, regulatory depreciation, operating expenditures and regulatory return on the regulatory capital base represent approximately 20%, 35% and 40%, respectively, of entities’ allowed revenue.[6]

(b) a preparer in the water industry in the United Kingdom said that the significance of these incentives can vary. We have reviewed regulatory reports for a few entities within the water industry in the United Kingdom and have noted that this type of long-term performance incentives represents approximately 1% of the entities’ allowed revenue for a regulatory period.

Other long-term performance incentive schemes

22. Other long-term performance incentives encourage an entity:

(a) to be efficient in the investments it undertakes in the later years of a performance period;

(b) to save energy through installing energy-saving technologies for its customers; and

(c) to connect renewable energy systems into its grid.

23. These performance incentives can only give rise to a bonus. The bonus calculations depend on inputs that relate to an average performance considering the individual

[6] State of the Energy Market 2021.

yearly performances achieved during the performance period or on inputs that relate to the last year of the performance period. For example:

(a) the average return on equity for the entire performance period.

(b) the average of volume sales achieved during a performance period.

(c) the volume of energy saved on a continuing basis during a performance period as a result of, for example, installation of energy-saving technologies for customers.

(d) the balance of the regulatory capital base related to the final year within the performance period. However, in some cases, the regulator may not explicitly establish upfront which year within the performance period and what type of regulatory capital base (forecasted, actual etc) it will use for the calculation of the final bonus.

24. According to the feedback gathered, the amount of the bonuses is generally not significant relative to the entities' allowed revenue.

Applying the proposals

25. As mentioned in paragraph 14, long-term performance incentives (bonuses or penalties) relating to a performance period are generally included in the regulated rates the entity will charge customers in the next regulatory period.

26. In general, entities currently account for those long-term performance incentives in the period in which the related amounts are included in regulated rates charged. Based on a review of the financial statements of a sample of entities in Australia and Canada subject to the performance incentives described in paragraphs 16–24, none of the entities sampled provide information about the impact of performance incentives on individual reporting periods in their financial statements.

27. Applying the proposals, an entity would need to estimate the amount of the performance incentive for the entire performance period and determine the portion of that estimate that relates to the reporting period (paragraph 5(b)).

Feedback from preparers

28. Preparers told us it would be difficult to obtain estimates of the performance incentive particularly during the early years of a performance period—that is, the proposals would require an entity to estimate in year 1 its performance for years 2 to 5 (of a five-year performance period) and estimate the amount of the bonus or penalty for the entire performance period. Preparers said that the level of uncertainty associated with estimating the amount of the performance incentives in the earlier years of a performance period is the highest. As time goes by, the level of uncertainty reduces. However, some preparers said that because estimated amounts could vary significantly over the performance period—in some cases bonuses could reverse and become penalties—they would only be able to make reliable estimates at the end of the performance period.

29. Those preparers said estimating actual performance for each of the years within a performance period is difficult because the level of actual performance is affected by events that are sometimes difficult to anticipate:

    (a) natural disasters such as major storms;

    (b) shocks such as Covid 19 pandemic and supply chain disruptions;

    (c) changes in the nature of expenditures that were not foreseen—for example, when carrying out a project an entity may decide to replace a budgeted operating expenditure with a capital expenditure and vice versa;

    (d) technological changes; and

    (e) legislative changes—for example, new energy-transition, safety or cyber-security regulations.

30. Even though events such as those in paragraph 29 can affect entities' actual performance, regulators do not typically revise the regulatory expenditure allowances or other performance targets to factor in these types of events.

31. Other factors that make estimating the final amount of a bonus or penalty difficult are:

   (a) lack of information about inputs used to calculate the incentives—some regulators may determine inputs that will affect the calculation of the bonus or penalty after the start, and in some cases only at the end, of the performance period (paragraph 23(d)). In such cases estimating the final amount of a bonus or penalty during the earlier years of a performance period may be particularly difficult. Nevertheless, based on our outreach, entities are generally able to rely on past regulatory decisions to identify, and subsequently estimate, the input that the regulator will use for the calculation.

   (b) regulatory adjustments—regulators often review an entity's performance, including the entity's calculation of the amount of bonus or penalty, for the entire performance period. As a result of the review, the regulator may make adjustments to that amount. A common type of adjustment arises when the regulator determines that expenditure underspend is not an efficiency saving but rather a deferral of expenditure to the next performance period. Preparers said it would be generally difficult to estimate the adjustments affecting the amount of bonus or penalty for the entire performance period early in the performance period.

   (c) in some cases, as mentioned in paragraph 20, the design of the performance incentives is such that the later years of the performance period receive higher weight in the calculation of the bonus or penalty. This design can make it difficult to estimate the amount of a bonus or penalty, in the early years of a performance period when the level of outcome and measurement uncertainties is the highest.

Feedback from users of financial statements

32. A few users—representing both credit and equity analysts—supported retaining the Exposure Draft proposals, together with disclosures about:

   (a) the assumptions and uncertainties associated with estimating the performance incentive; and

(b) the causes and effects of the changes in circumstances on which estimates were based.

33. These users said that recognising regulatory assets and regulatory liabilities arising from long-term performance incentives would provide information about the entity's performance for the current reporting period and the entity's expected performance over the remaining performance period.

34. However, a few other credit analysts said retaining the proposals when the regulatory assets and regulatory liabilities are subject to high outcome and measurement uncertainties would not always provide useful information. This is because the level of uncertainties may be so high that users would be unable to use information about an entity's performance for a reporting period to assess the entity's future performance and related future cash flows.

Staff analysis

35. As mentioned in paragraph 8, some respondents were concerned about the significant outcome and measurement uncertainties to which some long-term performance incentives are subject. The staff analysis focuses on these concerns and is structured as follows:

(a) alternative approaches suggested by respondents (paragraphs 36–53); and

(b) the proposed recognition and measurement requirements (paragraphs 54–65).

Alternative approaches suggested by respondents

36. Respondents suggested the following alternative approaches to the recognition and measurement of regulatory assets and regulatory liabilities arising from long-term performance incentives:

(a) recognising regulatory assets and regulatory liabilities when specified conditions related to measurement uncertainty are met (paragraph 9(a)); and

(b) constraining the measurement of regulatory assets and regulatory liabilities (paragraph 9(b)).

Recognition when specified conditions are met

37. A few respondents suggested recognising a regulatory asset or a regulatory liability arising from long-term performance incentives when it can be *reliably measured* or when the *amount and timing of future cash flows are known*. When developing the proposals in the Exposure Draft, the IASB considered but rejected recognition of a performance incentive only when the outcome (that is, future cash flows) is known (paragraph 7).

38. We think in most cases reflecting a long-term performance incentive in profit or loss in the period in which an entity's performance gives rise to the incentive will provide useful information about performance in that period. This will be the case even if the performance incentive is subject to high measurement uncertainty. The *Conceptual Framework* states that a high level of measurement uncertainty does not necessarily prevent a measure from providing useful information about an asset or a liability. In the case of long-term performance incentives:

(a) the incentives are typically designed to test performance for which entities can reasonably be held to account. This means that entities ought to have a degree of control over their performance and a level of confidence in estimating the corresponding amount of bonus or penalty.

(b) the estimates of the incentives would reflect changes in circumstances such as those mentioned in paragraphs 29 and 31. A few users to whom we spoke said information about the causes and effects of those changes would be useful (paragraph 32(b)).

39. Introducing the recognition conditions specified in paragraph 37 may delay the provision of useful information, possibly to the end of a performance period.

40. In addition, introducing those recognition conditions would result in a 'cliff effect' in the period in which an entity recognises a regulatory asset or a regulatory liability

arising from a long-term performance incentive. This is because the entity would recognise that regulatory asset or regulatory liability only when those conditions are met. The amount recognised would reflect the entity's *cumulative performance* to date. Consequently, that amount would not represent the entity's performance for the reporting period in which the performance incentive is recognised.

41. The users of financial statements to whom we spoke expressed mixed views about this 'cliff effect'. A few credit analysts said the 'cliff effect' would reduce their ability to assess underlying performance and hence predict future cash flows. These analysts thought a gradual reflection of the performance incentives over the performance period would provide more useful information. However, an equity analyst said the 'cliff effect' would not concern them as long as they had the information needed to make adjustments to reverse the 'cliff effect'. This analyst said that recognising a regulatory asset or a regulatory liability only when the entity is relatively confident about its estimates would provide more reliable information for their analysis.

42. We think that introducing recognition conditions specified in paragraph 37 would be more complex and would require at least as much judgement as applying the proposals in the Exposure Draft. This is because this approach would require an entity:

    (a) to first determine when the outcome and measurement uncertainties fall below a specified level; and

    (b) to then estimate the performance incentive using the most likely amount method or the expected value method and reflect the portion of that performance incentive relating to the entity's *cumulative performance* to date.

43. On balance, we think applying this approach would result in limited benefits that would not outweigh the associated costs for preparers (paragraph 42) and some users (paragraph 41).

Constraining the measurement

44. Some respondents suggested introducing a constraint on the measurement of regulatory assets and regulatory liabilities arising from long-term performance incentives similar to the constraint on estimates of variable consideration in IFRS 15. This approach was considered but rejected by the IASB when it developed the proposals (paragraph 7).

45. IFRS 15 constrains the amount of variable consideration to the extent that it is *highly probable* that *a significant reversal* in the amount of *cumulative revenue* recognised will *not* occur when the uncertainty associated with the variable consideration is subsequently resolved. The objective of the measurement constraint in IFRS 15 is focussed on possible downward revenue adjustments (that is, *revenue reversals*) rather than on both downward and upward adjustments.[7]

46. If the measurement constraint in IFRS 15 was applied to long-term performance incentives, the measurement of a regulatory asset or a regulatory liability would be constrained so that it is highly probable that a *significant reversal* in the net cumulative amount of regulatory income and regulatory expense recognised will not occur.[8] Consequently, an entity would recognise relatively lower regulatory assets or relatively higher regulatory liabilities. In other words, the application of the measurement constraint in IFRS 15 would give rise to an asymmetric measurement threshold for regulatory assets and regulatory liabilities arising from long-term performance incentives.

47. We considered how the measurement constraint in IFRS 15 could be adapted to preserve symmetry when applied to long-term performance incentives—that is, constraining both a bonus (regulatory income) and a penalty (regulatory expense). Such an approach could constrain the measurement of regulatory assets and regulatory liabilities to the extent that it is *highly probable* that the cumulative amount of the

7 Paragraphs BC206–BC207 of the Basis for Conclusions accompanying IFRS 15.

8 Paragraph 67 of the Exposure Draft proposes that an entity presents in its statement(s) of financial performance all regulatory income minus all regulatory expense in a separate line item immediately below revenue.

performance incentives recognised during a performance period will be included in the total amount of the performance incentives at the end of the performance period.

48. A few credit analysts we spoke with supported the measurement constraint described in paragraph 47 (accompanied by disclosures about the measurement uncertainty and about how the entity has applied the constraint). According to these users, a measurement constraint may achieve a reasonable balance between reflecting performance for individual reporting periods and avoiding volatility over a performance period arising from changes in estimates. However, a few stakeholders we spoke with said constraining the measurement may raise more concerns for regulatory liabilities than for regulatory assets.

49. In cases when the level of outcome and measurement uncertainties is high, we think there is merit in constraining the measurement of regulatory assets and regulatory liabilities to provide only information that meets a high level of confidence about an entity's performance for each reporting period.

50. However, we think that constraining the measurement of regulatory assets and regulatory liabilities may not faithfully represent an entity's performance for individual reporting periods. This is because:

    (a) preparers said that in situations when the highly probable threshold is met only towards the end of a performance period, they would measure a regulatory asset or regulatory liability at zero for most of the performance period.

    (b) as the level of uncertainty decreases over the performance period, an entity would recognise 'catch-up' adjustments to the constrained amount of the regulatory asset or regulatory liability that relate to performance of prior reporting periods.

51. We agree with the IASB when it developed the proposals that introducing a measurement constraint would add complexity to the final Standard (paragraph 7). This is because such a measurement constraint would create an exception that would only be applied to a specific population of regulatory assets and regulatory liabilities. In addition, a measurement constraint may lead to entities applying assumptions and

judgements twice: first to determine the estimate of a regulatory asset or a regulatory liability applying the most likely amount method or the expected value method and then to constrain that estimate so that it meets the highly probable threshold.[9]

52. During phase 1 of the post-implementation review of IFRS 15, stakeholders commented on the challenges with exercising judgement in applying the constraint to estimates of variable consideration in conditions of high uncertainty. Stakeholders raised the matter for variable consideration involving outcomes outside of an entity's control and long-term performance obligations. An accounting firm also said there is a tendency to constrain an estimate of variable consideration to zero for very long-term contracts.[10] According to our outreach, these observations are also relevant for long-term performance incentives (paragraphs 29, 31 and 50(a)).

53. On balance, we think the costs of applying a measurement constraint for preparers (paragraph 51) would outweigh the benefits of the information provided for some users (paragraph 48).

The proposed recognition and measurement requirements

54. This section analyses:

    (a) the costs and benefits of the proposed recognition and measurement requirements (paragraphs 55–62); and

    (b) need for additional guidance (paragraphs 63–64).

Costs and benefits of the proposed recognition and measurement requirements

55. Applying the proposed recognition and measurement requirements to long-term performance incentives, an entity would:

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[9] When discussing the application of the variable consideration constraint in IFRS 15, the IASB observed that an entity would not be required to apply a two-step process if the entity's calculation of the estimated revenue incorporates the entity's expectations at a level at which it is highly probable that the cumulative amount of revenue recognised would not result in a significant revenue reversal (paragraph BC215 of the Basis for Conclusions accompanying IFRS 15).

[10] Agenda Paper 6C of March 2023 IASB meeting.

(a) recognise a regulatory asset or a regulatory liability that exists (or is more likely than not to exist) regardless of the measurement uncertainty; and

(b) estimate uncertain future cash flows arising from the regulatory asset or regulatory liability using either 'the most likely amount' method or 'the expected value' method, whichever better predicts the cash flows (paragraph 5(b)).

56. If a long-term performance incentive is subject to significant outcome and measurement uncertainties, we expect that an entity would provide disclosures about those uncertainties, the assumptions used in estimating uncertain future cash flows and the changes in estimates. The entity would provide these disclosures either applying the requirements in IAS 1 *Presentation of Financial Statements* and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* or applying any specific disclosure requirements that the IASB may develop for those long-term performance incentives.[11]

57. We acknowledge that circumstances such as those in paragraphs 29 and 31 may make estimating performance incentives difficult. However, based on the feedback on the Exposure Draft and the outreach, we still think that the recognition of regulatory assets or regulatory liabilities, accompanied by disclosures mentioned in paragraph 56, would generally provide useful information (paragraphs 33 and 38).

58. In most cases entities will have the information needed to reasonably estimate the amount of a performance incentive. Entities are also likely to gain experience in estimating performance incentives over time.

59. In other specific cases, there may be factors that mitigate the effects of these circumstances in paragraphs 29 and 31. For example, some of the schemes we discussed in our outreach give greater weight to the performance achieved in the later years of a performance period (paragraph 31(c)). When an entity estimates a performance incentive in the early years of a performance period, the performance of

[11] Paragraphs 125–131 of IAS 1 and paragraphs 39–40 of IAS 8.

these later years is subject to the highest level of uncertainties. However, the entity would reflect the relatively lower weight of the performance achieved in an early reporting period in determining the portion of the performance incentive that relates to that period. In other words, we think the effect of higher uncertainty in an early reporting period on the quality of the estimate may be offset by the lower weight attributed by the scheme to the performance of that early period.

60. Based on our outreach and analysis:

 (a) we have not obtained evidence that long-term performance incentives subject to significant outcome and measurement uncertainties are widespread (paragraph 13) and represent a significant portion of the entities' allowed revenue (paragraphs 21 and 24); and

 (b) users of financial statements have different views on the importance of information about amounts arising from long-term performance incentives (paragraph 15).

61. On balance, we think applying the proposals to regulatory assets and regulatory liabilities arising from long-term performance incentives would result in benefits for users (paragraph 57) that outweigh the associated costs for preparers (paragraphs 28–31). We plan to discuss disclosures at a future meeting.

62. Appendix B provides a comparison of the proposals and the alternative approaches.

Need for additional guidance

63. As mentioned in paragraph 9(c), some respondents suggested that the IASB provides additional guidance about how an entity estimates the amount of a performance incentive and determines the portion of that estimated amount that relates to a reporting period.

64. As mentioned in paragraph 60(a), we did not obtain evidence that long-term performance incentives subject to significant outcome and measurement uncertainties are widespread and represent a significant portion of the entities' allowed revenue. Moreover, determining an estimate of a performance incentive and allocating that

estimate to individual reporting periods would depend on the specifics of the performance scheme. Therefore, we think developing such guidance may not be a proportionate response and may be difficult given the variety of performance schemes. On balance, the staff recommend that the final Accounting Standard does not provide additional guidance on estimating the amount of long-term performance incentives and determining the portion of that estimated amount that relates to a reporting period.

65. Consequently, considering the analysis in paragraphs 54–64, we recommend that the final Accounting Standard retains the proposal that an entity is required to estimate the amount of a long-term performance incentive and determine the portion of that estimated amount that relates to the reporting period using a reasonable and supportable basis.

Question for the IASB
1. Does the IASB agree with the staff recommendation in paragraph 65?

Appendix A—Stakeholders we contacted

A1. The table below provides details of the stakeholders we contacted to better understand the concerns about significant outcome and measurement uncertainties that arise from some long-term performance incentives.

Stakeholder type	**Industry**	**Jurisdiction**
Accounting firms (4)	Accountancy	Global
Preparers (6)	Electricity (3)	Asia-Oceania
	Gas (2)	United Kingdom and Canada
	Water (1)	United Kingdom
Preparer / Representative body (1)	Electricity	Asia-Oceania
Users (4)	Water (1)	Europe
	Electricity (3)	Europe and Asia-Oceania
Regulators (2)	Electricity and Gas	United Kingdom and Australia

Appendix B—Comparison of the proposals and the alternative approaches

		Alternative approaches	
Aspects considered	**Proposals (paragraph 5)**	**Prohibiting recognition (paragraphs 37–43)**	**Constraining measurement (paragraphs 44–53)**
Judgement and complexity	Requires an estimate of the performance incentive that may be subject to significant outcome and measurement uncertainties using the most likely amount method or the expected value method.	Requires two layers of assessment (paragraph 42): • determine when the outcome and measurement uncertainties fall below a specified level; and • estimate the performance incentive using the most likely amount method or the expected value method.	May require two layers of assessment (paragraph 51): • estimate the performance incentive using the most likely amount method or the expected value method; and • constrain the estimate so it meets the highly probable threshold.
Effect in the financial statements	May lead to volatility early in a performance period, especially when the level of outcome and measurement uncertainties is significant.	Delays recognition and therefore the provision of useful information, possibly to the end of a performance period (paragraph 39). Leads to a ‘cliff effect’ that reflects cumulative performance to date when the regulatory asset or regulatory liability is recognised (paragraph 40).	Leads to ‘catch-up’ adjustments over a performance period that relate to an entity’s performance in prior reporting periods (paragraph 49). May result in measurement of regulatory assets or regulatory liabilities at zero until late in a performance period (paragraph 50(a)).

Usefulness of information	Provide information about an entity's actual performance for a reporting period and expected performance over the performance period (paragraph 33). However, when the level of outcome and measurement uncertainties is significant, information about an entity's performance for a reporting period may not help users to assess the entity's future performance and future cash flows (paragraph 34).	Mixed views—the 'cliff effect': • is not concerning because estimates that meet a high level of confidence would provide more reliable information. • provides less useful information than a gradual reflection of the performance incentives over a performance period (paragraph 41).	Provides only information that meets a high level of confidence about an entity's performance for each reporting period (paragraph 49). However, constraining the measurement may raise more concerns for a regulatory liability than for a regulatory asset (paragraph 48).