
IASB[®] meeting

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Project **Rate-regulated Activities**
Topic **Enforceability and recognition**
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Objective

1. This paper sets out staff analysis and recommendations on the interaction between the assessment of enforceability and the recognition of regulatory assets and regulatory liabilities proposed in the Exposure Draft [Regulatory Assets and Regulatory Liabilities](#) (Exposure Draft).

Summary of staff recommendations

2. The staff recommend:
 - (a) enhancing the proposed requirements on enforceability in the final Accounting Standard;
 - (b) retaining the proposed single assessment of the existence of enforceable present rights and enforceable present obligations at the level of the individual regulatory asset or regulatory liability in the final Accounting Standard;
 - (c) clarifying in the final Accounting Standard that rights and obligations do not need to be certain for an entity to be able to conclude they would be enforceable; and
 - (d) incorporating the principles underlying an entity's right to payment for performance completed to date in paragraph 35(c) of IFRS 15 into the

requirements on enforceability in the final Accounting Standard. These principles would be used in establishing the requirements for regulatory returns on an asset not yet available for use and long-term performance incentives.

Structure of the paper

3. This paper is structured as follows:
 - (a) proposals in the Exposure Draft (paragraphs 5–8);
 - (b) feedback received (paragraphs 9–14); and
 - (c) staff analysis (paragraphs 15–62).
4. The appendices to this paper include extracts from the Exposure Draft and IFRS Accounting Standards.

Proposals in the Exposure Draft

5. The Exposure Draft defines regulatory assets, regulatory liabilities and regulatory agreements in terms of enforceable rights and obligations (**emphasis added**):

regulatory agreement	A set of enforceable rights and obligations that determine a regulated rate to be applied in contracts with customers.
regulatory asset	An enforceable present right , created by a regulatory agreement , to add an amount in determining a regulated rate to be charged to customers in future periods because part of the total allowed compensation for goods or services already supplied will be included in revenue in the future.
regulatory liability	An enforceable present obligation , created by a regulatory agreement , to deduct an amount in determining a regulated rate to be charged to customers in future periods because the revenue already recognised includes an amount that will provide part of the total allowed compensation for goods or services to be supplied in the future.

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6. These definitions affect the proposals on:
- (a) scope (paragraphs 3–6 of the Exposure Draft). An entity would apply the proposals in the Exposure Draft to all of its regulatory assets and regulatory liabilities; and
 - (b) recognition (paragraphs 25–28 of the Exposure Draft). An entity would recognise all regulatory assets and all regulatory liabilities that exist at the end of the reporting period (paragraph 25). In determining whether a regulatory asset or a regulatory liability exists an entity would consider all relevant facts and circumstances, including those listed in paragraph 27 of the Exposure Draft.¹ If it is uncertain whether a regulatory asset or a regulatory liability exists, an entity would recognise the regulatory asset or regulatory liability if it is more likely than not that it exists (paragraph 28 of the Exposure Draft).
7. The Exposure Draft does not have a separate section on assessing enforceability. Enforceability is discussed in the sections of the Exposure Draft dealing with:
- (a) regulatory agreements (paragraphs 7–9 of the Exposure Draft). Paragraph 8 of the Exposure Draft explains that regulatory agreements may take various forms (such as a contractual licensing agreement or a service concession arrangement or rights and obligations specified by statute, legislation or regulations). Paragraph 9 of the Exposure Draft (**emphasis added**) states:

Whether rights and obligations in a regulatory agreement are enforceable **is a matter of law**. Regulatory decisions or court rulings may provide evidence about the enforceability of those rights and obligations.
 - (b) recognition (paragraphs 25–28 of the Exposure Draft). The facts and circumstances listed in paragraph 27 of the Exposure Draft could assist an entity in determining the existence of regulatory assets and regulatory liabilities (which, by definition, require an assessment of enforceability).

¹ Paragraph 27 of the Exposure Draft is included in Appendix A of this paper.

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8. Enforceability of all future cash flows arising from regulatory assets and regulatory liabilities is also a feature that the Exposure Draft requires in the measurement proposals. We will bring an analysis of the interaction between enforceability and measurement to a future meeting.

Feedback received

9. Many respondents who commented agreed with the proposed scope—that is, to apply the proposals to all an entity’s regulatory assets and regulatory liabilities. In addition, most respondents who commented agreed with the proposed definitions of regulatory asset and regulatory liability and with the proposed recognition requirements.²
10. However, many respondents commenting on the proposed scope, definitions of regulatory asset and regulatory liability and recognition requirements said that assessing whether rights and obligations are enforceable could be very challenging and requested further guidance and illustrative examples. A securities regulator from Latin America and an accounting firm, recommended that the final Standard clarify or define the term ‘enforceable right’. Some of these respondents identified situations in which assessing the existence of enforceable present rights and enforceable present obligations can be difficult. They said:
- (a) regulatory environments may not be fully developed—entities may operate in jurisdictions where the regulatory environment is not fully developed and therefore there is no history of whether a specific right or obligation will be enforced. A few national standard-setters, preparers, and accounting firms in both emerging and developed jurisdictions said that, in such situations, it is difficult for entities to foresee regulatory decisions based on past practice.
 - (b) a regulatory agreement establishes a broad framework, but it may not be sufficiently detailed, or may be silent, on whether an entity would have a right to recover specific costs, including unexpected costs or events (for example,

² The IASB discussed feedback from comment letters and outreach events on the proposed scope, definitions of regulatory assets and regulatory liabilities and recognition requirements at its meeting in October 2021 (Agenda Papers [9A](#), [9B](#) and [9D](#)).

costs incurred in the context of the Covid-19 pandemic). These respondents said that, in such situations, an entity will need to assess the terms and conditions of the regulatory agreement to determine whether the costs will be recoverable. In commenting on the fact that regulatory agreements may not contain sufficient detail to indicate the recoverability of specific items, a preparer from North America suggested the terms ‘expected’ or ‘expected to be realised’ should be applied when referring to specific regulatory assets and regulatory liabilities.

- (c) an entity’s ability to include amounts in future regulated rates may be subject to the discretion of the regulator. For example, a regulator may have the discretion to indefinitely defer an increase to regulated rates considering the impact that such increase may have on inflation, or to substitute an entity’s ability to increase or decrease regulated rates with other forms of compensation in some circumstances.
11. Paragraph 27 of the Exposure Draft outlines facts and circumstances that an entity should consider when determining whether a regulatory asset or a regulatory liability exists. Some respondents—mainly a few standard-setters and professional accounting bodies from Africa and Asia-Oceania—said the facts and circumstances outlined in paragraph 27(g)–(i) did not provide a sound basis for assessing existence of regulatory assets or regulatory liabilities, with a few of these stakeholders suggesting some improvements.
12. Some respondents—mainly a few accounting firms, a few European national standard-setters and a few professional accountancy bodies from Asia-Oceania—questioned:
- (a) how the assessment of enforceability of rights and obligations interplays with the assessment of the existence of regulatory assets and regulatory liabilities. Does an entity need to first assess enforceability at the regulatory agreement level and then assess the existence of regulatory assets and regulatory liabilities?

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- (b) whether the ‘more likely than not’ threshold was appropriate for an entity to assess whether a right or an obligation is enforceable. According to these stakeholders, a right or an obligation is unlikely to be enforceable if it is only more likely than not that it exists. In their view, a right or an obligation is enforceable only if it is highly probable that it exists.
13. A few preparers in Asia-Oceania and Europe also questioned whether an entity would have enforceable present rights or enforceable present obligations in relation to performance incentives that test entities’ performances across multiple periods (long-term performance incentives—paragraph B19 of the Exposure Draft). These respondents thought an enforceable present right (obligation) would arise only after the entity has met (failed to meet) the performance criteria at the end of the performance period. According to these respondents, the recognition of a performance incentive before the performance period is ended would:
- (a) not represent a right, or an obligation, arising from the regulatory agreement; and
- (b) not meet the definition of a regulatory asset or a regulatory liability in the Exposure Draft.

One of these respondents also said that the recognition of such regulatory assets and regulatory liabilities may be prejudicial to discussions to be held with the regulators.

14. A few respondents expressed similar concerns about items affecting regulated rates only when related cash is paid or received (paragraphs 59–66 of the Exposure Draft). These respondents thought an enforceable present right (obligation) would arise only when cash is paid (received). These items will be discussed at a future meeting.

Staff analysis

15. The analysis is structured as follows:
- (a) difficulties in assessing the existence of enforceable present rights or enforceable present obligations (paragraphs 16–34);

- (b) clarifying the interaction between the enforceability and existence assessment (paragraphs 35–47); and
- (c) existence of enforceable present rights or enforceable present obligations in relation to long-term performance incentives (paragraphs 48–62).

Difficulties in assessing enforceability

16. As mentioned in paragraph 10, respondents said that assessing the existence of enforceable rights or enforceable obligations is particularly challenging when:
- (a) regulatory environments are not fully developed—entities may operate in jurisdictions where the regulatory environment is not fully developed and therefore there is no history of a specific transaction.
 - (b) a regulatory agreement is not sufficiently detailed, or is silent, on whether an entity would have a right to recover specific costs.
 - (c) an entity’s ability to include amounts in future regulated rates is subject to the discretion of the regulator.
17. We think we can broadly categorise these concerns as describing circumstances in which the assessment of enforceability is challenging due to:
- (a) the general legal and regulatory environment not being fully developed (paragraph 16(a) and paragraphs 19–24); and
 - (b) specific circumstances that make the determination of whether a regulatory asset or a regulatory liability should be recognised challenging (paragraphs 16(b) and 16(c) and paragraphs 25–34).
18. Paragraphs 19–34 use this categorisation to analyse the respondents’ concerns.

The general legal and regulatory environment

19. The Exposure Draft defines regulatory assets and regulatory liabilities as enforceable present rights and enforceable present obligations. Regulatory assets and regulatory

liabilities are therefore subsets of the rights and obligations created by a regulatory agreement.³

20. Paragraph 9 of the Exposure Draft says that whether rights and obligations in a regulatory agreement are enforceable is a matter of law. Regulatory decisions or court rulings may provide evidence about the enforceability of those rights and obligations. These proposals imply that an entity would assess whether rights and obligations are enforceable considering the laws and the legal and regulatory frameworks within which an entity operates, including the existence of appropriate enforcement mechanisms such as courts of law. In some circumstances this assessment may require that the entity exercises judgement. We would expect the assessment of enforceability to be more challenging in jurisdictions with less developed legal or regulatory frameworks than in jurisdictions with mature legal or regulatory frameworks. Consequently, we acknowledge the concerns raised by respondents (paragraph 16(a)).
21. Having said that, assessing the enforceability of rights and obligations and the possible challenges with that assessment are not unique to the model for accounting for regulatory assets and regulatory liabilities. Other IFRS Accounting Standards also include requirements that rely on an entity assessing the enforceability of rights and obligations. The application of these requirements implies, in some cases, that entities exercise judgement.
22. In reflecting on respondents' requests for more guidance on enforceability, we have considered the nature and extent of the guidance in IFRS Accounting Standards and whether there are any arguments for developing more extensive guidance. Appendix B includes a summary of relevant requirements in the *Conceptual Framework for Financial Reporting (Conceptual Framework)* and some recent IFRS Accounting Standards.
23. The statement in paragraph 9 of the Exposure Draft that enforceability is a matter of law is consistent with IFRS 15 *Revenue from Contracts with Customers* and IFRS 17

³ Paragraphs 20 and BC40 of the Basis for Conclusions on the Exposure Draft.

Insurance Contracts.⁴ Paragraph BC32 of the Basis for Conclusions on IFRS 15 states:

Determining whether a contractual right or obligation is enforceable is a question to be considered within the context of the relevant legal framework (or equivalent framework) that exists to ensure that parties' rights and obligations are upheld. The boards observed that the factors that determine enforceability may differ between jurisdictions [...]

24. Neither IFRS 15 nor IFRS 17 contains detailed guidance on assessing enforceability. We think this is because assessments of enforceability rely on the legal framework of each jurisdiction and these frameworks vary across jurisdictions. In light of this variation across jurisdictions, we recommend that the IASB does not include detailed guidance on assessing enforceability in the final Standard. However, we think that, without going beyond the guidance on enforceability in current Accounting Standards, it would be possible to enhance the proposed requirements on enforceability in the final Standard (paragraph 34).

Specific circumstances that make the determination of whether a regulatory asset or a regulatory liability should be recognised challenging

25. We acknowledge that the circumstances outlined in paragraphs 16(b) and 16(c)—lack of detailed regulatory agreements and recoverability of costs subject to the discretion of a regulator—would make it more challenging for an entity to assess the existence of enforceable present rights or enforceable present obligations that meet the definitions of regulatory assets or regulatory liabilities.
26. Although these circumstances could create uncertainty as to the existence of regulatory assets or regulatory liabilities, such uncertainty would not be expected to affect all an entity's regulatory assets or regulatory liabilities. Based on the feedback received on the Exposure Draft, in the majority of cases, we would not expect that an entity would need to exercise a high degree of judgement in determining whether its

⁴ See paragraph 10 of IFRS 15 and paragraph 2 of IFRS 17 in Appendix B.

regulatory assets or regulatory liabilities are more likely than not to exist. Having said that, we think that enhancing the proposed requirements on enforceability could help entities with this determination.

27. For example, we think the proposed requirements could be improved by clarifying that enforceability refers to the *ability* of the parties to a regulatory agreement to enforce the rights and obligations arising from the regulatory agreement, considering the wider legal and regulatory context of the jurisdiction(s) in which the entity operates.
28. This clarification might help entities form a view on the existence of a regulatory asset in relation to the recoverability of unexpected costs, such as costs associated with the Covid-19 pandemic. In the case of unexpected costs it is possible that a regulatory agreement does not deal with such costs or, if it does it may be unclear how the terms of the agreement apply to such costs. In such cases there is unlikely to be any relevant history of enforceability (for example, direct or indirect precedents). In the absence of clear terms in the regulatory agreement, or a history of enforceability, an entity may nevertheless have sufficient evidence to determine that it has a right to recover the unexpected costs and that it would be *able* to enforce that right. For example, the entity may have been negotiating with the regulator to incorporate terms in the regulatory agreement whereby the entity would be entitled to recover specified costs incurred beyond its control and an amendment of these terms is almost final.
29. We think the proposed requirements could also be enhanced by clarifying that enforceability assessments are made *at a point in time*, using all reasonable and supportable information.
30. Respondents also commented on the indicators listed in paragraph 27 of the Exposure Draft.⁵ Paragraph 27 states that an entity determines whether a regulatory asset or regulatory liability exists, considering all relevant facts and circumstances, including any of the indicators listed in that paragraph.

⁵ Paragraph 27 of the Exposure Draft is included in Appendix A of this paper.

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31. Most respondents supported the inclusion of these indicators. A few respondents commented on the last three indicators in paragraph 27(g)–(i) (being indirect precedents, preliminary views of the regulator, and advice from legal or other advisors). According to these respondents, these indicators may not always provide persuasive evidence of the existence of enforceable rights and enforceable obligations. Consequently, they suggested these indicators be omitted or strengthened (for example, by requiring that any advice or views be expressed in writing or be from *independent* experts or advisors).⁶
32. We do not recommend omitting the indicators in paragraph 27(g)–(i) as they may be useful in some circumstances. Paragraph 27 says that an entity should consider *all* relevant facts and circumstances, *including any of* the indicators listed in that paragraph. The indicators in paragraph 27(g)–(i) could be relevant for an entity to assess the existence of enforceable present rights or enforceable present obligations when a regulatory agreement is not sufficiently detailed or the recoverability of specific costs is subject to discretion of the regulator—that is, the circumstances discussed in paragraphs 16(b) and 16(c).
33. Consequently, we think the final Standard should clarify that:
- (a) an entity will need to consider all reasonable and supportable evidence and the weight of that evidence. Taken in isolation, individual indicators may not be sufficient to enable the entity to make an assessment about the existence of enforceable present rights and enforceable present obligations.
 - (b) the importance of the indicators in paragraph 27 of the Exposure Draft could differ depending on the legal and regulatory frameworks within which an entity operates.

⁶ Paragraph 27(i) of the Exposure Draft refers to ‘advice from qualified and experienced legal or other advisors’.

34. To summarise, we recommend enhancing the proposed requirements on enforceability in the final Accounting Standard. This could be done by clarifying that:
- (a) enforceability refers to the ability of the parties to a regulatory agreement to enforce the rights and obligations arising from the regulatory agreement (paragraphs 27–28).
 - (b) enforceability depends on the legal and regulatory frameworks within which an entity operates, including the existence of appropriate enforcement mechanisms such as courts of law (paragraph 20).
 - (c) enforceability assessments are made at a point in time (paragraph 29).
 - (d) an entity will need to consider all reasonable and supportable evidence and the weight of that evidence. Taken in isolation, individual indicators in paragraph 27 of the Exposure Draft would not necessarily be sufficient to enable an entity to make an assessment of enforceability (paragraph 33(a)).
 - (e) the importance of the indicators in paragraph 27 of the Exposure Draft could differ depending on the legal and regulatory frameworks within which an entity operates (paragraph 33(b)).

Question for the IASB

1. Does the IASB agree with the staff recommendation to enhance the proposed requirements on enforceability in the final Accounting Standard (paragraph 34)? If so, does the IASB have any comments on the extent or content of those enhancements?

Interaction between enforceability and existence

35. As mentioned in paragraph 12, some respondents:
- (a) did not understand the interaction between the enforceability of rights and obligations and the proposed recognition requirements (paragraphs 36–42); or

- (b) questioned whether the ‘more likely than not’ recognition threshold was appropriate for an entity to assess whether a right or an obligation is enforceable (paragraphs 43–47).

Interaction between enforceability of rights and obligations and the proposed recognition requirements

36. The proposals in the Exposure Draft:
- (a) define a regulatory agreement as ‘a set of enforceable rights and obligations that determine a regulated rate to be applied in contracts with customers’;
 - (b) define regulatory assets and regulatory liabilities as enforceable present rights and enforceable present obligations created by a regulatory agreement; and
 - (c) establish a recognition threshold of ‘more likely than not’ when it is uncertain whether a regulatory asset or a regulatory liability exists.
37. Some respondents seemed to have read the Exposure Draft as requiring that an entity carry out two enforceability assessments; the first being whether a regulatory agreement is enforceable and the second being whether the regulatory assets and regulatory liabilities are enforceable. These respondents considered that, in the second assessment, an entity would be assessing whether it is ‘more likely than not’ that a right or an obligation is enforceable.
38. When developing the Exposure Draft, we do not think it was the IASB’s intention to require entities to carry out two enforceability assessments. The Exposure Draft proposes that an entity recognise all regulatory assets and all regulatory liabilities that exist. When it is uncertain whether regulatory assets or regulatory liabilities exist, paragraph 28 of the Exposure Draft requires that an entity determine whether it is more likely than not that they exist. By referring to ‘regulatory assets’ and ‘regulatory liabilities’, paragraph 28 of the Exposure Draft requires that entities carry out a single assessment, being whether it is more likely than not that an *enforceable present right* (that is, a regulatory asset) or an *enforceable present obligation* (that is a regulatory liability) exists. In other words, by requiring that entities recognise only

those regulatory assets and regulatory liabilities that are more likely than not to exist, the Exposure Draft combines the assessment of existence uncertainty and enforceability in a single assessment.

39. Given that some respondents read the Exposure Draft as proposing two enforceability assessments (at the regulatory agreement level and at the regulatory asset or regulatory liability level) we have considered whether the final Standard should explicitly require two assessments. We agree that the existence of an enforceable regulatory agreement would provide evidence that enforceable present rights that are regulatory assets and enforceable present obligations that are regulatory liabilities exist. Similarly, the lack of an enforceable regulatory agreement—for example, in a regulatory environment that is still developing—would provide evidence that the rights and obligations arising from that agreement, amongst them possible regulatory assets or regulatory liabilities, are not enforceable and that regulatory assets and regulatory liabilities do not exist.
40. However, when assessing whether an entity has enforceable present rights or enforceable present obligations that meet the definition of regulatory assets or regulatory liabilities, we think that the existence of an enforceable regulatory agreement would be a necessary condition, but would not on its own be a sufficient condition. For example, regulatory agreements that are enforceable may not be comprehensive or contain sufficient detail to assess the enforceability of the rights and obligations that are potential regulatory assets or regulatory liabilities. An entity assessing the existence of enforceable rights—that may be regulatory assets—and enforceable obligations—that may be regulatory liabilities—would still need to consider the specific facts and circumstances surrounding those rights and obligations. This analysis is summarised in Table 1.

Table 1—Level of enforceability	
Is the regulatory agreement enforceable?	Are the potential regulatory assets or regulatory liabilities enforceable?
Yes	The final conclusion will depend on the assessment of enforceability at the regulatory asset or regulatory liability level.
No	It is unlikely that potential regulatory assets or regulatory liabilities would be enforceable.

41. We do not think it would be appropriate to require two enforceability assessments (at the regulatory agreement level and at the regulatory asset or regulatory liability level). We think requiring two assessments would lead to unnecessary costs because the existence of an enforceable regulatory agreement would not guarantee the existence of enforceable present rights and enforceable present obligations that meet the definitions of regulatory assets and regulatory liabilities.
42. We recommend that the final Accounting Standard continues to require a single assessment of the existence of enforceable present rights and enforceable present obligations at the level of the individual regulatory asset or regulatory liability.

Appropriateness of the ‘more likely than not’ recognition threshold

43. The Exposure Draft states that if it is uncertain that a regulatory asset or a regulatory liability exists, an entity recognises the regulatory asset or regulatory liability if it is more likely than not it exists (paragraph 28 of the Exposure Draft). Some respondents questioned the appropriateness of the proposed recognition threshold and said that a right or an obligation is unlikely to be enforceable if it is only more likely than not that it exists.
44. Paragraph 38 of this paper explains that the Exposure Draft proposed a single assessment of the existence of enforceable present rights and enforceable present obligations at the level of the individual regulatory asset or regulatory liability. In the

case of uncertainty, the ‘more likely than not requirement’ in paragraph 28 of the Exposure Draft would form part of that single assessment.

45. We do not think the degree of certainty as to the enforceability of a right or an obligation is determined by the degree of certainty of the existence of that right or obligation. The Exposure Draft does not require that potential regulatory assets and regulatory liabilities be certain in order to be assessed as being enforceable. We think there may be cases when an entity has some degree of uncertainty as to the existence of a right (for example, there may be a final approval pending which would not allow an entity to have full certainty about the existence of its right) but the entity may have sufficient evidence that it would be able to enforce its right.
46. We have recommended (paragraph 34) that the requirements in the final Standard be enhanced by clarifying that enforceability refers to the ability of the parties to a regulatory agreement to enforce the rights and obligations arising from the regulatory agreement, and that enforceability depends on the legal and regulatory frameworks within which an entity operates. After considering respondents’ comments on the proposed recognition threshold (paragraph 43), we think that it would also be helpful to clarify that rights and obligations do not have to be certain in order for an entity to conclude on their enforceability.
47. If the IASB agrees to enhance the proposed requirements on enforceability (as recommended in paragraph 34), we recommend that the final Accounting Standard also clarify that a right or obligation does not need to be certain for an entity to be able to conclude that it would be enforceable.

Question for the IASB

2. Does the IASB agree with the staff recommendation that the final Accounting Standard:
 - (a) continue to require a single assessment of the existence of enforceable present rights and enforceable present obligations at the level of the individual regulatory asset or regulatory liability (paragraph 42).
 - (b) clarify that rights and obligations do not need to be certain for an entity to be able to conclude they would be enforceable (paragraph 47).

Enforceability and long-term performance incentives

48. As mentioned in paragraph 13, a few respondents said that an entity's right to a bonus in relation to a long-term performance incentive, or obligation for a penalty, would arise only after the performance criteria have been met, or have failed to be met, at the end of the performance period.
49. The Exposure Draft proposed that:
- (a) amounts relating to a performance incentive would form part of, or would reduce, the total allowed compensation for goods or services supplied in the period in which an entity's performance gives rise to the bonus or penalty (paragraph B17 of the Exposure Draft); and
 - (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 and determine the portion that relates to the reporting period (paragraph B19 of the Exposure Draft).
50. In developing these proposals the IASB distinguished between existence uncertainty and outcome uncertainty. The IASB considered that it was generally certain that an entity would have an enforceable right to an amount relating to a performance incentive (little or no existence uncertainty). The IASB's conclusion about the existence of an enforceable right to an amount relating to a performance incentive also applied to long-term performance incentives that are conditional on future performance.⁷ However, the IASB acknowledged there could be uncertainty about the amount of the bonus or penalty (outcome uncertainty).
51. The analysis in this section focuses on enforceability and existence uncertainty. Some long-term performance incentives could also have significant outcome and measurement uncertainty. The IASB will discuss the recognition and measurement of long-term performance incentives at a future meeting.

⁷ Paragraph BC109 of the Basis for Conclusions accompanying the Exposure Draft.

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52. The IASB's conclusions in developing the Exposure Draft are consistent with the discussion of rights and obligations in the *Conceptual Framework*. For example:
- (a) the *Conceptual Framework* states that a right may take many forms including rights to benefit from an obligation of another party to transfer an economic resource if a specified uncertain future event occurs (paragraph 4.6(a)(iv)).
 - (b) one of the criteria for a liability to exist is that the entity has an obligation to transfer an economic resource. The *Conceptual Framework* explains that although the obligation must have the potential to require the entity to transfer an economic resource, certainty of the transfer is not required (paragraph 4.37). An obligation to transfer an economic resource could include obligations to transfer an economic resource if a specified uncertain future event occurs (paragraphs 4.37 and 4.39).
53. The *Conceptual Framework* makes it clear that rights and obligations can exist, even if they are conditional on future events. Long-term performance incentives can therefore give rise to rights and obligations in the current period, even though they are conditional on an entity's future performance.
54. In the case of long-term performance incentives, we do not think the enforceability of rights and obligations is necessarily dependent on the completion of the performance period. The existence of a present enforceable right for a portion of a performance incentive relating to a reporting period will depend upon the terms and conditions in the regulatory agreement, as well as the ability of an entity to enforce its right at that point in time.
55. Within this project, the IASB discussed a similar issue. In July 2022 the IASB discussed whether an entity could have an enforceable present right for returns on an asset not yet available for use, accrued during the construction period, if the entity was only allowed to include those returns in regulated rates charged once the asset was in operation. To assess this matter, the IASB discussed the principles underlying an

entity's right to payment for performance completed to date as described in paragraph 35(c) of IFRS 15.^{8,9}

56. Paragraph 35(c) of IFRS 15 requires that entities assess whether they would have an enforceable right to payment for performance completed at a certain point in time. Paragraphs 37, B10 and B12 of IFRS 15 also require that, in assessing the existence and enforceability of a right to payment for performance completed to date, an entity considers:
- (a) whether it would have an enforceable right to demand or retain payment for performance completed to date if the contract were to be terminated before completion for reasons other than the entity's failure to perform as promised.
 - (b) the contractual terms as well as any legislation or legal precedent that could supplement or override those contractual terms.
57. In the context of regulatory returns on an asset not yet available for use described in paragraph 55, an entity could assess whether it has an enforceable present right to the accrued regulatory returns during construction. It could do this by considering whether it would have an enforceable present right to recover those returns if it were required to discontinue the construction of the asset in circumstances beyond its control. The IASB tentatively decided that the final Standard should specify that when an entity has an enforceable present right to regulatory returns on an asset not yet available for use, those returns would form part of the total allowed compensation for goods or services supplied during the construction period of that asset. The final Standard will provide guidance for entities to assess whether their rights to these regulatory returns are enforceable.
58. The context in which IFRS 15 is applied differs from the context in which the final Standard would be applied. IFRS 15 is applied to contracts between an entity and its customers. This model will be applied to regulatory agreements whereby a regulator

⁸ Agenda Papers [9B](#) and [9C](#) discussed at the IASB meeting in July 2022.

⁹ IFRS 15 paragraph 35(c) is included in Appendix B of this paper.

regulates the price entities can charge for goods and services they supply to their customers.

59. However, we think the same arguments can be applied to the assessments of enforceability of an entity's right to a bonus, or obligation for a penalty, before the end of the performance period in the case of long-term performance incentives. For example, the amount of a bonus may be dependent on the performance achieved by an entity during a 5-year period. In this case, an entity would not generally claim its right to an amount of that bonus before the end of the 5-year period. However, an entity would still be able to assess whether it would be able to enforce its right for an amount of the bonus relating to the performance it delivered during a particular year. For example, if events beyond the control of the entity led to the termination of the regulatory agreement at the end of year 1, the entity might have an enforceable present right for the amount of the bonus that relates to its performance up to the end of year 1.
60. The proposals in the Exposure Draft (regarding determining the portion of a long-term performance incentive that relates to a reporting period) would require that an entity assess whether it has an enforceable present right or an enforceable present obligation in relation to a portion of a long-term performance incentive. As mentioned in paragraph 57, this is similar to the case when an entity accrues regulatory returns on an asset not yet available for use during the construction period and it is allowed to include those returns in the regulated rates it charges only once the asset is in operation. During the construction period, such an entity would be required to assess whether it has an enforceable present right for the regulatory returns accrued to date. Assessing the enforceability of rights and obligations before a specified condition is met—with the specified condition being when performance is met, or have failed to be met, at the end of the performance period, or the asset is completed and put into operation—could be challenging. We think incorporating the principles underlying an entity's right to payment for performance completed to date in IFRS 15 could help an entity when carrying out these assessments.

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61. We think that the enhancements recommended to the enforceability requirements in paragraph 34, together with the incorporation of the principles underlying an entity's right to payment for performance completed to date in paragraph 35(c) of IFRS 15, could help entities assessing the existence of enforceable present rights or enforceable present obligations in relation to long-term performance incentives that are conditional upon future performance.
62. We recommend incorporating the principles underlying an entity's right to payment for performance completed to date in paragraph 35(c) of IFRS 15 into the requirements on enforceability in the final Accounting Standard. These principles would be used in establishing the requirements for regulatory returns on an asset not yet available for use (paragraph 57) and long-term performance incentives (paragraph 61).

Question for the IASB

3. Does the IASB agree with the staff recommendation in paragraph 62?

Appendix A—Extracts from the Exposure Draft

A1. This Appendix reproduces paragraph 27 of the Exposure Draft.

- 27 An entity determines whether a regulatory asset or regulatory liability exists using judgement considering all relevant facts and circumstances, including any:
- (a) confirmation from the regulator of amounts to be added or deducted in determining future regulated rates;
 - (b) explicit requirements or guidelines in the regulatory agreement;
 - (c) regulatory decisions or court rulings interpreting the regulatory agreement;
 - (d) evidence that allowable expenses have been incurred;
 - (e) evidence that performance criteria leading to a performance incentive bonus or penalty have been met or have not been met;
 - (f) direct precedents—the entity’s experience with the regulator’s interpretation of the regulatory agreement in similar circumstances;
 - (g) indirect precedents—such as the experience of other entities regulated by the same regulator, the decisions of other regulators or court rulings in similar circumstances;
 - (h) preliminary views expressed by the regulator; or
 - (i) advice from qualified and experienced legal or other advisors.

Appendix B—Extracts from the *Conceptual Framework* and recent IFRS Accounting Standards

- B1. This Appendix contains extracts from the *Conceptual Framework* and recent IFRS Accounting Standards regarding enforceability.
- B2. Paragraphs 4.31, 4.46 and 4.60 of the *Conceptual Framework* are reproduced.

Conceptual Framework for Financial Reporting

4.31 Many obligations are established by contract, legislation or similar means and are legally enforceable by the party (or parties) to whom they are owed. Obligations can also arise, however, from an entity's customary practices, published policies or specific statements if the entity has no practical ability to act in a manner inconsistent with those practices, policies or statements. The obligation that arises in such situations is sometimes referred to as a 'constructive obligation'.

...

4.46 A present obligation can exist even if a transfer of economic resources cannot be enforced until some point in the future. For example, a contractual liability to pay cash may exist now even if the contract does not require a payment until a future date. Similarly, a contractual obligation for an entity to perform work at a future date may exist now even if the counterparty cannot require the entity to perform the work until that future date.

...

4.60 All terms in a contract—whether explicit or implicit—are considered unless they have no substance. Implicit terms could include, for example, obligations imposed by statute, such as statutory warranty obligations imposed on entities that enter into contracts to sell goods to customers.

- B3. Paragraphs 10, 37, B10, B12, B13 of IFRS 15 and paragraphs BC32 and BC145 of the Basis for Conclusions accompanying IFRS 15 are reproduced. The definition of a contract in Appendix A of IFRS 15 is also reproduced.

IFRS 15 Revenue from Contracts with Customers

10 A contract is an agreement between two or more parties that creates enforceable rights and obligations. Enforceability of the rights and obligations in a contract is a matter of law. Contracts can be written, oral or implied by an entity's customary business practices. The practices and processes for establishing contracts with customers vary across legal jurisdictions, industries and entities. In addition, they

may vary within an entity (for example, they may depend on the class of customer or the nature of the promised goods or services). An entity shall consider those practices and processes in determining whether and when an agreement with a customer creates enforceable rights and obligations.

...

35 An entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognises revenue over time, if one of the following criteria is met:

- (a) the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs (see paragraphs B3–B4);
- (b) the entity's performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced (see paragraph B5); or
- (c) the entity's performance does not create an asset with an alternative use to the entity (see paragraph 36) and the entity has an enforceable right to payment for performance completed to date (see paragraph 37).

...

37 An entity shall consider the term of the contract, as well as any laws that apply to the contract, when evaluating whether it has an enforceable right to payment for performance completed to date in accordance with paragraph 35(c). The right to payment for performance completed to date does not need to be for a fixed amount. However, at all times throughout the duration of the contract, the entity must be entitled to an amount that at least compensates the entity for performance completed to date if the contract is terminated by the customer or another party for reasons other than the entity's failure to perform as promised. Paragraphs B9–B13 provide guidance for assessing the existence and enforceability of a right to payment and whether an entity's right to payment would entitle the entity to be paid for its performance completed to date.

...

contract An agreement between two or more parties that creates enforceable rights and obligations.

...

B10 An entity's right to payment for performance completed to date need not be a present unconditional right to payment. In many cases, an entity will have an

unconditional right to payment only at an agreed-upon milestone or upon complete satisfaction of the performance obligation. In assessing whether it has a right to payment for performance completed to date, an entity shall consider whether it would have an enforceable right to demand or retain payment for performance completed to date if the contract were to be terminated before completion for reasons other than the entity's failure to perform as promised.

...

B12 In assessing the existence and enforceability of a right to payment for performance completed to date, an entity shall consider the contractual terms as well as any legislation or legal precedent that could supplement or override those contractual terms. This would include an assessment of whether:

- (a) legislation, administrative practice or legal precedent confers upon the entity a right to payment for performance to date even though that right is not specified in the contract with the customer;
- (b) relevant legal precedent indicates that similar rights to payment for performance completed to date in similar contracts have no binding legal effect; and
- (c) an entity's customary business practices of choosing not to enforce a right to payment has resulted in the right being rendered unenforceable in that legal environment. However, notwithstanding that an entity may choose to waive its right to payment in similar contracts, an entity would continue to have a right to payment to date if, in the contract with the customer, its right to payment for performance to date remains enforceable.

B13 The payment schedule specified in a contract does not necessarily indicate whether an entity has an enforceable right to payment for performance completed to date. Although the payment schedule in a contract specifies the timing and amount of consideration that is payable by a customer, the payment schedule might not necessarily provide evidence of the entity's right to payment for performance completed to date. This is because, for example, the contract could specify that the consideration received from the customer is refundable for reasons other than the entity failing to perform as promised in the agreement.

...

BC32 The definition of a contract emphasises that a contract exists when an agreement between two or more parties creates enforceable rights and obligations between those parties. Determining whether a contractual right or obligation is enforceable is a question to be considered within the context of the relevant legal framework

(or equivalent framework) that exists to ensure that parties' rights and obligations are upheld. The boards observed that the factors that determine enforceability may differ between jurisdictions. Although there must be enforceable rights and obligations between parties for a contract to exist, the boards decided that the performance obligations within the contract could include promises that result in the customer having a valid expectation that the entity will transfer goods or services to the customer even though those promises are not enforceable (see paragraph B87).

...

BC145 In addition, the boards clarified that an entity need not have a present unconditional right to payment but, instead, it must have an enforceable right to demand and/or retain payment for performance completed to date if the customer were to terminate the contract without cause before completion. For example, consider a consulting contract in which the consulting entity agrees to provide a report at the end of the contract for a fixed amount that is conditional on providing that report. If the entity were performing under that contract, it would have a right to payment for performance completed to date if the terms of the contract (or other law) require the customer to compensate the entity for its work completed to date if the customer terminates the contract without cause before completion. The boards clarified this notion because the contractual payment terms in the contract might not always align with the entity's enforceable rights to payment for performance completed to date.

B4. Paragraphs B34 of IFRS 16 and paragraph BC127 of the Basis for Conclusions accompanying IFRS 16 are reproduced.

IFRS 16 Leases

B34 In determining the lease term and assessing the length of the non-cancellable period of a lease, an entity shall apply the definition of a contract and determine the period for which the contract is enforceable. A lease is no longer enforceable when the lessee and the lessor each has the right to terminate the lease without permission from the other party with no more than an insignificant penalty.

...

Cancellable leases

BC127 For the purposes of defining the scope of IFRS 16, the IASB decided that a contract would be considered to exist only when it creates rights and obligations that are enforceable. Any non-cancellable period or notice period in a lease would

meet the definition of a contract and thus, would be included as part of the lease term. To be part of a contract, any options to extend or terminate the lease that are included in the lease term must also be enforceable; for example, the lessee must be able to enforce its right to extend the lease beyond the non-cancellable period. If optional periods are not enforceable, for example, if the lessee cannot enforce the extension of the lease without the agreement of the lessor, the lessee does not have the right to use the asset beyond the non-cancellable period. Consequently, by definition there is no contract beyond the non-cancellable period (plus any notice period) if there are no enforceable rights and obligations existing between the lessee and lessor beyond that term. In assessing the enforceability of a contract, an entity should consider whether the lessor can refuse to agree to a request from the lessee to extend the lease.

- B5. Paragraph 2 of IFRS 17 and paragraph BC69 of the Basis for Conclusions accompanying IFRS 17 are reproduced.

IFRS 17 Insurance Contracts

2 An entity shall consider its substantive rights and obligations, whether they arise from a contract, law or regulation, when applying IFRS 17. A contract is an agreement between two or more parties that creates enforceable rights and obligations. Enforceability of the rights and obligations in a contract is a matter of law. Contracts can be written, oral or implied by an entity's customary business practices. Contractual terms include all terms in a contract, explicit or implied, but an entity shall disregard terms that have no commercial substance (ie no discernible effect on the economics of the contract). Implied terms in a contract include those imposed by law or regulation. The practices and processes for establishing contracts with customers vary across legal jurisdictions, industries and entities. In addition, they may vary within an entity (for example, they may depend on the class of customer or the nature of the promised goods or services).

...

BC69 IFRS 17 defines a contract as an agreement between two or more parties that creates enforceable rights and obligations, and explains that contracts can be written, oral or implied by an entity's business practices. IFRS 17 also requires an entity to consider all its substantive rights and obligations, whether they arise from contract, law or regulation. Thus, when referring to contractual terms the effects of law and regulation are also considered. These requirements are consistent with IFRS 15. They apply when an entity considers how to classify a

contract and when assessing the substantive rights and obligations for determining the boundary of a contract. However, in measuring a group of insurance contracts, IFRS 17 requires an entity to include estimates of future cash flows that are at the discretion of the entity and hence may not be enforceable. The Board's reasons for requiring such cash flows to be included in the measurement are set out in paragraphs BC167–BC169.