IFRS Accounting

# Staff paper

Agenda reference: 9D

**IASB® meeting**

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| Date | **February 2023** |
| Project | **Rate-regulated Activities** |
| Topic | **Total allowed compensation–performance incentives** |
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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) for accounting for performance incentives, except those that test entities' performances across multiple periods (long-term performance incentives).

2. We will analyse feedback received on the recognition and measurement of long-term performance incentives and make recommendations at a future meeting.

## Staff recommendations

3. We recommend the final Accounting Standard retains the proposals in paragraphs B16–B18 of the Exposure Draft that amounts relating to a performance incentive, including those incentives that test only an entity's performance of construction work, 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.

## Structure of the paper

4. This paper is structured as follows:

   (a) proposals in the Exposure Draft (paragraphs 5–6);

   (b) feedback received (paragraphs 7–8); and

   (c) staff analysis (paragraphs 9–22).

## Proposals in the Exposure Draft

5. Paragraphs B16–B18 of the Exposure Draft propose that 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. The Exposure Draft proposes the same treatment if the performance criteria test only an entity's performance of construction work (construction-related performance incentives—paragraph B18 of the Exposure Draft). That is, amounts for performance incentives that test specified milestones while constructing an asset would form part of or reduce the total allowed compensation for goods or services supplied during construction.

6. In paragraphs BC103–BC105 of the Basis for Conclusions on the Exposure Draft, the IASB acknowledged that the proposed treatment of construction-related performance incentives would arguably not align with the principle underlying the model—that is, that an entity should reflect the total allowed compensation for goods or services supplied as part of its reported financial performance for the period in which the entity supplies those goods or services. This is because the asset is still being constructed and thus is not yet available for use. The IASB however noted that the proposals aim to reflect performance incentives in profit or loss in the period in which an entity's performance gives rise to the incentives, even for incentives for performing construction work, because that period is when the performance occurs. In addition,

the IASB concluded that aligning the treatment of construction-related incentives with the treatment of all other performance incentives would:

(a) provide more useful and understandable information than applying different approaches for different types of performance incentives; and

(b) avoid unnecessary costs because an entity would not need to develop and implement different policies and processes for different types of performance incentives nor would it need to determine which incentives relate to performing construction work and which do not.

## Feedback received

7. Most respondents agreed with the proposals for performance incentives, including the treatment for construction-related performance incentives. A few European preparers said the proposals were appropriate and aligned to the regulatory agreements.

8. A few respondents raised concerns or qualified their support for the proposals:

(a) an accounting firm agreed with the proposed treatment for construction-related performance incentives provided that the performance is directly linked to goods or services supplied to customers during the construction period (paragraph 10(a));

(b) an intergovernmental body in Asia-Oceania expressed the concern that the proposals may result in performance incentives being recognised earlier than if the requirements of other IFRS Accounting Standards had been applied. This respondent questioned the benefit of the proposals in cases when the likelihood of recoverability of the performance incentives is relatively low (paragraph 10(b)); and

(c) a European preparer said that in some cases the terms of the regulatory agreements are vague and the regulator exercises discretion affecting the measurement and determination of performance incentives. In those circumstances, this respondent thought the assessment of whether rights and obligations are enforceable is challenging and recommended the final Standard provide further guidance on this matter (paragraph 10(b)).

## Staff analysis

9. Most respondents agreed with the proposals in the Exposure Draft that amounts relating to a performance incentive would 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 bonus or penalty. We think that the proposal in the Exposure Draft to reflect performance incentives in profit or loss in the period in which an entity's performance gives rise to the incentives is appropriate because that period is when performance occurs (or fails to occur).

10. The paragraphs that follow analyse comments raised by respondents on:

    (a) construction-related performance incentives (paragraphs 11–17)—for this item, we have a question for the IASB after paragraph 17; and

    (b) other matters—the items described in this section are addressed in other agenda papers. Consequently, this section does not include questions for the IASB (paragraphs 18–22).

### *Construction-related performance incentives*

11. Most respondents also agreed with the proposals that amounts for performance incentives that test specified milestones while constructing an asset would form part of or reduce the total allowed compensation for goods or services supplied during construction (paragraph 7).

12. Many respondents pointed out an inconsistency between the proposed treatment of construction-related performance incentives and the proposed treatment of regulatory returns on an asset not yet available for use.[1] These respondents recommended the

[1] Agenda Paper 9C discussed by the IASB at its October 2021 meeting.

final Standard align the treatment of regulatory returns on an asset not yet available for use with that of construction-related performance incentives. The IASB's tentative decision in July 2022 aligned the treatment of those items. That tentative decision would require an entity to reflect regulatory returns on an asset not yet available for use in profit or loss during the construction period if the entity has an enforceable present right to these returns.[2, 3]

13. As mentioned in paragraph 8(a), an accounting firm said they agreed that a performance incentive should form part of total allowed compensation in the period in which the performance occurs provided that the performance is directly linked to goods or services supplied to customers in that period. This respondent questioned whether in all circumstances the provision of construction services could be considered the goods or services that an entity supplies its customers during the construction period of an asset. Consequently, this respondent would not consider amounts relating to construction-related performance incentives as forming part of total allowed compensation during the construction period in all circumstances.

14. We agree with the rationale in paragraph BC104 of the Basis for Conclusions on the Exposure Draft, and with the view of most respondents, that the compensation for the construction-related performance incentive is related to an entity's performance in executing the construction activity and thus should form part of total allowed compensation in the period in which the performance occurs—that is during the construction period (paragraph 6).

15. When the IASB developed these proposals the IASB discussed that some construction-related performance incentives may be conditional on an entity satisfying requirements when supplying goods or services in future periods with the asset under construction. For example, a regulatory agreement may reward an entity with a bonus for achieving specified construction milestones but specify that an amount of that bonus is subject to the asset continuing to operate at a specified level of capacity over

2 Agenda Papers 9B and 9C discussed by the IASB at its July 2022 meeting.

3 The IASB's tentative decision dealing with the treatment of regulatory returns on an asset not yet available for use can be found here.

a specified period. In that case, the bonus is not solely for achieving construction milestones; part of it is for maintaining a given capacity level over a period specified by the regulatory agreement. For this specific case, the Exposure Draft proposed:

> B18 […] If the performance criteria test the performance of construction work but are also fully or partly conditional on the entity's performance when it subsequently supplies goods or services to customers using the asset being constructed, the conditional part of the performance incentive forms part of or reduces the total allowed compensation for those goods or services.

16. Respondents to the Exposure Draft did not raise concerns on these proposals.

17. Based on the analysis above, we recommend the final Accounting Standard retains the proposals in paragraphs B16–B18 of the Exposure Draft that amounts relating to a performance incentive, including those incentives that test only an entity's performance of construction work, 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.

| Question for the IASB |
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| 1. Does the IASB agree with the staff recommendation in paragraph 17? |

### *Other matters*

18. As mentioned in paragraph 8(b), a respondent questioned the appropriateness of the proposed threshold for recognition in the context of performance incentives.

19. The Exposure Draft proposes a recognition threshold of 'more likely than not' when it is uncertain whether a regulatory asset or a regulatory liability exists. When developing the proposals for the accounting of performance incentives, 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). However, the IASB acknowledged there could be uncertainty about the amount of the bonus or penalty (outcome uncertainty).

20. Based on the evidence gathered, we agree with the IASB's conclusion in the Exposure Draft that the existence uncertainty relating to performance incentives is generally low. This is because the terms and conditions of these performance incentives are generally clearly set out in the regulatory agreements. There may however be significant outcome and measurement uncertainty, particularly in the case of long-term performance incentives.

21. The recognition threshold of 'more likely that not' proposed in Exposure Draft is designed to deal with existence uncertainty. Agenda Paper 9B analyses the feedback received relating to the proposed recognition threshold. As mentioned in paragraph 2, we will analyse feedback received on the recognition and measurement for long-term performance incentives and make recommendations at a future meeting.

22. Some respondents commented on the difficulty of assessing whether rights and obligations arising from performance incentives are enforceable in some circumstances (paragraph 8(c)). Agenda Paper 9C provides analysis on the comments received relating to enforceability.