Staff paper

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IASB® meeting

Date	**February 2023**
Project	**Rate-regulated Activities**
Topic	**The recognition threshold**
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Objective

1. This paper sets out staff analysis and recommendations on the proposed threshold for the recognition of regulatory assets and regulatory liabilities in the Exposure Draft *Regulatory Assets and Regulatory Liabilities* (Exposure Draft).

Staff recommendations

2. The staff recommend that the final Accounting Standard:

   (a) retains the proposal that an entity should recognise a regulatory asset or a regulatory liability that is subject to existence uncertainty if it is more likely than not that the asset or liability exists.

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

   (c) specifies that an entity should recognise all regulatory assets and all regulatory liabilities that exist regardless of the level of measurement uncertainty, except for regulatory assets and regulatory liabilities:

      (i) whose measurement depends on benchmarks not known at year end (paragraph (e)); and

(ii) arising from long-term performance incentives. This topic will be discussed at a future meeting.

(d) retains the proposed symmetric recognition threshold for regulatory assets and regulatory liabilities.

(e) specifies that regulatory assets or regulatory liabilities whose measurement depends on benchmarks not known at year end should be recognised only when any uncertainty associated with their measurement is resolved.

Structure of the paper

3. This paper is structured as follows:

(a) proposals in the Exposure Draft (paragraphs 4–7);

(b) feedback received (paragraphs 8–15); and

(c) staff analysis (paragraphs 16–73).

Proposals in the Exposure Draft

4. Paragraph 25 of the Exposure Draft proposes that an entity should recognise all regulatory assets and all regulatory liabilities existing at the end of the reporting period.

5. Paragraph 28 of the Exposure Draft proposes that, if it is uncertain whether a regulatory asset or a regulatory liability exists (existence uncertainty), an entity should recognise the regulatory asset or regulatory liability if it is more likely than not that it exists.

6. The Exposure Draft includes an indicative list of facts and circumstances that an entity would consider in determining whether a regulatory asset or a regulatory liability exists (paragraph 27 of the Exposure Draft).

7. The IASB proposed that entities reflect any outcome or measurement uncertainties in the measurement of the regulatory assets or regulatory liabilities (paragraphs BC126–BC128 of the Basis for Conclusions on the Exposure Draft).[1, 2]

Feedback received

8. Most respondents who commented agreed with the proposed recognition requirements, including the proposed 'more likely than not' recognition threshold that an entity would apply when it is uncertain whether a regulatory asset or a regulatory liability exists.[3]

9. A few respondents (an accountancy body, a regulator and an academic) disagreed with the proposed recognition threshold because, according to these respondents, the 'more likely than not' threshold is inconsistent with the *Conceptual Framework for Financial Reporting* (the *Conceptual Framework*). Those respondents said:

   (a) the *Conceptual Framework* does not include a probability threshold in the recognition criteria.

   (b) recognising a regulatory asset or a regulatory liability that is subject to existence uncertainty, as proposed by the Exposure Draft, is *less* stringent than the recognition criteria in the *Conceptual Framework*. This is because, according to one of these respondents, the *Conceptual Framework* specifies that recognition of a particular asset or liability may not always provide relevant information if its existence is uncertain.

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[1] The *Conceptual Framework for Financial Reporting* (the *Conceptual Framework*) defines 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 (paragraph 6.61 and the Appendix to the *Conceptual Framework*).

[2] The *Conceptual Framework* defines measurement uncertainty as the uncertainty that arises when monetary amounts in financial reports cannot be observed directly and must instead be estimated (paragraph 2.19 and the Appendix to the *Conceptual Framework*).

[3] The IASB discussed feedback from comment letters and outreach events on the proposed recognition requirements at its meeting in October 2021 (Agenda Paper 9D).

10. A few respondents across stakeholder groups asked the IASB to provide more guidance on applying the proposed 'more likely than not' recognition threshold in different situations. Among these respondents:

    (a) a European regulator questioned the assumption in the Exposure Draft that there is generally little uncertainty about whether regulatory assets or regulatory liabilities exist; and

    (b) other respondents identified difficulties in assessing the existence of enforceable present rights or enforceable present obligations (Agenda Paper 9C).

11. Some respondents (mostly national standard-setters and preparers in Europe and Asia-Oceania) said that recognising regulatory assets and regulatory liabilities when there is significant outcome uncertainty or significant measurement uncertainty would not provide useful information to the users of financial statements. A respondent explicitly questioned the assumption in the Exposure Draft that measurement uncertainty is unlikely to be significant. Those respondents were particularly concerned about outcome and measurement uncertainties that arise from:

    (a) performance incentives that test an entity's performance across multiple periods (long-term performance incentives). Some of these 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. A few of these respondents thought that for such a regulatory asset or regulatory liability, the probability of an inflow or outflow of economic benefits may not be high. According to those respondents, estimating the future cash flows in a range of possible outcomes, especially early in the performance assessment period, would be very costly and subjective.

    (b) costs incurred in certain circumstances. For example, an allowable expense may be determined based on benchmarks that an entity will not know at the time its financial statements are authorised for issue (benchmarks not known at year end).

12. Consequently, some of those respondents said an entity should not recognise a regulatory asset or a regulatory liability if there is a significant outcome uncertainty or significant measurement uncertainty. Those respondents suggested the final Standard require that regulatory assets and regulatory liabilities be recognised if:

    (a) it is highly likely that they exist—these respondents would suggest a higher probability recognition threshold;

    (b) the probability of an inflow or outflow of economic benefits is high; or

    (c) they meet an 'existence' threshold and can be reliably measured, or the amount and timing of future cash flows are known.

13. Some of the respondents mentioned in paragraph 11 also suggested the final Standard should include a constraint on the measurement of regulatory assets and regulatory liabilities, similar to the constraint on estimates of variable consideration in IFRS 15 *Revenue from Contracts with Customers*.[4] For example, an entity should include cash flows in the measurement of a regulatory asset only to the extent it is highly probable that a significant reversal in the amount of the regulatory asset will not occur when the uncertainty associated with that asset is subsequently resolved. An accounting firm and an accountancy body, while agreeing with the 'more likely than not' recognition threshold, suggested explaining in the Basis for Conclusions on the final Standard why the measurement requirements do not contain such a constraint.

14. A few respondents (a national standard-setter in Asia-Oceania and an academic) said regulatory assets and regulatory liabilities should be subject to asymmetric recognition thresholds. For example, the respondents suggested applying the 'more likely than not' recognition threshold to regulatory liabilities and a 'highly probable' recognition threshold to regulatory assets. Those respondents referred to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* as an example of an IFRS Accounting

[4] Paragraph 56 of IFRS 15.

Standard that specifies asymmetric recognition thresholds for assets and liabilities whose existence is uncertain.

15. A few respondents—mainly an accounting firm and a European preparer—suggested that an entity should provide disclosures when significant judgement is required to assess whether a regulatory asset or a regulatory liability exists or disclosures relating to unrecognised regulatory assets or regulatory liabilities and, if a measurement constraint as described in paragraph 13 were to be introduced, unrecognised amounts relating to recognised regulatory assets or regulatory liabilities.

Staff analysis

16. The staff analysis is structured as follows:

    (a) the 'more likely than not' recognition threshold (paragraphs 17–51).

    (b) the symmetric recognition threshold for regulatory assets and regulatory liabilities (paragraphs 52–58).

    (c) allowable expenses based on benchmarks not known at year end (paragraphs 59–73).

The 'more likely than not' recognition threshold

17. The IASB considered the *Conceptual Framework* when developing the proposed recognition threshold.

18. The *Conceptual Framework* states that an asset or a liability is recognised only if recognition of that asset or liability and any resulting income, expenses or changes in equity provides users of financial statements with useful information—that is, relevant information that faithfully represents the asset or liability and any resulting income, expenses or changes in equity.

19. The recognition criterion of:

    (a) relevance considers whether it is uncertain that an asset or a liability exists (**existence uncertainty**) and whether the **probability of an inflow or outflow**

of economic benefits is low. An asset or a liability can exist even if the probability of an inflow or outflow of economic benefits is low.

(b) faithful representation considers whether the level of uncertainty involved in estimating a measure of an asset or a liability (**measurement uncertainty**) may be so high that the estimate may not provide a sufficiently faithful representation of that asset or liability. Measurement uncertainty may be affected by both existence uncertainty and the uncertainty about the amount or timing of any inflow or outflow of economic benefits (outcome uncertainty).

20. The following paragraphs analyse feedback on the proposed recognition threshold in terms of the recognition requirements in the *Conceptual Framework*, specifically the requirements dealing with:

(a) existence uncertainty (paragraphs 21–30);

(b) probability of a flow of economic benefits (paragraphs 31–41); and

(c) measurement uncertainty (paragraphs 42–51).

Existence uncertainty

21. When developing the Exposure Draft, the IASB learnt that there is generally little uncertainty about whether regulatory assets or regulatory liabilities exist.[5] The IASB noted that a regulatory agreement would not specify every transaction or event that it is intended to cover. The IASB, however, considered this would not introduce significant existence uncertainty that would affect the recognition of regulatory assets and regulatory liabilities. Consequently, the IASB concluded that setting a recognition threshold of ‘more likely than not’ applied to existence uncertainty would result in the recognition of regulatory assets and regulatory liabilities that would provide relevant information.

[5] Paragraph BC124 of the Basis for Conclusions on the Exposure Draft.

22. As mentioned in paragraph 9, a few respondents questioned the proposed recognition threshold because, according to them, the *Conceptual Framework*:

    (a) does not include a probability threshold in the recognition criteria (paragraph 23). The respondent raising this matter thinks the proposed threshold may not have a significant role in the recognition of regulatory assets and regulatory liabilities if there is little uncertainty that regulatory assets and regulatory liabilities exist.

    (b) specifies that recognition of a particular asset or liability may not always provide relevant information if the existence of the asset or liability is uncertain (paragraph 24). The respondent raising this matter thinks entities should recognise only regulatory assets and regulatory liabilities whose existence is certain.

23. In response to feedback in paragraph 22(a), the *Conceptual Framework* does not prevent the IASB from setting a probability threshold for recognition, if the IASB considers that setting a threshold would achieve a better balance between the benefits and the costs of recognition than setting no threshold.[6] Paragraphs 26–29 discuss why the proposed recognition threshold of 'more likely than not' would achieve that cost-benefit balance.

24. In response to feedback in paragraph 22(b), the *Conceptual Framework* permits recognition of regulatory assets or regulatory liabilities that are subject to existence uncertainty.[7] If a regulatory asset (regulatory liability) is more likely than not to exist, we think recognition of that asset (liability) would provide sufficiently relevant information about an entity's enforceable present right (obligation) to add (deduct) an amount to (from) future regulated rates. Recognition and measurement, accompanied by disclosures about the existence uncertainty, would result in better information about the uncertainty than that provided by disclosures alone.

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[6] Paragraph BC5.14 of the Basis for Conclusions on the *Conceptual Framework* says: 'The […] *Conceptual Framework* does not provide detailed guidance on how to consider existence uncertainty in making recognition decisions because the appropriate approach will depend on facts and circumstances.'

[7] Paragraphs 5.12–5.14 of the *Conceptual Framework*.

25. As mentioned in paragraph 10, a European regulator questioned the assumption in the Exposure Draft that there is generally little uncertainty about whether regulatory assets and regulatory liabilities exist. Other respondents gave examples of circumstances in which existence uncertainty may not be low—for example, when regulatory environments are not fully developed, the regulatory agreements are not sufficiently detailed, or there is a high degree of discretion by the regulator (paragraph 10). A preparer in North America suggested setting a recognition threshold of highly likely to exist. According to this respondent, such a threshold would deal better with circumstances of high existence uncertainty (paragraph 12(a)).

26. We acknowledge there will be circumstances in which assessing whether it is more likely or not that a regulatory asset or a regulatory liability exists will be difficult. Having said that, these circumstances would typically affect only specific regulatory assets or regulatory liabilities of an entity. Most respondents who commented on the proposed recognition threshold of 'more likely than not' agreed with that proposal (paragraph 8). Therefore, we expect that in most cases an entity would not need to exercise a high degree of judgement in determining whether its regulatory assets or regulatory liabilities are more likely than not to exist. Agenda Paper 9C provides analysis relating to the assessment of whether enforceable present rights or enforceable present obligations exist in the circumstances described in paragraph 25.

27. It could be argued that the model would be simpler if entities were required to recognise all regulatory assets and regulatory liabilities, regardless of the level of existence uncertainty. However, we think such requirements would not always result in relevant information.

28. In circumstances when the assessment of existence is difficult, we acknowledge that applying a higher probability recognition threshold may reduce complexity and subjectivity. However, this would make entities' statements of financial position and statements of financial performance less complete. This is because some regulatory assets and regulatory liabilities would not meet the higher recognition threshold, but their recognition, accompanied by disclosures about any existence uncertainty, would nevertheless provide useful information.

29. As mentioned in paragraph 26, we expect that entities would not need to exercise a high degree of judgement in the assessment of existence in most cases. On balance, we think in most cases applying the proposed recognition threshold would provide useful information that would outweigh the associated costs. Therefore, we recommend the final Accounting Standard retains the proposal that an entity should recognise a regulatory asset or a regulatory liability that is subject to existence uncertainty if it is more likely than not that the asset or liability exists.

30. We plan to discuss specific disclosures about recognised and unrecognised regulatory assets and regulatory liabilities that are subject to existence uncertainty at a future meeting.

Probability of a flow of economic benefits

31. Based on feedback on the Exposure Draft, a few respondents:

(a) identified cases (for example, long-term performance incentives) in which the probability of flows of economic benefits may be low (paragraph 11(a)).

(b) seemed to have linked significant outcome uncertainty to a low probability of an inflow or outflow of economic benefits (paragraphs 11(a) and 12(b)). These respondents thought that when a regulatory asset or regulatory liability is subject to significant outcome uncertainty, the probability of an inflow or outflow of economic benefits may not be high.

32. When developing the proposed recognition requirements, the IASB concluded that even if the probability of a flow of economic benefits is low, recognition of a regulatory asset or a regulatory liability would still result in relevant information.[8] Having said that, the IASB noted that if a regulatory asset or regulatory liability exists, the probability that it will give rise to an inflow or outflow of economic benefits is generally high.[9] Consequently, the IASB concluded that it was unnecessary for the model to prohibit recognition of regulatory assets or regulatory

[8] Paragraph BC126 of the Basis for Conclusions on the Exposure Draft.
[9] Paragraph BC127 of the Basis for Conclusions on the Exposure Draft.

liabilities when the probability of an inflow or outflow of economic benefits does not meet a specified minimum threshold.

33. The IASB also considered outcome uncertainty in developing the proposed recognition requirements. The IASB proposed that any uncertainty about the amount or timing of inflows or outflows should affect the measurement of regulatory assets or regulatory liabilities.[10]

34. As mentioned in paragraph 31(a), a few respondents identified cases in which the probability of flows of economic benefits may be low (for example, long-term performance incentives). The *Conceptual Framework* states that recognition of a particular asset or liability may not always result in relevant information if, for example, an asset or liability exists, but the probability of an inflow or outflow of economic benefits is low (paragraph 19).

35. Based on the evidence we have gathered, we think the probability of flows of economic benefits arising from regulatory assets or regulatory liabilities is generally high. We think respondents that identified long-term performance incentives as a case of low probability of flows of economic benefits may have in mind specific performance incentives that may result in no flows of economic benefits in certain circumstances or may have confused the probability of a flow of economic benefits with outcome uncertainty (paragraphs 37–41). Based on the evidence gathered, we think performance incentives are designed so that they typically result in inflows or outflows of economic benefits.

36. Therefore, based on the feedback received, we agree with the IASB's conclusion in the Exposure Draft that the probability that regulatory assets and regulatory liabilities will give rise to an inflow or outflow of economic benefits is generally high (paragraph 32). Therefore, we recommend the final Accounting Standard retains the proposal not to set a recognition threshold based on the probability of a flow of economic benefits.

[10] Paragraph BC126 of the Basis for Conclusions on the Exposure Draft.

37. As noted in paragraph 31(b), feedback suggests some respondents may have confused the probability of a flow of economic benefits with outcome uncertainty.

38. The *Conceptual Framework* distinguishes a low probability of an inflow or outflow of economic benefits associated with an asset or a liability from outcome uncertainty. The *Conceptual Framework* includes the probability of an inflow or outflow of economic benefits in the recognition criterion of relevance (paragraph 19). The *Conceptual Framework* includes measurement uncertainty in the recognition criterion of faithful representation (paragraph 19) and says that outcome uncertainty may sometimes contribute to measurement uncertainty.[11]

39. We think a few paragraphs in the Basis for Conclusions on the Exposure Draft may have contributed to respondents' confusion between probability of flows of economic benefits and outcome uncertainty by either:

    (a) including outcome uncertainty in the discussion of the recognition criterion dealing with relevance in the *Conceptual Framework* (paragraph BC123 (b)—**emphasis added**); or

    (b) relating outcome uncertainty to the probability of flows of economic benefits (paragraphs BC126 and BC127—**emphasis added**).

> BC123 In relation to relevant information, the *Conceptual Framework* says that recognition of a particular asset or liability and any resulting income, expenses or changes in equity may not always result in relevant information when:
>
> (a) it is uncertain whether an asset or liability exists; or
>
> (b) an asset or liability exists, but **the outcome is uncertain** and **the probability of an inflow or outflow of economic benefits is low**.
>
> […]

[11] Paragraphs 5.12–5.17 and 6.62 of the *Conceptual Framework*.

> BC126 In relation to **outcome uncertainty**, the Board proposes that an entity recognise all regulatory assets and regulatory liabilities, **regardless of how likely an inflow or outflows of economic benefits is**. […]
>
> BC127 […] Thus, the Board expects that entities would recognise most regulatory assets and regulatory liabilities whose existence is certain, even if the Board were to prohibit their recognition in cases of **outcome uncertainty when the probability of an inflow or outflow of economic benefits does not meet some specified minimum threshold**.

40. We think significant outcome uncertainty may co-exist with a low probability of a flow of economic benefits. However, in the case of regulatory assets or regulatory liabilities that respondents have identified as being subject to significant outcome uncertainty (for example, long-term performance incentives), the probability of a flow of economic benefits is generally high (see paragraph 35).

41. We think the final Accounting Standard should address respondents' confusion about the probability of a flow of economic benefits and outcome uncertainty. We will do this by using outcome uncertainty in a way that is consistent with the *Conceptual Framework.*

Measurement uncertainty

42. Feedback on the Exposure Draft identified situations in which a regulatory asset or a regulatory liability may be subject to significant outcome uncertainty or significant measurement uncertainty (paragraph 11). Some respondents said recognition of regulatory assets and regulatory liabilities when there is a significant outcome or measurement uncertainty would not provide useful information.

43. A few of these respondents suggested requiring recognition of regulatory assets and regulatory liabilities when they can be reliably measured or when the amount and timing of future cash flows are known (paragraph 12(c)). Other respondents suggested the final Standard introduces a measurement constraint similar to that in IFRS 15 for estimates of variable consideration (paragraph 13).

44. In developing the proposed recognition requirements, the IASB learnt that the cash flows arising from regulatory assets or regulatory liabilities are generally fairly stable and predictable and that entities would typically be able to make reasonable estimates when measuring regulatory assets and regulatory liabilities. As a result, the IASB concluded that measurement uncertainty is unlikely to affect whether the recognition of a regulatory asset or a regulatory liability faithfully represents that asset or liability.[12] Because of this, the IASB concluded that it was unnecessary for the model to prohibit recognition of regulatory assets or regulatory liabilities when the measurement uncertainty exceeds a specified threshold.

45. The *Conceptual Framework* states that even a high level of measurement uncertainty does not necessarily prevent an estimate from providing useful information.[13] Nevertheless, the *Conceptual Framework* envisages circumstances in which the measurement uncertainty of an asset or a liability may be so high that the estimate may not provide a sufficiently faithful representation of that asset or liability. However, it is only in limited circumstances that an asset or a liability would not be recognised because no relevant measures that are available (or can be obtained) would provide useful information about the asset or liability.[14]

46. We learnt that specific regulated industries in some jurisdictions are undergoing significant changes resulting in significant uncertainty. Those uncertainties typically affect the regulatory processes and decisions, thereby affecting entities' ability to make reasonable estimates.

47. Nevertheless, we think the level of measurement uncertainty associated with most regulatory assets and regulatory liabilities is unlikely to be so high that there is no relevant measure that would provide a sufficiently faithful representation of the regulatory asset or regulatory liability. This is supported by feedback from respondents who have identified only two situations in which regulatory assets and regulatory liabilities are subject to significant outcome or measurement uncertainty:

[12] Paragraph BC128 of the Basis for Conclusions on the Exposure Draft.

[13] Paragraph 2.19 of the *Conceptual Framework*.

[14] Paragraphs 5.21–5.22 of the *Conceptual Framework*.

allowable expenses based on benchmarks not known at year end and long-term performance incentives.

48. Paragraphs 59–73 discuss the recognition of regulatory assets and regulatory liabilities whose measurement depends on benchmarks not known at year end. These paragraphs recommend specific recognition requirements for these regulatory assets and regulatory liabilities.

49. We plan to discuss the recognition and measurement of regulatory assets and regulatory liabilities arising from long-term performance incentives at a future meeting.

50. Therefore, we recommend the final Accounting Standard specifies that an entity should recognise all regulatory assets and all regulatory liabilities that exist regardless of the level of measurement uncertainty, except for regulatory assets and regulatory liabilities:

(a) whose measurement depend on benchmarks not known at year end (paragraphs 59–73); and

(b) arising from long-term performance incentives (paragraph 49).

51. We plan to discuss specific disclosures about regulatory assets and regulatory liabilities that are subject to significant measurement uncertainty at a future meeting.

Questions for the IASB

1. Does the IASB agree that the final Accounting Standard:

(a) retains the proposal that an entity should recognise a regulatory asset or a regulatory liability that is subject to existence uncertainty if it is more likely than not that the asset or liability exists (paragraph 29)?

(b) retains the proposal not to set a recognition threshold based on the probability of a flow of economic benefits (paragraph 36)?

(c) specifies that an entity should recognise all regulatory assets and all regulatory liabilities that exist regardless of the level of measurement uncertainty, except for regulatory assets and regulatory liabilities:

Questions for the IASB
(i) whose measurement depends on benchmarks not known at year end; and
(ii) arising from long-term performance incentives (paragraph 50)?

The symmetric recognition threshold for regulatory assets and regulatory liabilities

52. As mentioned in paragraph 14, only a few respondents questioned the proposal to apply the same recognition threshold to both regulatory assets and regulatory liabilities.

53. In developing the proposed recognition requirements, the IASB gathered no evidence that supported setting a higher recognition threshold for regulatory assets than for regulatory liabilities—that is, an asymmetric threshold for regulatory assets and regulatory liabilities. The IASB concluded that because a single regulatory agreement could give rise to both regulatory assets and regulatory liabilities, setting an asymmetric recognition threshold may result in information that could be difficult to interpret.[15]

54. Respondents that suggested setting an asymmetric recognition threshold preferred applying a higher threshold to regulatory assets and a lower threshold to regulatory liabilities, arguing that such an approach would be prudent. However, the *Conceptual Framework* describes prudence as supporting neutrality—one of the characteristics of faithful representation.[16]

55. The following paragraph of the *Conceptual Framework* is relevant when developing the requirements of an IFRS Accounting Standard (**emphasis added**):

[15] Paragraph BC125 of the Basis for Conclusions on the Exposure Draft.

[16] Paragraph 2.16 of the *Conceptual Framework* says that 'Prudence is the exercise of caution when making judgements under conditions of uncertainty.' The exercise of prudence neither means that assets are not overstated and liabilities are not understated nor allows for the understatement of assets and the overstatement of liabilities.

> 2.17 The exercise of prudence does not imply **a need for asymmetry**, for example, a systematic need for more persuasive evidence to support the recognition of assets or income than the recognition of liabilities or expenses. Such asymmetry is not a qualitative characteristic of useful financial information. Nevertheless, particular Standards **may contain asymmetric requirements** if this is a consequence of decisions intended to select the most relevant information that faithfully represents what it purports to represent.

56. We have not obtained evidence supporting a need for setting a higher recognition threshold for regulatory assets than for regulatory liabilities. Both regulatory assets and regulatory liabilities may be subject to similar levels of existence uncertainty and outcome or measurement uncertainty. This indicates a symmetric recognition threshold for both regulatory assets and regulatory liabilities would result in useful information for users of financial statements.

57. Moreover, in some cases, a difference in timing that originated as a regulatory liability (regulatory asset) in a reporting period may turn into a regulatory asset (regulatory liability) in a subsequent reporting period. If the final Standard were to specify an asymmetric recognition threshold, an entity may be required to recognise such a difference in timing in the period of origination when it gives rise to a regulatory liability but not when it gives rise to a regulatory asset. Furthermore, an entity may decide to derecognise a difference in timing that originated as a regulatory liability when it subsequently turns into a regulatory asset, even if the level of existence uncertainty remains unchanged. Therefore, setting an asymmetric recognition threshold for regulatory assets and regulatory liabilities could result in information that is difficult to interpret.

58. Consequently, we think a symmetric recognition threshold would result in more useful information than an asymmetric recognition threshold for regulatory assets and regulatory liabilities. Therefore, we recommend the final Accounting Standard retains the proposed symmetric recognition threshold for regulatory assets and regulatory liabilities.

Question for the IASB
2. Does the IASB agree with the staff recommendation in paragraph 58?

Allowable expenses based on benchmarks not known at year end

59. The IASB discussed allowable expenses determined based on benchmarks at its October 2022 meeting.[17] At that meeting the IASB discussed the case of regulatory agreements determining the amount of compensation for an item of expense by reference to the expenses of an entity's peer group (benchmark expenses). The IASB discussed examples in which the benchmark expenses are known by an entity at the time when its financial statements are authorised for issue.

60. Some respondents said that there would be significant measurement uncertainty associated with regulatory assets or regulatory liabilities that are based on benchmarks that at not known at the time when an entity's financial statements are authorised for issue (benchmarks not known at year end) (paragraph 11(b)). The paragraph below provides an example.

61. Assume a regulatory agreement determines the compensation for an allowable expense for Year 1 using an average of the estimated expense that will be incurred by a peer group (estimated benchmark expense) in that year. In Year 2 (generally after entities in the peer group have issued their financial statements for Year 1), the regulator publishes the actual benchmark expense based on submissions received from the peer group. The regulator requires that entities adjust the difference between the actual benchmark expense and the estimated benchmark expense for Year 1 in regulated rates charged in a future period.

62. In this example, a regulatory asset (regulatory liability) will arise in Year 1 if the estimated benchmark expense included in the regulated rates charged in Year 1 is

[17] Agenda Paper 9A discussed at the October 2022 IASB meeting.

lower (higher) than the actual benchmark expense for that year. However, the entity would know the actual benchmark expense for Year 1 only after its financial statements for that year are authorised for issue.

63. Some respondents said that the entity would not have the information necessary to estimate the actual benchmark expense until the regulator publishes the actual benchmark expense. This is because the entity would not have information about the factors affecting the expense of its peers (for example, the level of efficiency) that would be necessary for the entity to estimate the actual benchmark expense with a reasonable level of confidence.

64. In this case, we think the outcome and measurement uncertainties associated with actual benchmark expenses could be significant and any estimated amounts may not faithfully represent the regulatory asset or regulatory liability.

65. The proposed model is designed to supplement the revenue information provided by applying IFRS 15. When assessing possible recognition or measurement requirements that could be applied to benchmarks not known at year end, we considered requirements in IFRS 15 that result in either constraining estimates of variable consideration (paragraphs 66–69) or the recognition of revenue only when the uncertainty is resolved (paragraphs 70–73).

Measurement constraint

66. Paragraph 56 of 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.

67. In the case of a regulatory asset or a regulatory liability arising from adjustments using benchmarks not known at year end, its measurement could be constrained to, for example a ‘highly probable amount’. Introducing a ‘highly probable’ measurement constraint would imply entities are able to estimate the amounts that fulfil the constraint. However, the lack of information mentioned in paragraph 63 would continue to be a key factor contributing to measurement uncertainty.

68. Because of the lack of information, we think that, in many cases, an entity may conclude that no single amount of the regulatory asset or regulatory liability would meet the 'highly probable' threshold. If this is the case, the entity would measure the regulatory asset or regulatory liability at the value of zero. The application of the threshold in that manner would not give rise to useful information.

69. Therefore, we think introducing a constraint on the measure of regulatory assets and regulatory liabilities related to benchmarks not known at year end would result in benefits that are likely to be significantly outweighed by the associated costs.

Recognition when uncertainty is resolved

70. When developing IFRS 15, the IASB considered a licence of intellectual property for which the consideration is based on the customer's subsequent sales or usage (sales-based or usage-based royalties). For such a licence, both users and preparers of financial statements generally indicated that if an entity recognised a minimum amount of revenue it would not provide relevant information. Consequently, the IASB decided that for such a licence, an entity should not recognise any revenue for the uncertain amounts until the customer's subsequent sales or usage occurs—that is, until the uncertainty is resolved.[18]

71. We think the case of sales-based or usage-based royalties in IFRS 15 can be analogised to the case of a regulatory asset or a regulatory liability arising from adjustments using benchmarks not known at year end. In the latter case the final Standard could prohibit an entity from recognising the regulatory asset or regulatory liability arising from the uncertain amounts until the uncertainty is resolved. This approach is simple to apply and may achieve an accounting outcome that:

(a) is similar to the outcome of applying a measurement constraint using a 'highly probable' threshold (paragraph 68); or

(b) would be aligned with the *Conceptual Framework* if the entity, applying the proposed measurement requirements, had concluded that no single amount

[18] Paragraphs BC219 and BC415 of the Basis for Conclusions on IFRS 15.

would faithfully represent the regulatory asset or regulatory liability (paragraph 45).

72. Because the outcome and measurement uncertainties associated with benchmarks not known at year end are significant, we think this approach would not result in less useful information than what an entity would have provided applying the proposed recognition and measurement requirements. On the whole, we think the benefits of this approach would outweigh the associated costs.

73. Therefore, we recommend the final Accounting Standard specifies that regulatory assets or regulatory liabilities whose measurement depends on benchmarks not known at year end should be recognised only when any uncertainty associated with their measurement is resolved.

Question for the IASB
3. Does the IASB agree with the staff recommendation in paragraph 73?