KPMG

Regulatory assets and regulatory liabilities

Global IFRS Institute

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Proposals for a new IFRS® Standard for companies subject to rate regulation

Highlights

- Recognising regulatory assets and regulatory liabilities – An overlay approach
- Who would be affected?
- What could the impact be?
- Find out more and have your say – Comment deadline is 30 July 2021*

Rate regulation, common in the utility and other sectors, can have a significant effect on a company's long-term financial performance. However, unlike some national GAAPs, IFRS Standards do not contain comprehensive guidance on the accounting impacts of rate regulation[1].

The International Accounting Standards Board (the Board) has published the exposure draft (ED) **Regulatory Assets and Regulatory Liabilities**. To complement the ED, our **New on the Horizon** (PDF 1.5 MB) publication explores its proposals in greater detail, with illustrative examples.

The ED proposes a new accounting model under which a company subject to rate regulation that meets the scope criteria would recognise regulatory assets and liabilities.

This accounting model would align the total income recognised in a period under IFRS Standards with the total allowed compensation the company is permitted to earn by the rate regulator, often reducing reported volatility in financial performance.

"This is a huge milestone in the Board's long-running project on rate regulation. The key issues are which companies would fall within the scope of the proposals and how the proposed new accounting model would apply to the variety of forms of rate regulation we see globally in practice."

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Recognising regulatory assets and regulatory liabilities – An overlay approach

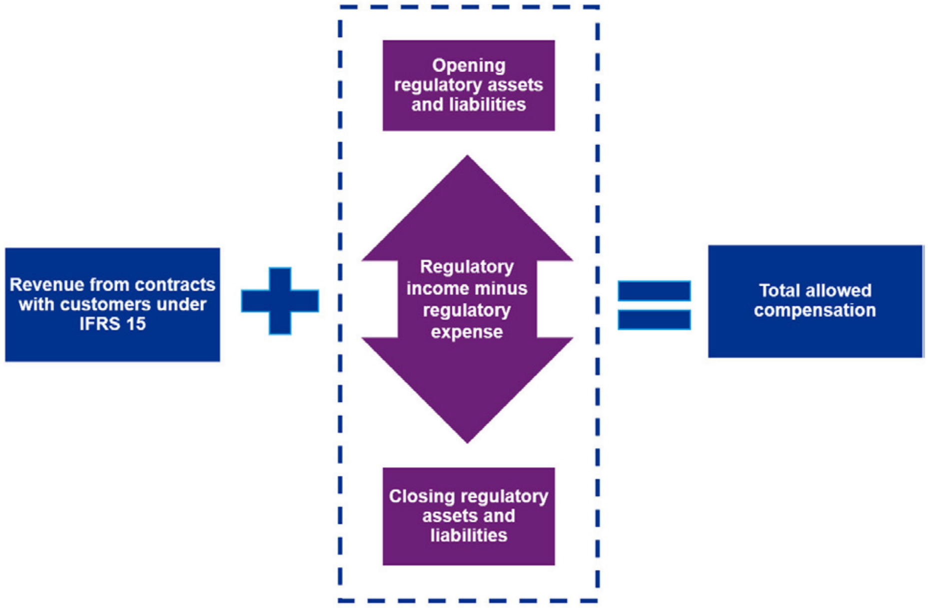
The key proposal in the ED is that a company that is subject to rate regulation should report in its financial statements the total allowed compensation it is permitted to earn by the rate regulator for goods and services supplied in the period.

1 IFRS 14 *Regulatory Deferral Accounts* permits, but does not require, a first-time adopter of IFRS Standards to continue using previous GAAP to account for regulatory deferral account balances.

To achieve this, the ED proposes an 'overlay' approach under which a company would, first, continue to apply the requirements of existing IFRS Standards – for example, to recognise and measure revenue from contracts with customers. Then, a company would recognise:

- *a regulatory asset* – when it has an enforceable present right to add an amount in determining the regulated rate to be charged to customers in future periods; and
- *a regulatory liability* – when it has an enforceable present obligation to deduct an amount in determining the regulated rate to be charged to customers in future periods.

Movements in regulatory assets and liabilities would give rise to regulatory income and expense. Broadly speaking, the total revenue recognised under existing IFRS Standards plus regulatory income minus regulatory expense under the proposed new IFRS Standard would align with the total allowed compensation determined by the rate regulator.



The company would present regulatory income minus regulatory expense separately in the statement of financial performance, immediately below revenue. Regulatory assets and liabilities would be presented separately from other assets and liabilities.

The Board believes that this approach would improve the information provided to users about the financial performance and financial position of companies subject to rate regulation.

Transition

A company would apply the proposals retrospectively to annual reporting periods beginning 18 to 24 months after the proposed new IFRS Standard is issued. IFRS 14 *Regulatory Deferral Accounts* would be withdrawn.

Who would be affected?

It is possible that some companies in the utility sector would not meet the scope criteria, whereas some outside the utility sector would be captured.

A company would fall within the scope of the proposals if it meets the following conditions:

- the company is a party to a regulatory agreement;
- the regulatory agreement determines the regulated rate that the company can charge for goods or services supplied to its customers; and

– the regulated rate is determined in a such a way that some or all the total allowed compensation for goods or services supplied in one period is charged to customers in a different period.

The proposed standard provides some guidance for these conditions. If a company meets these criteria, then it would be required to apply the accounting model in the ED. Unlike the approach in IFRS 14, the new accounting model would not be optional.

What could the impact be?

Companies covered by the proposals who did not apply IFRS 14 would recognise new assets and liabilities, and new items of income and expense. The impact on financial performance will depend on the facts and circumstances of the company but common cases would include the following.

– If recognition of income under IFRS Standards previously lagged total allowed compensation permitted by the regulator, then a company would see an increase in net assets on transition to the new standard.

– If a company previously experienced material short-term timing differences between recognition of income under IFRS Standards and total allowed compensation permitted by the regulator, volatility in reported earnings would be reduced.

Companies that applied IFRS 14 would transition to the new requirements; there is no option to automatically carry forward existing IFRS 14 accounting.

Find out more and have your say

The Board has requested comments on the ED by 30 July 2021*. We encourage preparers and users of financial statements to read and comment on the proposals.

Read our **New on the Horizon** (PDF 1.5 MB) publication, which explores some of the potential impacts and offers illustrative examples showing how financial statements might be presented.

For further information on the proposals, speak to your KPMG contact.

* This article was updated on 30 March 2021, to include references and links to our New on the Horizon publication and also to reflect the Board decision in March 2021 to extend the comment deadline from 30 June 2021 to 30 July 2021.

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