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Mr. Andreas Barckow  
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Our ref RD/288

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Dear Mr. Barckow

### **Comment letter on ED/2021/1 Regulatory Assets and Regulatory Liabilities**

We appreciate the opportunity to comment on the International Accounting Standards Board's (the Board) Exposure Draft *Regulatory Assets and Regulatory Liabilities* (the ED or the proposals). We have consulted with, and this letter represents the views of, the KPMG network.

We support the continuation of the Board's comprehensive project to explore the development of an accounting model for rate-regulated activities. We believe that the project has the potential to resolve the long-running debate as to whether regulatory timing differences should be recognised as assets and liabilities, or otherwise reflected, in general purpose financial statements prepared under IFRS. The ED is a major milestone in this project.

We generally agree with the proposals. In particular, we agree with the proposed accounting model, under which an entity:

- recognises regulatory assets and liabilities when it has an enforceable right or obligation to adjust the regulated rate, because the regulatory agreement specifies that part of the total allowed compensation for goods and services supplied in a period is included in determining the regulated rate for another period; and
- applies existing IFRS Standards in accounting for other assets and liabilities.

However, we have concerns over certain aspects of the proposals and a number of recommendations as to how the proposals could be amended or clarified, or where we believe additional guidance is required in order to promote consistent application. We describe our key concerns below and have included our detailed answers to the questions in the ED in the appendix to this letter.

### **Scope of the proposals (Question 1)**

We generally agree that the scope criteria should focus on the existence of enforceable rights or obligations that commonly arise when entities are subject to rate regulation but are not recognised as assets or liabilities under existing IFRS Standards. However, we recommend that the Board consider developing a definition of a ‘Regulator’ and require that the ED will apply only if there is a regulator. We believe that this would:

- clarify the types of arrangements to which the proposals are intended to apply;
- reduce the risk that other types of arrangements are caught inadvertently. For example, we understand that the application of the ED to certain financial and insurance products have been discussed by stakeholders during the comment period; and
- reduce the risk of structuring opportunities within groups and between related entities under which artificial ‘regulatory agreements’ may be constructed in order to drive the reported results of an entity.

We believe that in developing the definition of a regulator, the Board could draw from the definitions and guidance included in IFRS 14 *Regulatory Deferral Accounts* and IFRIC 12 *Service Concession Arrangements*. We note that the definition could focus on the function or the role entrusted to the regulatory body, which could be to act in the public interest, monitor the maintenance of public infrastructure, and ensure viability of the regulated entity. That is, we suggest that the definition of a regulator should not focus on the type of the regulatory body or person but on its key functions.

In addition, we expect ‘enforceability’ to be a key issue while applying the ED and would urge the Board to include comprehensive guidance in the ED. In particular, how a regulated entity should assess whether enforceable rights or obligations exist in a regulatory agreement, along with illustrative examples that refer to common issues seen in practice. We believe that as most regulatory agreements are ultimately subject to the discretion of the government to increase or decrease regulated rates, assessing enforceability becomes a complex issue.

### **Total allowed compensation (Question 3)**

We disagree with the proposed treatment of regulatory returns on assets not yet available for use. The ED proposes that if a regulator permits a return on an asset not yet available for use, that return should be recognised only once the asset is in use and be spread over the recovery period.

The ED’s analysis appears to be driven largely by consideration of stand-alone assets. For example, illustrative example 3 to the ED discusses the regulatory return on a stand-alone asset that is being constructed. That asset is physically distinct from the assets that are being used to deliver services to customers. However, in our experience, the more common scenario is that the assets being constructed form part

of a wider distribution network, which remains operational during the construction period to ensure continuity of services to customers.

In such cases, the requirement to maintain continuity of service and the requirement to construct assets to maintain and enhance the network are obligations under the entity's regulatory agreement, broadly construed. We therefore think it is reasonable for the entity to include the regulatory return on the asset in the period in which it is allowed by the regulator.

Paragraph B18 of the ED refers to performance incentives during the period of construction, which may be included in total allowed compensation in the period in which the construction of the infrastructure occurs. However, the entity's enforceable rights to regulatory returns on the same construction project is not permitted to be included in total allowed compensation until later periods. We see an inherent inconsistency between these two requirements, which should be eliminated by aligning the requirements for construction-related performance incentives and regulatory returns on the related construction expenditure. We also believe that this requirement of the ED creates liabilities that may not meet the definition of a liability under the IFRS Conceptual Framework.

#### **Discount rates (Question 6)**

We agree that regulatory assets and regulatory liabilities should usually be discounted using the regulatory interest rate. This is consistent with the economics of the rate-setting process and will also reduce complexity. However, we have the following recommendations:

- In many cases, regulatory assets and regulatory liabilities are expected to be recovered within a short time frame. For example, an entity may expect that the costs of unplanned storm damage in one period will be included in the regulated rates in the next period. Discounting regulatory balances that are short-term in nature provides little benefit. We recommend that the Board considers a practical expedient, similar to that in paragraph 63 of IFRS 15 *Revenue from Contracts with Customers*, under which an entity would not be required to discount a regulatory asset or regulatory liability if the expected period between recognition and settlement/recovery is one year or less.
- We note that the proposals regarding the minimum interest rate apply to regulatory assets, but not regulatory liabilities. Many types of timing differences could give rise to assets in some periods and liabilities in other periods. We recommend that the Board aligns the proposals for discounting regulatory assets and regulatory liabilities.
- We recommend that the Board addresses the possibility of negative interest rates in a rate-setting context. We note that negative interest rates are prevalent in certain jurisdictions and it would be useful to develop guidance on the

requirements of the sufficiency of the discount rate in the context of a negative interest rate environment.

**Presentation (Question 8)**

While we generally agree that regulatory items should be presented separately, we recommend that the total of regulatory income minus regulatory expense be presented as part of revenue. We believe that regulatory income meets the definition of revenue, as it represents income that arises in the course of the ordinary activities of the entity.

That is, revenue in the statement of profit and loss would potentially include:

- revenue from contracts with customers, which would continue to be subject to the disclosure requirement of IFRS 15, including those regarding disaggregation of revenue;
- the total of regulatory income minus regulatory expense; and
- any other items that the entity concludes meets the definition of revenue.

We also recommend that the Board considers the general aggregation and disaggregation requirements under IAS 1 *Presentation of Financial Statements* and the proposals in the ED and clarify whether the ED would supersede IAS 1 in this aspect.

Please contact Reinhard Dotzlaw at [Reinhard.Dotzlaw@kpmgifrg.com](mailto:Reinhard.Dotzlaw@kpmgifrg.com), Phil Dowad at [pdowad@kpmg.ca](mailto:pdowad@kpmg.ca) or Brian O'Donovan at [brian.odonovan@kpmgifrg.com](mailto:brian.odonovan@kpmgifrg.com) if you wish to discuss any of the issues raised in this letter.

Yours sincerely

*KPMG IFRG Limited*

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## Appendix: Responses to specific questions

### Question 1 — Objective and Scope

Paragraph 1 of the Exposure Draft sets out the proposed objective: an entity should provide relevant information that faithfully represents how regulatory income and regulatory expense affect the entity's financial performance, and how regulatory assets and regulatory liabilities affect its financial position.

Paragraph 3 of the Exposure Draft proposes that an entity apply the [draft] Standard to all its regulatory assets and all its regulatory liabilities. Regulatory assets and regulatory liabilities are created by a regulatory agreement that determines the regulated rate in such a way that part of the total allowed compensation for goods or services supplied in one period is charged to customers through the regulated rates for goods or services supplied in a different period (past or future).<sup>1</sup> The [draft] Standard would not apply to any other rights or obligations created by the regulatory agreement—an entity would continue to apply other IFRS Standards in accounting for the effects of those other rights or obligations.

Paragraphs BC78–BC86 of the Basis for Conclusions describe the reasoning behind the Board's proposals. They also explain why the Exposure Draft does not restrict the scope of the proposed requirements to apply only to regulatory agreements with a particular legal form or only to those enforced by a regulator with particular attributes.

- (a) Do you agree with the objective of the Exposure Draft? Why or why not?
- (b) Do you agree with the proposed scope of the Exposure Draft? Why or why not? If not, what scope do you suggest and why?
- (c) Do you agree that the proposals in the Exposure Draft are clear enough to enable an entity to determine whether a regulatory agreement gives rise to regulatory assets and regulatory liabilities? If not, what additional requirements do you recommend and why?
- (d) Do you agree that the requirements proposed in the Exposure Draft should apply to all regulatory agreements and not only to those that have a particular legal form or those enforced by a regulator with particular attributes? Why or why not? If not, how and why should the Board specify what form a regulatory agreement should have, and how and why should it define a regulator?
- (e) Have you identified any situations in which the proposed requirements would affect activities that you do not view as subject to rate regulation? If

**so, please describe the situations, state whether you have any concerns about those effects and explain what your concerns are.**

**(f) Do you agree that an entity should not recognise any assets or liabilities created by a regulatory agreement other than regulatory assets and regulatory liabilities and other assets and liabilities, if any, that are already required or permitted to be recognised by IFRS Standards?**

We agree with the overall objective of the ED. We support the efforts of the Board to improve the information provided to users of the financial statements of entities that are subject to rate regulation.

We generally agree that the scope criteria should focus on the existence of enforceable rights or obligations that commonly arise when entities are subject to rate regulation but are not recognised as assets or liabilities under existing IFRS Standards. However, we have a number of suggestions to amend the proposed scope criteria in order to avoid unintended consequences. In this context, we think the primary risk is that the proposals apply to arrangements not intended by the Board, or that stakeholders are required to expend undue effort to assess whether arrangements not considered by the Board are or are not within scope.

We recommend that the Board considers developing the definition of a 'Regulator' and require that the ED will apply only if there is a regulator. We believe that this would:

- clarify the types of arrangements to which the proposals are intended to apply;
- reduce the risk that other types of arrangements are caught inadvertently. For example, we understand that the application of the ED to certain financial and insurance products have been discussed by stakeholders during the comment period; and
- reduce the risk of structuring opportunities within groups and between related entities under which artificial 'regulatory agreements' may be constructed in order to drive the reported results of an entity.

We believe that in developing the definition of a regulator, the Board could consider the definitions and guidance included in IFRS 14 and IFRIC 12. We note that the definition could focus on the function or the role entrusted to the regulatory body, which could be to act in public interest, monitor the maintenance of public infrastructure and ensure viability of the regulated entity. That is, we suggest that the definition of a regulator should not focus on the type of the regulatory body or person, but on its key functions and should be subject to additional outreach.

We are aware that the Board considered and rejected specifying the characteristics a regulator must possess, as explained in paragraph BC86 of the ED. However, our assessment is that, on balance, the benefits of reducing unintended consequences and simplifying the application of the scope criteria justify developing a definition of a regulator and requiring that the proposals apply only when there is a regulator.

We also recommend that the Board clarify whether the scope criteria would be met in the following commonly experienced scenarios:

- We understand that in some jurisdictions, a regulatory balance is settled by a cash payment from/to the regulator. While we note that the ED addresses payments from/to a regulator on cancellation of a regulatory agreement (see paragraphs B35-38), it does not address payments/receipts during the term of the regulatory agreement. We appreciate that in some cases such balances may meet the definition of financial assets or liabilities. However, we note that there are important recognition and measurement differences between financial assets and liabilities and regulatory assets and liabilities.
- In some jurisdictions, the regulator determines the regulated rate based on the performance of a dominant market player. This regulated rate is then applied to all entities within the jurisdiction. Assuming that the dominant market player is within scope, there is then a question as to whether the other entities that apply the regulated rate are also within scope, i.e. when the regulated rate is not based on an entity's own revenue and expense, rather on another significantly larger entity's revenue and expense. If it is the intention of the Board that the other entities would not be in scope, then we recommend that paragraph 6(c) of the ED be amended to state 'part of the entity's total allowed compensation for goods or services supplied by the entity in one period...'
- Certain contracts between commercial entities for the delivery of goods or services contain 'catch-up' or 'adjustment' clauses for costs incurred in the past that would only apply for future delivery of goods or services. In the absence of a definition of a regulator, it appears that the ED would require recognition of regulatory assets or regulatory liabilities for such contracts.
- We understand that sometimes, governments impose a 'rate freeze' or specify rate increases through 'legislation' or 'order' for various political reasons, often for a specified period of time, which leads to a temporary suspension of the normal regulatory structure. It is unclear whether the ED applies in such circumstances. It would be useful to discuss whether such measures impact the recognition and measurement of specific regulatory assets and liabilities in the short-term, or call into question whether such arrangements are within scope.
- Certain agreements provide a specified return over the life of the agreement. For example, certain banking and insurance products may guarantee a minimum return to its customers. It would be useful to specify whether an adjustment to a future cash flow in order to restore a specified financial return meets the scope criterion in paragraph 6(c) of the ED.

Generally, we expect assessing 'enforceability' to be a key application issue in applying the ED in the context of a regulatory agreement, for several reasons:

- Regulatory assets and regulatory liabilities are governed by a rate-setting mechanism that specifies when and how to recover/fulfil through rate adjustments and for some items to be reviewed and considered at a future date. This future date could be several years away and, more often, subject to political arbitration. Therefore, it could be challenging for a regulated entity to assert that it has an enforceable right based on past practices.
- Assessing enforceability of options at the boundary of the regulatory agreement with respect to short-term arrangements could be particularly complex and challenging.
- Regulators will often retain some degree of discretion which could either be implicit or explicit. For example, some regulated entities are a form of government organisation and the government (regulator) has the right to cancel the regulatory agreement at any time.

We recommend that the Board considers including a detailed and expanded discussion on enforceability, including but not limited to indicators of enforceability, along with examples on how a regulated entity would assess whether a regulatory agreement creates enforceable rights and obligations. For example, the ED could make it explicit that only binding agreements create regulatory assets or regulatory liabilities. A binding agreement exists where the regulator does not have an alternate provider to deliver goods or services to a particular category of customers.

In doing so, we believe it is important that the ED distinguishes clearly between considerations relevant to the assessment as to whether an arrangement is within scope, and those relevant to the assessment as to whether a particular regulatory item qualifies for recognition. We note that a number of the factors in paragraph 27 of the ED seem relevant to the latter but not the former. For example, 'direct precedents', as per paragraph 27(d), may be relevant to the recognition assessment, but a regulator's past practice should not impact the scope assessment in the absence of an enforceable regulatory agreement.

#### **Question 2—Regulatory assets and regulatory liabilities**

**The Exposure Draft defines a regulatory asset as 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.**

**The Exposure Draft defines a regulatory liability as 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.**



**Paragraphs BC36–BC62 of the Basis for Conclusions discuss what regulatory assets and regulatory liabilities are and why the Board proposes that an entity account for them separately.**

- (a) Do you agree with the proposed definitions? Why or why not? If not, what changes do you suggest and why?**
- (b) The proposed definitions refer to total allowed compensation for goods or services. Total allowed compensation would include the recovery of allowable expenses and a profit component (paragraphs BC87–BC113 of the Basis for Conclusions). This concept differs from the concepts underlying some current accounting approaches for the effects of rate regulation, which focus on cost deferral and may not involve a profit component (paragraphs BC224 and BC233–BC244 of the Basis for Conclusions). Do you agree with the focus on total allowed compensation, including both the recovery of allowable expenses and a profit component? Why or why not?**
- (c) Do you agree that regulatory assets and regulatory liabilities meet the definitions of assets and liabilities within the Conceptual Framework for Financial Reporting (paragraphs BC37–BC47)? Why or why not?**
- (d) Do you agree that an entity should account for regulatory assets and regulatory liabilities separately from the rest of the regulatory agreement (paragraphs BC58–BC62)? Why or why not?**
- (e) Have you identified any situations in which the proposed definitions would result in regulatory assets or regulatory liabilities being recognised when their recognition would provide information that is not useful to users of financial statements?**

We generally agree with the ED with respect to:

- the proposed definitions of regulatory assets and regulatory liabilities;
- the proposed definition of total allowed compensation as it includes both the recovery of allowable expenses and a profit component. We believe this is a correct representation of the recovery or fulfilment that will result from goods or services already supplied; and
- the recognition of regulatory assets and regulatory liabilities separately, due to the specific nature of these assets and liabilities.

In addition, for the reasons explained in our response to Question 1, we recommend that the Board develop a definition of a ‘Regulator’. This may have a consequential impact on some other definitions. However, we do not think this would require a

fundamental reconsideration of the other definitions and would help reduce the risk that the definitions are seen to be circular.

We have not identified situations in which the proposed definitions would result in regulatory assets or regulatory liabilities not providing information that is useful to users of financial statements.

### **Question 3—Total allowed compensation**

**Paragraphs B3–B27 of the Exposure Draft set out how an entity would determine whether components of total allowed compensation included in determining the regulated rates charged to customers in a period, and hence included in the revenue recognised in the period, relate to goods or services supplied in the same period, or to goods or services supplied in a different period. Paragraphs BC87–BC113 of the Basis for Conclusions explain the reasoning behind the Board’s proposals.**

- (a) Do you agree with the proposed guidance on how an entity would determine total allowed compensation for goods or services supplied in a period if a regulatory agreement provides:**
- (i) regulatory returns calculated by applying a return rate to a base, such as a regulatory capital base (paragraphs B13–B14 and BC92–BC95)?**
  - (ii) regulatory returns on a balance relating to assets not yet available for use (paragraphs B15 and BC96–BC100)?**
  - (iii) performance incentives (paragraphs B16–B20 and BC101–BC110)?**
- (b) Do you agree with how the proposed guidance in paragraphs B3–B27 would treat all components of total allowed compensation not listed in question 3(a)? Why or why not? If not, what approach do you recommend and why?**
- (c) Should the Board provide any further guidance on how to apply the concept of total allowed compensation? If so, what guidance is needed and why?**

We generally agree with the proposals on total allowed compensation and components thereof, including regulatory returns that apply to a capital base.

However, we disagree with the proposed treatment of regulatory returns on assets not yet available for use. The ED proposes that if a regulator permits a return on an asset not yet available for use, that return should be recognised only once the asset is in use and be spread over the recovery period. We disagree with this approach for the following reasons:

- The ED’s analysis appears to be driven largely by consideration of stand-alone assets. For example, illustrative example 3 to the ED discusses the regulatory return on a stand-alone asset that is being constructed. That asset is physically distinct from the assets that are being used to deliver services to customers. However, in our experience, the more common scenario is that the assets being constructed form part of a wider distribution network, which remains operational

during the construction period to ensure continuity of services to customers. Therefore, we suggest the Board consider developing a slightly more realistic example of returns on asset not yet available for use.

- In such cases, the requirement to maintain continuity of service and the requirement to construct assets to maintain and enhance the network are obligations under the entity's regulatory agreement, broadly construed. We therefore think it is reasonable for the entity to include the regulatory return on the asset in the period in which it is allowed by the regulator.
- Paragraph B18 of the ED refers to performance incentives during the period of construction, which may be included in total allowed compensation in the period in which the performance occurs. However, the entity's enforceable rights to regulatory returns on the same construction project is not permitted to be included in total allowed compensation until later periods. We see an inherent inconsistency between these two requirements, which should be eliminated by aligning the requirements for construction-related performance incentives and regulatory returns on the related construction expenditure.
- Paragraph 5 of the ED states that a 'regulatory liability is an enforceable present obligation to deduct an amount in determining a regulated rate to be charged to customers in future periods'. We believe that the regulatory liability that the ED requires an entity to recognise during the period of construction may not meet the definition of regulatory liability. In some regulatory agreements, if the construction is never completed, or until the construction is complete, there is no present enforceable obligation on the entity. The return on assets under construction included in the total allowed compensation of a given period is often included in the tariff in the same period. The regulatory adjustment mechanism, if any, is based on differences between anticipated and actual capital expenditure. This means that most of the revenue that the ED would require to be deferred would relate to revenue currently recognised under IFRS 15. Further, there will be no future transfer of economic resources in relation to the corresponding liability. Therefore, we believe that the resulting deferred revenue does not meet the definition of a liability under the Conceptual Framework.
- Finally, we note that Illustrative Example 3 assumes that the recovery period is no longer than five years. In practice, the recovery period could be decades. Maintaining cost records and tracking regulatory variances over such extended periods could be operationally challenging to apply in practice for most entities.

We have identified three areas in which we believe it would be useful for the Board to provide further guidance on the determination of total allowed compensation.

The first area in which we believe the Board should provide additional guidance is regulatory regimes in which the regulatory asset base is not broken down into components by the regulator for the purpose of setting rates. Rather, the regulator tracks a single undifferentiated capital value, and uses a mathematical formula to

allocate this amount to periods in order to determine the total allowed compensation. This annual allowance may be intended to reflect the long-run average annual consumption of the capital value, but is not expressed as depreciation of individual capital assets. We understand that variants of this approach are common in a number of jurisdictions.

This approach has implications for the application of the proposals in a number of areas. For example, in the case of the regulatory return on assets not yet in use discussed above (Illustrative Example 3 in the ED), it is unclear what the recovery period would be under which a regulatory liability would be settled. More generally, it is unclear whether, and if so how, an entity would identify and measure timing differences between regulatory depreciation and accounting depreciation, as discussed in Illustrative Example 2 in the ED.

In such regulatory regimes, it seems that the fundamental question which the Board needs to decide is whether:

- regulatory assets and regulatory liabilities arise as described in Illustrative Examples 2 and 3. If so, the follow on question is whether it is sufficient to state that they should be recognised on a ‘reasonable and supportable basis’ as suggested in paragraph B15 of the ED, or whether more specific guidance is required; or
- regulatory assets and regulatory liabilities do not arise as described in Illustrative Examples 2 and 3.

Secondly, we are aware of cases in which some of the components of total allowed compensation are determined by the regulator by reference to financial statements prepared under local GAAP. We recommend the Board clarify how to determine timing differences under IFRS when some components of total allowed compensation have been determined under another GAAP.

Thirdly, we are aware that regulatory settlements are commonly determined and expressed in real terms. Components of total allowed compensation may then be subject to indexation by CPI between regulatory settlements in order to determine the regulated rate that entities charge to customers. Alternatively, indexation adjustments may be allowed retrospectively. We recommend that the Board clarify how such mechanisms impact the determination of total allowed compensation.

#### **Question 4—Recognition**

**Paragraphs 25–28 of the Exposure Draft propose that:**

- **an entity recognise all its regulatory assets and regulatory liabilities; and**
- **if it is uncertain whether a regulatory asset or regulatory liability exists, an entity should recognise that regulatory asset or regulatory liability if it is more likely than not that it exists. It could be certain that a regulatory asset or regulatory liability exists even if it is uncertain whether that asset or**

**liability will ultimately generate any inflows or outflows of cash. Uncertainty of outcome would be addressed in measurement (Question 5).**

**Paragraphs BC122–BC129 of the Basis for Conclusions describe the reasoning behind the Board’s proposals.**

- a) Do you agree that an entity should recognise all its regulatory assets and regulatory liabilities? Why or why not?**
- b) Do you agree that a ‘more likely than not’ recognition threshold should apply when it is uncertain whether a regulatory asset or regulatory liability exists? Why or why not? If not, what recognition threshold do you suggest and why?**

We generally agree that an entity should recognise all its regulatory assets and regulatory liabilities. We believe that this would improve the understanding of an entity’s performance and enhance comparability over time. Further, we also note the following:

- Some IFRS Standards apply different recognition criteria to assets and liabilities, essentially for reasons of prudence. However, we believe that asymmetric recognition criteria for regulatory assets and regulatory liabilities would not be appropriate, as all regulatory balances eventually flow into rate adjustments – i.e. they become adjustments to revenue.
- We observe that short-term timing differences such as cost or quantity variances may result in regulatory assets in one period and regulatory liabilities in another period. Applying a different recognition model to such items would add complexity and we question whether it would provide benefits to users of financial statements.

We also agree that a ‘more likely than not’ recognition threshold should apply where uncertainty exists, for the following reasons:

- The threshold has a precise meaning under IFRS Standards. We believe it is better understood than other recognition thresholds such as highly probable, reasonably certain, etc.
- We believe that stakeholders are accustomed to using a ‘more likely than not’ threshold for recognition, and considering measurement separately, as this is the general approach to liabilities within the scope of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.
- We believe it is appropriate to use the same approach for regulatory assets and regulatory liabilities. As rate increases or decreases are subject to the same mechanism, we believe it would be consistent to follow the same approach for initial recognition.

However, as we note in our response to Question 1, we believe that assessing enforceability will be a key application issue.

We also note that while the ED addresses derecognition of regulatory assets and regulatory liabilities in the context of cancellation of a regulatory agreement

(paragraphs B38 and BC153), it does not address derecognition more holistically. For example, if an entity were to securitise regulatory assets and receive cash from a financial institution, then would an entity apply the derecognition guidance in IFRS 9 *Financial Instruments*, or follow some other approach?

#### **Question 5—Measurement**

**Paragraph 29 of the Exposure Draft specifies the measurement basis. Paragraphs 29–45 of the Exposure Draft propose that an entity measure regulatory assets and regulatory liabilities at historical cost, modified by using updated estimates of future cash flows. An entity would implement that measurement basis by applying a cash-flow-based measurement technique. That technique would involve estimating future cash flows—including future cash flows arising from regulatory interest—and updating those estimates at the end of each reporting period to reflect conditions existing at that date. The future cash flows would be discounted (in most cases at the regulatory interest rate—see Question 6). Paragraphs BC130–BC158 of the Basis for Conclusions describe the reasoning behind the Board’s proposals.**

- (a) Do you agree with the proposed measurement basis? Why or why not? If not, what basis do you suggest and why?**
- (b) Do you agree with the proposed cash-flow-based measurement technique? Why or why not? If not, what technique do you suggest and why?**

**If cash flows arising from a regulatory asset or regulatory liability are uncertain, the Exposure Draft proposes that an entity estimate those cash flows applying whichever of two methods—the ‘most likely amount’ method or ‘expected value’ method—better predicts the cash flows. The entity should apply the chosen method consistently from initial recognition to recovery or fulfilment. Paragraphs BC136–BC139 of the Basis for Conclusions describe the reasoning behind the Board’s proposal.**

- (c) Do you agree with this proposal? Why or why not? If not, what approach do you suggest and why?**

We generally agree with the proposed measurement basis and with the proposed cash-flow based measurement technique, as it is overall consistent with the principles that apply to revenue from contracts with customers.

However, we have several comments with respect to the practical application of the measurement proposals in certain specific scenarios. For example:

- We expect that a key application issue will be the determination of the boundary of the regulatory agreement. Regulatory agreements range from those that appear to be ‘evergreen’ (i.e. with annual renewals), to those that could theoretically last in perpetuity so long as the entity continues to comply with the licence conditions. The proposed approach to determination of the boundary of a regulatory agreement combines a focus on enforceable rights and obligations with an

assessment as to the practicability of exercising renewal and termination options. This guidance echoes, but is different from, the guidance in other IFRS Standards about the boundary of a contract, for example the guidance in IFRS 16 *Leases* on enforceability and the lease term.

- Further, in some jurisdictions, the usual arrangement is that the regulatory agreement specifies that all of the assets, liabilities etc. required to fulfil regulatory obligations are kept within a single corporate entity. At the point in time the regulatory agreement ‘ends’, whether through termination or effluxion of time, the regulator directs the investor in the corporate entity to transfer the shares in the corporate entity to itself, or to another investor. We recommend that the Board clarify how to apply the guidance on the boundary of the regulatory agreement. For example, is the regulatory agreement perpetual for the corporate entity? If so, does the investor apply the guidance on the boundary of the regulatory agreement, or also assume that the regulatory agreement is perpetual and apply the deconsolidation guidance in IFRS 10 *Consolidated Financial Statements*?
- In some jurisdictions, the regulator only passes on a portion of the increased prices to the regulated entities. Measurement of regulatory balances in such instances could be challenging. We recommend the Board to develop specific guidance in such instances.
- As noted to our response to Question 1, we expect practical issues in assessing enforceability of a regulatory agreement, i.e. whether uncertainty impacts measurement of regulatory balances. We recommend that the Board provide examples of how to apply paragraphs B28-B34 of the ED.
- It is also unclear whether the expected ‘uncollectability’ factored in the computation of total allowed compensation is different from the ECL computation under IFRS 9. Also, in the case of a regulatory liability, it is unclear whether any uncertainty in measurement should also capture the refund that may be forfeited by customers. We suggest that the Board clarify whether the credit risk assessment for regulatory balances is different from the ECL model.
- We agree that an entity should apply either the ‘most likely amount’ or the ‘expected value’ method to estimating cash flows, depending on which method better depicts the cash flows. We recommend the ED state explicitly that these methods apply to measurement uncertainty only. That is, recognition is considered separately and is not factored into this assessment – e.g. an expected value calculation does not consider possible outcomes in which the regulatory asset or regulatory liability is not ‘more likely than not’ to exist.

#### **Question 6—Discount rate**

**Paragraphs 46–49 of the Exposure Draft propose that an entity discount the estimated future cash flows used in measuring regulatory assets and regulatory liabilities. Except in specified circumstances, the discount rate would be the regulatory interest rate that the regulatory agreement provides. Paragraphs**

**BC159–BC166 of the Basis for Conclusions describe the reasoning behind the Board’s proposals.**

**(a) Do you agree with these proposals? Why or why not? If not, what approach do you suggest and why?**

Paragraphs 50–53 of the Exposure Draft set out proposed requirements for an entity to estimate the minimum interest rate and to use this rate to discount the estimated future cash flows if the regulatory interest rate provided for a regulatory asset is insufficient to compensate the entity. The Board is proposing no similar requirement for regulatory liabilities. For a regulatory liability, an entity would use the regulatory interest rate as the discount rate in all circumstances. Paragraphs BC167–BC170 of the Basis for Conclusions describe the reasoning behind the Board’s proposals.

**(b) Do you agree with these proposed requirements for cases when the regulatory interest rate provided for a regulatory asset is insufficient? Why or why not?**

**(c) Have you identified any other situations in which it would be appropriate to use a discount rate that is not the regulatory interest rate? If so, please describe the situations, state what discount rate you recommend and explain why it would be a more appropriate discount rate than the regulatory interest rate.**

Paragraph 54 of the Exposure Draft addresses cases when a regulatory agreement provides regulatory interest unevenly by applying a series of different regulatory interest rates in successive periods. It proposes that an entity should translate those rates into a single discount rate for use throughout the life of the regulatory asset or regulatory liability.

**(d) Do you agree with the proposal? Why or why not? If not, what do you recommend and why?**

We agree that regulatory assets and regulatory liabilities should usually be discounted using the regulatory interest rate. This is consistent with the economics of the rate-setting process and will also reduce complexity.

We have the following comments on the proposals in this area:

- In many cases, regulatory assets and regulatory liabilities are expected to be recovered within a short time frame. For example, an entity may expect that the costs of unplanned storm damage in one period will be included in the regulated rates in the next period. Discounting regulatory balances that are short-term in nature provides little benefit. We recommend that the Board considers a practical expedient, similar to that in paragraph 63 of IFRS 15, under which an entity would not be required to discount a regulatory asset or regulatory liability if the expected period between recognition and settlement/recovery is one year or less.



- We agree that an entity should assess the sufficiency of the regulatory interest rate. However, we understand that the Board expects that an entity will often conclude that the regulatory interest rate is sufficient, such that it will usually use the regulatory interest rate rather than an alternative minimum rate. In order to make this clear, we recommend that the ED specify that there is a rebuttable presumption that the entity will use the regulatory interest rate, and the conditions under which that presumption would be rebutted – e.g. when the indicators in paragraph 52 of the ED are present.
- We note that the proposals regarding the minimum interest rate apply to regulatory assets, but not regulatory liabilities. As noted in our response to Question 4, we observe that many types of timing differences could give rise to assets in some periods and liabilities in other periods. In such cases, it becomes challenging to apply different discounting requirements for the same regulatory item for different reporting periods.

Further, in accordance with paragraph 24 of the ED, if rights and obligations arising from the same regulatory agreement that have similar expiry patterns and are subject to similar risks are aggregated, then the resulting net right or obligation would be subject to a different measurement (discounting) basis.

For these reasons, we recommend that the Board aligns the proposals for discounting regulatory assets and regulatory liabilities.

In general, we have not identified additional situations in which it would be appropriate to use a discount rate that is not the regulatory interest rate. However, we recommend that the Board addresses the possibility of negative interest rates in a rate-setting context. We note that negative interest rates are prevalent in certain jurisdictions and it would be useful to develop guidance on the requirements of the sufficiency of the discount rate in the context of a negative interest rate environment.

Regarding the proposals in paragraph 54 of the ED regarding uneven regulatory interest, we note that there are two main scenarios in which a regulatory agreement might provide for multiple interest rates.

Firstly, a regulatory agreement may provide that different interest rates apply to the same timing difference in different periods. In this scenario, we generally support the proposed requirement to calculate a single discount rate for use throughout the life of the regulatory asset or regulatory liability. However, we think this requirement should apply only once the regulator has accepted a given item and begun to apply regulatory interest. For example, an entity may recognise a regulatory asset in one period because the entity believes that the regulator will accept a claim in a later period. If the regulator will apply regulatory interest only from the later period, then we think there is little benefit in requiring the entity to calculate a 'single' discount rate that average a notional nil rate up to the date the regulator accepts the item and the regulatory interest rate thereafter.

Secondly, a regulatory agreement may provide that different interest rates apply to different classes of timing difference. In this scenario, we recommend that the Board clarify that the entity should apply the different regulatory interest rates to the related regulatory assets and regulatory liabilities, rather than seeking to determine a 'single' interest rate.

**Question 7—Items affecting regulated rates only when related cash is paid or received**

**In some cases, a regulatory agreement includes an item of expense or income in determining the regulated rates in the period only when an entity pays or receives the related cash, or soon after that, instead of when the entity recognises that item as expense or income in its financial statements.**

**Paragraphs 59–66 of the Exposure Draft propose that in such cases, an entity would measure any resulting regulatory asset or regulatory liability using the measurement basis that the entity would use in measuring the related liability or related asset by applying IFRS Standards. An entity would adjust that measurement to reflect any uncertainty that is present in the regulatory asset or regulatory liability but not present in the related liability or related asset.**

**Paragraphs BC174–BC177 of the Basis for Conclusions describe the reasoning behind the Board's proposals.**

- (a) Do you agree with the measurement proposals when items of expense or income affect regulated rates only when related cash is paid or received? Why or why not? If not, what approach do you suggest for such items and why?**

**When these measurement proposals apply and result in regulatory income or regulatory expense arising from remeasuring the related liability or related asset through other comprehensive income, paragraph 69 of the Exposure Draft proposes that an entity would also present the resulting regulatory income or regulatory expense in other comprehensive income. Paragraphs BC183–BC186 of the Basis for Conclusions describe the reasoning behind the Board's proposal.**

- (b) Do you agree with the proposal to present regulatory income or regulatory expense in other comprehensive income in this case? Why or why not? If not, what approach do you suggest and why?**

We agree that for items of income or expense that affect regulated rates only when cash is paid or received, the resulting regulatory asset or liability should be measured on the same basis that the relevant IFRS Standard applies to the underlying item, adjusted for uncertainties present in the regulatory item, but not in the underlying item.

We note that this measurement exception would generally apply to items such as pension obligations, decommissioning costs, deferred taxes etc. These items are often of an uncertain amount or timing and are not always measured on a discounted cash flow basis. For example, deferred tax is not discounted, and is subject to asymmetric

recognition requirements for assets and liabilities. We regard the measurement essentially as a practical expedient that will avoid what would otherwise be significant accounting mismatches.

Put another way, if the Board believed that it was justifiable on conceptual and cost benefit grounds to measure a regulatory asset that matched a deferred tax asset or liability by discounting the expected cash flows, we would suggest that the Board first reconsider the recognition and measurement requirements of IAS 12 *Income Taxes*.

We note that items to which the measurement exception are likely to apply will often be very long dated. In some cases, the cash flow to settle the underlying item may not be expected to occur within the boundary of the regulatory agreement as determined in accordance with paragraphs B28-B34 of the ED – or there may be uncertainty as to whether this will be the case. Further, the entity may expect that if the underlying item is not settled within the boundary of the regulatory agreement, then it will receive compensation as discussed in paragraphs B35-B38 of the ED.

We believe it is unclear how the measurement exception would interact with the boundary of the regulatory agreement in such cases. For example, should the entity measure the regulatory asset or liability using the measurement exception in paragraphs 59-66, or using the guidance on compensation for cancellation of a regulatory agreement in paragraphs B35-B38? And how would this interact with the guidance on reassessment of and changes to the boundary of a regulatory agreements in paragraphs B39-B40 of the ED?

We suggest that the Board clarifies the interaction between the measurement exception and the boundary of the regulatory agreement.

In addition, we recommend that the Board consider whether the application of the measurement exception should be limited strictly to cases in which an item affects regulatory rates only when the related cash is paid or received. For example, we are aware of cases in which a substantial portion (but not all) of an item will affect regulatory rates when the related cash is paid and the balance of the item will affect regulated rates on a different basis. In addition, we are aware of cases in which a substantial portion (but not all) of an item will affect regulatory rates when it is recognised as an expense and the balance of the item will affect regulated rates on a different basis. We are also aware of cases in which an item will affect regulated rates when it is recognised as an expense in accordance with local GAAP, which may be different to when it is recognised as an expense under IFRS Standards. Some believe that the measurement exception would provide relevant information in such cases.

We also support the proposal to present regulatory income or regulatory expense in other comprehensive income, when the remeasurement of the related liability or related asset is accounted for through other comprehensive income.

However, we note that complexity may arise in determining the regulatory income or regulatory expense to be included in profit or loss versus other comprehensive income. For example, when a regulatory asset is recognised to match a defined benefit

obligation, the underlying item will be remeasured partly through profit or loss and partly through other comprehensive income, and will be reduced by cash payments in the period. It may be simpler for the ED to state that regulatory income or expense is recognised in other comprehensive income to the extent that income or expense relating to the underlying item is recognised in other comprehensive income. We also recommend that the Board considers developing an example to illustrate the split presentation of the regulatory item.

#### **Question 8—Presentation in the statement(s) of financial performance**

**Paragraph 67 of the Exposure Draft proposes that an entity present all regulatory income minus all regulatory expense as a separate line item immediately below revenue. Paragraph 68 proposes that regulatory income includes regulatory interest income and regulatory expense includes regulatory interest expense. Paragraphs BC178–BC182 of the Basis for Conclusions describe the reasoning behind the Board’s proposals.**

- (a) Do you agree that an entity should present all regulatory income minus all regulatory expense as a separate line item immediately below revenue (except in the case described in Question 7(b))? Why or why not? If not, what approach do you suggest and why?**
- (b) Do you agree with the proposed inclusion of regulatory interest income and regulatory interest expense within the line item immediately below revenue? Why or why not? If not, what approach do you suggest and why?**

We generally agree that regulatory assets, liabilities, income and expense should be presented separately from other balances in the financial statements.

However, we question whether the total of regulatory income minus regulatory expense should be presented as a separate line item *below* revenue. We note that regulatory income does not represent revenue from contracts with customers, and therefore should be distinguished from revenue arising under IFRS 15. However, regulatory income does appear to meet the definition of revenue – i.e. it is income arising in the course of an entity’s ordinary activities.

We therefore recommend that an entity be permitted or required to present the total of regulatory income minus regulatory expense within revenue. That is, revenue in the statement of profit and loss would potentially include:

- revenue from contracts with customers, which would continue to be subject to the disclosure requirement of IFRS 15, including those regarding disaggregation of revenue;
- the total of regulatory income minus regulatory expense; and
- any other items that the entity believes meet the definition of revenue.

We agree that the total of regulatory income minus regulatory expense should include regulatory interest income and regulatory expense, for the following reasons:

- These items are regulatory timing differences that will be settled or recovered through adjustments to future rates.
- They will usually be measured at the regulatory interest rate, not at a rate at which the entity would enter into a financing transaction with its customers, as either borrower or lender.
- The entity will in any case disclose these amounts as required by paragraph 78 of the ED, permitting a user to aggregate interest income and interest expense arising under other IFRS Standards with regulatory interest income and interest expense, if they believe this is useful.

In addition, we recommend that the Board clarify the interaction between the general requirements in IAS 1 on aggregation/disaggregation of line items and the presentation proposals in the ED.

In general, while finalising the presentation proposals of the ED, we recommend that the Board should be informed of the Board's work on the Exposure Draft on *Primary Financial Statements*. The two proposals should complement each other and be developed in a consistent manner.

#### **Question 9—Disclosure**

**Paragraph 72 of the Exposure Draft describes the proposed overall objective of the disclosure requirements. That objective focuses on information about an entity's regulatory income, regulatory expense, regulatory assets and regulatory liabilities, for reasons explained in paragraphs BC187–BC202 of the Basis for Conclusions. The Board does not propose a broader objective of providing users of financial statements with information about the nature of the regulatory agreement, the risks associated with it and its effects on the entity's financial performance, financial position or cash flows.**

- (a) Do you agree that the overall disclosure objective should focus on information about an entity's regulatory income, regulatory expense, regulatory assets and regulatory liabilities? Why or why not? If not, what focus do you suggest and why?**
- (b) Do you have any other comments on the proposed overall disclosure objective?**

**Paragraphs 77–83 of the Exposure Draft set out the Board's proposals for specific disclosure objectives and disclosure requirements.**

- (c) Do you have any comments on these proposals? Should any other disclosures be required? If so, how would requiring those other disclosures**

**help an entity better meet the proposed disclosure objectives?**

**(d) Are the proposed overall and specific disclosure objectives and disclosure requirements worded in a way that would make it possible for preparers, auditors, regulators and enforcement bodies to assess whether information disclosed is sufficient to meet those objectives?**

We do not agree that the overall disclosure objective should focus on information about an entity's regulatory income, regulatory expense, regulatory assets and regulatory liabilities. Instead we believe that it should focus on:

- the rate-mechanism adjustments that apply in regulatory agreements to which the reporting entity is party; and
- the relationship between the reporting entity's revenue and expenses and the total allowed compensation under those agreements.

We say this as we believe that these features are key for understanding the specific nature, relevance and uncertainties attached to an entity's regulatory accounting.

In relation to the specific disclosure objectives and the specifics of individual disclosures, we consider them to be clearly worded, although we consider that some adjustments would likely be needed in view of our disagreement with the overall disclosure objective. For example, one additional disclosure that we believe to be necessary is the presentation of the conditions for recovering/fulfilling the regulatory assets and liabilities from customers (in other words, the rate-mechanism adjustment) and the estimated corresponding term. This is because regulatory assets and liabilities differ from financial assets and financial liabilities due to the nature of the counterparty and when they are receivable or payable.

We also have a specific comment on paragraph 80 of the Exposure Draft which states that 'To achieve the objective in paragraph 79, an entity shall disclose in the notes:

(a) quantitative information, using time bands, about when it expects to recover the regulatory assets and fulfil the regulatory liabilities.'

We recommend that the Board clarify how the time bands are to be determined when a regulatory asset or regulatory liability has not yet been approved by the regulator. For example, does the entity need to estimate the time band in such circumstances, or can the entity just disclose the fact that it is unknown (which we understand to be the case under US GAAP)?

However, we consider it is primarily a matter for users to comment on the benefits of the proposed disclosures, and for preparers to comment on the cost of compiling the proposed disclosures, so that the Board can make a balanced assessment of the disclosure proposals.

More generally, we recommend that any finalisation of the disclosure proposals should be informed by the Board's work on disclosures generally, in particular the current Exposure Draft *Disclosure requirements in IFRS Standards - A pilot approach*.

**Question 10—Effective date and transition**

**Appendix C to the Exposure Draft describes the proposed transition requirements. Paragraphs BC203–BC213 of the Basis for Conclusions describe the reasoning behind the Board's proposals.**

**(a) Do you agree with these proposals?**

**(b) Do you have any comments you wish the Board to consider when it sets the effective date for the Standard?**

We note that the ED proposes a full retrospective transition approach with optional relief only available for certain past business combinations. This is a stark contrast to IFRSs 9, 15, 16 and 17 – each of which permitted or required a modified retrospective transition approach with extensive transition reliefs.

We recommend that the Board reconsider the transition approach once other aspects of the proposals have been finalised, in the light of feedback from users on the benefits of a full retrospective approach and from preparers on the likely costs of that approach.

The limited feedback we have received from preparers suggests that some aspects of the proposals may be more complex to apply retrospectively than others. In particular, the requirement to identify timing differences associated with items of PPE that have very long useful lives may be difficult to apply in the following cases:

- Regulatory returns on assets not yet in use – Application of this requirement retrospectively would require an entity to identify cases in which the regulator permitted a regulatory return on an asset before it was brought into use, calculate the original amount of the regulatory liability, identify the date from which the asset was available for use, estimate the recovery period and calculate the remaining balance of the regulatory liability at the date of initial application.
- Assets for which the recovery period is different to the asset's useful life – Similarly, entities would be required to identify such cases and recalculate the remaining balance of the regulatory asset or liability at the date of initial application.

In both cases, subject to materiality, the entity would be required to obtain this information on an asset-by-asset basis. The long useful lives of infrastructure assets mean that entities may need to go back decades in order to obtain the required information. In turn, it could be difficult for entities to avoid the use of hindsight in calculating the remaining balance of regulatory assets and liabilities at the date of initial application.

Depending on the feedback the Board receives on the costs and benefits of full retrospective application, it may wish either to develop targeted practical expedients for specific types of timing difference, or defer the effective date of the standard.

We have the following additional observations about the effective date of the standard:

- The final standard should be available for early adoption as envisaged in the ED to compensate for the time that has elapsed since this project commenced. We expect that some entities will wish to adopt the standard as early as possible.
- To consider a longer time frame for application of the final standard than the proposed 18-24 months in the ED, depending on the Board’s conclusions on transition as discussed above. This would allow sufficient time for entities to compile and maintain detailed records, ensure completeness of regulatory assets and liabilities, the accuracy of measurement, the completeness of disclosures which could be substantial and engage with various external stakeholders.
- Issue guidance for entities subject to rate-regulation who may become first-time adopters of IFRS Standards once the final standard is published. We suggest the Board consider whether any additional consequential amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards* may be required for such entities.

#### **Question 11—Other IFRS Standards**

**Paragraphs B41–B47 of the Exposure Draft propose guidance on how the proposed requirements would interact with the requirements of other IFRS Standards. Appendix D to the Exposure Draft proposes amendments to other IFRS Standards. Paragraphs BC252–BC266 of the Basis for Conclusions describe the reasoning behind the Board’s proposals.**

- (a) Do you have any comments on these proposals? Should the Board provide any further guidance on how the requirements proposed in the Exposure Draft would interact with any other IFRS Standards? If yes, what is needed and why?**
- (b) Do you have any comments on the proposed amendments to other IFRS Standards?**

We broadly support the guidance on how the proposed requirements would interact with the requirements of other IFRS Standards. A particular advantage of the proposed overlay approach is that it reduces the need for consequential amendments to other IFRS standards. We therefore welcome this approach, which reduces complexity compared to IFRS 14.

#### *Interaction with IAS 12 Income Taxes*

We generally agree with the discussion of IAS 12 in paragraphs B41 -B46 but recommend that the following points are clarified:

- Paragraphs B42-B43 discuss the recognition of regulatory assets and liabilities when there are timing differences in relation to income tax, while paragraph B44 discusses



recognition of deferred tax on regulatory assets and liabilities. We recommend that the ED states explicitly whether B44 applies to regulatory assets and liabilities recognised in accordance with paragraphs B42-B43.

- Paragraph B44 states that the tax base of a regulatory asset or liability is ‘typically’ nil, and that a deferred tax asset or liability is ‘typically’ recognised. We recommend that this paragraph be expanded to explain: why the tax base of a regulatory asset or liability is typically nil; why the initial recognition does not apply; and how to assess the recoverability of a potential deferred tax asset when a deductible temporary difference arises in relation to a regulatory item.
- Paragraph B46 is essentially a short illustrative example explaining how income taxes affect the measurement of regulatory assets and liabilities in a specific scenario. Conversely, none of the illustrative examples in the ED include tax assumptions or consider income taxes when measuring regulatory assets and liabilities. We recommend that B46 be converted into an illustrative example, and that tax assumptions be added to the existing illustrative examples.

#### *Interaction with IFRIC 12 Service Concession Arrangements*

We have significant concerns about the interaction of the proposals and IFRIC 12. As noted in paragraph B47, it is likely that some service concession arrangements will fall within the scope of the proposals and IFRIC 12. It is not clear to us, however, how particular aspects of IFRIC 12 will be affected. Understanding the interaction between the proposals and IFRIC 12 will be important due to the widespread use in some parts of the world of service concession arrangements in order to deliver essential public services that are delivered by rate-regulated utility companies elsewhere.

One key point is that under IFRIC 12 a government body is typically both grantor and customer in the same arrangement. In some cases, the government body may be the *sole* customer under the arrangement. This is possible in both the financial asset and intangible asset model, since under IFRIC 12 the operator bases the classification of the arrangement consideration on the allocation of demand risk, not the identity of the payer. We are unclear how the proposals apply to service concession arrangements in which the government acts as both grantor/regulator and the sole customer.

Additional considerations will apply when the grantor is customer for some services and the public are customers for other services. This is clearly the case in the intangible asset model and in the ‘bifurcated’ model in which an operator recognises an intangible asset and a financial asset. However, it can also be the case when the operator applies the financial asset model because the grantor provides a shortfall guarantee, as described in paragraph 16 of IFRIC 12.

We therefore believe that additional guidance on the interaction of the proposals with IFRIC 12’s requirements is needed, so that preparers are clear as to how to apply the two different sets of requirements. We believe this would require the staff to develop,

and the Board to review, comprehensive examples illustrating each of the financial, intangible and bifurcated models under IFRIC 12.

We note that the consequential amendments to IFRIC 12 arising from the introduction of IFRS 9 and IFRS 15 have already added significant complexity to operator accounting. We therefore recommend that the Board conduct a comprehensive review of the operation of IFRIC 12, encompassing the impact of IFRSs 9 and 15 in addition to the potential impact of the proposals.

#### **Question 12—Likely effects of the proposals**

**Paragraphs BC214–BC251 of the Basis for Conclusions set out the Board’s analysis of the likely effects of implementing the Board’s proposals.**

- (a) Paragraphs BC222–BC244 provide the Board’s analysis of the likely effects of implementing the proposals on information reported in the financial statements and on the quality of financial reporting. Do you agree with this analysis? Why or why not? If not, with which aspects of the analysis do you disagree and why?**
  
- (b) Paragraphs BC245–BC250 provide the Board’s analysis of the likely costs of implementing the proposals. Do you agree with this analysis? Why or why not? If not, with which aspects of the analysis do you disagree and why?**
  
- (c) Do you have any other comments on how the Board should assess whether the likely benefits of implementing the proposals outweigh the likely costs of implementing them or on any other factors the Board should consider in analysing the likely effects?**

As discussed earlier in our letter, we support the Board’s efforts to develop guidance on accounting for the financial statement impacts of rate regulation and believe that this will improve the general quality of financial reporting by entities that are subject to regulatory mechanisms.

In relation to the likely costs and effects of implementing the proposals, we believe these are matters that preparers and users of financial statements are best placed to comment on, and that our comments on these areas should be considered in that light.

Having said that, the Board’s analysis of the likely effects of implementing the proposals appears to us to be pitched at rather a high level, being more qualitative than quantitative in nature.

While the Board’s effects analysis indicates that the likely costs of implementing the proposals will not be significant, we have heard more mixed views when conducting our own (limited) outreach with preparers, with some preparers that do not currently recognise regulatory assets and liabilities suggesting that implementation costs could in fact be high. One common observation is that the Illustrative Examples in the ED often illustrate timing differences that reverse within a few years, implying that little effort is

required to track them. In practice, regulatory differences may in fact persist for decades – for example, those arising from returns on assets not yet in use and regulatory depreciation, reflecting the very long useful lives of infrastructure assets and the associated regulatory recovery periods.

We further note that the Board’s effects analysis appears to focus on existing users of IFRS Standards, whereas we understand that the introduction of the proposals may prompt some rate-regulated entities to become first-time adopters.

We therefore recommend that the Board should:

- Conduct additional outreach with preparers that do not currently recognise regulatory assets and liabilities so as to better understand the likely costs of implementation for those entities.
  
- Expand the effects analysis to include the impact on first-time adopters of IFRS Standards.

**Question 13—Other comments**

**Do you have any other comments on the proposals in the Exposure Draft or on the Illustrative Examples accompanying the Exposure Draft?**

We have no additional comments to make.