



Regulatory assets and regulatory liabilities

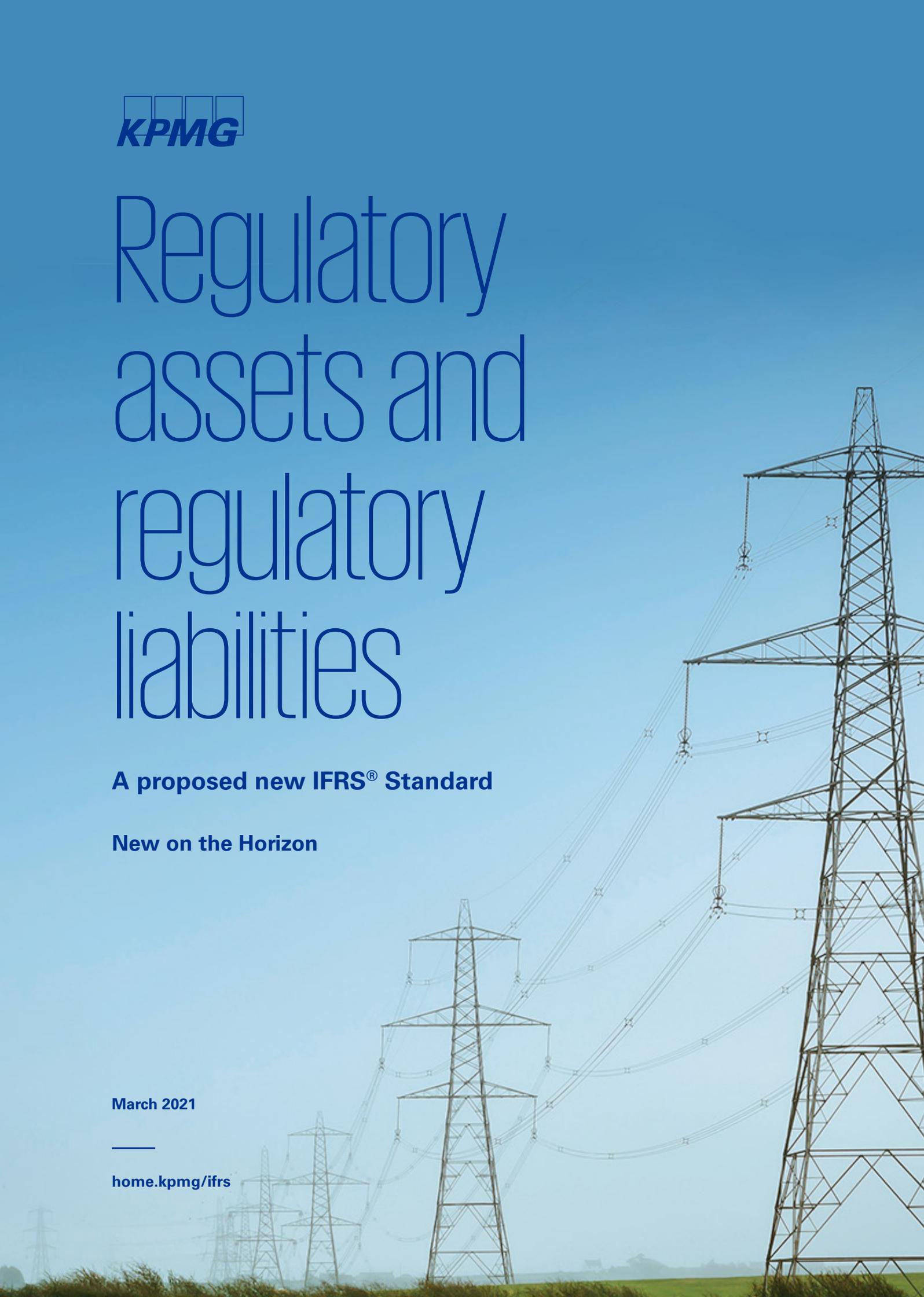
A proposed new IFRS® Standard

New on the Horizon

March 2021



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Regulatory assets and regulatory liabilities

A proposed new standard for companies subject to rate regulation

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.

The International Accounting Standards Board's (the Board) exposure draft *Regulatory Assets and Regulatory Liabilities* (the ED or the proposals) sets out a new accounting model to address this. Under the proposals a company subject to rate regulation that meets the scope criteria would recognise regulatory assets and regulatory liabilities.

This accounting model would align a company's total income recognised in a period under IFRS Standards with its 'total allowed compensation' – i.e. the amount that a company is permitted to charge by the rate regulator. This would reduce volatility in reported financial performance.

This is a huge milestone in the Board's long-running project on accounting for the effects of rate regulation. The key issues are which companies would fall in 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.

The proposals are likely to impact companies in the utility and transport sectors in particular. However, the scope is not limited to companies that operate in a specific industry sector. All companies subject to price control will need to consider whether they are caught – deliberately or not – by the broadly drawn scope criteria.

As the Board continues to seek views on its proposals (until 30 July 2021), this *New on the Horizon* explores some of the potential impacts and offers illustrative examples showing how financial statements might be prepared and presented under this future standard.

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1

The proposals at a glance

1.1

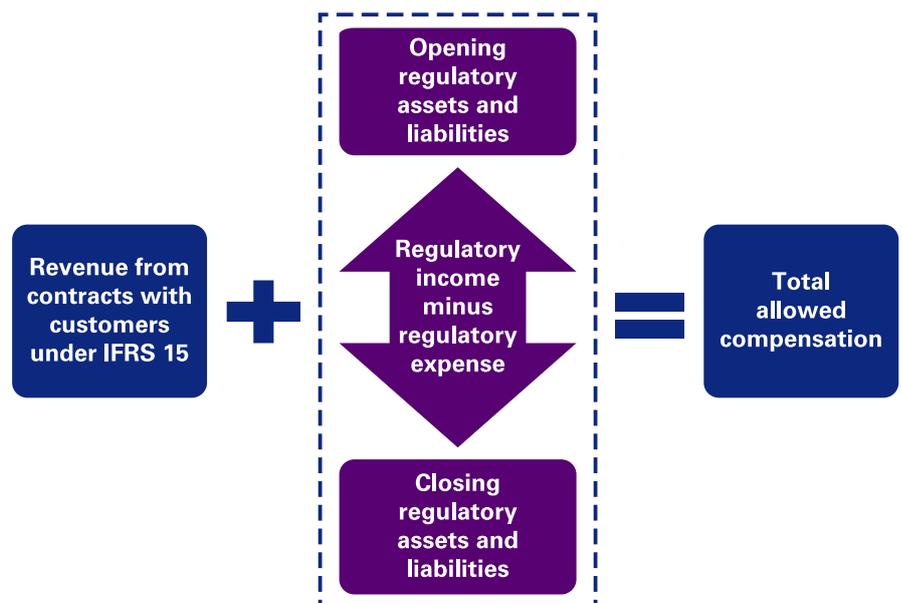
The accounting model

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

To achieve this, the ED proposes an ‘overlay’ approach under which a company would, first, continue to apply the requirements of existing IFRS Standards (e.g. recognise and measure revenue from contracts with customers) and then 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 regulatory liabilities would give rise to regulatory income and expense. Broadly speaking, the total revenue recognised under existing standards plus regulatory income minus regulatory expense under the proposed new 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 regulatory liabilities would be presented separately from other assets and liabilities.

1.2

Who would be affected?

Although many companies in the utility sector would meet the scope criteria, it is possible that some would not. Some companies outside the utility sector might also meet the scope criteria.

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

- The company is a party to an enforceable regulatory agreement.
- The regulatory agreement determines the regulated rate that the company can charge for goods or services supplied to its customers.
- The regulated rate is determined in such a way that some or all of the total allowed compensation for goods or services supplied in one period is charged to customers in a different period.

If a company meets all of these criteria, then it would be required to apply the accounting model in the ED.

1.3

Key impacts

Companies covered by the proposals would recognise new assets and liabilities, and new items of income and expense. The impact on financial performance would 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 proposed new standard.
- If a company previously experienced timing differences between recognition of income under IFRS Standards and total allowed compensation permitted by the regulator, then volatility in reported earnings would be reduced.

Companies would need to reconsider their financial statement presentation, including key metrics and alternative performance measures. For example, companies that currently use alternative performance measures to report the effects of rate regulation that are not captured under existing standards may reconsider this approach.

Companies may need to gather new information to measure regulatory assets and regulatory liabilities when preparing their financial statements. However, the Board expects that the costs of gathering this information would be limited, because affected companies will typically use this information when determining regulated rates and/or in regulatory submissions.

1.4

Effective date and transition

The Board intends that the proposed new standard would apply to annual reporting periods beginning 18 to 24 months after it is issued. Earlier application would be permitted.

A company would apply the proposed new standard retrospectively, but transition relief would be available for certain past business combinations. IFRS 14 would be withdrawn.

2 Introducing rate regulation

This section provides a basic introduction to rate regulation, the financial reporting issues created by rate regulation, and how the ED proposes to address those issues.

This section provides context for the more detailed discussion of the proposals in the chapters that follow. Readers who are familiar with the topic may prefer to start with [Chapter 3](#).

2.1 What is rate regulation?

Rate regulation is a system under which the prices (rates) that a company charges its customers are set under a regulatory agreement. Often, though not always, prices are set by a regulator.

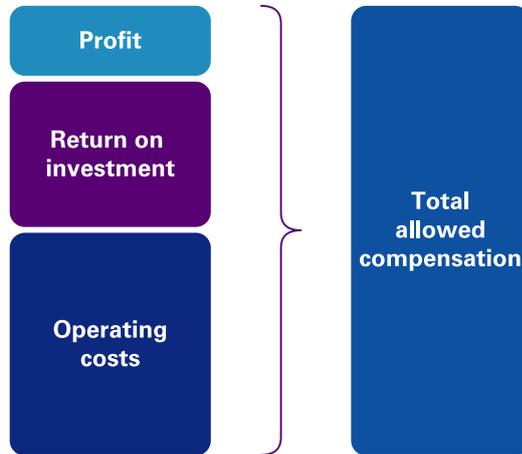
There are a variety of reasons why prices may be regulated. A common one is that a company enjoys a natural monopoly within a geographical market. For example, a water distribution company may have a monopoly within the area covered by its water distribution network. This is because it would not be economically or practically feasible for a competitor to enter the market and build a rival water distribution network.

In such cases, the regulator will seek to balance the interests of the company and its customers when setting rates. The regulator will wish the company to earn sufficient income to maintain continuity and quality of supply. The regulator will also wish to ensure that, in the absence of competition, customers are not overcharged for the service they receive from the company and that prices are not subject to erratic changes year-on-year.

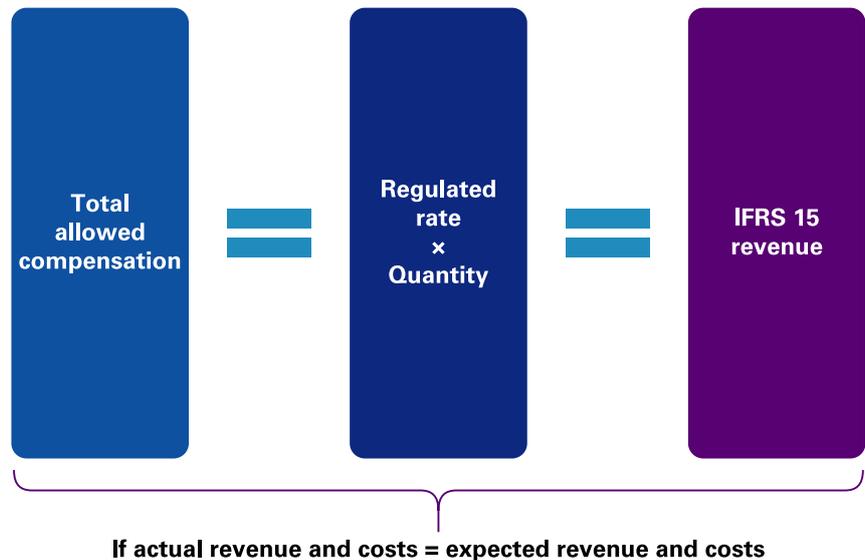
In the regulatory system addressed by the proposals, the regulator would determine the *total* amount that it believes the company should charge for goods and services that it supplies in a period. The ED calls this amount 'total allowed compensation'.

In a simple case, the regulator would determine the total allowed compensation as the income that would allow the company to:

- cover its operating costs;
- earn a return on its investments; and
- make a reasonable profit.



The 'regulated rate' will be the unit price that the company will charge its customers in the period – i.e. the total allowed compensation divided by an assumed quantity of goods and services to be supplied to customers. Often, the regulated rate will be visible to customers through the bills they receive from the company.



Under currently effective IFRS Standards, a company applies IFRS 15 *Revenue from Contracts with Customers* to account for its revenue from contracts with customers. The fact that prices have been set by a regulator has no additional accounting consequences.

2.2

What is the issue addressed by the ED?

In practice, a company's revenue in a period may be different from the revenue assumed by the regulator in setting rates. There are many possible reasons for this. The company may experience revenue or cost variances, capital projects may be delayed or accelerated, the company may or may not earn performance incentives etc.

Under some regulatory regimes, differences arising in one period will affect the regulated rate in future periods. That is, the regulator will increase or decrease rates in the future, so that a company can recover or settle these differences.

Crucially, in some cases the company may have an *enforceable* right (obligation) to add (deduct) an amount in determining the regulated rate in a future period. The existence of such a right (obligation) will have a direct impact on the company's future cash flows, through changes to the regulated rates.

Under currently effective IFRS Standards, such a right (or obligation) does not generally qualify to be recognised as an asset (or liability).

2.3

What is the Board proposing?

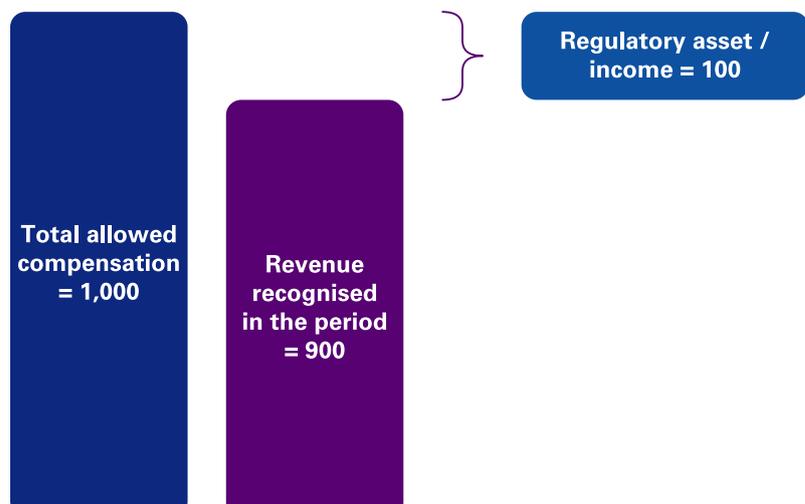
The Board is proposing that, in cases when the right (obligation) to add (deduct) an amount in determining a future rate is *enforceable*, the company would recognise additional assets (liabilities) and income (expense) to reflect that right (obligation). The Board believes that this would improve the information provided to users of the financial statements.

To take a very simple example, suppose that the regulator determines that a company should be entitled to charge 1,000 in the year 2021. That is, the total allowed compensation is 1,000. The regulator assumes that the company will provide an equal amount of service to 100 customers and will therefore charge each customer $1,000 / 100 = 10$ each. That is, the regulated rate is 10. For simplicity, assume that there is no difference between expected and actual costs.

Under the regulatory system, the company would have an *enforceable right* to add an amount in determining the regulated rate for 2022 if its revenue is less than 1,000 in 2021. Equally, the company would have an *enforceable obligation* to deduct an amount in determining the regulated rate for 2022 if its revenue is more than 1,000 in 2021.

In 2021, the company provides services to only 90 customers. The company therefore charges its customers a total of $90 \times 10 = 900$. The company's IFRS 15 revenue is 900. The company has an enforceable right to add 100 in determining the regulated rate for 2022.

Under the proposals, the company would recognise regulatory income of 100 in 2021 and a regulatory asset of 100 at the end of 2021.



2.4

How to use this publication

In practice, systems of rate regulation are far more complex than the simple example above, and the ED seeks to address that complexity. This guide to the ED is structured as follows.

Chapter	Topic	Content
3	Key concepts	
3.1	Scope	The scope of the ED – i.e. how to identify which companies would need to apply the proposals – and the key definitions on which the scope criteria are based
3.2	Regulatory assets and regulatory liabilities	Definitions of regulatory assets and liabilities, illustrated by simple examples
3.3	Components of total allowed compensation	A deeper dive into total allowed compensation, identifying the key components of total allowed compensation and how the ED addresses them
3.4	Unit of account	When regulatory rights and obligations may be accounted for together, and when they would have to be accounted for separately
4	Applying the proposals – Recognition and measurement	
4.1	Recognition	When to recognise and derecognise regulatory items, and how uncertainty about existence, amount or timing would affect recognition
4.2	Measurement	An overview of the measurement requirements, which for many regulatory assets and regulatory liabilities would involve a discounted cash flow approach
4.3	Estimating cash flows	How to identify which cash flows are used in measuring regulatory assets and regulatory liabilities, and how to estimate those cash flows
4.4	Discount rate	How to estimate the discount rate to be used, which would often but not always be the regulatory interest rate
4.5	Subsequent measurement	Subsequent measurement, including when to change the discount rate

Chapter	Topic	Content
4.6	Measurement exception	An alternative measurement model to be applied when regulated rates will be based on future cash flows – e.g. for taxes in some systems
5	Presentation and disclosures	
5.1	Statement of financial performance	Presentation in the statement of financial performance, including a proposal to present regulatory income/expense separately, immediately below revenue
5.2	Statement of financial position	Presentation in the statement of financial position, including a proposal to present regulatory assets and regulatory liabilities separately from other assets and liabilities
5.3	Disclosures	Disclosure proposals
6	How the proposals would interact with other standards, including those on income taxes and service concession arrangements	
7	Effective date, the proposed requirement for retrospective application and a proposed exception for past business combinations	

3

Key concepts

3.1

Scope

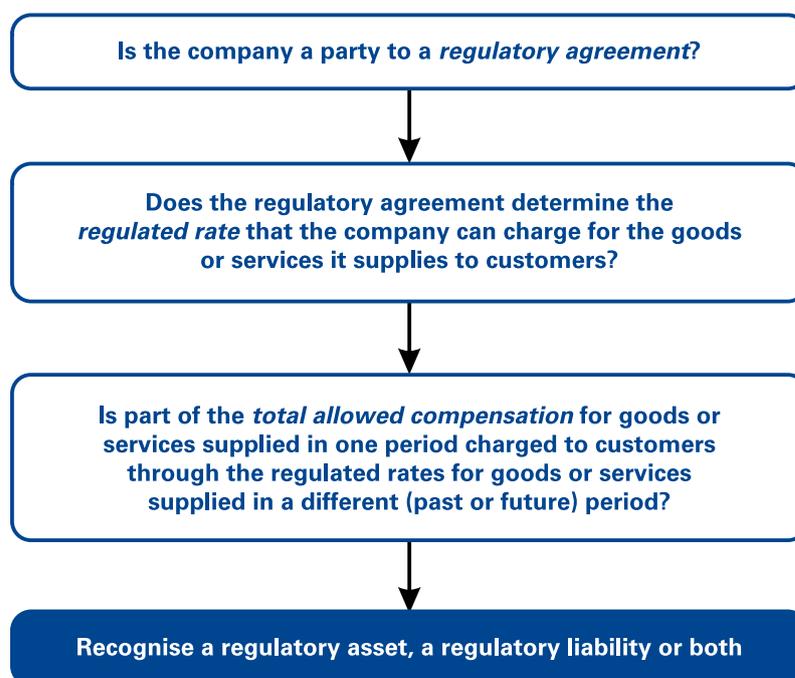
The proposals would apply to a company that is bound by a regulatory agreement. This could include a company involved in some regulated and some unregulated activities.

ED.3

A company would apply the proposals to all of its regulatory assets and regulatory liabilities when the relevant criteria are met.

A regulatory asset or a regulatory liability can exist only if *all* of the below criteria are met.

ED.6



ED.7–8

A regulatory agreement is a set of enforceable conditions that determines a regulated rate that a company charges as or when it provides goods and services under its contracts with customers. Only a regulatory agreement can create a regulatory asset and a regulatory liability.

ED.10

The regulatory agreement determines the regulated rate – i.e. the price that a company charges its customers as or when it supplies goods and services.

ED.11

Total allowed compensation is the amount that a company is entitled to charge its customers for goods and services supplied in the period. This amount reflects the regulatory rate that may be charged partly in the period or partly in other periods.



Would the proposed new standard be specific to certain industries?

No. Rate regulation is common in certain industries, including utilities and transport. However, the scope criteria would not be specific to those industries. Instead, the scope criteria would focus on key features of the regulatory regime, including whether the regime is enforceable.

As a result, some transport and utility companies would be outside the scope of the proposals. Conversely, some companies in other industries may be captured.

Understanding the scope proposals, and assessing whether it is clear whether a given regulatory regime would meet the scope criteria, will be a key issue for companies.

Companies need to apply the scope criteria when assessing whether the proposals would apply to them. This differs from IFRS 14, where they are optional.

ED.BC60



Do the proposals cover other rights and obligations created under the regulatory agreement?

No. A company would apply other standards when accounting for the effects of other rights and obligations created under a regulatory agreement.

This is consistent with the 'overlay' approach that underpins the ED – i.e. a company would generally continue to apply current IFRS Standards to its income, expenses, assets and liabilities and, in addition, apply the proposals to its regulatory assets and regulatory liabilities.

ED.8.9

ED.BC85



Do the proposals require the regulatory agreement to be in a specified form?

No. Regulatory agreements may take different forms, including for example:

- a contractual licencing agreement between a company and a regulator;
- a service concession arrangement; or
- a set of rights and conditions imposed by statute, legislation or regulation.

The key requirement is that the regulatory agreement is enforceable, in whatever form it takes. This will be a matter of law.

Evidence on the enforceability of terms in the regulatory agreement may be provided by regulatory decisions or court rulings.

In practice, assessing enforceability would be a key application issue under the proposals, driving key aspects of the recognition test for regulatory assets and regulatory liabilities.

ED.BC85, 86



Do the proposals address the type or characteristics of the regulatory body?

No. The Board considered whether to define a regulatory body and the characteristics that body must possess but decided not to because those characteristics could vary greatly.

Further, regulators and other enforcement authorities could take several legal forms, may contain various features and can be established to have different objectives and mandates.

Due to the diversity involved, the Board would then have difficulty in ascertaining which characteristics to consider. Therefore, the proposals do not address this.

3.2 Regulatory assets and regulatory liabilities

A company recognises revenue under IFRS 15 *Revenue from Contracts with Customers* as it satisfies its performance obligations by transferring the promised goods or services. For a company that is subject to rate regulation, the amount charged to customers will reflect the regulated rate.

ED.10

A regulated rate is a price for goods or services, determined by a regulatory agreement, that a company charges its customers in the period when it supplies those goods or services.

ED.12(a)

However, the revenue recognised under IFRS 15 in a period is often different from the amount the company is permitted to charge under the regulatory agreement – for example, due to timing differences.

ED.16

To supplement the information a company needs to provide under IFRS 15, it also reports the total allowed compensation relating to the goods or services supplied during that period. This means that a company would also recognise a regulatory asset or a regulatory liability, or both.

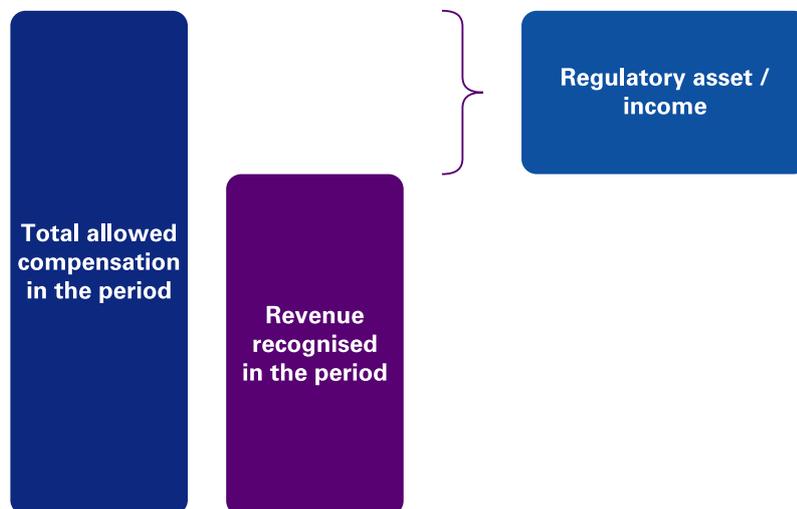
3.2.1 Regulatory asset

ED.4

A company would recognise a regulatory asset when it has a right to add an amount when determining the regulated rate in a future period. This would typically be the case when revenue recognised under IFRS 15 for the period is lower than the amount the company is permitted to charge under the regulatory agreement in the period.

A company would recognise a regulatory asset to depict its enforceable present right created by a regulatory agreement to add an amount to determine the regulated rate to be charged to the customers in the future periods. This is because part of the total allowed compensation for the goods or services already supplied will be included in revenue in the future.

When a company recognises a regulatory asset, it would also record regulatory income. This income would depict a part of the total allowed compensation for goods or services supplied in the current period that will be recognised as revenue in the future periods.



Example 1: Regulatory asset

Company X is bound by a regulatory agreement that permits the regulated rate to include any variances between estimated and actual input costs incurred in the rates charged to customers in the next year.

X incurs actual input costs of 3,000 during Year 1 but is compensated only for its estimated input costs of 2,200 as part of the rates charged to customers in Year 1.

In Year 1, X has an enforceable present right to add 800 to the rates that it will charge customers in Year 2. This is because part of the total allowed compensation (800 out of 3,000) for goods or services already supplied will be included in revenue in Year 2.

Applying the proposed model, X recognises the following in Year 1.

	Debit	Credit
Regulatory asset	800	
Regulatory income		800
<i>To recognise the regulatory asset</i>		

3.2.2

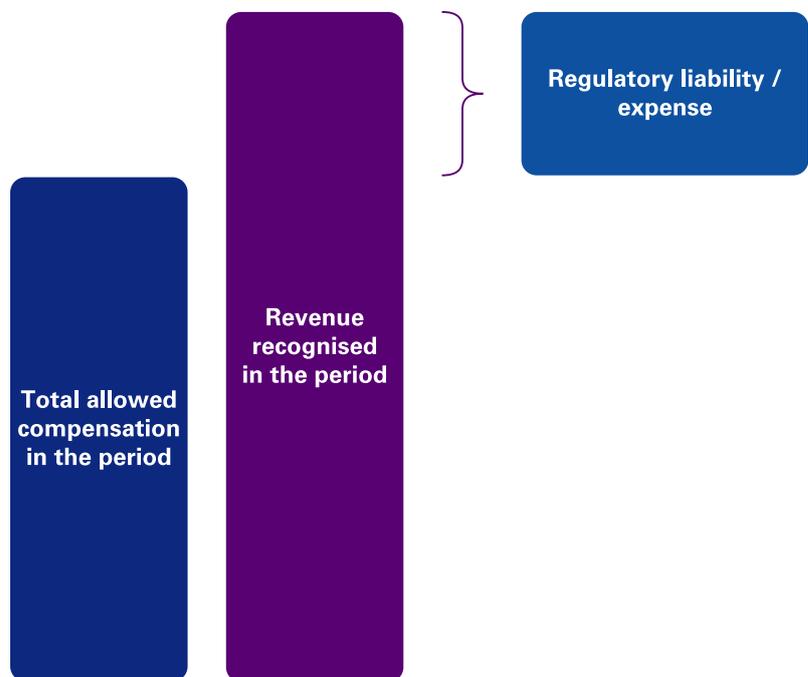
ED.5

Regulatory liability

A company would recognise a regulatory liability when it has an obligation to deduct an amount in determining the regulated rate in a future period. This would typically be the case when revenue recognised under IFRS 15 for the period is higher than the amount that the company is permitted to charge under the regulatory agreement in the period.

A company would recognise a regulatory liability to depict its enforceable present obligation created by a regulatory agreement to deduct an amount to determine the regulated rate to be charged to customers in future periods. This is 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.

When a company recognises a regulatory liability, it would also record a regulatory expense. This expense would reflect the amount of the total allowed compensation that is recognised in revenue for the current period relating to goods or services that will be supplied in future periods.



Example 2: Regulatory liability

Modifying [Example 1](#), Company X incurs actual input costs of 1,500 in Year 1 but is compensated for higher estimated input costs (submitted to the regulator) of 2,200 in its rates charged to customers in Year 1.

In Year 1, X has an enforceable present obligation to deduct the difference between its actual and estimated input costs (700) from the rates that it will charge customers in Year 2. This is because the revenue recognised in Year 1 includes part of the total allowed compensation (700) for goods or services to be supplied in Year 2.

Applying the proposed new model, X recognises the following in Year 1.

	Debit	Credit
Regulatory expense	700	
Regulatory liability		700
<i>To recognise the regulatory liability</i>		

ED.BC58

 **Could a regulatory asset and a regulatory liability be accounted for together with other assets and liabilities?**

No. The Board is proposing that a company would account for regulatory assets and regulatory liabilities separately because this would provide useful information to users of financial statements.

The Board believes that a company subject to rate regulation has incremental cash flows arising from a regulatory asset or a regulatory liability – i.e. they occur only because the company has that asset or liability. Further, these cash flows are largely independent of cash flows that arise from other rights and obligations under the regulatory agreement and, therefore, would be recognised as separate assets and liabilities.

ED.BC52

 **Would the regulatory asset or regulatory liability be a financial asset or a financial liability?**

No. A regulatory asset or regulatory liability would be a right or obligation to adjust prices chargeable to customers in the future. Although this right (obligation) would affect future cash flows, it would not itself be a present right (obligation) to receive (pay) cash.

Instead, a company would generally recognise a financial asset when its performance under its contracts with its customers means that it has an unconditional right to receive cash, subject only to the passage of time.

3.2.3

Differences that do not lead to recognition of a regulatory asset or a regulatory liability

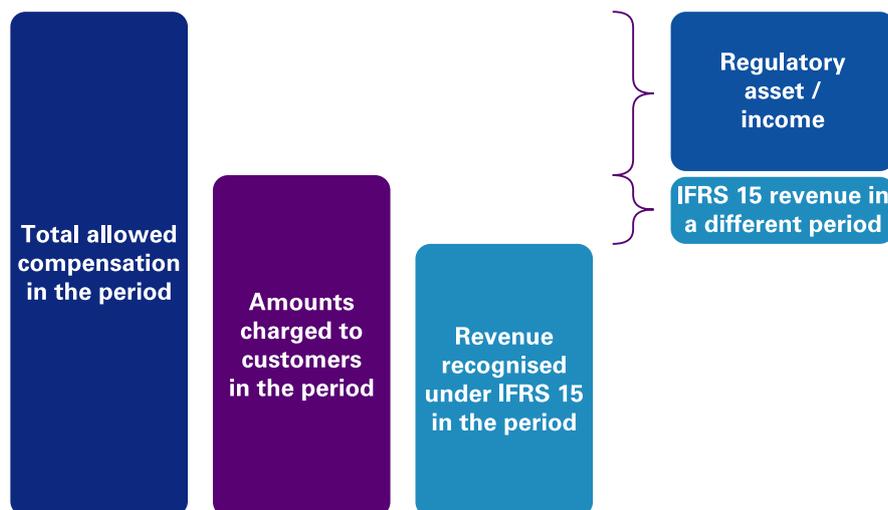
ED.18

A company would not always recognise all of the amount that it is entitled to charge customers as revenue from contracts with customers in the period the goods and services have been provided – e.g. if:

- the contract is not in the scope of IFRS 15 because the criteria in paragraph 9 of the standard have not been met; or
- estimates of variable consideration are constrained under paragraph 56 of IFRS 15.

ED.19

In these cases, a company would not recognise an additional regulatory asset or regulatory liability for the shortfall.



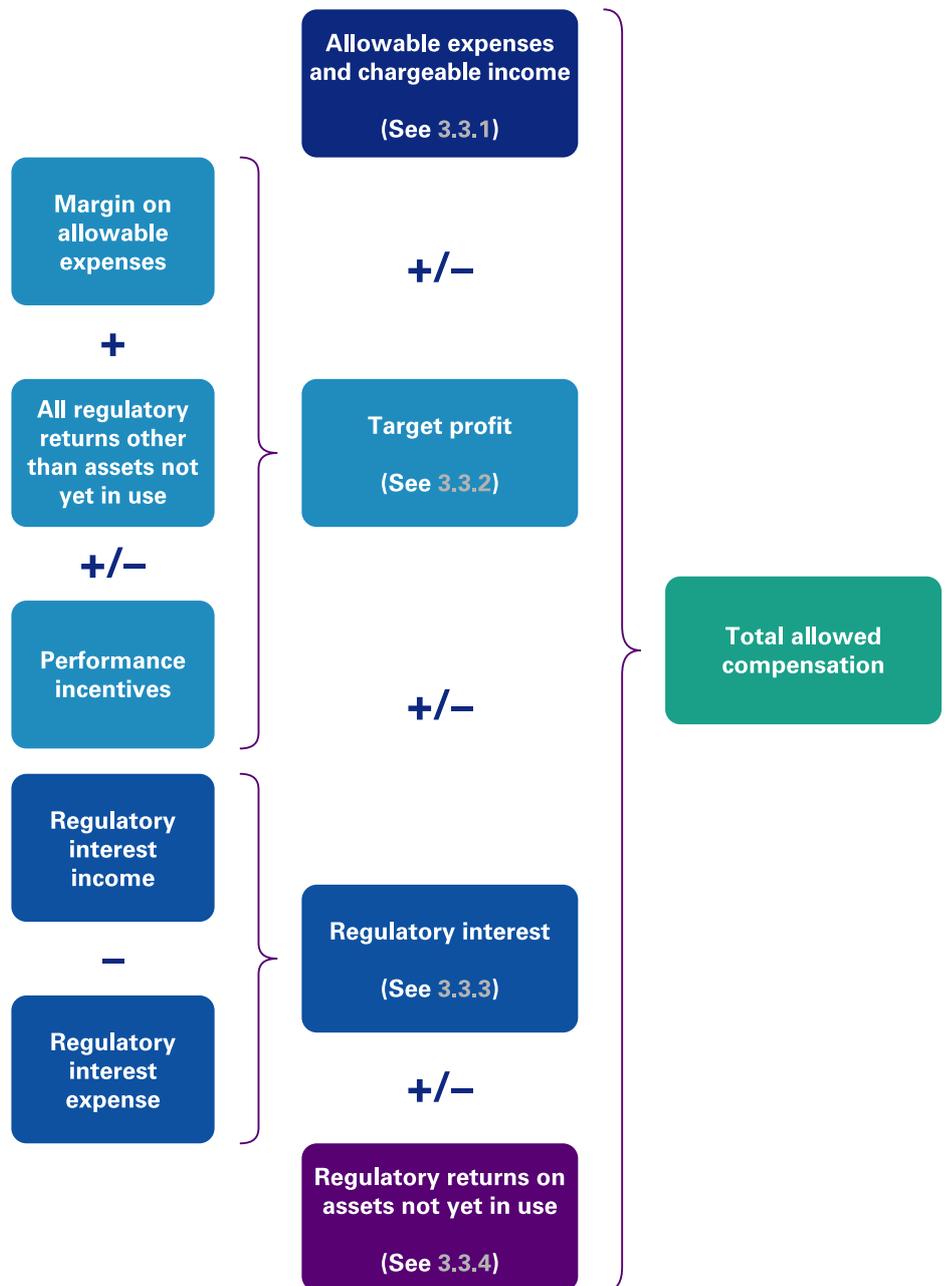
3.3

ED.11

Components of total allowed compensation

Total allowed compensation is the full amount of compensation for goods or services supplied that a regulatory agreement entitles a company to charge customers. This includes amounts chargeable in the same period or in a different period.

The total allowed compensation typically includes various components, as shown in the diagram below.



3.3.1

ED.B3–B5

Allowable expenses and chargeable income

The regulatory agreement would determine the expenses that could be included in the regulated rate charged to the customer. Under the proposals, an allowable expense would be an expense, as defined in IFRS Standards, that a regulatory agreement allows a company to recover from its customers as part of the regulated rate charged to those customers.

ED.B9

Similar to an allowable expense, a regulatory agreement may treat an amount of income as chargeable. This establishes that this income relates to the supply of goods or services in some period.

A company would recognise chargeable income that relates to the supply of goods or services in the same period in which it recognises income under IFRS Standards. For example, a regulatory agreement may require a gain on disposal of an asset to be deducted in determining the regulated rate.

ED.IE1



Example 3: Input cost and quantity variances

Company X supplies goods and services to its customers. Under a regulatory agreement, X is entitled to recover the actual costs that it incurs in supplying those goods and services to its customers. For simplicity, this example ignores regulatory interest on regulatory balances.

The regulated rate that X can charge its customers in Year 1 is 5.40 per unit based on:

- an estimated quantity of 100 units to be supplied in Year 1;
- estimated variable costs of 400 (4.00 per unit); and
- estimated fixed input costs of 140.

In Year 1, X supplies only 90 units to customers and recognises revenue of 486 (5.40 × 90 units).

It also incurs the following variable and fixed input costs, which are higher than estimated, and recognised as an expense under IFRS Standards.

	Per Unit	Units	Year 1 total
Variable input costs	5.00	90	450
Fixed input	–	–	150
Total input costs			600

There are no cost or quantity variances in Year 2.

In determining the regulated rates for Year 2, the regulatory agreement entitles X to add an amount to recover the cost and quantity variances that arose in Year 1.

Under the proposals, the total allowed compensation for goods and services supplied in Years 1 and 2 would be the allowable expenses incurred in supplying the goods and services. These are the actual input costs incurred by X of 600 in both Year 1 and Year 2.

The total allowed compensation for goods and services supplied in Year 1 (600) exceeds the revenue recognised (486) during that year by 114. Under the proposals, X recovers part of the total allowed compensation (i.e. 114 of the total of 600) through the regulated rates to be charged to customers in Year 2.

	Year 1	Year 2
Revenue	486	714*
Regulatory income/expense	114	(114)
	600	600
Input costs	(600)	(600)

* Calculated as the total allowed compensation for Year 2 (600) plus the under-recovery of income in Year 1 (114). Under the regulatory agreement, this under-recovery is included in the total allowed compensation in Year 2.

ED.B6–B7



How would a company account for an asset consumed over several reporting periods?

A company may use an asset to supply goods and services to customers over several periods – e.g. an item of property, plant and equipment. If a regulatory agreement allows the cost of this asset as an allowable expense, then the company would allocate the cost of the asset systematically to determine the total allowed compensation for goods or services supplied in each of those periods.

In determining this allocation, a company would use the judgements and estimates that it made when applying other standards – e.g. allocating the total cost of an asset over its useful life under IAS 16 *Property, Plant and Equipment*.

3.3.2

ED.B10–B11

Target profit

The proposals describe target profit as the profit that a company is entitled to add in determining a regulated rate for the goods or services supplied in a period. Target profit would form part of the total allowed compensation for the period.

ED.B12

ED.B13–15

ED.B16–20

Components of target profit	
Profit margins on allowable expenses	When a regulatory agreement entitles a company to recover a profit margin on an allowable expense, this would form part of total allowed compensation in the period in which the expense is recognised under IFRS Standards.
Regulatory returns	<p>A regulatory agreement will often entitle a company to recover a return on a defined asset base – e.g. a ‘regulatory asset base’ or similar. Items in the regulatory asset base may be the same as or different from those recognised under IFRS Standards and may be measured at different amounts.</p> <p>Regulatory returns would generally be included in total allowed compensation, except when the related asset is not yet available for use – see 3.3.4.</p>
Performance incentives	A regulatory agreement may provide a company with performance incentives for meeting specific performance criteria or might penalise it for not meeting the criteria. Performance incentives form part of the total allowed compensation for goods or services supplied in the period in which a company performs.

ED.IE 2A



Example 4A: Regulatory return – Asset with same useful life in both the regulatory agreement and the financial statements

Company X has an item of plant that is recognised at 2,000 both for regulatory purposes and under IAS 16. The plant has a useful life of five years and X depreciates it using the straight-line method over its useful life.

The regulatory agreement entitles X to recover through the regulated rates:

- the cost of the item of plant over its useful life of five years; and
- a regulatory return computed as 4% of the unrecovered balance of the item of plant at the beginning of each year.

Therefore, the following amounts relating to the item of plant are expected to be included in the regulated rates to be charged to its customers.

	Year 1	Year 2	Year 3	Year 4	Year 5
Opening balance	2000	1600	1200	800	400
Regulatory return	80	64	48	32	16
Total allowed compensation*	(480)	(464)	(448)	(432)	(416)

* Calculated as the sum of the recovery of cost of the plant per year (400) plus the regulatory return accruing in that year.

If the actual quantity supplied to customers differs from the estimated quantity, then that quantity variance causes an under- or over-recovery of the total allowed compensation. The regulatory agreement specifies that the under- or over-recovery will be added or deducted when determining the regulated rates to be charged to customers in the next year.

For simplicity, assume that there is no regulatory interest.

X estimated that it would supply the following number of units each year for Years 1–5. However, the actual quantities of goods or services supplied differ from these estimates as shown.

	Year 1	Year 2	Year 3	Year 4	Year 5
Estimated quantity supplied	100	110	120	90	80
Actual quantity supplied	90	115	115	100	80
Variance	(10)	5	(5)	10	–

Because of these quantity variances, the estimated revenue under the regulatory agreement differs from the actual revenue for Years 1–5 as shown below.

	Year 1	Year 2	Year 3	Year 4	Year 5
Amounts forecast to be included in the regulated rates	480	464	448	432	416
Scheduled recovery or fulfilment of variances*	–	48	(23)	18	(50)
Estimated revenue (a)	480	512	425	450	366
Estimated quantity supplied (b)	100	110	120	90	80
Regulated rate per unit (c = a/b)	4.80	4.65	3.54	5.00	4.58
Actual quantity (d)	90	115	115	100	80
Actual revenue (e = c × d)	432	535	407	500	366

* Calculated as nil for Year 1 and estimated revenue minus actual revenue of Years 1–4 for Years 2–5.

X determines that the total allowed compensation for Years 1–5 comprises the following.

- Allowable expenses: i.e. depreciation expense of 400 per year.
- The regulatory return of 4% that X is entitled to on the outstanding opening balance of the item of plant.

	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Total allowed compensation	480	464	448	432	416	2240
Actual revenue	432	535	407	500	366	2240
Difference	48	(71)	41	(68)	50	–

If no other transactions took place in Years 1–5, then X would include the following in its income statement for each of these years.

	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Allowable expenses (depreciation)	432	535	407	500	366	2240
Regulatory income/ (expense)	48	(71)	41	(68)	50	–
	480	464	448	432	416	2240
Depreciation expense	(400)	(400)	(400)	(400)	(400)	(2000)
Profit	80	64	48	32	16	240

ED.IE2B



Example 4B: Regulatory return – Useful life of asset differs between regulatory agreement and financial statements

Modifying Example 4A:

- the item of plant has a useful life of four years and the company recognises depreciation expense on a straight-line basis over this period;
- the regulatory agreement requires the cost of the asset to be added to the regulatory capital base, to be recovered over a period of five years; and
- actual quantities supplied to customers equal estimated quantities: i.e. no quantity variances arise in Years 1–5.

The total allowed compensation for the goods or services supplied in each of Years 1–5 is equal to:

- allowable expenses reflecting depreciation expense of 500 per year for Years 1–4, being the useful economic life of the plant; and
- a regulatory return of 4%, which X is entitled to on the unrecovered balance of the regulatory capital base at the beginning of each of Years 1–5.

Accordingly, the total allowed compensation for Years 1–5 is as follows.

	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Allowable expenses (depreciation expense)	500	500	500	500	–	2000
Regulatory return	80	64	48	32	16	240
Total allowed compensation	580	564	548	532	16	2240
Amounts charged to customers	(480)	(464)	(448)	(432)	(416)	(2240)
Difference	100	100	100	100	(400)	–

If no other transactions took place in Years 1–5, X would include the following in its income statement for each of these years.

	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Revenue	480	464	448	432	416	2240
Regulatory income/ (expense)	100	100	100	100	(400)	–
Total allowed compensation	580	564	548	532	16	2240
Depreciation expense	(500)	(500)	(500)	(500)	–	(2000)
Profit	80	64	48	32	16	240



Would items for amounts included in the regulatory base need to be measured under IFRS Standards?

ED.B24–B25

Not necessarily.

Items would be included in the regulatory base as determined by the regulatory agreement. The nature and amount of these items could be measured on a basis that differs from the requirements of IFRS Standards.

For example, the carrying amount of an item of property, plant and equipment under a regulatory agreement could include costs that would not qualify for capitalisation under IAS 16.



Could a company smooth regulatory returns that decline over time as the asset is being used?

ED.BC94

No. When the base used to determine regulatory returns declines over a period of time, the regulatory return that is attributable to the base would also decline as the assets are being used (see [Example 4B](#) above).

The Board discussed whether the declining pattern reflects the economics of the regulated activity if the company provides similar goods and services of a similar quality in each of those periods. The Board concluded that it does and that smoothing the regulatory returns over the useful life of the asset included in the base would not provide useful information.

ED.B18, BC105



When would a company recognise performance incentives that relate to construction of an asset?

A performance incentive relating to construction of an asset to be used by the company to provide goods and services would be recognised in total allowed compensation in the period(s) in which the construction takes place.

The ED acknowledges that construction-related performance incentives do not relate to supply of goods or services. Arguably, recognising total allowed compensation when construction takes place rather than when the company supplies goods or services would be a departure from the principle underlying the model.

However, the Board believes that recognising construction-related performance incentives when construction takes place:

- would provide useful and understandable information rather than applying different approaches for different types of performance incentives; and
- would be cost-effective because a company need not develop different policies and procedures for different types of performance incentives, nor would it need to determine which incentives relate to construction work.

ED.B19, BC106, BC137



Is the proposed approach to performance incentives consistent with IFRS 15?

No – it is similar but not identical.

For example, if the performance criteria test a company’s performance over a time frame that is not yet complete, a company would use either the ‘most likely amount’ or the ‘expected value method’ to determine the amount of a performance incentive. That portion would form part of (or reduce) the total allowed compensation for goods or services supplied in that reporting period.

This approach to estimating performance incentives would be consistent with that for determining variable consideration under IFRS 15.

IFRS 15.53

IFRS 15.56–57

However, the proposals do not include a mechanism similar to the constraint in IFRS 15. Under this mechanism, a company estimates variable consideration as described above, and restricts the amount of revenue recognised such that it is highly probable that there will not be a significant reversal of revenue when the underlying uncertainty is resolved.

The absence of a constraint-style mechanism in the proposals means that the treatment of regulatory performance incentives would not be as prudent as the treatment of contractual performance incentives under IFRS 15.

3.3.3

ED.B21–B22

Regulatory interest

Regulatory interest compensates or charges a company for the time value of money until recovery of the regulatory asset or fulfilment of the regulatory liability. This is because the present value of the estimated future cash flows arising from a regulatory asset or a regulatory liability changes as time passes. This is commonly referred to as ‘unwinding the discount rate’. When the discount unwinds, a company would recognise either regulatory interest income or regulatory interest expense.

ED.IE1

**Example 5: Regulatory interest**

Continuing [Example 3](#), the regulatory agreement features an interest rate of 5% on any unrecovered or unfulfilled balance at the start of a year to compensate, or charge, the company for the time lag settlement of a variance.

Under the proposals, the total allowed compensation for goods and services supplied in Years 1 and 2 comprises:

- allowable expenses incurred in supplying goods and services: i.e. the actual input costs (600) incurred by the company in both Year 1 and Year 2; and
- regulatory interest income of 5% on the regulatory balances that Company X is entitled to include in determining the regulated rates to be charged to customers in Year 2.

	Year 1	Year 2	Total
Input costs	600	600	1200
Regulatory interest income (114 × 5%)	–	6	6
Total allowed compensation	600	606	1206
Amounts charged to customers	(486)	(720)	(1206)
Regulatory income/ (expense)	114	(114)	–

The total allowed compensation for goods and services supplied in Year 1 (600) exceeds the revenue recognised (486) during that year by 114. Under the proposals, X also recovers the regulatory interest income of 114 through the regulated rates to be charged to customers in Year 2.

If no other transactions took place in Years 1 and 2, then X would include the following in its statements of financial performance for those years.

	Year 1	Year 2
Revenue	486	720
Regulatory income/ (expense)	114	(114)
Total allowed compensation	600	606
Input cost expense	(600)	(600)

3.3.4

ED.B15, BC96–100

Regulatory return on assets not yet in use

Regulatory agreements could include regulatory returns on assets that are not yet being used to supply goods and services to customers. In these cases, the proposals state that the regulatory returns on the asset not yet in use would form part of the total allowed compensation only when the asset is placed in to use. This would be recovered through the regulated rates for the goods or services supplied over the remaining period(s) in which the asset is recovered.

ED.IE3



Example 6: Regulatory return on an asset not yet available for use

At the beginning of Year 1, Company Y completes the construction of an item of plant that it will use in the supply of goods or services to customers from the start of Year 2. For the remainder of Year 1, Y is engaged in obtaining permits for the plant and it cannot commission the plant until the beginning of Year 2. Therefore, it cannot supply goods or services to customers until this time.

The cost of the item of plant both for regulatory purposes and under IAS 16 is 2,000. It has a useful life of three years and Y depreciates it over this period using the straight-line method.

The regulatory agreement stipulates that Y will add the construction costs into the regulatory capital base as they are incurred. Therefore, Y is entitled to recover part of its construction costs before the asset is placed into use.

Further, a regulatory return of 4% is provided on the unrecovered balance of the regulatory capital base at the beginning of the year and Y is entitled to recover the cost of the item of plant evenly over four years. In each year, Y is also entitled to include in the regulated rates any accrued regulatory return for the year.

Therefore, the amount for inclusion in the regulated rates to be charged to customers relating to the item of plant in each year is as follows.

	Year 1	Year 2	Year 3	Year 4
Opening balance	2000	1500	1000	500
Regulatory return	80	60	40	20
Amounts expected to be included in regulatory rates*	(580)	(560)	(540)	(520)
Closing balance	1500	1000	500	–

* Calculated as the depreciation expense for 4 years (500 per year) plus the regulatory return at 4%.

Y determines the total allowed compensation for Years 1–4 to be the following.

- The allowable expenses incurred in supplying the goods or services relate to the consumption of the item of plant: i.e. the depreciation expense recognised of 667 (2,000/3) per year for Years 2–4.
- The regulatory return of 4% that Y is entitled to on the unrecovered balance of the regulatory capital base at the beginning of the year. This regulatory return forms part of the total allowed compensation in the same year in which the regulatory agreement entitles Y to charge it. However, Y would need to adjust it for the return that was provided on the balance when the asset was not in use.

Y determines that the regulatory return included in the regulatory rates when the asset is not yet in use (Year 1) forms part of the total allowed compensation in later periods. That is, it forms part of the total allowed compensation only once the asset is in use (Years 2–4).

The proposals do not provide guidance on how to allocate the regulatory return on an asset not yet available for use. The period over which this allocation should be made is determined by the ED as being the remaining periods in which the company recovers the carrying amount of such an asset through regulated rates once it is available for use. Therefore, Y uses a reasonable and supportable basis to allocate this. In this example, a straight-line basis of allocation is considered appropriate.

	Year 1	Year 2	Year 3	Year 4	Total
Allowable expense (depreciation)	–	667	667	666	2000
Regulatory return	80	60	40	20	200
Adjustment for asset not yet in use*	(80)	27	27	26	–
Total allowed compensation	–	754	734	713	2200
Revenue	580	560	540	520	2200
Regulatory income (expense)	(580)	194	194	193	–

* Part of the profit in Years 2–4 arises because the revenue in Year 1 included 80 of regulatory return that will form part of total allowed compensation only once the asset is available for use.

If no other transactions took place in Years 1–4, then Y would include the following in its income statement.

	Year 1	Year 2	Year 3	Year 4	Total
Revenue	580	560	540	520	2200
Regulatory income/(regulatory expense)	(580)	194	194	193	–
Depreciation	–	667	667	666	2000
Profit	–	87	67	46	200

3.4

ED.24, BC114

Unit of account

A company would generally account for the right or obligation arising from each individual difference in timing under the regulatory agreement as a separate unit of account. However, a company may treat rights and obligations arising from the same regulatory agreement as arising from the same difference in timing in some cases.



Could a company group rights or obligations in a single unit of account?

ED.24, BC115

It depends.

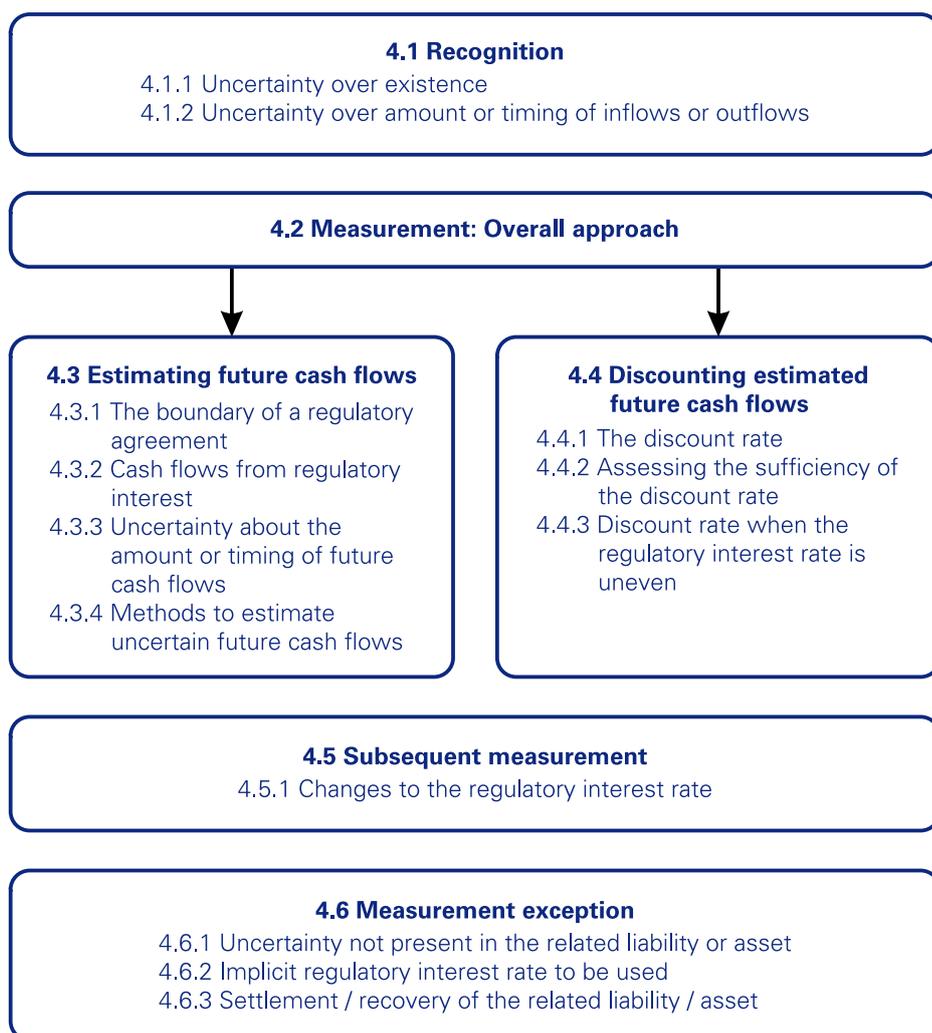
A company would be permitted to group rights, obligations or rights and obligations into a single unit of account if all of the items in the group have similar implications for the company's prospects for future cash flows – i.e. they have similar characteristics, risks and expiry patterns.

For example, grouping rights and obligations would provide useful information when they:

- cannot or are unlikely to be the subject of separate transactions;
- cannot or are unlikely to expire in different patterns;
- are likely to have similar implications for the company's prospects for future net cash inflows: i.e. they share similar economic characteristics and risks; or
- are used together in the business activities conducted by a company to produce cash flows and are measured by reference to estimates of their interdependent future cash flows.

4 Applying the proposals

This chapter explains how to recognise and measure regulatory assets and regulatory liabilities. The following diagram gives an overview showing which sections discuss which topics.



4.1

ED.25

Recognition

Under the proposals, a company would recognise:

- all regulatory assets and all regulatory liabilities existing at the reporting date; and
- all regulatory income and all regulatory expense arising during the reporting period.

Components of regulatory income or regulatory expense	
Component	Explanation
<i>ED.78</i>	<p>Regulatory assets created during the current period (income)</p> <p>The part of the total allowed compensation for goods or services supplied in the current period that will be included in revenue in future periods.</p>
<i>ED.78</i>	<p>Regulatory liabilities created during the current period (expense)</p> <p>The amount included in revenue in the current period that will provide part of the total allowed compensation for goods or services to be supplied in future periods.</p>
<i>ED.78</i>	<p>Regulatory assets recovered during the current period (expense)</p> <p>The amount included in revenue in the current period that provides part of the total allowed compensation for goods or services supplied in past periods.</p>
<i>ED.78</i>	<p>Regulatory liabilities fulfilled during the current period (income)</p> <p>The part of the total allowed compensation for goods or services supplied in the current period that was included in revenue in past periods.</p>
<i>ED.78, A</i>	<p>Regulatory interest income on regulatory assets and regulatory interest expense on regulatory liabilities (income or expense)</p> <p>Regulatory interest compensates or charges a company for the time lag until recovery of a regulatory asset or fulfilment of a regulatory liability.</p>
<i>ED.78, BC141</i>	<p>Remeasurements of regulatory assets and regulatory liabilities (income or expense)</p> <p>Companies would update their estimates of future cash flows to reflect changes in estimated timing or amount. This would mean that a separate impairment test would not be needed for regulatory assets.</p>
<i>ED.78, ED.B40</i>	<p>Changes in the carrying amount of a regulatory asset or regulatory liability caused by a change in the boundary of a regulatory agreement (income or expense)</p> <p>A change in the regulatory agreement could bring additional cash flows from events arising in previous periods within its boundary.</p>

ED.BC 129

**Is there a derecognition test?**

No. The ED does not propose a specific derecognition test for regulatory assets or regulatory liabilities. Instead, the ED assumes that a regulatory asset or regulatory liability would be:

- recovered or fulfilled through changes in future regulated rates, resulting in the recognition of regulatory expense or income; and/or
- remeasured if the estimated cash flows change.

This is similar to the approach in IFRS 15, which does not contain a specific derecognition test for contract assets and contract liabilities. However, questions have arisen in practice about derecognition under IFRS 15 when, for example, companies have sought to sell or securitise future cash flows from contracts with customers. It is possible that similar questions will arise in relation to regulatory assets and regulatory liabilities.

4.1.1

ED.28

Uncertainty over existence

The ED proposes that if there is uncertainty over whether a regulatory asset or regulatory liability exists, then a company would recognise a regulatory asset or regulatory liability if it is more likely than not that it exists.

Factors to consider in determining whether a regulatory asset or a regulatory liability exists

Source	Example factors to consider
The regulatory agreement	<ul style="list-style-type: none"> – Explicit requirements or guidance set out in the agreement – The company's experience with the regulator's interpretation of the regulatory agreement in similar circumstances.
Actions of the regulator	<ul style="list-style-type: none"> – Preliminary views expressed by the regulator – Confirmation from the regulator of amounts to be added or deducted in determining future regulated rates – Regulatory decision
Actions of the company	<ul style="list-style-type: none"> – Evidence that allowable expenses have been incurred – Evidence that performance criteria leading to a performance incentive bonus or penalty have or have not been met

Third parties	<ul style="list-style-type: none"> – Advice from qualified and experienced legal or other advisers – The experience of other companies regulated by the same regulator – The decisions of other regulators in similar circumstances
Legal bodies	<ul style="list-style-type: none"> – Court rulings interpreting the regulatory agreement – Court rulings in similar circumstances



Would there be different recognition thresholds for regulatory assets and regulatory liabilities?

ED.BC124–125

No.

The Board understands that there is generally little uncertainty about whether regulatory assets or regulatory liabilities exist. This is because the detailed regulatory agreements that govern the determination of regulated rates, together with regulatory oversight of the process for applying those agreements in practice, establish whether the asset or liability exists.

In situations where there is uncertainty, a company would recognise a regulatory asset or regulatory liability if it is more likely than not that it exists. This is consistent with the threshold set for recognising provisions under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

However, unlike IAS 37, the ED applies the same recognition criteria for both assets and liabilities. IAS 37 sets out a higher threshold for recognising contingent assets, requiring them to be virtually certain. A similar distinction between recognising assets and liabilities is seen in IAS 12 *Income Taxes*. In general, IAS 12 requires deferred tax liabilities to be recognised for all taxable temporary differences. However, deferred tax assets can only be recognised to the extent that it is probable that taxable profit will be available against which a deductible temporary difference or tax loss or credit can be used.

The Board's view is that a single regulatory agreement could give rise to both regulatory assets and regulatory liabilities, and that setting an asymmetric recognition threshold would result in information that could be difficult to interpret. However, others might argue that this is also the case under IAS 12 given that a jurisdiction's tax regime produces both taxable and deductible temporary differences. As discussed above, this has not prevented the Board from applying different recognition criteria to assets and liabilities under that standard.

4.1.2

ED.BC.126

Uncertainty over amount or timing of inflows or outflows

Any uncertainty about the amount or timing of the inflows or outflows relating to a regulatory asset or regulatory liability would be reflected in the measurement of the regulatory asset or regulatory liability.



Would measurement uncertainty be a reason not to recognise a regulatory asset or regulatory liability?

ED.BC127

No. Regulatory agreements typically set out explicit terms that, together with requirements to keep detailed records, generally enable companies to make reasonable estimates when measuring their regulatory assets or regulatory liabilities. This means that measurement uncertainty is unlikely to be significant, as long as the regulatory framework is strong.

ED.BC126

Therefore, the Board is proposing that a company would recognise all regulatory assets and regulatory liabilities, regardless of the level of measurement uncertainty. The degree of uncertainty associated with these balances would be captured instead in their subsequent measurement. The Board feels that this approach would capture the economics of rate-regulated activities better than not recognising such balances at all.

4.2

ED.29

Measurement: Overall approach

Under the proposals, a company would measure regulatory assets and regulatory liabilities at historical cost, modified on subsequent measurement by using updated estimates of the amount and timing of future cash flows.

There would be one exception, which is discussed in [Section 4.6](#) below.

ED.30

When applying the measurement basis, a company would use a cash flow-based measurement technique that:

- includes an estimate of all future cash flows arising from a regulatory asset or regulatory liability; and
- discounts those estimated future cash flows to their present value.

ED.31

The ED proposes that a company would include all estimated future cash flows arising from a regulatory asset or regulatory liability, and only those cash flows.

ED.32

In estimating those cash flows, a company would consider:

- all reasonable and supportable information that is available without undue cost or effort about past events and about conditions existing at the reporting date; and
- current expectations about future conditions other than future changes in the regulatory agreement or in legislation.

ED.45

If regulated rates are denominated in a foreign currency, then a company would account for any related regulatory assets or regulatory liabilities as monetary items under IAS 21 *The Effects of Changes in Foreign Exchange Rates*.

ED.BC133-134



Would the proposals require a current value measurement basis?

Yes. The measurement basis could also have been described as a current value measurement basis, modified to use a historical discount rate. However, the Board proposes to describe it as a historical cost measurement basis, modified by updating it for changes in estimates of future cash flows.

The logic behind this is that the measurement of regulatory assets and regulatory liabilities:

- depends on cash flows that result from total allowed compensation and from regulated rates, both of which can be viewed as forms of price; and
- requires a company not to update the discount rate unless the regulatory agreement changes the regulatory interest rate.

There are some similarities to the treatment of contract assets and contract liabilities under IFRS 15 as shown in the following table.

	Measurement under the ED	Measurement under IFRS 15
Assets	Based on total allowed compensation for goods and services already supplied (including target profit if applicable)	Based on the transaction price that gives the company the right to consideration from the customer
Liabilities	Based on amounts included in regulated rates already charged to customers and, as a result, included in revenue already recognised	Based on consideration received or due from a customer in advance of the transfer of goods or services

However, there are a number of differences between the measurement approaches in the ED and in IFRS 15. For example:

- the proposals contain no equivalent mechanism to the constraint in IFRS 15, meaning that variable amounts such as performance incentives may be recognised earlier under the ED than under IFRS 15; and
- in some cases, the proposals would require a company to reflect credit risk in the measurement of a regulatory balance, meaning that collectability may reduce regulatory income in cases when it would not reduce revenue under IFRS 15.

4.3 Estimating future cash flows

4.3.1 The boundary of a regulatory agreement

ED.33

The cash flows to be included in the measurement of regulatory assets and regulatory liabilities would be those that are within the boundary of a regulatory agreement.

ED.B28

The boundary of the regulatory agreement is defined in the ED as being the latest future date at which a company has:

- an enforceable present right to recover a regulatory asset by increasing the regulated rate to be charged to customers; or
- an enforceable present obligation to fulfil a regulatory liability by decreasing the regulated rate to be charged to customers.

Enforceable present rights and obligations

ED.B30, B32

The table below illustrates the criteria that a company would need to meet for it to have an enforceable present right or obligation.

	Supply	Cancellation
Enforceable present right to add an amount to the regulated rate	Regulatory agreement gives the company the right to supply goods and services	Only the company has a right to cancel the regulatory agreement without receiving compensation
Enforceable present obligation to deduct an amount from the regulated rate	Regulatory agreement obliges the company to supply goods and services	The company cannot cancel the regulatory agreement without compensating the party that will fulfil the regulatory liability



Why is the boundary of the regulatory agreement important?

ED.BC143

The boundary of the regulatory agreement is important because a company's right to add (or obligation to deduct) an amount when determining the regulated rates is enforceable only if those increases or decreases will occur within the boundary of the regulatory agreement.

This means that potential cash flows that arise outside the boundary of the regulatory agreement would not give rise to regulatory assets or regulatory liabilities.

Rights to renew or cancel a regulatory agreement

ED.B33

Rights to renew or cancel a regulatory agreement impact the boundary of the regulatory agreement, and, therefore, the recognition of regulatory assets and regulatory liabilities.

Under the proposals, a company would disregard a right held by any party to renew or cancel the regulatory agreement if there are no circumstances in which that party has the practical ability to exercise that right.

ED.B34

The ED gives the following examples of situations where the holder of a right to renew or cancel a regulatory agreement may not have the practical ability to exercise it:

- the economic consequences of exercising the right would be significantly more adverse for the holder than the consequences of not exercising it;
- exercising the right held by a company would lead to that company being liquidated or ceasing to trade; or
- exercising a right (held by a regulator) would lead to major disruption in the provision of an essential public service.

ED.B35–36

Under some regulatory agreements, a regulator or another company may have a right to cancel the agreement but would have to provide or arrange compensation for regulatory assets not yet recovered or regulatory liabilities not yet fulfilled, were the right to be exercised.

The ED proposes that receipts or payments for this compensation would be cash flows within the boundary of the regulatory agreement to the extent that they depend solely on the monetary amount of unrecovered regulatory assets or unfulfilled regulatory liabilities.



Would the probability of whether a right to renew or cancel will be exercised matter?

ED.BC145–146, IFRS 10.B22

No. The focus of the model would be on whether rights and obligations exist, not on how likely it is that they will lead to cash flows. This helped the Board to decide where the boundary of a regulatory agreement would be.

Under the proposals, a company holding a right to cash flows would assess whether it has the practical ability to exercise that right – not whether it is likely to exercise the right or whether it intends to do so.

In determining whether a right exists, a company would therefore focus only on whether there are circumstances in which it has the practical ability to exercise the right. This focus on substantive rights is consistent with the Board's decisions in other areas of IFRS Standards – e.g. when assessing whether an investor has power over an investee in IFRS 10 *Consolidated Financial Statements*.

Reassessment and changes to the boundary

ED.B39–40

The ED proposes that a company would reassess the boundary of a regulatory agreement at each reporting date, considering all changes in facts and circumstances.

If this reassessment brings any additional cash inflows or cash outflows within the boundary of a regulatory agreement, then the company would update the measurement of its regulatory assets or regulatory liabilities.

**Example 7: Additional cash flows following reassessment of the boundary of a regulatory agreement**

ED.B29

Company Y operates in the power industry. It has a 31 December reporting date and is subject to the terms of a regulatory agreement that governs the provision of power in the local market in which Y operates.

In 20X0, Y incurs an input cost variance of 500, which it would be entitled to recover in 20X2. However, at the end of 20X0, Y assesses that the boundary of the regulatory agreement is 31 December 20X1. Accordingly, it does not include the cash flows resulting from recovering the input cost variance in the regulatory asset at 31 December 20X1 because it does not expect to recover the input cost variance.

ED.B40

At 31 December 20X1, Company Y reassesses the boundary of the regulatory agreement and concludes that the boundary has changed to 31 December 20X2. The input cost variance of 500 incurred in 20X0 now falls within the boundary and Y therefore recognises a regulatory asset as at 31 December 20X1.

**Would reassessing the boundary result in the recognition of new regulatory assets and liabilities, or is it a remeasurement?**

ED.BC156–158

This is not specified in the ED.

The Board's view is that a change in the regulatory boundary would give rise to an enforceable present right or obligation, meaning that it would be appropriate to recognise a regulatory asset or regulatory liability despite the amount relating to a previous period.

It would also reflect the fact that revenue in the period is affected by amounts related to goods or services supplied in an earlier period. Under the proposals, disclosure would alert users of the financial statements to such changes.

The ED does not specify whether reassessment would result in the recognition of new regulatory assets and regulatory liabilities, or a remeasurement of them. However, the Board considered that additional cash flows brought within the boundary by a change in the boundary should be included. This is because recognising a regulatory asset or regulatory liability provides a more faithful representation of the company's financial position and a more understandable depiction of the company's financial performance in the period when the regulatory asset will be recovered, or when the regulatory liability will be fulfilled.

Under the proposals, disclosure would alert users of the financial statements to such changes.

4.3.2

ED.36

Cash flows from regulatory interest

Cash flows arising from a regulatory asset or a regulatory liability would include cash flows from regulatory interest.

ED.B21–22

Regulatory interest compensates or charges a company for the time lag until recovery of a regulatory asset or fulfilment of a regulatory liability. As time passes, the discount from measuring estimated future cash flows at their present value unwinds. A company would recognise regulatory interest as this occurs.

ED.B22–23

Regulatory interest income and regulatory interest expense

As discussed in 3.3.3, regulatory interest income would be recognised on a regulatory asset; regulatory income expense would be recognised on a regulatory liability.

When a regulatory agreement treats a regulatory asset or a regulatory liability as a separate base, a company would apply the regulatory interest rate to that base under the ED.

ED.B24

Larger regulatory bases and the components of regulatory return

Some regulatory agreements do not identify a regulatory asset or a regulatory liability separately but instead apply a return rate to the whole of a larger base (e.g. a regulatory capital base) of which the regulatory asset or regulatory liability forms a part. The larger base and the regulatory return provided on it each have three components as shown below:

Regulatory base components	Regulatory return components
Regulatory assets	Regulatory interest income
Regulatory liabilities	Regulatory interest expense
All other components	Regulatory return

ED.B25–26



Example 8: Components of regulatory return on a regulatory capital base

Company Y is party to a regulatory agreement. The regulatory agreement determines the regulated rate that Y can charge its customers, with that rate being determined so that some of the total allowed compensation supplied in one period is charged to customers in a different period.

Under the regulatory agreement, Y is entitled to a return rate of 10% on the outstanding balance of the regulatory capital base at the beginning of the period.

The outstanding balance at the beginning of Y's current reporting period is 1,000, entitling it to charge a regulatory return of 100 to its customers.

The outstanding balance of the regulatory capital base at the beginning of the current period includes the following.

Components of the regulatory capital base at the beginning of the period	Analysis under the ED	Asset/ (liability)	Interest/ (expense)/ return
Allowable overheads of 200 that were expensed immediately, being ineligible for capitalisation under IAS 16	Creates a right to increase future regulated rates. Therefore, Y would recognise a regulatory asset and regulatory interest income.	200	20
300 charged to customers in advance to fund investment in infrastructure	Creates an obligation to decrease future regulated rates. Therefore, Y would recognise a regulatory liability and regulatory interest expense.	(300)	(30)
Remaining components of 1,100 (1,000 - 200 + 300)			110
			100



How would cash flows from regulatory interest differ from other cash flows?

The cash flows from regulatory interest would result only from the time lag until recovery of the regulatory asset or fulfilment of the regulatory liability. That time lag would not affect the amount of any other cash flows arising from a regulatory asset or regulatory liability, but would affect their timing and may affect their uncertainty.

ED.36

For further information on regulatory interest income or regulatory interest expense, see 4.3.1.

4.3.3

ED.37

Uncertainty about the amount or timing of future cash flows

If there is uncertainty about the amount or timing of future cash flows from a regulatory asset or regulatory liability, then under the proposals a company would assess whether it bears that uncertainty or whether its customers bear it.

A company's customers would bear the uncertainty if the regulatory agreement will adjust future regulated rates so that those rates reflect the outcome of the uncertainty, including regulatory interest sufficient to compensate or charge the company for any change in the timing of the cash flows.

ED.38

Applying the ED's proposed requirements to credit risk (i.e. the risk that some customers will not pay the amounts charged) would lead a company to the following analysis.

Situation	Credit risk borne by	Result
The regulatory agreement treats amounts uncollected as allowable in determining regulated rates for a later future period	The customer	The company would include in its estimates of future cash flows the cash that it will collect in that later period
The regulatory agreement does not treat uncollected amounts as allowable in determining regulated rates for a later future period	The company	The company would estimate future cash flows after deducting an estimate of the amounts that it might not be able to collect



Which sources of uncertainty would be included when estimating future cash flows?

ED.BC138

All sources of measurement uncertainty would be included when estimating future cash flows under the proposals.

Reflecting all sources of uncertainty has the benefit of simplicity. When the company includes credit risk in estimating future cash flows, this might mean that estimated cash flows would be less than the amount that is ultimately charged to customers and reflected in revenue under IFRS 15. This is because IFRS 15 generally requires that revenue recognised is not reduced by amounts that the company might not be able to collect from a customer.

4.3.4

ED.39

Methods to estimate uncertain future cash flows

The ED puts forward two possible methods of estimating uncertain future cash flows:

- the 'most likely amount' method; and
- the 'expected value' method.

A company would be allowed to use whichever of these two methods better predicts the future cash flows.

ED.39

Applying the ED's proposed requirements to credit risk (i.e. the risk that some customers will not pay the amounts charged) would lead a company to the following analysis.

Method	Description	When appropriate
The 'most likely amount' method	Uses an estimate of single most likely amount in a range of possible outcomes (i.e. possible cash flow amounts)	<ul style="list-style-type: none"> – If the possible outcomes are clustered around one outcome – If there are only two possible outcomes and they differ widely
The 'expected value' method	Provides an estimate of the sum of probability-weighted amounts in a range of possible outcomes	<ul style="list-style-type: none"> – May better predict the uncertain cash flows if there is a range of possible outcomes

ED.42 The ED proposes that after selecting whichever of the two methods better predicts the cash flows, a company would continue to apply that method until it has recovered the regulatory asset or fulfilled the regulatory liability.

ED.41 A company would be permitted to use the most likely amount for some regulatory assets or regulatory liabilities and the expected value for others if doing so is expected to better predict their cash flows.

Aggregation

ED.40 When selecting one of the methods, a company would also assess whether the method will predict the cash flows better by:

- considering each regulatory asset and each regulatory liability separately; or
- aggregating any of them together with other regulatory assets or regulatory liabilities.

Own non-performance risk

ED.43 Under the proposals, a company's estimates of future cash flows arising from a regulatory liability would not reflect the company's own non-performance risk.

Events after the reporting date

ED.44 A company would apply IAS 10 *Events after the Reporting Date* when estimating future cash flows. Therefore, it would adjust its estimates of future cash flows only for an event occurring after the reporting date that gives additional evidence of conditions that existed at that date. Estimated cash flows would not be adjusted for changes in the regulatory agreement or relevant legislation that occurred after the company's reporting date.

ED.BC136, 137



Why do the proposals not specify a probability threshold?

The Board has not specified a probability threshold because it views the proposal to estimate future cash flows using either the most likely amount method or the expected value method as consistent with the *Conceptual Framework for Financial Reporting*.

Under the Conceptual Framework, possible variations in amount or timing are considered in selecting a single amount from within a range of possible cash flows. The most likely amount and the expected value are identified as two possible ways of identifying an amount within the central part of that range (which will usually provide the most relevant information on the uncertainty).

The ED's proposed requirement for a company to use whichever method will better predict the amount and timing of the cash flows is also consistent with the existing requirements in:

- IFRS 15 on estimating the amount of variable consideration to be included in the calculation of the transaction price in a revenue contract; and
- IFRIC 23 *Uncertainty over Income Tax Treatments* on predicting the resolution of an uncertainty over a tax treatment.

IFRS 15.53

IFRIC 23.11

IAS 37.39

In contrast, the ED's proposals differ slightly from the requirements in IAS 37 regarding uncertainties over the amount to be recognised as a provision. IAS 37 states that these uncertainties are dealt with by various means according to the circumstances. When the provision being measured involves a large population of items, the obligation is estimated by 'expected value' – i.e. weighting all possible outcomes by their associated probabilities. However, when there is a continuous range of possible outcomes and each point in that range is as likely as any other, the mid-point of the range is used.

Returning to the ED's proposals, if there are only two possible outcomes in a given scenario and a company uses the 'most likely amount' method, then the result would be the same as using a probability threshold of 'more likely than not' (i.e. 51 per cent).

ED.BC141



Would regulatory assets be subject to the requirements for non-financial assets under IAS 36 *Impairment of Assets*?

No. The Board believes that regulatory assets should be treated differently from other non-financial assets that are tested for impairment under IAS 36, because they do not form part of any cash-generating unit. The Board's reasoning is that cash flows arising from regulatory assets are largely independent of those generated by any other assets.

4.4

Discounting estimated future cash flows

4.4.1

ED.48, 53

The discount rate

Under the proposals, a company would generally use the regulatory interest rate for a regulatory asset or regulatory liability as the discount rate for that regulatory asset or regulatory liability.

This proposed requirement would be subject to the regulatory interest rate being sufficient for a regulatory asset. A company would not assess whether the regulatory rate is sufficient for a regulatory liability. This means that the regulatory interest rate would always be used for a regulatory liability.

ED. A

The ED defines the regulatory interest rate as “The interest rate provided by a regulatory agreement to compensate an entity for the time lag until recovery of a regulatory asset or to charge the entity for the time lag until fulfilment of a regulatory liability.”



Why is the Board proposing to use the regulatory interest rate as the discount rate?

The Board is proposing to use the regulatory interest rate to discount estimated future cash flows on cost-benefit grounds.

Usually, the Board would propose a discount rate that reflects the characteristics of the estimated future cash flows. For example, when estimating value in use under IAS 36, the discount rate is required to reflect the risks specific to the asset for which the future cash flow estimates have not been adjusted.

For the purposes of the ED, however, the Board concluded that this level of precision would not be needed to meet the overall objective of the model. It believes that any incremental benefit obtained from this level of precision would be unlikely to outweigh the additional costs and complexity. Therefore, the Board is proposing to use the regulatory interest rate as the discount rate, except when the regulatory interest rate for a regulatory asset is insufficient.

ED.BC164, IAS 36.55

4.4.2

Assessing the sufficiency of the discount rate

ED.50, 58

Under the proposals, a company would assess whether there is any indication that the regulatory interest rate for a regulatory asset may be insufficient to compensate the company for:

- the time value of money; and
- uncertainty in the amount and timing of the future cash flows arising from that regulatory asset.

This assessment would be required on initial recognition of a regulatory asset and following a change to the regulatory interest rate.

The ED gives the following examples of indications that the regulatory interest rate for a regulatory asset may be insufficient.

ED.52

Indications of insufficiency	Comment
<p>The regulatory interest rate is lower than:</p> <ul style="list-style-type: none"> – the regulatory interest rate provided for other regulatory assets that: <ul style="list-style-type: none"> – are in the same currency; – have a similar nature and maturity profile; and – are subject to similar uncertainties; or – the interest rate on loans that are in the same currency and have: <ul style="list-style-type: none"> – a maturity profile; – credit risk; and – terms and conditions similar to those of the regulatory asset (after deducting any part of that interest rate intended to recover the cost of servicing the loans and any estimated credit losses already included in the estimated cash flows). 	<p>The ED suggests that such loans could be loans that a company provides itself or loans for which the interest rate is readily observable.</p>

ED.51

If there are indications that the regulatory interest rate for a regulatory asset may be insufficient to compensate for the time value of money and uncertainty of future cash flows, then a company would estimate the minimum interest rate sufficient to provide that compensation.

In doing this, a company would use the higher of:

- the regulatory interest rate; and
- that minimum interest rate.

ED.BC167


What would the practical implications be of using the minimum rate?

Although the proposed core requirement to use the regulatory rate as the discount rate is notably simple, the proposals on assessing the sufficiency of the discount rate would introduce complexity and subjectivity.

The quantitative effect of using the minimum rate rather than the regulatory interest rate would be to reduce the carrying amount of regulatory assets. The Board’s rationale for this is that the low regulatory interest rate would effectively disallow part of the company’s allowable expenditure.

However, the Board expects this requirement to apply only infrequently, because regulated rates are generally set to maintain the financial viability of the regulated company.

There is no equivalent requirement to adjust the discount rate for regulatory liabilities. The Board believes that adjusting the discount rate for regulatory liabilities would add unnecessary cost and complexity.

4.4.3

ED.54

Discount rate when the regulatory interest rate is uneven

The ED proposes that a company would determine a single discount interest rate if the regulatory agreement provides for uneven regulatory interest rates – i.e. if different regulatory interest rates would apply for different periods over the life of a regulatory asset or a regulatory liability. A company would not consider possible future changes in the regulatory interest rate when converting the uneven regulatory interest rates into a single discount rate.

4.5

ED.55

Subsequent measurement

The ED proposes that after initial recognition, a company would measure a regulatory asset or regulatory liability by:

- updating the estimated amounts and timings of future cash flows arising from the regulatory asset or regulatory liability at each reporting date to reflect conditions existing at that date; and
- continuing to use the discount rate determined on initial recognition unless the regulatory interest rate changes.

ED.56

The ED lists the following examples of when a company would update the estimated future cash flows arising from a regulatory asset or a regulatory liability.

- Recovery of part or all of the regulatory asset or fulfilment of part or all of the regulatory liability.
- Accrual of regulatory interest not yet reflected in the regulated rates charged to customers.
- Changes in estimates of the amount or timing of future cash flows because of a change in facts and circumstances or because of new information.

ED.57

Examples of changes in facts and circumstances or new information, grouped by source, include:

Source	Example
Actions of the company	<ul style="list-style-type: none"> – Resolution of an uncertainty as a result of meeting, or not meeting, a performance incentive target
The regulatory agreement	<ul style="list-style-type: none"> – Changes in the regulatory agreement – Changes in the regulatory interest rate – A change in the boundary of the regulatory agreement
Actions of the regulator	<ul style="list-style-type: none"> – The regulator's agreement or disagreement with regulatory filings made by the company or other companies – The exercise of a cancellation option or the outcome of a renewal process
Legal bodies	<ul style="list-style-type: none"> – Resolution of an uncertainty following a court ruling – Changes in legislation

4.5.1

ED.58–62

Changes to the regulatory interest rate

A regulatory agreement may change the regulatory interest rate at regular intervals or in some other specified way. This change could impact the cash flows arising from a regulatory asset or regulatory liability, which would then require the company to:

- use the new regulatory interest rate to update its estimated future cash flows; and
- apply the guidance discussed in 4.4.2 above to determine whether the new discount rate is:
 - the new regulatory interest rate (translated into a single rate if necessary); or
 - (for a regulatory asset only) the new minimum interest rate if the new regulatory interest rate is not sufficient.

4.6

ED.59,62

Measurement exception

The ED proposes an alternative measurement basis for regulatory assets and regulatory liabilities relating to items that affect regulated rates only when the related cash is paid or received. Common examples include provisions for environmental clean-up costs, tax and pension contributions, which a regulatory agreement might treat on a cash basis as opposed to the accounting bases prescribed by IAS 12, IAS 19 *Employee Benefits* or IAS 37.

ED.61

The ED proposes that instead of using the modified historical cost measurement basis proposed for all other regulatory assets and regulatory liabilities, these regulatory assets and regulatory liabilities would be measured by:

- using the same measurement basis used in measuring the related liability or related asset by applying IFRS Standards; and
- adjusting the measurement of the regulatory asset or regulatory liability to reflect any uncertainty present in it but not present in the related liability or related asset.

4.6.1

ED.60,65

Uncertainty not present in the related liability or related asset

Examples of uncertainties that may not be present in the related liability or related asset are demand risk and credit risk.

When adjusting for these uncertainties, a company would consider the effects of the uncertainty both on:

- the estimated amount and timing of the future cash flows; and
- (if applicable) the price that would be charged for bearing the risk that the amount or timing of the future cash flows may differ from the estimate made by the company.

4.6.2

ED.63

Implicit regulatory interest rate to be used

The ED notes that for regulatory assets or regulatory liabilities measured in this way, the regulatory interest rate would be zero if the related liability or related asset is not measured at present value.

However, if the related liability or related asset is measured at present value, then the amount of cash paid or received would implicitly include both the underlying expense or income and a finance component for the time lag until that payment or receipt. The ED further notes that the regulatory agreement would not identify regulatory interest as a separate part of the cash flows arising from these regulatory assets or regulatory liabilities.

As a result, the regulatory interest rate would not be observable from the regulatory agreement.

Under the proposals, companies would therefore use the regulatory interest rate that is implicit in the measurement of the regulatory asset or regulatory liability in these circumstances. That is, if the measurement basis used in measuring the related liability or related asset by applying IFRS Standards specifies a discount rate to be used, then this would also be used in measuring the regulatory asset or regulatory liability.

4.6.3

ED.66

Settlement/recovery of related liability/asset

The ED proposes that a company would cease to apply the measurement basis described in this section when it has paid or received cash to settle the related liability or recover the related asset.

It would instead revert from that date to measuring any remaining part of the regulatory asset or regulatory liability under the ED's normal measurement requirements. Similar accounting would apply if a company were to derecognise the related liability or related asset for any other reason, but part of the regulatory asset or regulatory liability were to continue to exist.

ED.BC175, IFRS 3.27–28, IAS 37.53



Why is the Board proposing a different measurement basis when regulated rates would be based on future cash flows?

This is for the following reasons.

- The cash flows arising from the regulatory assets or regulatory liabilities are expected to replicate the cash flows arising from the related liabilities or related assets (except for the effect of any uncertainty present in the regulatory asset or regulatory liability but not present in the related liability or related asset).
- It would avoid creating accounting mismatches in the statement(s) of financial performance that would result from using different measurement bases.
- It would be consistent with the requirements in IFRS 3 *Business Combinations* for indemnification assets and for reimbursement assets.

However, the proposals in this area represent a significant departure from the approach to all other regulatory assets and regulatory liabilities. The effects of this departure could be material for many companies. Items such as deferred taxes and defined benefit obligations can themselves be material, endure for prolonged periods and be subject to significant and unpredictable remeasurements.

The effect of the Board's proposed approach would be that a company would essentially mirror the accounting for these items through recognising matching regulatory assets and regulatory liabilities, subject to the adjustments discussed above.

5

Presentation and disclosures

5.1 Presentation in the statement of financial performance

ED.67,69

A company would generally present regulatory income minus regulatory expense as a separate line item immediately below revenue. However, regulatory income or regulatory expense arising when an underlying asset or underlying liability is remeasured through other comprehensive income would also be recognised in other comprehensive income.

ED.68

Regulatory income and regulatory expense would include regulatory interest income and regulatory interest expense.

Statement of financial performance (Illustrative)	
Revenue	10,200
Regulatory income minus regulatory expense*	1,130
Expenses	(10,700)
Net profit	630
*See 5.3.1 for an analysis of this amount.	



Could regulatory income and regulatory expense be presented as part of revenue?

ED.BC179

No.

Regulatory assets and regulatory liabilities would be enforceable rights or enforceable obligations to increase or decrease future regulated rates. They would not affect the amount of revenue to be recognised in the current period but would affect the amount of revenue to be recognised in future periods. Therefore, the Board believes that regulatory income and regulatory expense should be presented as a separate line item immediately below revenue.

IFRS 15.A

However, 'revenue' is defined in IFRS 15 as 'income arising in the course of an entity's ordinary activities'. Regulatory income is arguably income that arises in the course of a regulated entity's ordinary activities.

Therefore, although the proposals clearly distinguish regulatory income and expense from revenue from contracts with customers in the scope of IFRS 15, it is less clear why the Board believes that regulatory income and expense should not be presented within a more general heading of revenue, subject to separate disclosure.

ED.67–68

**Could a company disaggregate the components of regulatory income and expense in the statement of financial performance?**

No.

The ED proposes that a company would present a single line item on the face of the statement of profit or loss, comprising the total amount of:

- regulatory income;
- regulatory expense;
- regulatory interest income; and
- regulatory interest expense.

The ED proposes corresponding consequential amendments to IAS 1 *Presentation of Financial Statements*.

However, IAS 1 also contains a general requirement to present additional items (including by disaggregating required line items), headings and subtotals when this is relevant to understanding the company's financial performance.

There is no further commentary in the ED about how the requirements of the ED and IAS 1 would interact.

ED.BC184–185

**Why would a company be required to present certain items of regulatory income and regulatory expense in other comprehensive income?**

The proposals would generally require regulatory income and regulatory expense to be recognised in the statement of profit or loss.

However, the ED argues that where the related asset or related liability is remeasured through other comprehensive income, presenting the component of regulatory income or regulatory expense in profit or loss for the same remeasurement would lead to two opposite effects – e.g. a gain in profit or loss and an equal and opposite loss in other comprehensive income.

Therefore, in these cases the ED proposes presenting the regulatory income or regulatory expense in other comprehensive income.

Conversely, it could be argued that the regulatory asset or regulatory liability will be recovered or settled through adjustments to the regulated rate – i.e. through adjustments to revenue that will be recognised in the statement of profit or loss. It is irrelevant whether the balance originates through other comprehensive income; it will always be recovered or settled through profit or loss.

A company would be required to include regulatory interest within a single line item for regulatory income and expense, and yet disaggregate some items of regulatory income to present them in other comprehensive income.

Overall, and consistent with other proposals in the ED, the Board's objective is to avoid accounting mismatches.

5.2 Presentation in the statement of financial position

ED.70 Under the proposals, a company would present regulatory assets and regulatory liabilities as separate line items in its statement of financial position. Under the requirements of IAS 1, a company presents current and non-current portions of the regulatory asset and regulatory liability separately, except when it presents assets and liabilities in order of liquidity.

ED.71 A company would be able to offset regulatory assets and regulatory liabilities if and only if:

- it has a legally enforceable right to offset by including them in the same regulated rate; and
- it expects to include the amounts resulting from the recovery or fulfilment of those regulatory assets and regulatory liabilities in the same regulated rates for goods or services supplied in the same future period.



Why does the ED require all regulatory items to be presented separately from items accounted for under other IFRS Standards?

The ED's presentation proposals are consistent with the general overlay approach underpinning the ED. That is, a company would recognise, measure and present items in the scope of other standards according to the requirements of those standards. Regulatory items would then be dealt with separately.

In effect, a user of the financial statements would be able to analyse a company's financial performance and financial position both with and without the regulatory accounting model proposed in the ED.

5.3 Disclosures

ED.72 A company would be required to disclose information on regulatory income, regulatory expense, regulatory assets and regulatory liabilities. This information, together with other information provided in the financial statements, would provide users with a basis for:

- understanding the relationship between a company's revenue and expenses as if the total allowed compensation had been fully reflected in revenue, and the company's prospects for future cash flows; and
- understanding the company's regulatory assets and regulatory liabilities at the reporting date and evaluating how they will affect the amount, timing and uncertainty of future cash flows.

5.3.1

ED.77

Disclosures relating to statement of financial performance

A company would be required to disclose information that would enable users to understand how the company's financial performance would be affected if the company supplied goods or services in one period, but part of the total allowed compensation was or will be included in the regulated rates for goods or services supplied in different periods.

ED.78

To meet the disclosure objective, a company would disclose the following components of regulatory income or regulatory expense as a profit or loss.

Component	Disclosure
Recognition of regulatory asset	Part of the total allowed compensation that relates to goods or services supplied in the current period and will be included in revenue in future periods.
Recognition of regulatory liability	Amounts included in revenue in the current period that will provide part of the total allowed compensation for goods or services supplied in future periods.
Recovery of regulatory asset	Amounts included in revenue for the current period where part of the total allowed compensation relates to goods or services supplied in prior periods.
Fulfilment of regulatory liability	Part of the total allowed compensation for goods or services supplied in the current period that was included in revenue in prior periods.
Regulatory interest	Regulatory interest income on regulatory assets and regulatory interest expense on regulatory liabilities.
Remeasurements	Remeasurement of regulatory assets and regulatory liabilities and the reasons for it.
Change in a regulatory agreement's boundary	Changes to the carrying amount of regulatory assets and regulatory liabilities caused by a change in the boundary of a regulatory agreement and the reasons for that change.

ED.78

A company would disclose the movement of regulatory assets and regulatory liabilities. Although the ED does not prescribe a specific format, one possible format is illustrated below.

Disclosure of regulatory income and expense (illustrative)	
Origination of regulatory assets	1,620
Recovery of regulatory assets	(300)
Origination of regulatory liabilities	(340)
Fulfilment of regulatory liabilities	100
Regulatory interest income minus regulatory interest expense	90
Remeasurement of regulatory assets and regulatory liabilities	(30)
Changes in the boundary of the regulatory agreement	–
Regulatory income minus regulatory expense	1,130

5.3.2

ED.79

Disclosures relating to the statement of financial position

A company would be required to disclose information that provides a basis for understanding the company's regulatory assets and regulatory liabilities at the reporting date and the amount, timing and uncertainty of the future cash flows that would arise from those regulatory assets and regulatory liabilities.

ED.80–81

To meet the disclosure objective, a company would disclose the following information for regulatory assets and regulatory liabilities.

Information	Disclosure
Quantitative information	<ul style="list-style-type: none"> – Time bands to disclose when it expects to recover regulatory assets and fulfil regulatory liabilities. – Use of judgement to determine the appropriate number of time bands (e.g. less than one year, one to three years, three to five years and so on). – Whether the amounts disclosed in the notes are discounted or undiscounted.
Discount rate	<ul style="list-style-type: none"> – The discount rate or the ranges of discount rates used to measure regulatory assets and regulatory liabilities at the reporting date.
Minimum interest rate	<ul style="list-style-type: none"> – When a company uses the minimum interest rate as the discount rate, the regulatory interest rate for regulatory assets and regulatory liabilities.
Risks and uncertainties	<ul style="list-style-type: none"> – How risks and uncertainties affect the recovery of regulatory assets and fulfilment of regulatory liabilities.

5.3.3

ED.82–83

Other disclosures

A company would disclose information that provides a basis for understanding whether there were any changes in regulatory assets and regulatory liabilities that were *not* caused by regulatory income or regulatory expense. To achieve this, a company would provide a reconciliation from the opening to the closing carrying amounts of regulatory assets and regulatory liabilities.

ED.84

For regulatory assets and regulatory liabilities that are measured using future cash flows in accordance with [Section 4.6](#), a company would consider appropriate disclosures based on the disclosures for the underlying asset or underlying liability. It would also consider how to disclose this information. This is because the discount rates, risks and remeasurements would largely be the same.

ED.BC202



Why do the proposals not address disclosures for the statement of cash flows?

Although the proposals require extensive disclosures for the statement of financial performance and statement of financial position, they do not refer to cash flows that occur during the period.

This is because a company generally recovers a regulatory asset by increasing the regulatory rate and fulfils a regulatory liability by decreasing the regulated rate, rather than receiving or paying cash. This means that a regulatory balance generally becomes a balance in the scope of another standard before it becomes a cash flow.

ED.B35

However, this will not always be the case. For example, a regulatory asset may represent a right to receive compensation for cancellation of a regulatory agreement. The ED does not address how receipt of such compensation would be presented in the statement of cash flows.

6

Interaction with other standards

6.1

General approach

ED.15–16

The general approach to the way in which the proposals would interact with other standards can be described as an overlay approach. Under this general approach, a company would:

- first apply the requirements of existing IFRS Standards (e.g. by recognising revenue under IFRS 15); then
- recognise regulatory assets and regulatory liabilities.

ED.B41, B47

However, the ED does discuss explicitly how the proposals would interact with IAS 12 and IFRIC 12 *Service Concession Arrangements*.

6.2

IAS 12 *Income Taxes*

ED.B42, A

Tax expense is often an allowable expense, meaning that a company is able to recover it under its regulatory agreement by adding an amount when determining a regulated rate. Similarly, tax income would typically be chargeable income, meaning that a company is obliged to deduct it under its regulatory agreement when determining a regulated rate.

ED.B42

However, the proposals note that in some cases the regulated rate for a particular period does not include all of the current and deferred tax effects of transactions occurring during that period.

ED.B43

In these situations, a company would recognise a regulatory asset (or a regulatory liability) if some or all of the tax effects of transactions in the current period will affect the regulated rates in future periods, or affected the regulated rates in earlier periods.

ED.B44–B45

The ED notes that the tax base of a regulatory asset or a regulatory liability is typically zero, and that recognising a regulatory asset or a regulatory liability typically gives rise to a deferred tax liability or a deferred tax asset under IAS 12.

However, a company would assess how income taxes affect the measurement of regulatory assets and regulatory liabilities before it applies IAS 12.

ED.B46

**Example 9: Interaction with IAS 12**

Assume that:

- Company C has a regulatory asset arising from a performance incentive (bonus) of 60 that is yet to be included in determining the regulated rates;
- the tax rate is 40%; and
- the regulatory agreement allows all tax cash flows to ultimately be included in determining the regulated rates.

Step 1: Assess how income taxes affect the measurement of the regulatory asset

C considers the effect of amounts that it is entitled to add when determining its future regulated rates as a result of paying any income taxes as it recovers the regulatory asset.

In this example, the measurement of the regulatory asset (the bonus of 60) reflects pre-tax cash inflows of 100 and income tax payments of 40 ($100 \times 40\%$), which will arise as C recovers the regulatory asset relating to the bonus.

Step 2: Increase the regulatory asset by the amount calculated in Step 1

C is entitled to add the income tax payments of 40 when determining the future regulated rates.

Therefore, it increases the regulatory asset of 60 by this amount, resulting in a regulatory asset of 100.

Step 3: Apply IAS 12

The tax base of C's regulatory asset of 100 is zero. Therefore, C recognises a deferred tax liability of 40 ($100 \times 40\%$) under IAS 12.

6.3

ED.B47, IFRIC 12.5

IFRIC 12 Service Concession Arrangements

IFRIC 12 applies to public-to-private service concession arrangements if:

- the grantor controls or regulates the services that the operator must provide with the infrastructure, to whom it must provide them and their prices; and
- the grantor controls any significant residual interest in the infrastructure at the end of the term of the arrangement.

ED.B47

Some arrangements in the scope of IFRIC 12 may therefore create regulatory assets or regulatory liabilities that would be in the scope of the ED.

Under the proposals, a company would account for those regulatory assets or regulatory liabilities separately from the assets and liabilities that are in the scope of IFRIC 12.



Would all service concession arrangements in the scope of IFRIC 12 also be in the scope of the proposals?

No.

Price regulation is one of the key scope criteria of IFRIC 12 – a concession arrangement is only in the scope of IFRIC 12 if the grantor controls the prices to be charged to customers. This includes cases in which prices are controlled by an independent regulator acting in the public interest. Further, the ED acknowledges that a regulatory agreement could take the form of a service concession agreement.

However, many service concession arrangements will not meet the proposed requirement that part of the total allowed compensation for goods and services supplied in one period is charged to customers through regulated rates for goods or services supplied in a different period.

For example, consider a typical service concession agreement in which an operator builds and operates a toll road and has the right to collect tolls from users. This could be in the scope of IFRIC 12 if the relevant criteria are met, including the grantor controlling the tolls to be charged to users.

This service concession arrangement would not necessarily be in the scope of the proposals. For example, if the operator bears the risks that construction and operating costs are higher or lower than expected, and bears demand risk, then the operator will not have a right to earn a specified amount of compensation.

The service concession arrangement would only be in the scope of the proposals if the concession agreement gave the operator an enforceable right (obligation) to increase (decrease) tolls in future periods to recover (settle) cost and demand variances.

7

Effective date and transition

7.1

ED.C1

ED.BC203

Effective date

The ED proposes that companies would apply the final standard for annual periods beginning on or after a date to be set between 18 and 24 months from the date of its publication.

The Board believes that this length of time would allow companies to:

- make necessary updates to their systems;
- collect the incremental information needed to apply the proposals; and
- make any other changes necessary.



Would a first-time adopter of IFRS Standards be able to use the proposed requirements if they are finalised?

Yes. The finalised requirements would form part of the body of IFRS Standards that a first-time adopter would apply.

7.2

ED.C3

ED.BC204

Transition

The proposals, if they are finalised, would be applied retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. There is an exception, however, for past business combinations (see 7.2.1).



Why is the Board proposing retrospective application?

The ED proposes retrospective application, which generally provides more comparable trend information than other transition approaches.

The Board believes that this would be unlikely to burden companies in preparing their financial statements. This is because the proposed accounting model would use information that companies already need to gather and process in providing the inputs for determining regulated rates.

This approach differs from the major standards on financial instruments, insurance contracts, leases and revenue, all of which either required or permitted a form of modified retrospective transition.

7.2.1

ED.C2, 4

Past business combinations

The ED proposes that a company would not need to apply its requirements to past business combinations – i.e. those business combinations for which the date of acquisition is before the date of transition.

Instead, a company would elect at the date of transition either to apply the proposed requirements retrospectively or to apply a simpler approach. A company electing to use the simpler approach would apply it to all of its past business combinations.

Under the simpler approach, a company would:

- recognise and measure all regulatory assets acquired and regulatory liabilities assumed in a past business combination, which still exist at the date of transition, in accordance with the ED's proposed requirements;
- derecognise all items that were recognised as assets or liabilities in the past business combination, but which would not have been recognised if the ED's proposed requirements had always been applied;
- recognise any deferred tax effects arising from the recognition and derecognition adjustments described above;
- (if the company had measured non-controlling interests from the past business combination at their proportionate share in the recognised amounts of the acquiree's identifiable net assets, rather than at fair value) adjust the carrying amount of non-controlling interests remaining at the date of transition for their proportionate share of the net amount of the adjustments described above; and
- adjust the carrying amount of goodwill still remaining from the past business combination for the net amount of all of the adjustments described above. If the overall net adjustment reduces the carrying amount of goodwill to zero, then the company would recognise any remaining amount of adjustment in retained earnings or, if appropriate, another category of equity.

This approach would be applied separately to each past business combination.

ED.BC208, BC212

The retrospective application and the simpler approach compared	
Similarities	Differences
<p>Both retrospective application and the simpler approach would involve:</p> <ul style="list-style-type: none"> – recognising and measuring regulatory assets and regulatory liabilities that exist at the date of transition; – derecognising all regulatory balances (assets and liabilities that have been recognised but would not have been if the proposals had always been applied) relating to that business combination; – recognising any deferred tax effects of those adjustments; and – recognising any effect on the carrying amounts of non-controlling interests and goodwill. 	<p>A company applying the simpler approach would not determine:</p> <ul style="list-style-type: none"> – the initial carrying amount of regulatory assets and regulatory liabilities at the date of acquisition of past business combinations; – the initial carrying amount of regulatory balances (assets and liabilities that have been recognised but would not have been if the ED's proposals had always been applied) at the date of acquisition of past business combinations; – (separately for each past business combination): <ul style="list-style-type: none"> – the net effect of the adjustments resulting from the items identified in the bullet points above; and – the carrying amount of goodwill that the company would have recognised at the date of acquisition after those adjustments, without netting that goodwill off against a gain from a bargain purchase that arose in any other business combination; and – any further adjustment needed to that adjusted carrying amount of goodwill to reflect any impairments, reversals of impairments, and disposals from the date of acquisition until the date of transition.

ED.BC210



Why is the Board proposing a simpler approach for past business combinations?

The Board considers that the incremental information from quantifying every adjustment resulting from a full reconsideration of every past business combination would be unlikely to lead to benefits that outweigh the costs.

7.3 **Withdrawal of IFRS 14 *Regulatory Deferral Accounts***

ED.C5

If the proposals are finalised, then IFRS 14 would be withdrawn.

Therefore, companies that have applied IFRS 14 would transition to the new requirements with no carry-forward of their previous accounting under IFRS 14.



Would there be any transition relief for companies that previously applied IFRS 14?

ED.BC204

No.

Companies that previously applied IFRS 14 would be required to apply the proposals using the same retrospective transition approach as other companies.

IFRS 14 does not itself set out an accounting model for regulatory deferral accounts. Instead, it permits a company to 'grandfather' aspects of its accounting under previous GAAP on transition to IFRS Standards. IFRS 14's presentation and disclosure requirements also differ from those in the ED.

As a result, companies that previously applied IFRS 14 could see significant changes in their financial statements on transition to the proposed new standard.

Appendix I – List of examples

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About this publication

This publication has been produced by the KPMG International Standards Group (part of KPMG IFRG Limited).

This edition considers the new standard proposed by the International Accounting Standards Board in its January 2021 exposure draft ED/2021/1 *Regulatory Assets and Regulatory Liabilities*.

Further analysis and interpretation will be needed for an entity to consider the impact of the proposals in light of its own facts, circumstances and individual transactions. The information contained in this publication is based on initial observations developed by the KPMG International Standards Group and these observations may change. Accordingly, neither this publication nor any of our other publications should be used as a substitute for referring to the standards and interpretations themselves.

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Handbooks

Earnings per share



Fair value measurement



IFRS compared to US GAAP



Leases



Revenue



Share-based payments



More guidance and insight

Business combination and consolidation



Combined and/or carve-out financial statements



Insurance contracts



IBOR reform



Financial instruments



Banks



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