



# Agenda Paper 1

## Accounting for regulatory assets and regulatory liabilities arising from differences between the regulatory recovery pace and assets' useful lives

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## Purpose of the paper

- To discuss comments received from entities subject to incentive-based schemes on the proposals in the [Exposure Draft \*Regulatory Assets and Regulatory Liabilities\*](#) (Exposure Draft) relating to the **accounting for regulatory assets and regulatory liabilities arising from differences between regulatory recovery pace and assets' useful lives**.
- To explore possible alternative approaches that the International Accounting Standards Board (IASB) may consider in its redeliberations on those proposals.

## Structure of the paper

- The paper is divided into the following sections:
  - Types of regulatory schemes—Background information (pages 1–6);
  - Proposals in the Exposure Draft (pages 7–8);
  - Comments received (pages 8–9); and
  - Staff analysis (pages 9–20).
- Questions for the Group are included on page 21.

## Types of regulatory schemes—Background information

- This section aims to provide a summary of features of different regulatory schemes that the IASB received from its consultation [Request for Information \*Rate Regulation\*](#) published in 2013 and other sources (see References on page 22).
- Respondents to the Request for Information highlighted two general types of regulatory schemes:
  - cost-based (commonly known as 'cost-of-service' or 'return-on-base rate')—page 2; or
  - incentive-based (including revenue-cap or price-cap regulation)—pages 3–4.

## Types of regulatory schemes—Background information—*continued*

### Cost-based

- Theory—Regulator allows the entity to recover its expenses and a return on the investment. The approach is good for limiting the risks borne by the entities but provides no incentives for cost reduction.
- The allowed revenue is closely linked to operating expenditure, depreciation and interest costs as appearing in the statutory accounts, although the cost of equity is generally set at a level that is considered ‘fair’ and capital expenditure is scrutinised for its prudence before the entity being permitted to earn a return on it and start recovering it through depreciation. True-up mechanisms ensure that actual input costs are recovered. Consequently, this regulatory scheme generally relies heavily on setting allowed revenues based on recognised costs under the relevant accounting standards, and therefore it maps revenues to audited financial statements.
- Cost-based schemes could also determine the allowed revenue based on estimates of costs. True-up mechanisms would be used to adjust differences between estimated and actual costs. The adjustment is for cost (rather than volume) differences.

## Types of regulatory schemes—Background information—*continued*

### Incentive-based

- Theory—Regulator sets *ex ante* a fixed price for the service provided by the entity, who is then incentivised to optimise its processes since it will make a profit by reducing costs. Typically it provides larger incentives to cost reduction and creates more risks to entities than cost-based schemes.
- The calculation of the regulated rate tends to be more focused on targeted outputs (ie quantity/quality of the services) rather than on a set of inputs to control (ie output regulation rather than input regulation).
- Within incentive-based, we highlight a couple of approaches: building-block and total expenditures (totex).

### Incentive-based—Building-block approach

- This approach uses a ‘building-block’ methodology to determine ‘allowed revenue’. Each of the individual building blocks are separately assessed and determined *ex ante* based on forecasts. Main building blocks to determine the ‘allowed revenue’ are:
  - depreciation of the Regulatory Asset Base (RAB)<sup>(1)</sup>;
  - returns on the RAB;
  - operating expenditures;
  - incentives (bonuses or penalties); and
  - other adjustments.
- Differences between forecasts and actual amounts may give rise to true-ups in regulated rates charged in the future.

(1): The Exposure Draft referred to RAB as regulatory capital base (RCB).

## Types of regulatory schemes—Background information—*continued*

### Incentive-based—Totex (total expenditures) approach

- The regulator assesses total expenditures (Totex: opex and capex) for efficiency and productivity targets for the purposes of determining an ‘allowed revenue’ amount.
- A fixed part of Totex is capitalised in the RAB (slow money), with the non-capitalised part of Totex being recovered in the year in which it is allowed (fast money). The rate to split Totex between slow and fast money is informed by the ratio Opex/Totex and Capex/Totex and other considerations (eg companies’ business plans, incentives for companies to consider solutions that would imply operating rather than capital expenditures etc). As a result, this approach dilutes the link between the RAB and the actual assets of an entity.
- The ‘allowed revenue’ would include depreciation of RAB and returns on RAB. It would also include other items such as performance incentives—included on a forecast basis—and other adjustments.

In both approaches (building-block and Totex) regulators may apply different techniques to assess the efficiency of the operating/capital expenditures to be included as part of the ‘allowed revenue’ amount—efficiency audits, efficiency factors, benchmark techniques etc.

When using benchmarking techniques, each entity can increase its profit if it is more efficient than the benchmarked level. This technique increases the risk for entities because their revenue is disconnected from their actual costs.

## Types of regulatory schemes—Background information—*continued*

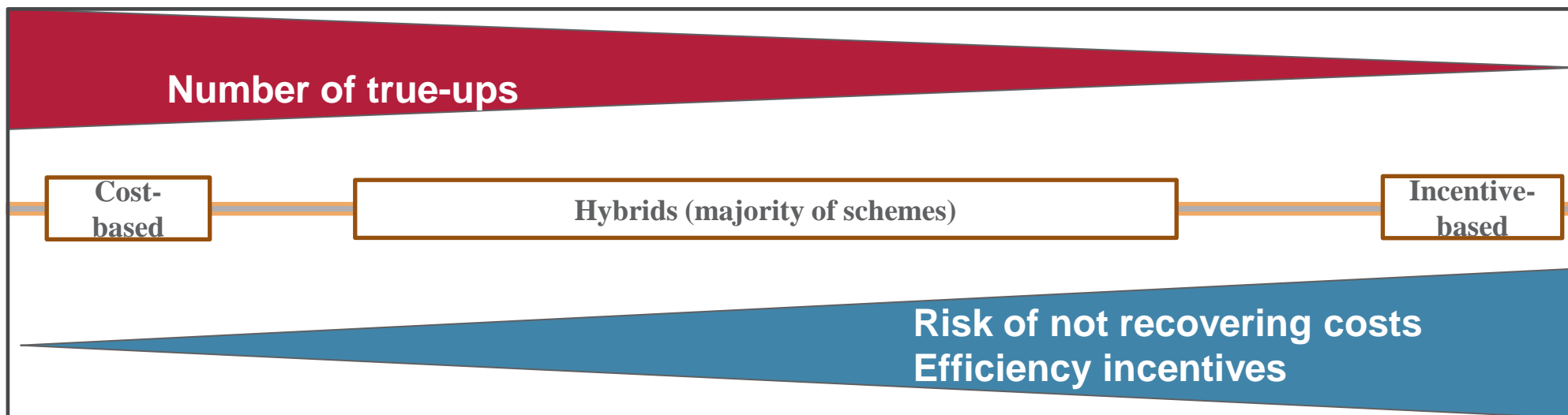
Pure cost-based and incentive-based schemes represent two extremes with most regulatory schemes falling in between, depending on the additional regulatory instruments implemented by the regulators in the schemes.

For example, many incentive-based schemes include true-ups and other adjustments that seek a combination of objectives (lowering risks borne by entities, allowing higher transfers to final customers etc). For example:

- Sharing of efficiency gains, determined by comparing actual incurred costs with expected/budgeted costs. This regulatory instrument balances properties of cost-based with properties of incentive-based at a level that depends on the applied sharing rule.
- Volume variances—variances between forecasted and actual consumption volumes are adjusted in future rates. This instrument seeks to pass demand risk to final customers.
- Non-controllable costs—variances between forecasted and actual non-controllable costs are adjusted in future rates.

**Types of regulatory schemes—Background information—*continued***

Based on the features on pages 2–4, we would expect the number of true-ups to be higher in cost-based schemes, with the risk of not recovering the costs and the efficiency incentives being higher in incentive-based schemes.



Consequently, the population of regulatory assets (RAs) and regulatory liabilities (RLs) for entities subject to the final Standard<sup>(2)</sup> will vary depending on the differences in timing arising from the different regulatory agreements. At a very high level, we could infer that the population of RAs/RLs could be larger entities subject to cost-based schemes than for entities subject to incentive-based schemes. However, this will vary and depend on the specific regulatory instruments used by the regulators.



(2): Any reference to ‘the Standard’ in this paper should be read as the final Standard that the IASB would issue after redeliberating the proposals in the Exposure Draft *Regulatory Assets and Regulatory Liabilities*.

## Proposals in the Exposure Draft

- The objective of the Exposure Draft is for an entity to provide ‘relevant information that faithfully represents how regulatory income and regulatory expense affect the entity’s financial performance, and how regulatory assets and regulatory liabilities affects its financial position.’
- In other words, the objective of the Exposure Draft is for entities to provide useful information about the effects of differences in timing in an entity’s financial statements.
- The Basis for Conclusions on the Exposure Draft discusses that differences in timing give rise to rights or obligations that fulfil the definitions of assets and liabilities in the Conceptual Framework (paragraphs BC37–BC47). The Exposure Draft captures differences in timing in the definitions of regulatory assets and regulatory liabilities (emphasis added):

Regulatory asset—**An enforceable present right**, created by a regulatory agreement, **to add an amount** in determining a regulated rate to be charged to customers in future periods because part of the total allowed compensation for goods or services already supplied will be included in revenue in the future.

Regulatory liability—**An enforceable present obligation**, created by a regulatory agreement, **to deduct an amount** in determining a regulated rate to be charged to customers in future periods because the revenue already recognised includes an amount that will provide part of the total allowed compensation for goods or services to be supplied in the future.

- Consequently, when a **difference in timing arises**:

Revenue recognised  
in a period

≠

Total allowed  
compensation

- The Exposure Draft defines total allowed compensation (for goods or services supplied) as (**emphasis added**):  
  
The full amount of compensation for goods or services supplied that a **regulatory agreement entitles** an entity to charge customers through the regulated rates, in either the period when the entity supplies those goods or services or a different period.
- The application guidance of the Exposure Draft aims to help an entity determine in which period that compensation should be reflected in profit or loss, regardless of when that compensation (or part of that compensation) was included in the rates charged.
- The application guidance on the Exposure Draft says that total allowed compensation comprises:
  - allowable expenses minus chargeable income;
  - target profit; and
  - regulatory interest income or regulatory interest expense.
- In relation to today’s topic (the accounting for regulatory assets or regulatory liability arising from differences between the regulatory recovery pace and assets’ useful lives), the proposed requirements that have raised most concerns from respondents that are subject to incentive-based schemes are included on page 8.

## Proposals in the Exposure Draft—*continued*

- Paragraph B7 of the Exposure says (**emphasis added**):  

[...] IAS 16 *Property, Plant and Equipment* specifies how to allocate the depreciable amount of an item of plant on a systematic basis over its useful life. **If a regulatory agreement allows an entity to recover the cost of an asset through the regulated rates charged to customers, the depreciation expense recognised in a period**, by applying IAS 16, is an **allowable expense** and the amount that recovers that depreciation expense forms part of the total allowed compensation for goods or services supplied in the same period. **That is the case even if, under the terms of the regulatory agreement, the recovery of the depreciation expense occurs in a different period**—for example, if the regulatory agreement uses a longer or shorter period of recovery than the asset’s useful life.
- [Illustrative Examples 2B and 2C](#) accompanying the Exposure Draft illustrate the case when the regulatory recovery period of the regulatory capital base is longer or shorter than an asset’s useful life.
- Many of the regulatory assets and regulatory liabilities in the Exposure Draft are actual adjustments to the future rates (cash differences in timing). However, some other are not. In particular, this may happen when the regulator considers a criterion for allowing an entity to include an item of expense in the rates charged that is different from that followed in accounting (see page 10). The case of differences between the regulatory recovery pace and the assets’ useful lives would be an example of regulatory assets or regulatory liabilities that would not give rise to adjustments in future rates (non-cash differences in timing).

## Comments received

- The comments received from respondents subject to incentive-based schemes relating to the accounting for regulatory assets and regulatory liabilities arising from differences between regulatory recovery pace and assets’ useful lives are detailed below.
- Respondents generally thought these regulatory assets and regulatory liabilities:
  - did not represent enforceable rights and enforceable obligations arising from their regulatory agreements;
  - would not meet the definitions of regulatory assets and regulatory liabilities (because they do not represent ‘rights to add an amount to’ or ‘obligations to deduct an amount from’ future rates); and
  - would not result in useful information to users of financial statements if recognised in the financial statements.
- In some cases, respondents referred to these regulatory assets and regulatory liabilities as ‘non-cash differences in timing’. This is because the cash flows from those differences in timing do not correspond to adjustments that the regulatory agreement will consider when determining the future rates.
- Respondents said that the Exposure Draft considers the RAB as if it was a regulatory asset register. However, according to them, an entity’s RAB cannot be linked or reconciled to the fixed asset register used for accounting purposes because:
  - the asset classes in the RAB and corresponding recovery periods are different to the asset classes and useful lives in the accounting asset register.
  - regulators may assess capex efficiency and decide to exclude capex from RAB.
  - RAB may be adjusted for inflation annually, whereas fixed assets are measured mainly at cost for accounting purposes.



## Comments received—*continued*

- RAB may include items that would not qualify for capitalisation under IAS 16 *Property, Plant and Equipment* (eg bonuses and penalties and operating expenditures).
- costs capitalised for accounting purposes may not have been included in the RAB (eg contributed assets).
- fair value adjustments made to the accounting cost base due to business combinations may not have been included in the RAB.
- These respondents did not believe it is appropriate to link regulatory depreciation with accounting depreciation—ie recognition of revenue for regulatory schemes should be based on an entity’s regulatory agreement and not based on when accounting depreciation is recognised in accordance with IFRS Accounting Standards.

## Staff analysis

The staff analysis explores possible courses of action for addressing respondents’ concerns on the accounting for regulatory assets and regulatory liabilities arising from differences between recovery pace of the RAB and assets’ useful lives.

The staff analysis is structured as follows:

- differences in timing as the common denominator of different regulatory schemes;
- cash and non-cash differences in timing;
- determining total allowed compensation when the recovery pace of the RAB differs from assets’ useful lives; and
- possible courses of action.

### ***Differences in timing as the common denominator***

- The main challenge of this project is to determine a set of principles that would enable the accounting for regulatory assets and regulatory liabilities arising from a wide variety of regulatory schemes.
- To do so, we think we need to focus on differences in timing. This is because the existence of differences in timing is the common denominator of the variety of regulatory schemes that will be in the scope of the final Standard. However, the population of regulatory assets and regulatory liabilities accounted for by entities will differ depending on the differences in timing arising in the different regulatory schemes.

## Staff analysis—Continued

### Cash and non-cash differences in timing

- Even though regulatory assets and regulatory liabilities are defined as enforceable present rights *to add an amount to* a future regulated rate (enforceable present obligations *to deduct an amount from* future regulated rates), the Exposure Draft does not limit differences in timing to those resulting to adjustments in future rates (cash differences in timing).
- For example, assume a regulatory agreement allows the recovery of an item of expense but considering a different pace than that for accounting purposes (**Example 1**):

Item of expense (in CU) <sup>(3)</sup>	Year 1	Year 2	Year 3	TOTAL
Regulatory compensation included in rates charged ( <i>recovery of an allowable expense</i> )	25	35	40	100
Accounting expense	33	33	34	100
Difference	(8)	2	6	-
Regulatory asset / (Regulatory liability)	8	6	-	-

- In this case, the regulatory agreement ‘**explicitly**’ gives the entity a right to recover the item of expense. However, when establishing the regulatory compensation to which the entity is entitled in Years 2 and 3, the regulatory agreement would not consider the accounting criterion for recognising this item of expense. Consequently, the regulatory agreement would *not* give the entity an ‘explicit’ right in Year 1 to increase rates charged in Year 2 and Year 3 by CU2 and CU6, respectively (ie a total amount of CU8). However, this right is ‘**implicit**’ as the regulatory agreement entitles the entity to recover the item of expense (ie CU100).

- The regulatory asset of CU8 in Year 1 would be an example of a non-cash difference in timing.
- In this example, the entity has a right to recover an item of expense. In accordance with the Exposure Draft, amounts that recover an item of expense would form part of total allowed compensation as the entity incurs that item of expense.
- In **Example 1**, the compensation for the item of expense is (partially) included in rates charged (and therefore in revenue) in a period that differs from the period when the entity incurred the corresponding expense to supply goods or services. Consequently, in Example 1 a difference in timing arises in Year 1.
- This shows that implicit rights can arise when the regulatory agreement explicitly allows an item to be included in the rates charged but the timing of when the item is included in rates differs from when that item would be considered as forming part of the total allowed compensation for accounting purposes.
- **Example 1** is overly simplistic and assumes that the regulatory compensation can be *easily linked* to a specific item of expense that is recognised in the financial statements that the regulatory agreement entitles an entity to recover.
- What happens when it is difficult to establish a direct relationship between the regulatory compensation (regulatory depreciation) and the underlying expense (accounting depreciation)? This leads us to the next section: determining total allowed compensation when the recovery pace of the RAB differs from the assets’ useful lives (determining total allowed compensation).

(3): Monetary amounts are denominated in ‘currency units’ (CU).

## Staff analysis—Continued

### *Determining total allowed compensation*

- Some respondents to the Exposure Draft said that they disagreed with how the Exposure Draft proposed to determine total allowed compensation when the recovery pace of the RAB differed from the assets' useful lives.
- The accounting for regulatory assets or regulatory liabilities arising from differences between recovery pace of the RAB and assets' useful lives is primarily tackled in the Illustrative Examples accompanying the Exposure Draft.
- The Illustrative Examples assume the following simplifications:
  - there is a one-to-one relationship between regulatory compensation and accounting expense (for example, regulatory depreciation can be traced back to accounting depreciation);
  - the RAB consists of a single asset, which implies the RAB can be reconciled with an entity's fixed asset register; and
  - the measurement basis of the RAB coincides with that used to measure property, plant and equipment in accordance with IAS 16 *Property, Plant and Equipment* (ie cost).
- We are aware that in some jurisdictions (**Case A**), the following takes place:
  - Regulatory accounting and reporting requirements are aligned as much as possible to IFRS Standards, with any deviations being in the public interest. This means that:
    - componentisation of assets recorded for regulatory purposes is broadly aligned to that used for accounting purposes with any differences tracked separately;
    - measurement basis and capitalisation policies used for accounting purposes are generally aligned with those used for regulatory purposes with any differences tracked separately; and
    - depreciation rates used for regulatory purposes broadly coincide with those used for accounting purposes, with regulators reserving their right to deviate from accounting if necessary when approving entities' revenue requirements.
  - Regulatory rules require regulatory information to be reconciled to audited financial statements for both income statement and balance sheet items (it may be a high level reconciliation though).
  - The rate setting aims to reflect cause and effect relationships in matching an entity's expenses with its revenue requirements and rates charged to customers.

We think the proposals in the Exposure Draft can be operationalised in this regulatory setting. The regulatory setting above seems to have features closer to 'cost-based' schemes on page 2.

## Staff analysis—Continued

- We are however aware the regulatory practices in other jurisdictions differ from those described for Case A (**Case B**):
  - Componentisation of the RAB—The RAB may include operating and capital expenditures and other items such as working capital movements or performance incentives.
 

The RAB may be split in asset classes that are different from those used for accounting purposes.

In some other cases, once assets have entered the RAB they may be treated as being a single ‘lump’. This makes removing any capital expenditure that is disallowed (on efficiency and prudence grounds) by the regulator straightforward. However that means one cannot reconcile the RAB with the entity’s assets register.
  - Measurement of the RAB—The RAB may be measured using historical cost but also other measurement bases (for example, replacement cost).
 

In addition, regulators may (a) apply efficiency measures to capex, which may mean that amounts included in the RAB would differ from those in accounting and (b) index the RAB to reflect inflation.
  - Depreciation of the RAB—In those cases where the RAB is split in asset classes, each class would have its own depreciation profile (for example, depreciation rate for a class may be the average of the economic lives of the assets included in that class).
 

When assets enter the RAB as a single ‘lump’, regulators may use the weighted average of the useful lives of the assets as the main factor for determining the depreciation pace. Regulators may adjust the weighted average to consider a variety of factors such as the financeability of the entity (considering both an entity’s financing needs and the financing available to the entity, for example, via bonds) and intergenerational equity.<sup>(4)</sup>
- Our understanding is that entities in regulatory schemes similar to that described in Case B would be subject to incentive-based schemes (pages 3–4). These entities have a right to recover the RAB through regulatory depreciation.
- The main component of RAB will be, in most cases, capex and therefore, there is a connection between regulatory depreciation and accounting depreciation. However, in Case B, the accounting depreciation is not used as a basis for determining the regulatory depreciation, which means the link between regulatory depreciation with accounting depreciation is not as direct as in Case A.
- Operationally, Case B brings into question whether the benefits of accounting for regulatory assets and regulatory liabilities arising from differences between the recovery pace of the RAB and assets’ useful lives outweigh the relating costs.
- We still think that differences between RAB’s recovery pace and assets’ useful lives can provide users of financial statements with useful information. This is because regulators determine the RAB’s depreciation profile considering an entity’s financeability. For example, an accelerated depreciation profile of the RAB compared to assets’ useful lives could indicate the regulator is trying to avoid financeability issues for the entity. Consequently, for entities subject to Case B, the final Standard could require disclosures that help users bridge regulatory depreciation and accounting depreciation.

(4): Financeability refers to the duty placed on regulators to ensure that a regulated entity is able to finance its functions. This duty has two components: (a) enabling the entity to earn a return on its RAB that is at least equal to its cost of capital, and (b) enabling the entity to raise finance from capital markets readily and on reasonable terms.

## Staff analysis—Possible courses of action

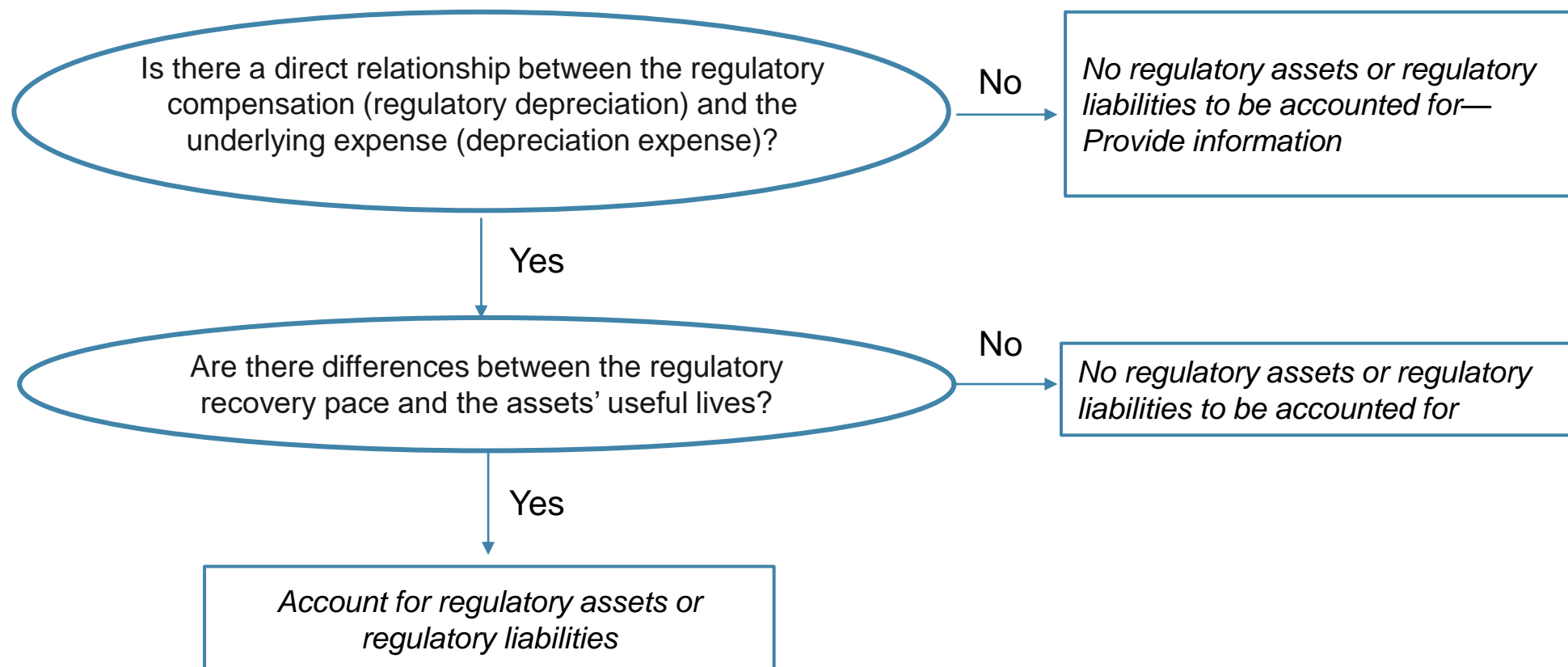
- The Exposure Draft provides application guidance for entities to determine in which periods components of total allowed compensation affect profit or loss.
- Many respondents raised concerns about the way the Exposure Draft proposed to determine total allowed compensation for depreciation expense (ie an allowable expense).
- The determination of total allowed compensation for allowable expenses proposed in the Exposure Draft (framed in **dark red** in the table on the right) did not cause concerns:
  - when the regulatory compensation is determined on the basis of accounting expenses (Case A on page 11); and
  - generally for pass-through adjustments relating to items of expense.
- However, respondents subject to incentive-based schemes said that the final Standard should not assume regulatory depreciation can be directly linked to accounting depreciation.
- The following pages deal with some possible courses of action:
  - Course of Action 1—consider the relationship between regulatory depreciation and accounting depreciation (pages 14–16);
  - Course of Action 2—overall calculation (pages 17–18); and
  - Course of Action 3—confirm the proposals (page 19).
- Page 20 includes a description of a fact pattern that is related to today’s topic. Question 5 on page 21 specifically refers to this matter.

Table BC2 Components of total allowed compensation	
Component	When the component affects profit or loss
Amount that recovers allowable expenses minus chargeable income (see paragraph BC89)	In the period when an entity recognises the expense or income by applying IFRS Standards
Any component of target profit not listed below (see paragraph BC90)	In the period when the regulatory agreement entitles an entity to add that component in determining a regulated rate for goods or services supplied in that period
Profit margins on allowable expenses (see paragraph BC91)	In the period when an entity recognises the expense by applying IFRS Standards
All regulatory returns (see paragraphs BC92–BC95), except those on assets not yet available for use	In the period when the regulatory agreement entitles an entity to add that return in determining a regulated rate for goods or services supplied in that period
Regulatory returns on assets not yet available for use (see paragraphs BC96–BC100)	Only once the asset is available for use and then over the remaining periods in which the carrying amount of the asset is recovered through the regulated rates
Performance incentives (see paragraphs BC101–BC110)	In the period in which an entity’s performance gives rise to the incentive bonus or penalty
Regulatory interest income and regulatory interest expense (see paragraphs BC111–BC113)	As the discount unwinds until recovery of the regulatory asset or fulfilment of the regulatory liability

**Staff analysis—Possible courses of action—continued**

**Course of Action 1—Consider the relationship between regulatory depreciation and accounting depreciation**

- The final Standard could provide guidance (for example, in the form of indicators) for entities to determine when linking regulatory depreciation back to accounting depreciation would not be appropriate and may result in costs (mainly implementation costs for preparers) outweighing the benefits of providing the information.
- The flowchart in this page aims to help visualise how the final Standard could articulate the proposals relating to accounting for regulatory assets and regulatory liabilities when the regulatory recovery pace differs from assets’ useful lives.



## Staff analysis—Possible courses of action—*continued*

### Course of Action 1—*continued*

- If the proposals for accounting for regulatory assets and regulatory liabilities arising from differences between the regulatory recovery pace and assets' useful lives are articulated using the flowchart in page 14, entities would need to be equipped with application guidance to determine:
    - when it would not be appropriate to link regulatory depreciation to accounting depreciation (**Judgement 1**).
  - **Judgement 1**—The majority of the items within the RAB are items that an entity capitalises for accounting purposes. This means that, to some extent, there is a link between the RAB and items of property, plant and equipment. However, in some cases there is little or no direct link. When this happens, accounting for regulatory assets and regulatory liabilities may not result in useful information.
  - **Examples of indicators** that may provide evidence there is little or no direct link between regulatory depreciation and accounting depreciation are:
    - the determination of the regulatory depreciation included in rates is not based on the accounting depreciation or the regulatory depreciation is based on a RAB that departs significantly from the entity's assets.
    - the determination of the regulatory depreciation pace considers factors other than useful life of the assets and those factors can have an impact in the regulatory recovery pace of the RAB (for example, intergenerational equity).
    - it is not possible for items in the RAB to be reconciled to audited financial statements.
- If an entity concluded that:
    - there is no direct relationship between regulatory depreciation and accounting depreciation (link is weak) and therefore the benefits would not outweigh the costs (**Judgement 1**)

the entity would not need to account for regulatory assets or regulatory liabilities in those cases when the regulatory recovery pace and assets' useful lives differ.

These entities would instead need to **provide information**, including:

    - Description of the main reasons that support the conclusion there is no direct relationship between regulatory depreciation and accounting depreciation. This may include a description of:
      - items forming part of the RAB, with an explanation of the main differences between RAB and property, plant and equipment; and
      - information that compares regulatory depreciation vs accounting depreciation and description of the main factors explaining the difference (ie main criteria underpinning the RAB recovery period and the assets' useful lives).

The list of indicators would not be exhaustive.

**Staff analysis—Possible courses of action—*continued***

**Course of Action 1—*continued***

- The following table aims to consider pros and cons of the Course of Action 1:

Pros	Cons
<p>May provide a feasible solution for entities subject to regulatory schemes in which there is no direct relationship between regulatory depreciation and accounting depreciation. This course of action may also be less costly to implement than the proposals in the Exposure Draft.</p>	<p>It could provide an incentive for entities to analogise the requirements to other situations to conclude there is no direct link between regulatory compensation and underlying items of expense. This possibility could however be overcome by restricting the application of this course of action to depreciation expense only.</p>
<p>May result in different outcomes that reflect differences in the way rates are set between different regulatory schemes.</p>	<p>It may be difficult for entities to determine whether there is a direct relationship between regulatory depreciation and accounting depreciation, which may lead to entities reaching different judgments for the same or similar fact patterns/situations.</p>



## Staff analysis—Possible courses of action—*continued*

### Course of Action 2—Overall calculation

- A possible course of action could be to identify differences in timing by comparing two bases (ie the RAB and the entity's total assets).
- An entity would first need to make the bases comparable. To do so an entity would need to (the list is not exhaustive):
  - remove from the RAB all items that are not in the entity's fixed assets register;
  - not consider assets in its fixed assets register that are not part of the RAB (for example, contributed assets); and
  - remove differences between the RAB and the entity's assets that relate to measurement differences between the two bases.
- Once the bases are comparable:
  - A regulatory asset would arise when the difference between the RAB and the total assets of the entity (ie  $RAB > \text{entity's assets}$ ) is fully due to the regulatory recovery pace of the RAB being longer than the useful lives of the entity's assets. The final Standard could establish the recovery period of that regulatory asset to be the assets' weighted average useful lives. This would be a non-cash difference in timing.
  - A regulatory liability would arise when the difference between the RAB and the total assets of the entity (ie  $RAB < \text{entity's assets}$ ) is fully due to the regulatory recovery pace of the RAB being shorter than the useful lives of the entity's assets. The final Standard could establish the fulfilment period of that regulatory liability to be the assets' weighted average useful lives. This would be a non-cash difference in timing.

**Staff analysis—Possible courses of action—continued**

**Course of Action 2—continued**

- The following table aims to consider pros and cons of the Course of Action 2:

Pros	Cons
<p>Would result in comparable information across entities applying the final Standard.</p>	<p>Entities would need to ensure the RAB is a base that is comparable to an entity’s assets on a yearly basis. This may be both operational challenging and complex, which may impact on the feasibility of this option. See pages 8–9 for items that make the RAB not comparable with an entity’s assets. However, it can be argued this course of action may be less costly to implement than the proposals in the Exposure Draft.</p>
<p>It could decrease operational complexity as the regulatory asset or regulatory liability would be accounted for at the level of the RAB/an entity’s total assets rather than at an entity’s individual assets level.</p>	<p>The weighted average of the useful lives of an entity’s assets would keep on changing mainly due to capex and assets’ retirements. In addition, the recovery pace of the RAB may also change. This means that an entity would need to reflect these changes in the accounting for the regulatory asset or regulatory liability.</p>
	<p>The usefulness of the resulting information could be questioned for entities for which there is no direct relationship between regulatory depreciation and accounting depreciation.</p>

**Staff analysis—Possible courses of action—continued**

**Course of Action 3—Confirm the proposals**

- A possible course of action could be to confirm the proposals in paragraphs B5–B7 of the Exposure Draft and [Illustrative Examples](#) IE2B and IE2C accompanying the Exposure Draft. Under this course of action an entity would account for regulatory assets and regulatory liabilities arising from differences between the recovery pace of the RAB and assets’ useful lives.
- The following table aims to consider pros and cons of the Course of Action 3:

Pros	Cons
<p>Would result in comparable outcomes for all entities applying the final Standard.</p>	<p>Questions the feasibility and implementation costs of the proposals for entities for which the RAB cannot be linked or reconciled to the fixed asset register used for accounting purposes (pages 8–9).</p>
	<p>Users we have talked to have said they would not find the information that would arise from the accounting of regulatory assets or regulatory liabilities arising from differences between the recovery pace of the RAB and assets’ useful lives to be useful. A few of them said they would not consider these assets or liabilities in their analyses.</p>

## Staff analysis—RELATED MATTER

### Pre-funding of an asset

- The Exposure Draft includes an illustrative example that has some analogies with the topic covered in this material and therefore it is worth discussing. In particular when the recovery period of the RAB is shorter than the asset's useful lives.
- [Illustrative Example 6A](#) deals with an entity that supplies goods or services to customers. During Year 1 the entity constructs an asset that is available for use from the beginning of Year 2 and has a useful life of 20 years. The cost of the asset is CU1,000. The entity obtained CU60 through rates charged during Year 1 (ie when the asset was not yet available for use). The entity will recover the remainder of the cost (ie CU940) through rates charged over the life of the asset (ie CU47 per year over 20 years).
- The Exposure Draft considers the CU60 received through rates in Year 1, and recognised in revenue in that same period, to be pre-funding that allows the entity to cover part of the cost of the asset during the construction period—ie the pre-funding of CU60 provides part of the total allowed compensation for goods or services to be supplied in the future when the asset is in operation.
- The Exposure Draft proposes to account for a regulatory liability of CU60 in Year 1. That regulatory liability will be fulfilled over the asset's useful life (ie CU3 per year: CU60 of pre-funding divided by the 20-year useful life).
- Entities in regulatory environments such as that described in Case B (page 12) could raise similar concerns to those raised for the accounting for regulatory assets and regulatory liabilities arising from differences between the recovery pace of the RAB and the assets' useful lives (pages 8–9).
- Question 5 on page 21 refers to this fact pattern.

**Questions for the Consultative Group:**

1. Have we correctly analysed the pros and cons of each course of action?
2. Are there any implementation issues associated with Courses of Action 1 and 2, which we should be aware of?<sup>(5)</sup>
3. For Course of Action 1:
  - (a) what do you think about the indicators that an entity would consider in relation to Judgement 1 on page 15? Are there any other indicators we should consider?
  - (b) page 15 identifies information entities would provide if they do not account for regulatory assets and regulatory liabilities arising from differences between the recovery pace of the RAB and the assets' useful lives. Do you agree these entities should provide this information? What other information, if any, should these entities provide?
4. Are there other potential courses of action we should consider?
5. Page 20 describes a fact pattern that has similarities to the case when the recovery period of the RAB is shorter than the assets' useful lives. We would like to understand:
  - (a) how common is the fact pattern (ie rates charged during the construction of an asset recover part of the carrying amount of the asset) in your jurisdiction.
  - (b) whether there is information relating to this fact pattern that would be useful for users of the financial statements the IASB should consider requiring in the final Standard.

(5): Implementation issues associated with Course of Action 3 are summarised on pages 8–9.

## References

- Response summary from the Request for Information ([AP9 July 2013](#)).
- Glachant J.M., Sagan M., Rious V. and Douguet V. (2013). *Incentives for investments: Comparing EU electricity TSO regulatory schemes*. Florence School of Regulation. Available at: [https://cadmus.eui.eu/bitstream/handle/1814/29677/2013\\_Glachant\\_et-al\\_IncentivesForInvestments\\_dig.pdf](https://cadmus.eui.eu/bitstream/handle/1814/29677/2013_Glachant_et-al_IncentivesForInvestments_dig.pdf)
- Economic Consulting Associates. September 2018. Methodologies and parameters used to determine the allowed or target revenue of gas transmission system operators (TSOs). Available at: [https://documents.acer.europa.eu/Official\\_documents/Acts\\_of\\_the\\_Agency/Publication/Consultant%20Report.pdf](https://documents.acer.europa.eu/Official_documents/Acts_of_the_Agency/Publication/Consultant%20Report.pdf)
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