STAFF PAPER

July 2019

IASB® meeting

Project	Rate-regulated Activities		
Paper topic	Cover note		

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Purpose of the session

1. The purpose of this meeting is:

   (a) to provide additional analysis in response to the questions raised by the Board members in previous meetings (matters dealt with in agenda papers 9A and 9B) and on a matter subsequently identified by the staff (agenda paper 9C);

   (b) to ask the Board to publish an exposure draft rather than a second discussion paper to obtain feedback on the accounting model for regulatory assets and regulatory liabilities (the model); and

   (c) to ask Board members for permission to begin the balloting process for the consultation document.

2. In this meeting, we will discuss the following agenda papers and ask the Board for decisions about the aspects of the model presented in them:

   (a) **Agenda Paper 9A** *Interaction with IFRS 3* Business Combinations asks the Board to make an exception to the recognition and measurement principles of IFRS 3 for regulatory assets and regulatory liabilities;

   (b) **Agenda Paper 9B** *The regulatory agreement period* explores how the model would be applied if the term of the regulatory agreement is, may be, shorter than the period over which timing differences would reverse;

(c) **Agenda Paper 9C** *Incentive schemes* discusses how an entity should address situations where, at the financial reporting date, it is not yet certain whether it will become entitled to a bonus (or liable for a penalty);

(d) **Agenda Paper 9D** *The consultation document—an exposure draft or a discussion paper* asks the Board to publish an exposure draft rather than a second discussion paper as the next consultation document to obtain feedback on the model;

(e) **Agenda Paper 9E** *Effect analysis* provides a summary of the likely effects the Board has been considering as it has been making decisions about the model; and

(f) **Agenda Paper 9F** *Due process and permission to begin the balloting process* provides a summary of the due process steps undertaken to date and asks the Board for permission to begin the balloting process for the consultation document.

3. The Appendix summarises, for information purposes, the tentative decisions made by the Board that determine the core features of the model. Tentative decisions made at the last Board meeting are underlined.

Next steps

4. Staff consider that the package of materials in the agenda papers for this and previous meetings provide sufficient content for the Board to decide whether the staff can start the balloting process for an exposure draft. However, we have identified some discrete issues that we aim to discuss with the Board in September 2019 before completing the drafting of the consultation document for balloting, as follows:

(a) transition;

(b) completion of our analysis to identify whether the model would need to deal specifically with any interactions with other IFRS Standards (we have not found any items in addition to those already addressed in Agenda Paper 9B discussed at the Board’s November 2018 meeting, plus the interaction with IFRS 3 discussed in Agenda Paper 9C for this meeting); and

(c) consequential amendments.

APPENDIX—summary of the Board's tentative decisions to date[1]

<u>(decisions from the June 2019 Board meeting are underlined)</u>

Topic	**Board's tentative decisions** (extracts from the IASB Update)	Board meeting
Scope	The model should apply to defined rate regulation established through a formal regulatory framework that: (a) is binding on both the entity and the regulator; and (b) <u>establishes a basis for setting the rate that gives rise to the entity's rights to add amounts to, and obligations to deduct amounts from, future rate(s) because of goods or services already supplied or because of amounts already charged to customers.</u>	March 2018 June 2019
Unit of account	The model will use as its unit of account the individual timing differences that create the incremental rights and obligations arising from the regulatory agreement.	February 2018
Regulatory assets and regulatory liabilities	The model defines regulatory asset and regulatory liability as follows: (a) regulatory asset—the present right <u>to add an amount to the rate(s) to be charged to customers in future periods because the total allowed compensation for the goods or services already supplied exceeds the amount already charged to customers</u>—meets the definition of an asset in the *Conceptual Framework*.	February 2018 June 2019

[1] This appendix does not consist of a complete inventory of all tentative decisions made by the Board but only those that determine the core features of the model. A complete record of the Board's tentative decisions from May 2015-June 2019 can be found: https://www.ifrs.org/projects/work-plan/rate-regulated-activities/#project-news

Topic	**Board's tentative decisions** (extracts from the IASB Update)	Board meeting
	(b) regulatory liability—the present obligation to deduct an amount from the rate(s) to be charged to customers in future periods because the total allowed compensation for the goods or services already supplied is lower than the amount already charged to customers—meets the definition of a liability in the *Conceptual Framework*.	
Recognition of regulatory assets and regulatory liabilities	The model: (a) should require the recognition of regulatory assets or regulatory liabilities if it is more likely than not that they **exist**—the model sets a symmetrical recognition threshold in cases of **existence uncertainty**; and (b) should not set thresholds that would prevent recognition of a regulatory asset or regulatory liability for which there is: (i) low probability of an inflow or outflow of economic benefits; or (ii) high measurement uncertainty. The Board tentatively decided not to develop specific requirements for derecognition of regulatory assets and regulatory liabilities, or for fines imposed on an entity that are payable through deductions from the rate(s) charged to customers.	March 2018 June 2019
Measurement of regulatory assets	An entity should measure all regulatory assets and regulatory liabilities using a modified historical cost measurement basis—except those regulatory assets and regulatory liabilities that relate to expenses or income to be included in or deducted from the future rate(s) when cash is paid or received, discussed separately below. To apply that measurement basis, an entity should use a cash-flow-based measurement technique that: (a) includes an estimate of all the future cash flows arising from a regulatory asset or regulatory liability, including the cash flows relating to the regulatory interest or regulatory return; and (b) discounts those estimated future cash flows to their present value. If the entity assesses that the regulatory interest rate or return rate is adequate, it should use that rate as the discount rate.	May 2018 July 2018 June 2019

Topic	**Board's tentative decisions** (extracts from the IASB Update)	**Board meeting**
	The model should: (a) apply an indicator-based approach to assessing whether the regulatory interest rate or return rate is adequate to compensate or charge the entity for the time value of money and for the uncertainty inherent in the cash flows arising from the regulatory asset or regulatory liability; and (b) include guidance on indicators to consider in making that assessment. If, in limited circumstances, the regulatory interest rate or return rate is inadequate to compensate the entity for the time value of money and uncertainty inherent in the cash flows arising from a regulatory asset, an entity should determine a 'minimum rate' to use as the discount rate. The 'minimum rate' is one that the entity would expect to receive for a stream of cash flows with the same timing and uncertainty as those of the regulatory asset If, in limited circumstances, the regulatory interest rate or return rate provides excess compensation or excess charge for the time value of money and uncertainty inherent in the cash flows, an entity should: (a) recognise that excess as regulatory income or regulatory expense immediately if it arises from an identifiable transaction or other event, such as the awarding of a bonus or imposition of a penalty; but (b) use the regulatory interest rate or return rate as the discount rate if that excess does not arise from an identifiable transaction or other event. For subsequent measurement: (a) the measurement of regulatory assets should reflect changes, if any, in the estimates of the future cash flows the regulatory assets will generate. (b) the discount rate established at initial recognition should remain unchanged during the subsequent measurement of the regulatory assets. (In its July 2018 meeting, the Board tentatively decided the discount rate established at initial recognition	

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	should change if the interest or return rate provided by the regulatory agreement changes—see 'Changes in estimated cash flows, including changes caused by changes in the discount rate' section of this table). ***Estimating future cash flows*** For each regulatory asset recognised, an entity should: (a) estimate future cash flows using either the 'most likely amount' method or the 'expected value' method, depending on which method the entity concludes would better predict the amount of the cash flows arising from a particular timing difference; and (b) apply the same method consistently from the origination of the timing difference until its reversal. An entity should determine whether to consider the outcome of each timing difference separately or together with one or more other timing differences, based on the approach that would better predict the amount of the resulting future cash flows. <u>For some regulatory assets and regulatory liabilities, expenses or income will be included in or deducted from future rate(s) when cash is paid or received, but the related liabilities and assets are recognised and measured using requirements in other IFRS Standards. An entity should measure these regulatory assets and regulatory liabilities by:</u> (a) <u>using the same measurement basis that the entity uses when measuring the related liability or related asset; and</u> (b) <u>adjusting the measurement of the regulatory asset or regulatory liability to reflect any uncertainty not present in the related liability or related asset.</u>	

Topic	**Board's tentative decisions** (extracts from the IASB Update)	Board meeting
	Changes in estimated cash flows, including changes caused by changes in the discount rate The model adopts the treatment required by IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to account for changes in estimated future cash flows. Consequently: (a) the effect of a change in estimated future cash flows should be recognised prospectively in profit or loss in: (i) the period of change, if the change affects only that period; or (ii) the period of change and future periods, if the change affects both; and (b) if the change gives rise to a change in a regulatory asset, the change should be recognised by adjusting the carrying amount of the related asset in the period of change. When a regulator changes the interest rate or return rate used to compensate an entity for the period between the origination and reversal of a timing difference, the entity should: (a) measure the outstanding regulatory asset balance using the revised interest rate or return rate to discount the estimated future cash flows; and (b) recognise any resulting change in the carrying amount of the regulatory asset in the period of change.	
Measurement of regulatory liabilities	The model should apply the same measurement requirements for regulatory liabilities and regulatory assets.	July 2018

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Presentation	*Statement of financial position* An entity should: (a) present regulatory assets and regulatory liabilities as separate line items in addition to the line items required by IAS 1 *Presentation of Financial Statements*; (b) applying IAS 1, classify regulatory assets and regulatory liabilities as current or noncurrent, except when a presentation based on liquidity is used; and (c) offset regulatory assets and regulatory liabilities only if they are expected to lead to adjustments to the same future rate(s) charged to customers and, consequently: (i) they have the same pattern and timing of reversal; (ii) they arise in the same regulatory regime; and (iii) the entity has a legally enforceable right to offset them. Although offsetting would be permitted when the conditions in subparagraphs (c)(i)–(iii) are met, it should not be required. *Statement(s) of financial performance* An entity should: (a) present all regulatory income and regulatory expense in profit or loss, except as indicated in (e); (b) present regulatory income and regulatory expense netted as a separate line item (regulatory income or regulatory expense line item) in addition to the line items required by IAS 1;	November 2018 June 2019

Topic	**Board's tentative decisions** (extracts from the IASB Update)	Board meeting
	(c) present the regulatory income or regulatory expense line item immediately below the revenue line item(s) required by IAS 1; and (d) include regulatory interest income and regulatory interest expense within the regulatory income or regulatory expense line item; and (e) <u>present in other comprehensive income (OCI) regulatory income or regulatory expense that is related to items of expense or income presented in OCI, and present that regulatory income or regulatory expense immediately above or immediately below the related expense or income.</u> An entity is not prohibited from disaggregating the required line items and presenting additional line items or subtotals in the primary financial statements when such presentation would be relevant to an understanding of the entity's financial position and/or financial performance, as required by IAS 1.	
Disclosure	*Disclosure objectives* The overall disclosure objective for defined rate regulation should be focused on the effects that the transactions or other events that give rise to regulatory timing differences have on an entity's financial performance and financial position. The objective should not be broadened to include the provision of information about the general regulatory and economic environment; nor to include information about all the effects of defined rate regulation on the entity's financial performance, financial position and cash flows. The specific disclosure objectives should focus on information to help users of financial statements: (a) to understand the effects of regulatory timing differences on the entity's financial performance by distinguishing between: (i) fluctuations in revenue and expenses compensated for through the rate-adjustment mechanism; and	November 2018 June 2019

Topic	**Board's tentative decisions** (extracts from the IASB Update)	Board meeting
	(ii) fluctuations in revenue and expenses for which there is no such compensation; (b) to understand and assess the amount, timing and uncertainty of (prospects for) future cash flows that will result from the entity's regulatory assets and regulatory liabilities; and (c) to understand how the entity's financial position was affected during the period by transactions or other events that caused changes in the carrying amounts of regulatory assets and regulatory liabilities. *Disclosure requirements* An entity should disclose: (a) a breakdown of the regulatory income or regulatory expense line item in profit or loss into the following components: (i) originations of regulatory assets, together with qualitative and quantitative information about the reasons for their amounts; (ii) originations of regulatory liabilities, together with qualitative and quantitative information about the reasons for their amounts; (iii) recovery of regulatory assets; (iv) fulfilment of regulatory liabilities; and (v) changes in the carrying amount of regulatory assets and regulatory liabilities due to changes in estimates, together with qualitative and quantitative information about the reasons for those changes;	

Topic	**Board's tentative decisions** (extracts from the IASB Update)	Board meeting
	(b) a maturity analysis of the carrying amounts of regulatory assets and of regulatory liabilities at the end of the period, and an explanation of how the future recovery of regulatory assets or the future fulfilment of regulatory liabilities is affected by risks and uncertainty; (c) the discount rate or ranges of discount rates used to discount the estimated cash flows reflected in the carrying amounts of regulatory assets and of regulatory liabilities at the end of the period and, if different, the related regulatory interest or return rate(s) approved by the regulator, together with qualitative and quantitative information about the reasons for those differences; (d) a reconciliation of the carrying amount of regulatory assets and of regulatory liabilities from the beginning to the end of the period; and (e) regulatory interest or regulatory return arising on regulatory assets or regulatory liabilities as a separate caption in: (i) the breakdown of regulatory income or regulatory expense for the period; or (ii) the reconciliation of the carrying amounts of regulatory assets and of regulatory liabilities from the beginning to the end of the period. An entity should assess whether the information provided through the disclosure requirements is sufficient to meet the overall disclosure objective. If not, the entity should disclose any additional information needed to meet that objective.	
Interactions between the model and IFRS Standards	*Exceptions to the requirements of other IFRS Standards* The measurement requirements of IAS 36 *Impairment of Assets* and IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* should not be applied to regulatory assets and regulatory liabilities.	November 2018

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	In November 2018, the Board discussed aspects of the interaction between the model and IFRS 3 *Business Combinations* and asked the staff to conduct further analysis for discussion at a future meeting. [2] *Guidance on applicability of other IFRS Standards* The model should include application guidance about its interaction with IAS 12 *Income Taxes,* similar to the application guidance in paragraph B10 of IFRS 14 *Regulatory Deferral Accounts*. However, the Board tentatively decided against including an explicit statement—similar to that made in paragraph 16 of IFRS 14 in relation to regulatory deferral items—that other IFRS Standards apply to regulatory assets, regulatory liabilities, regulatory income and regulatory expense in the same way as they apply to other assets, liabilities, income and expenses. *Isolation of regulatory items through presentation and disclosure requirements* The model should not carry forward the presentation and disclosure requirements in IFRS 14 for an entity to isolate, using subtotals, regulatory items from the assets, liabilities and net income and expense recognised using other IFRS Standards. *Location of requirements and guidance on interactions with other IFRS Standards* Any requirements and application guidance on interactions between the model and other IFRS Standards should be included in a future Standard on rate-regulated activities, rather than added to those other Standards.	

[2] The staff is bringing further analysis for discussion on this topic at this meeting (please see Agenda Paper 9A).