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Purpose and structure of this paper

1. This paper aims to provide an initial assessment of the likely effects the Board has been considering as it has been making tentative decisions about the accounting model for regulatory assets and regulatory liabilities (the model). We are not asking the Board to make decisions on the matters discussed in this paper.

2. The structure of the paper is as follows:

   (a) summary (paragraphs 4–5);

   (b) effects analysis—the *Due Process Handbook* (paragraphs 6–7);

   (c) the problem we are trying to solve (paragraphs 8–13);

   (d) purpose of the model (paragraphs 14–15); and

   (e) assessing how the financial statements are likely to change and the likely effects of the proposals (paragraphs 16–61).

3. The appendix to this paper includes:

   (a) comparison of the model with US GAAP (Table 1);

   (b) an analysis of diversity in the accounting models currently used for reporting the financial effects of regulatory balances (Table 2); and

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(c) comments gathered from some users of financial statements about reflecting the financial effects of defined rate regulation (Table 3).

Summary

4. The application of the model will affect entities' financial statements differently depending on whether they are currently recognising regulatory balances or not, however, the following are the likely effects of the proposals relating to:

   (a) the resulting information:

      (i) a more complete depiction of an entity's financial position and financial performance, through recognition of regulatory assets, regulatory liabilities, and resulting regulatory income and regulatory expenses;

      (ii) enhanced comparability of financial information between different reporting periods for an entity and between different entities in different jurisdictions;

      (iii) enhanced ability of users to understand and assess entities' financial performance and future cash flows; and

      (iv) enhanced information for better economic decision-making;

   (b) the costs:

      (i) only limited costs for preparers to apply the model because most of the information needed should already be available and because the proposed requirements have been developed considering operational aspects; and

      (ii) elimination of the need for users to gather and rely on unaudited and non-comparable sources of information, which will contribute to reducing the costs of analysis for users.

5. We expect the model would provide users of financial statements with benefits, in the form of more useful information—that would outweigh the costs of implementing the model.

Effect analysis—the *Due Process Handbook*

6. The *Due Process Handbook* (Handbook) describes the effect analysis as the Board's process for assessing the likely *effects* of a new or amended IFRS Standard that is undertaken as the new or amended Standard is developed.[1] 'In particular, the IASB's views on the likely effects are approved by the IASB and presented as part of, or with, the Basis for Conclusions that is published with each Exposure Draft and Standard.'[2]

7. The Due Process Oversight Committee (DPOC) has undertaken a review of the due process procedures. As a result of that review, it published proposed amendments to the Handbook in April 2019 with comments to be received by 29 July 2019.[3] One of these proposed amendments affects the effect analysis procedures. The Board's work on effect analysis has also been informed by the recommendations of the Effects Analysis Consultative Group (EACG), established in 2013 by the Trustees to advise the Board on further developing a methodology for effect analysis. The proposed amendments in the 'Effect analysis' section of the Handbook aim to reflect these developments as well as to incorporate the EACG's recommendations.[4]

The problem we are trying to solve—unrecognised present rights and present obligations

8. The Board has previously discussed that the regulatory agreement not only establishes the **total allowed compensation**[5] for the goods or services supplied during a period but also determines **when** (ie in which periods) that total allowed compensation is included in the rate(s) charged to customers.

9. The regulatory agreement aims to charge customers the total allowed compensation for goods or services supplied during the **same** period in which the entity supplies

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[1] Paragraph 3.73 of the *Due Process Handbook* states that 'the costs and benefits are collectively referred to as *effects*'.

[2] Paragraph 3.74 of the *Due Process Handbook*.

[3] The Exposure Draft *Proposed amendments to the IFRS Foundation Due Process Handbook* published in April 2019 can be found: https://www.ifrs.org/-/media/project/due-process-handbook-review/proposed-amendments-to-due-process-handbook-april-2019.pdf?la=en

[4] These recommendations focus on: (a) embedding explicitly the process of analysing the effects throughout the standard-setting process; (b) explaining the scope of the analysis; (c) explaining how the Board reports the effects throughout the process; and (d) differentiating the effect analysis process from the final effect analysis report.

[5] This term is described in Agenda Paper 9A discussed at the Board June 2019 meeting. The paper can be found: https://www.ifrs.org/-/media/feature/meetings/2019/june/iasb/ap9a-rat-regulated-activities.pdf

those goods or services. However, in some cases, the regulatory agreement includes some of the total allowed compensation in the rate(s) charged to customers in a **different** period, causing timing differences that will be 'trued-up' later. These timing differences create present rights and present obligations as described in paragraphs 10(b)–10(c).

10. When, during the current reporting period, an entity subject to defined rate regulation supplies regulated goods or services to customers, the entity obtains one or more of the following:
    (a) a present right to charge customers in the current period at the rate established to be charged to customers for the goods or services supplied during the same period;
    (b) a present right 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; and
    (c) a 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.

11. IFRS 15 *Revenue from Contracts with Customers* provides users of financial statements with relevant information that faithfully represents the entity's right described in paragraph 10(a), ie the right to charge customers at the regulated rate(s) established for the current period in exchange for the goods or services supplied to customers during the same period. This right is incorporated in the entity's contracts with individual customers.

12. However, IFRS 15 does not provide information about the entity's right described in paragraph 10(b) or obligation described in paragraph 10(c). These rights and obligations arise through the regulatory agreement, rather than through the contracts with customers, and so are incremental to those reported using IFRS 15. These incremental rights and incremental obligations require the entity to add amounts to or deduct —amounts from—the future rate(s) charged to customers because amounts already charged to customers do not fully reflect the total allowed compensation to

which the entity is entitled in exchange for the goods or services it has already supplied.

13. Consequently, the financial statements of entities currently provide incomplete information about the entities' financial position and financial performance.

Purpose of the model

14. The purpose of the model is to **supplement** the information provided by IFRS 15 and other IFRS Standards by reflecting, in the current period, the incremental rights and incremental obligations identified in paragraphs 10(b)–10(c) to 'true-up' the total allowed compensation for the goods or services supplied during the period by adding amounts to, or deducting amounts from, the future rate(s).

15. The **core principle** of the model is that an entity recognises:

    (a) as an asset (**regulatory asset**): the entity's present right to add an amount to the future rate(s) to be charged to customers because the total allowed compensation for the goods or services already supplied exceeds the amount already charged to customers (paragraph 10(b));

    (b) as a liability (**regulatory liability**): the entity's present obligation to deduct an amount from the future rate(s) to be charged to customers because the total allowed compensation for the goods or services already supplied is lower than the amount already charged to customers (paragraph 10(c)); and

    (c) as **regulatory income** or **regulatory expense**, the movement between opening and closing carrying amounts of regulatory assets and regulatory liabilities. The movement reflects the origination and subsequent reversal of regulatory assets and regulatory liabilities during the period, plus other changes, for example changes in estimated cash flows.

Assessing how the financial statements are likely to change and the likely effects of the proposals

16. This section provides an initial assessment of the likely effects of the model by considering:[6]

    (a) how the proposed changes would be likely to affect how activities are reported in the financial statements (see paragraphs 17–25);

    (b) how those changes would improve the comparability of financial information between different reporting periods for an individual entity and between different entities in a particular reporting period (see paragraphs 26–35);

    (c) how the changes would improve user's ability to assess an entity's future cash flows (see paragraphs 36–39);

    (d) how the improvements to financial reporting would result in better economic decision-making (see paragraphs 40–43);

    (e) the likely effect on compliance costs for preparers, both on initial application and on an ongoing basis (see paragraphs 44–51);

    (f) how the likely costs of analysis for users would be affected (see paragraphs 52–58); and

    (g) the likely effects on financial stability (see paragraphs 59–61).

How proposed changes would be likely to affect how activities are reported in the IFRS financial statements

17. The proposed requirements of the model will affect entities differently depending on whether they currently:

    (a) do not recognise regulatory balances (see paragraphs 18–19); or

    (b) recognise regulatory balances (see paragraphs 20–25).

6 Paragraph 3.75 of the *Due Process Handbook*. The amendments to the Handbook do not propose substantial changes to the matters listed in paragraph 16, but include a new area for the Board's consideration, which is financial stability (paragraphs 59–61).

Entities that currently do not recognise regulatory balances

18. This group would encompass entities that are within the scope of the model (see Table 1 in the Appendix) and do not currently recognise regulatory balances in their financial statements because they:

    (a) transitioned to IFRS Standards before IFRS 14 *Regulatory Deferral Accounts* was published or after IFRS 14 was published but decided not to adopt—or were not eligible to apply—that Standard;[7, 8] and

    (b) currently apply other generally accepted accounting principles (GAAP) and would be first-time adopters of IFRS Standards.

19. For such entities, the application of the model would result in:

    (a) the recognition of regulatory assets and regulatory liabilities in the statement of financial position[9], with consequential impacts reflected as regulatory income/regulatory expense in the statement(s) of financial performance. Consequently, the application of the model is likely to impact these entities' net assets and net profit reported in the financial statements. We expect the impact of the recognition of the regulatory balances in the statement of financial performance will be relatively high compared to the impact in the statement(s) of financial position because:

        (i) regulated entities generally have a capital-intensive nature, with material infrastructure assets on their statement of financial position. Consequently, the recognition of regulatory assets and regulatory liabilities is not expected to materially affect their reported financial position; and

        (ii) in the rate-setting process, regulators balance the interests of regulated entities with the interests of customers. This means that

[7] IFRS 14 *Regulatory Deferral Accounts* permitted first-time adopters of IFRS Standards to continue recognising regulatory deferral account balances in their financial statements in accordance with their previous GAAP requirements.

[8] Staff research to date indicates that, in jurisdictions using IFRS Standards (including those that have transitioned to IFRS Standards prior to the publication of IFRS 14), regulatory assets and regulatory liabilities are not generally recognised, however, the sample of entities in Table 2 in the Appendix reflects some diversity in practice.

[9] Subject to meeting the recognition criteria.

although the rate will generally be set up to a level that aims to ensure that entities obtain a 'fair' return on their activities, the 'allowed' net profit is not expected to be significantly high. Consequently, the changes in the regulatory assets and regulatory liabilities balances are likely to significantly affect net profit in the statement(s) of financial performance.

(b) separate presentation of regulatory items in the primary financial statements, supplemented by comprehensive disclosures in the notes to inform users how the origination and reversal of regulatory assets and regulatory liabilities affected the entities' financial performance and financial position.

Entities that currently recognise regulatory balances

20. Entities that currently recognise regulatory balances in their financial statements typically apply IFRS 14, US GAAP or local GAAP (that is based on US GAAP in many instances).

21. IFRS 14 permits first-time adopters of IFRS Standards that already recognised regulatory deferral account balances in their financial statements in accordance with their previous GAAP to continue doing so, thus 'grandfathering' their previous GAAP requirements. The previous GAAP of these entities is often US GAAP or local GAAP based on US GAAP. Consequently, the analysis for the effects on the financial statements of these entities of applying the requirements of the model is based on the analysis of the differences between the model and the requirements in US GAAP (see paragraphs 22–24).[10]

22. Both sets of requirements (the model and US GAAP) attempt to reflect the economic effects on financial reporting of timing differences caused by rate regulation, however, while the model:

[10] The staff provided an educational session on the main differences between the model and the requirements contained in Topic 980 Regulated Operations in the US Financial Accounting Standards Board's *Accounting Standards Codification* (US GAAP). Agenda Paper 9F discussed at the June 2019 Board meeting.

(a) focuses on the accounting for present rights and present obligations incremental to those reported using IFRS 15, US GAAP is primarily a cost deferral approach; and

(b) is a supplementary approach with other IFRS Standards applied without modification, US GAAP overrides some standards, primarily in respect of property, plant and equipment, to align financial accounting with regulatory accounting.

23. Our initial assessment is that the model would result in similar outcomes to US GAAP however the principles underpinning the requirements are different. Table 1 in the Appendix sets out the main differences between the model and US GAAP. We note that for the aspects of the scope, recognition and measurement those differences would affect both:

(a) entities applying IFRS 14 using US GAAP or local GAAP based on US GAAP; and

(b) entities applying US GAAP or a local GAAP based on US GAAP.

24. For the aspects of presentation and disclosure, the differences shown in Table 1 in the Appendix would have effects only for entities switching to the model from US GAAP or a local GAAP based on US GAAP. Entities applying IFRS 14 are applying the specific presentation and disclosure requirements in that Standard instead of following their previous GAAP presentation and disclosure requirements.

25. IFRS 14 requires separate presentation of regulatory items in the statements of financial position and financial performance, using subtotals, to isolate them from the assets, liabilities and income and expense recognised using other IFRS Standards. The model does not carry these requirements in IFRS 14 but instead would require presentation of regulatory items in separate line items in the primary financial statements.[11] The model requires additional disclosures in financial statements and these are likely to be more focused on capturing the effects of the timing differences on entities' financial performance and future cash flows than disclosures currently provided by entities applying IFRS 14.[12]

[11] Agenda Paper 9C was discussed at the November 2018 Board meeting.
[12] Agenda Paper 9D was discussed at the November 2018 Board meeting.

How those changes improve the comparability of financial information

26. Research to date has shown that entities currently use different accounting models to report the effects of rate regulation. Consequently, the application of the model will result in improved comparability of financial information between:

    (a) different reporting periods for an entity (paragraphs 27–30); and

    (b) different entities (paragraphs 31–35).

Comparability of financial information between different reporting periods for an entity

27. As stated in paragraph 13, the financial statements of entities (particularly those that do not recognise regulatory balances arising from the timing differences) provide incomplete information about the entities' financial position and financial performance. This may create artificial volatility in the entities' statement(s) of financial performance that could mask any real volatility. This makes it difficult for users to:

    (a) understand and assess an entity's reported financial performance for the period; and

    (b) assess the amounts, timing and uncertainty of (prospects for) its future cash flows from the supply of goods or services.

28. The model aims to account for the incremental rights and incremental obligations arising from the timing differences by recognising regulatory assets and regulatory liabilities. The model would provide information about how defined rate regulation affects an entity's underlying financial position, performance and prospects for future cash flows.

29. The recognition of the incremental rights and incremental obligations will improve comparability of the financial information by:

    (a) enabling the total allowed compensation for the goods or services supplied in a reporting period to be recognised in that period; and

    (b) providing users of financial statements with information that will help them to distinguish fluctuations in revenue and expenses that are compensated for

or charged for through the rate, from fluctuations in revenue and expenses for which there is no compensation or charge.

30. Consequently, the application of the model will result in improved comparability of an entity's financial performance and financial performance trends across different reporting periods. It will also allow users to assess the amounts, timing and uncertainty of (prospects for) future cash flows associated with regulatory assets and regulatory liabilities and compare them across different reporting periods.

Comparability of financial information between different entities

31. As stated in paragraph 26, entities currently use various accounting models to report the effects of the rate regulation. Table 2 in the Appendix, based on a sample of entities in different jurisdictions, reflects this diversity.[13]

32. The diversity reflected in Table 2 in the Appendix is consistent with the feedback received in outreach discussions and comment letter responses to the Discussion Paper *Reporting the Financial Effects of Rate Regulation* published in September 2014 (the '2014 DP') that highlighted that there is some diversity in IFRS financial statements that is affecting comparability.[14] Consistent with the observations in Table 2, we have also identified some entities that already recognise, in IFRS financial statements, some regulatory deferral account balances as assets and liabilities, typically within the receivables and payables categories. Others recognise only regulatory 'liabilities' but it is not clear whether this is just the net amount after netting any regulatory deferral account debit balances or whether it is the sum of regulatory deferral account credit balances. This affects transparency of financial reporting and further adds to the diversity that exists in practice.

33. We are also aware that some entities that are subject to defined rate regulation and are eligible to apply IFRS 14 have not adopted IFRS Standards because:

    (a) the Board has made it clear that IFRS 14 is not intended to anticipate the outcome of the comprehensive Rate-regulated Activities project.[15] Such

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[13] This table is based on Exhibit 59 of the Research Paper *Rate-regulated Activities*, published in November 2018 by the Canadian Accounting Standards Board (AcSB). The Research Paper can be found: https://www.frascanada.ca/-/media/frascanada/acsb/news/acsb-research-paper-rate-regulated-activites-november-2018.pdf

[14] AP9: Initial analysis of responses to the Discussion Paper

[15] Paragraph BC21 of the Basis for Conclusions of IFRS 14.

entities consider that regulatory balances recognised by applying IFRS 14 may need to be derecognised from their financial statements if the Board concluded upon completion of the project that such balances should not be recognised. This continues to be a significant barrier to the adoption of IFRS Standards for such entities for which regulatory balances are material.

(b) some entities did not have any relevant rate-regulated activities in the period before they made the transition to IFRS Standards but subsequently acquired or commenced rate-regulated activities after adopting IFRS Standards or when such entities are newly formed businesses and adopt IFRS Standards in their first IFRS financial statements.

(c) entities whose previous GAAP permitted the recognition of regulatory balances but derecognised them upon adoption of IFRS Standards (see example of entities in Brazil in Table 2).

34. Also consistent with Table 2, our research to date has evidenced that some entities acknowledge a need to provide users with additional information about their rate-regulated activities and related regulatory balances and therefore provide this information either in the notes to the financial statements or in other sections within the annual report (for example, in earnings releases, management discussion and analyses and management commentaries). Such information is seldom comparable across different entities and leads users to rely on other sources of information and alternative performance measures that typically are unaudited. We expect the application of the model may help entities to eliminate the need for providing such information.

35. By providing a single and comprehensive accounting model in IFRS Standards, we expect that the existing diversity in practice will decrease and result in greater comparability across entities, industries, jurisdictions and reporting periods.

How the changes will improve the user's ability to assess the future cash flows of an entity

36. As mentioned in paragraph 15, the proposed requirements would result in the recognition of regulatory assets and regulatory liabilities in the financial statements of

entities subject to defined rate regulation. Those regulatory balances represent the incremental right/incremental obligation of an entity to include/deduct a specified amount in the future rate(s) to be charged to customers, and hence reflect future cash inflows (ie regulatory assets) or deductions from future cash inflows (ie regulatory liabilities).

37. Users value information that helps them 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.[16] The model requires disclosure of such information, including:[17]

(i) a maturity analysis showing the remaining time bands over which the entity expects to recover the carrying amount of regulatory assets or to fulfil the carrying amount of regulatory liabilities;

(ii) how the future recovery of regulatory assets or the future fulfilment of regulatory liabilities is affected by risks and uncertainty.

38. In addition, users have also told us that they need information about how timing differences have arisen and about how and when those timing differences will reverse. The disclosure objective and disclosure requirements of the model focus on the effects that the transactions or other events that give rise to timing differences have on the entity's financial performance and financial position by requiring entities to provide:

(a) breakdown of the regulatory income (expense) line item in profit or loss;

(b) reconciliation of the carrying amount of regulatory assets and the carrying amount of regulatory liabilities from the beginning to the end of the reporting period.

39. Such information will help users to better understand:

(a) the effects of timing differences on the entities' financial performance by distinguishing between:

(i) fluctuations in revenue and expenses compensated for through adjustments to the rate(s); and

[16] Summary of the Capital Markets Advisory Committee (CMAC) discussions, March 2017.
[17] Agenda Paper 9D discussed at the November 2018 Board meeting.

(ii) fluctuations in revenue and expenses for which there is no compensation; and

(b) how the entity's financial position has been affected by transactions or other events during the period that caused changes in timing differences.

How the improvements to financial reporting will result in better economic decision-making

40. By requiring the recognition of the incremental rights and incremental obligations arising from the timing differences as regulatory assets and regulatory liabilities, the application of the model will result in financial statements reflecting all the effects of the supply of goods or services as income or expenses in the same period as the period in which the supply of those goods or services take place. The resulting information will be useful for better assessing:

    (a) the entity's past and future financial performance;

    (b) the entity's past and future ability to generate net cash inflows; and

    (c) management stewardship of the entity's economic resources.

41. In addition, the expected enhanced comparability (see paragraphs 26–35) and the disclosure of information necessary to meet presentation and disclosure requirements of the model (see paragraphs 37–38) would result in better economic decision-making as they will provide greater transparency in the reporting of the effects of defined rate regulation on an entity's financial statements.

42. Our views that the model would result in better economic decision-making are aligned to the evidence gathered by the Canadian Accounting Standards Board (AcSB) in its research work (see footnote 13). That work explored the decision-usefulness of financial information that reflects the economics of rate-regulated activities, by accessing data taken from the practical experiences of users of the financial statements of entities with such activities. The AcSB research paper concludes that financial information that reflects the economics of rate-regulated activities is useful and has confirmatory and predictive value that is capable of making a difference in the decisions made by users.

43. Accordingly, we expect that the application of the model will provide financial information that will be useful and relevant to users of financial statements in making their investment and lending decisions, hence supporting better economic decision-making. In addition, relevant financial information about the effects of defined rate regulation captured by the model within the financial statements is likely to result in users placing greater reliance on such information as it would be comparable across entities and jurisdictions and is also likely to reduce any costs that users currently incur for gathering such information from alternative sources that are typically unaudited. In the long-term, this is expected to reduce the cost of capital for entities subject to defined rate regulation.

The likely effect on compliance costs for preparers

44. As with the implementation of any new IFRS Standard, we expect preparers to incur in the following costs when applying the model:

    (a) costs to implement changes in or develop new systems, processes and controls used to gather and archive regulatory data, make required adjustments, estimates and provide required disclosures, possibly including fees paid to external consultants;

    (b) costs to hire additional employees that may be needed to modify processes and internal controls accordingly;

    (c) incremental fees paid to external auditors to audit the financial statements in the period of initial application of the model;

    (d) costs required to educate management, finance and other personnel about the effects of the model;

    (e) costs required to implement the transition requirements;[18] and

    (f) costs required to educate users of financial statements about the effects on the financial statements.

[18] The Board has not yet discussed proposed transition requirements for the model. This matter will be discussed at a future meeting.

45. We think that some of the costs listed in paragraph 44 will be non-recurring, because they will be incurred only upon initial application of the model. However, we think that preparers are likely to incur the following costs on a recurring basis:

    (a) higher personnel costs to prepare the necessary information;

    (b) costs to maintain improved systems; and

    (c) increase in audit fees, particularly because of the increase in audit work relating to measurement of regulatory assets and regulatory liabilities and increased volume of disclosures (see disclosure section in Table 1 in the Appendix).

46. However, we expect that the likely costs of implementing the model would be partly limited by the detailed record-keeping requirements in regulatory agreements that enable identification and tracking of individual rate adjustments from origination to reversal through the rates charged to customers. Accordingly, our expectation is that the rate-regulated entities already have sufficiently quantitative and qualitative source data necessary to apply the model.[19]

47. Our views on the likely costs of applying the model consider the comparative advantage that preparers have in developing information, when compared with the costs that users would incur to develop surrogate information. Because of the extensive record-keeping requirements of regulatory agreements, we think that most of the information required to comply with the model is readily available to preparers. We acknowledge that some costs would be necessary to produce the information in the form needed to comply with the requirements of the model, but we consider those costs would be outweighed by the costs that users currently incur to retrieve (or estimate) – from alternative sources – information that lacks comparability and is typically unaudited (see paragraphs 52–58).

48. However, the model aims to account for only timing differences, not all differences between regulatory accounts and accounts prepared in accordance with IFRS Standards. This is likely to necessitate a good understanding of the principles and requirements of the model so that entities identify appropriately the timing differences

[19] Summary of information received from the Consultative Group for Rate Regulation (CGRR), December 2017

giving rise to regulatory assets and regulatory liabilities in the model as this may differ from their current accounting practice (see Table 1).

49. We think that the non-recurring costs (paragraph 44) and recurring costs (paragraph 45) of applying the model are likely to be lower for entities that currently recognise regulatory balances in their financial statements than for entities that do not currently recognise such balances. This is because even though the former may need to modify their current methodologies for measuring, presenting and disclosing regulatory balances these modifications should imply lower costs than applying the requirements from scratch.

50. We think that the following features of the model that aim to keep the requirements simple will also contribute to contain the costs for preparers when applying the model:

    (a) Recognition—the requirements for recognition are not unduly complex given the stable and predictable environment in which rate regulated entities generally operate. The symmetry in recognition requirements of the model for both regulatory assets and regulatory liabilities should also avoid undue costs for preparers in applying the model.

    (b) Measurement—the requirement to discount the estimates of future cash flows using the regulatory interest or return rate if that rate is adequate is expected to avoid costs for preparers for determining a discount rate.[20] In addition, the indicator-based approach to assessing the adequacy of the regulatory interest or return rate should also alleviate the costs for preparers for undertaking such an assessment when necessary.

51. The expected improvements in verifiability, comparability and understandability arising from the accounting for the incremental rights and incremental obligations will contribute to improving the faithful representation of the effects of defined rate

[20] At the Consultative Group for Rate Regulation (CGRR) 2017 meeting, some members stated that requiring entities to discount regulatory assets or regulatory liabilities using an interest or rate of return that differs from the one established by the rate regulator would cause operational complexities which may not outweigh the benefits of any other solution. Members questioned whether such a requirement would result in relevant information and questioned what any 'day one gain or loss' arising from discounting future cash flows at a different rate would represent. See summary of the information received from the CGRR at: https://www.ifrs.org/-/media/feature/meetings/2017/december/international-accounting-standards-board/ap09a-rra.pdf

regulation in an entity's financial statements. We think those benefits are likely to outweigh the costs that preparers may incur when implementing the model.

The likely effect on costs of analysis for users

52. Through the Rate-regulated Activities project, the Board has aimed to develop an accounting model so that users can compare effects of defined rate regulation on the financial position, performance and cash flows of any rate-regulated entity based in any jurisdiction. The model therefore aims to provide users of financial statements with relevant information about the incremental rights and incremental obligations created by defined rate regulation that current IFRS Standards do not capture.

53. In their March 2017 meeting, CMAC members who follow investments in rate-regulated industries, stated that companies should recognise regulatory assets and regulatory liabilities in the primary financial statements. These members suggested that failing to do so could be misleading when the collection of cash from customers through the regulated rate in the current period includes amounts relating to expenses to be incurred in future periods, or vice versa.[21]

54. We also understand that currently users adjust the financial statements for such variability in performance and consider in their analysis the effects on future cash flows resulting from adjustments to the future rate(s), consequently relying on other sources of information and alternative performance measures that typically are unaudited.

55. Table 3 in the Appendix is based on Appendix A of the AcSB research report cited previously. Table 3 includes only comments gathered from some users of financial statements (with **emphasis added**) relating to their views about reflecting the financial effects of defined rate regulation.

56. The application of the model by entities is likely to translate in costs for users for modifying their processes and analyses. However, such costs are likely to be non-recurring and are likely to be offset by a longer-term reduction in costs envisaged from the additional (comparable) information that would be provided by the improved

[21] Summary of the Capital Markets Advisory Committee (CMAC) discussions, March 2017.

requirements, thus eliminating the need for users to gather and rely on other sources of information.

57. We believe that the model will improve financial information relating to defined rate regulation that users can use for analysing financial performance trends and prospects of future cash flows. The likely significant benefits to users of application of the model would justify the potential costs that they may incur. Those benefits include:

    (a) depiction of the effects of defined rate regulation on an entity's financial position and financial performance (paragraph 15);
    (b) improved comparability across entities and jurisdictions (paragraphs 26–35);
    (c) enhanced ability of users to assess future cash flows (paragraphs 36–39); and
    (d) relevant information for better economic decision-making (paragraphs 40–43).

58. Although the application of the model may cause some initial costs, we think that the enhanced transparency provided by the model will provide clearer and more comparable information that is relevant for users and will provide faithful representation of the economic effects of defined rate regulation in the entities' financial statements. Therefore, it is our view that the benefits of improved financial reporting is likely to outweigh any additional costs of analysis for users.

Financial stability

59. The proposed amendments to the Handbook include a new consideration that the Board should incorporate in its assessments of the likely effects of new reporting requirements, as follows (**emphasis added**):

> 3.80 […] The Board has regard to effects on **financial stability** when assessing the effects of new financial reporting requirement where relevant. While it is generally impossible to quantitatively assess the possible broader economic consequences of new financial reporting requirements, the board may assess specific economic effects where relevant. The Board is not required to make a formal quantitative assessment of the overall effect of a new or amended Standard. Initial and ongoing costs and benefits are likely to affect different parties in different ways.

60. Based on our outreach and research to date, we understand that rate regulation largely affects capital-intensive industries. Such entities invest heavily in infrastructure assets that are used to supply goods or services in accordance with the regulatory agreement. Based on statistics from the International Energy Agency, the projected global investment requirements in the power sector are in the area of $16.4 trillion over the period 2014–2035.[22] Due to their capital-intensive nature and prominence in capital markets, rate-regulated entities are considered important for investors and lenders.

61. Even though the application of the model would affect the financial statements of relevant players in the capital markets such as rate-regulated entities, we do not think the proposals would impact financial stability but will mainly enhance the faithful representation of the entities' financial position and financial performance in their financial statements by accounting for rights and obligations that are currently not being dealt with by existing IFRS Standards.

[22] International Energy Agency, Special Report World Energy Investment Outlook 2014, (Paris, International Energy Agency, 2014)

APPENDIX

Table 1—US GAAP comparison			
Aspect	**Proposed model**[23]	**US GAAP**	**Likely effect of the difference**
Scope	Defined rate regulation is established through a formal regulatory framework that: (a) is **binding** on both the entity and the regulator; and (b) 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.	Requires **binding regulatory framework**. Rates are designed to recover **costs of service**. Focuses on an entity's **ability to recover costs** in order to apply the requirements.	The model focuses on the total allowed compensation (TAC) for specified goods or services supplied in a period. The TAC includes both allowable expenses and a target profit, which may take the form of bonuses or penalties, margins or a return or interest on a base amount. The scope requirement that the design of the rates in entities following US GAAP recover costs of service represents a narrower focus on the cause and effect relationship between costs and rates.[24] The model deals with an entity's ability to recover costs in the recognition and measurement principles and requirements rather than doing so in the scope requirements. We think the differences in the scope are not likely to result in materially different outcomes considering the alternative revenue programs in

[23] This column summarises the main requirements of the model. It does not constitute a complete inventory of all tentative decisions made by the Board.

[24] In addition to traditional cost-of-service revenue, development of rate-regulation has led regulators to authorise some alternative revenue programs, resulting in US GAAP permitting recognition of additional revenues (including incentives) if certain conditions are met. In such cases, the difference between TAC under the model and the outcome in US GAAP would likely be narrower.

Table 1—US GAAP comparison

Aspect	Proposed model[23]	US GAAP	Likely effect of the difference
			US GAAP (see footnote 24) and considering the model includes the ability to recover the costs in the recognition and measurement requirements.
Recognition	All regulatory assets and regulatory liabilities are recognised. If it is uncertain whether a regulatory asset or liability exists, the model requires its recognition if it is **'more likely than not'** that it exists (ie the model sets a symmetrical recognition threshold in cases of existence uncertainty). If there is a low probability of an inflow or outflow of economic benefits or high measurement uncertainty, that factor is considered in the measurement; it does not prevent recognition.	Requires capitalisation of incurred costs as a regulatory asset if they are **'probable'** of recovery through the rates. Incurred costs are those arising from cash paid out or an obligation to pay for an acquired asset or service, or a loss from any cause that has been sustained and has been or must be paid for. There are some exceptions to the capitalisation or deferral of incurred costs such as us: (a) Equity component of allowance for funds used during construction (AFUDC), provided during construction. This is capitalised as part of carrying amount of the utility plant applying US GAAP.	'Probable' used in US GAAP in practice may represent a higher threshold than 'more likely than not' as required per the model. However, due to the fairly stable and foreseeable environment in which rate-regulated entities generally operate, we do not think the difference in the recognition threshold would result in materially different outcomes. The model only establishes a threshold for existence uncertainty; other uncertainties are reflected in the measurement. The model would not recognise the equity component of the AFUDC during construction because the item of property, plant or equipment has not yet been used to supply goods or services to customers.

Table 1—US GAAP comparison

Aspect	Proposed model[23]	US GAAP	Likely effect of the difference
		(b) Intragroup profits on sales from an unregulated entity to a regulated entity within the same group with a profit—US GAAP specifies that the profit should not be eliminated (in consolidated financial statements).[25]	The model would not recognise the profit arising from sales from an unregulated entity to a regulated entity within the same group. Such profits would be eliminated, and then recognised over time as the asset is used to supply regulated goods or services by the regulated entity. In case of a regulated entity selling an asset to an unregulated entity of the same group at a profit or loss, both the model and US GAAP would reach the same conclusion (ie recognition of a regulatory liability or regulatory asset in consolidated financial statements). This is because the gain or loss will be reflected in the rate(s) charged to customers in the future period(s).
Measurement	The model uses a cash-flow-based measurement technique to measure all regulatory assets and regulatory liabilities, except those that relate to expenses or income to be included in or deducted from the future	The measurement requirements in US GAAP generally prohibit measurement of regulatory balances at discounted present value. The measurement is based on deferral or capitalisation of	We expect that in most cases the regulatory interest or return rate would be adequate (see paragraph 19(a)(ii)). In those cases, incorporating the interest or return in the estimates of future cash flows and discounting them using the same rate will result in a

[25] This applies if the price is reasonable and revenue recognised by the unregulated entity is approximately equal to the price that will result from the regulated entity's use of the product.

Table 1—US GAAP comparison

Aspect	Proposed model[23]	US GAAP	Likely effect of the difference
	rate(s) when cash is paid or received. That measurement technique is described as applying a modified historical cost measurement basis and would require entities to: (a) update estimates of future cash flows if changes occur; and (b) keep the discount rate established at initial recognition unchanged, unless the regulatory agreement changes the interest or return rate applicable to the future cash flows. The use of updated estimates of future cash flows means that there is no need for separate requirements on impairment.	incurred costs as long as recovery is probable.	measurement outcome that is identical or similar to that which would have been obtained without discounting. As a result, we do not expect that the difference between the model and US GAAP relating to the requirement of discounting in the model would result in materially different outcomes in most cases.
	In the limited circumstances when the regulatory interest or return rate is inadequate, the model requires an entity to determine a	In limited circumstances such as when no return is provided (for example, due to abandonment of plant or indirect disallowance), there	In cases where the regulatory interest or return rate is not adequate, the minimum adequate rate to be used according to the model is likely

Table 1—US GAAP comparison

Aspect	Proposed model[23]	US GAAP	Likely effect of the difference
	'minimum adequate rate'. Such rate would compensate the entity for the time value of money and uncertainty inherent in the cash flows with the same timing and uncertainty as those of the regulatory asset.	is specific guidance for discounting using specific discount rate(s). Guidance on discount rate(s) provides for using incremental borrowing rate for abandonments and overall cost of capital for indirect disallowances.	to result in an outcome different from the outcome under US GAAP. However: (a) for abandonments, we do not think that the outcomes would diverge significantly in most cases because the minimum adequate rate is likely to be close to the incremental borrowing rate in many cases; and (b) for indirect disallowance, differences in the outcomes would depend on the individual facts and circumstances.
	An entity should measure regulatory assets or 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 by: (a) using the same measurement basis that the entity uses when measuring the related liability or related asset; and (b) adjusting the measurement of the regulatory asset or regulatory liability to reflect any uncertainty not present	Pensions—US GAAP focuses primarily on the amount recognised by ASC 715 *Compensation—Retirement Benefits* and requires that the difference between the pension cost under ASC 715 and the pension costs determined for rate-making purposes be recognised as a regulatory asset or a regulatory liability if certain criteria are met. Decommissioning liabilities—An entity would recognise a regulatory liability or a regulatory asset for timing differences between plant	We expect that the measurement of regulatory assets or 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 would result in similar measurement outcomes under both the model and US GAAP (but presentation would be significantly different—see below).

Table 1—US GAAP comparison			
Aspect	**Proposed model[23]**	**US GAAP**	**Likely effect of the difference**
	in the related liability or related asset.	decommissioning costs recognised under ASC 410 *Asset Retirement and Environmental Obligations* and amounts allowed in the rates.	
Presentation	The model requires separate presentation of regulatory assets, regulatory liabilities, regulatory income and regulatory expense in primary financial statements, in addition to the line items required by IAS 1 *Presentation of Financial Statements*.	Generally, the requirements result in the 'net' presentation in the statement(s) of financial performance (ie allowable expenses entitled to be included in future rates are netted off the respective line items). US GAAP also adjusts revenue recognised in specified circumstances when regulatory liabilities arise, for example: (a) revenues subject to refund; (b) over-collection of costs relative to actual costs; or (c) advance billings.	The model requires presentation of regulatory balances as separate line items. The supplementary nature of the model means that the revenue or expense line items in the statement(s) of financial performance are not adjusted. Consequently, we think the differences in the model's approach to presenting regulatory items are likely to result in different outcomes than US GAAP, especially for the statement(s) of financial performance.
Disclosure	The model identifies an overall disclosure objective, supported by more granular specific disclosure objectives and disclosure requirements.	US GAAP has limited explicit disclosure requirements and disclosures in practice have evolved through application.	The model includes comprehensive disclosure requirements that are likely to mainly affect entities that currently do not recognise regulatory balances but would also affect, although to a lower extent, entities that

Table 1—US GAAP comparison			
Aspect	**Proposed model[23]**	**US GAAP**	**Likely effect of the difference**
	The overall disclosure objective does not focus on reporting all effects of defined rate regulation but is focused on the effects that the transactions or other events that give rise to timing differences have on an entity's financial performance and financial position. The specific disclosure objectives focus on the following areas: (a) financial performance; (b) amount, timing and uncertainty of future cash flows from regulatory assets and regulatory liabilities; and (c) changes in the carrying amounts of regulatory assets and regulatory liabilities.		currently do recognise regulatory balances applying IFRS 14, US GAAP or local GAAP. The model would require entities to disclose the following: (a) disaggregated information about regulatory income and regulatory expense; (b) qualitative and quantitative information about the reasons for origination of regulatory assets and regulatory liabilities and for changes in estimates; (c) maturity profile of regulatory assets and regulatory liabilities; (d) how the future recovery of regulatory assets and fulfilment of regulatory liabilities is affected by risks and uncertainty; (e) discount rates used to measure regulatory assets and regulatory liabilities and quantitative and qualitative reasons if different than the regulatory interest or return rate(s); and

Table 1—US GAAP comparison			
Aspect	**Proposed model[23]**	**US GAAP**	**Likely effect of the difference**
			(f) reconciliation of carrying amounts of regulatory assets and regulatory liabilities.

Table 2—Diversity in the accounting models currently used			
Region	**Country**	**Sampled entities**	**Methods of communicating the financial effects of regulatory balances**
Europe	Belgium	2 entities using IFRS Standards	Recognition in primary financial statements
	Spain	1 entity using IFRS Standards	Recognition in primary financial statements
	France	1 entity using IFRS Standards	Disclosure in financial statement notes
	Italy	1 entity using IFRS Standards	Recognition in primary financial statements
	Netherlands and Germany	1 entity using IFRS Standards	Disclosure in financial statement notes
	United Kingdom	1 entity using IFRS Standards	Disclosure in financial statement notes
	Portugal	1 entity using IFRS Standards	Recognition in primary financial statements
Africa	South Africa	1 entity using IFRS Standards	Disclosure in financial statement notes
Asia-Oceania	South Korea	1 entity using Korean IFRS Standards	Recognition in primary financial statements
	Hong Kong	1 entity using Hong Kong Financial Reporting Standards	Recognition in primary financial statements
	Australia	1 entity using IFRS Standards	Disclosure in financial statement notes

Table 2—Diversity in the accounting models currently used

Region	Country	Sampled entities	Methods of communicating the financial effects of regulatory balances
Americas	Canada	Recognition in primary financial statements if applying US GAAP (as permitted by Canadian Securities Administrators), IFRS Standards for first-time adopters after IFRS 14 was issued, Accounting Standards for Private Enterprises or if permitted by legislative framework.	
	United States	Recognition in the primary financial statements by applying US GAAP	
	Brazil	Due to IFRS Standards adoption in 2010, the regulator in Brazil published a resolution that requires entities in the power industry to prepare another set of financial statements called 'regulatory financial statements'. In these financial statements, entities must recognise regulatory assets and regulatory liabilities.[26]	
	Argentina	1 entity using IFRS Standards	Recognition in primary financial statements

[26] The transition to IFRS Standards in Brazil preceded the publication of IFRS 14 and resulted in the derecognition of regulatory balances in the financial statements of rate-regulated entities that previously recognised such balances in accordance with their local GAAP.

Table 3—Comments from a sample of users			
Date	**Group**	**Extract of comments**	**Source**
Europe			
Aug – Dec 2014	Interviewed 19 equity and credit analysts - 18 from European countries, 1 from U.S.	"IFRS financial statements generally do not provide the information that users regard as relevant to understanding the impact of rate-regulated activities on an entity's revenue and related costs, cash flows and financial position associated with an entity's rate-regulated activities." "**Most of the users broadly favour the inclusion of the financial effects of rate-regulated activities in the primary financial statements** as this would enhance the usefulness of the information provided. Users believe that recognising the economic effects of rate regulation in the primary statements would: a) result in a measure of performance that reflects what an entity is entitled to earn; b) result in useful financial information to assess prospects of future cash flows; and c) portray the economic reality of entities operating rate-regulated activities. They support separate presentation of the effects of rate regulation on rate-regulated activities as they assess different risks profiles when entities also operate activities that are not rate-regulated."	EFRAG Feedback Statement – February 2015

Table 3—Comments from a sample of users			
Date	**Group**	**Extract of comments**	**Source**
Dec 2014	Joint outreach event EFRAG, EFFAS, ABAF, IASB	"Some users noted that there are drawbacks to the recognition of these effects of rate regulation mainly because most rate-regulated regimes are complex and continually changing. In their view, the recognition of the effects of rate regulation at the at the expense of reliability and relevance would increase complexity and therefore reduce the understandability of financial statements." "Where enforceable rights and obligations exist, users preferred having this information recognised in the primary financial statements where a certain level of reliability is ensured; but they would be concerned about recognition if the definition of elements (e.g. assets and liabilities) in the Conceptual Framework were not met." "Where recognition of regulatory items in the primary statements were considered, sufficient, supplementary and quantitative disclosures should be mandatory to let users understand how management has exercised judgement and what risks are attached to the regulatory items."	Summary Report on User Event in Brussels – February 2015
Americas			
Date	**Area & Group**	**Extract of comments**	**Source**
Dec 2014	Roundtable with analysts,	Extract of some comments made by analysts in the meeting: • Courts support regulatory recovery of prudently incurred costs	Meeting summary of outreach event in Washington, DC

Table 3—Comments from a sample of users

Date	Group	Extract of comments	Source
	preparers, auditors and rate regulators	• Regulator's objectives include maintaining a low cost of capital for utilities • If there is **no recognition of regulatory assets and liabilities** under IFRS, - will result in an **increased reliance on non-GAAP disclosures**, thus increasing uncertainty, risk premiums and cost of capital - will require **greater resources and costs for FS users to find information from other sources** • Rate regulation creates a "new economic reality" • Noted that a major credit rating agency evaluates all 50 states from most supportive to least supportive regulatory environment, which impacts credit quality • Focus is on future cash flows and when expected to be recovered, so useful disclosures include: - analysis of **how/why regulatory balances arise** - a **maturity schedule** indicating when balances are expected to be recovered/reversed • Wants to see the **information audited** – non-GAAP disclosures are not consistent	

Table 3—Comments from a sample of users			
Date	**Group**	**Extract of comments**	**Source**
Canada			
Jan 2015	Scotia Capital (Corporate Bond Research)	"…MD&A disclosure may not be uniform, hindering comparability across companies. I think it would be optimal to have recognition and disclosure of regulatory assets and liabilities in the financial statements. In the long run, this will **enhance transparency and comparability**, and in **the long run, transparency and comparability play a big role in determining a firm's cost of capital."**	Comment Letter to the 2014 DP
Jan 2015	DBRS (Credit Rating Agency)	"In order to properly assess the financials of these entities and to ensure consistency and comparability year-over-year, **DBRS adjusts the IFRS financial statements of rate-regulated entities to include the effects of rate-regulated accounts** as DBRS views that regulatory assets and liabilities will eventually be reflected in future rates."	Comment Letter to the 2014 DP
Nov 2009	RBC Dominion Securities (Equity Analyst)	"…I believe that not allowing companies in the sector to reflect regulatory assets and liabilities in their financial statements has the potential to be **misleading**, and that I also continue to be concerned about the **increased use of non-GAAP measures** to communicate financial results following the transition to IFRS."	Comment Letter to the 2009 ED