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STAFF PAPER

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Project	Rate-regulated Activities		
Paper topic	Presentation		
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Purpose of this paper

1. The purpose of this paper is to recommend to the Board presentation requirements for the accounting model we are developing for defined rate regulation (model).

Summary of recommendations

2. In the statement of financial position, we recommend that an entity should:

   (a) present regulatory assets separately from regulatory liabilities as separate line items beyond the line items required by IAS 1 *Presentation of Financial Statements*;

   (b) offset regulatory assets and regulatory liabilities if, and only if, these assets and liabilities are reflected in the same adjustment to the rate(s) charged to customers and, consequently, have the same pattern and timing of reversal, arise in the same regulatory regime and the entity has a legally enforceable right to offset them; and

   (c) classify regulatory assets and regulatory liabilities as current or non-current, except when a presentation based on liquidity provides information that is reliable and more relevant.

3. In the profit or loss section of the statement(s) of profit or loss and other comprehensive income, we recommend that an entity should:

   (a) present regulatory income and regulatory expense netted as a separate line item beyond the line items required by IAS 1 (labelled in this paper as the regulatory income/(expense) line item);

   (b) include regulatory interest income and regulatory interest expense within the regulatory income/(expense) line item; and

   (c) present the regulatory income/(expense) line item immediately below the revenue line item(s) required by IAS 1.

4. In the other comprehensive section of the statement(s) of profit or loss and other comprehensive income, we recommend that, applying IAS 1, an entity should present regulatory income/(expense) as a separate line item(s) according to their nature and grouped with related items that:

   (a) will not be reclassified subsequently to profit or loss; and

   (b) will be reclassified subsequently to profit or loss.

5. We also recommend that the Board should:

   (a) make consequential amendments to IAS 1 to add the line items for regulatory assets, regulatory liabilities and regulatory income/ (expense) to the lists of items required to be presented separately in the statements of financial position and of profit or loss and other comprehensive income;[1] and

   (b) not prohibit an entity from disaggregating the required line items and presenting additional line items or subtotals in the primary statements when such presentation is relevant to an understanding of the entity's financial position and/ or financial performance, as required by IAS 1.[2]

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[1] Paragraphs 54 and 81A-82A of IAS 1 list the line items to be presented in the statements of financial position and of profit or loss and other comprehensive income.

[2] Paragraphs 55 and 85 of IAS 1 require an entity to present additional line items, headings and subtotals in the statements of financial position and of profit or loss and other comprehensive income when such presentation is relevant to an understanding of the entity's financial position and/ or financial performance.

Structure of the paper

6. The paper is structured as follows:

   (a) statement of financial position (paragraphs 7–14);

   (b) profit and loss section of statement of comprehensive income (paragraphs 15–45); and

   (c) other comprehensive income section of statement of comprehensive income (paragraphs 46–50).

Statement of financial position

7. At the May 2018 meeting, the Board examined the nature of regulatory assets and noted that they do not fit neatly into any of the defined categories of assets accounted for using existing IFRS Standards—a regulatory asset is not a financial asset, nor is it an intangible asset or an item of property, plant and equipment or inventory. A regulatory asset is not typically sold to produce cash flows directly, nor is it used with other assets to generate cash flows. We think that similar observations can be made for regulatory liabilities.[3]

8. Consequently, we recommend that the Board should require presentation in the statement of financial position of separate line items for regulatory assets and regulatory liabilities beyond the line items required by IAS 1.[4]

Offsetting

9. IAS 1 generally prohibits offsetting of assets and liabilities or income and expenses, except when offsetting reflects the substance of the transaction or other event.[5] We think that presentation of regulatory assets separately from regulatory liabilities will provide useful information to users of the financial statements when reversal of the regulatory assets or regulatory liabilities will result in separate adjustments to the

[3] Agenda Paper 9B discussed at the May 2018 Board meeting can be found: https://www.ifrs.org/-/media/feature/meetings/2018/may/iasb/ap09b-rra.pdf

[4] Paragraph 54 of IAS 1 lists line items that the statement of financial position should include.

[5] Paragraphs 32–33 of IAS 1.

future rate(s) charged to customers. Accordingly, we recommend that regulatory assets and regulatory liabilities are presented separately, without offsetting, if they:

(a) have different patterns and timings of reversal; or

(b) arise in separate regulatory regimes; or

(c) there is no legally enforceable right to set off the recognised amounts. Such a right would typically arise if the entity has a legally enforceable right to recover regulatory assets, and fulfil regulatory liabilities, through the same adjustment to the rate(s) charged to customers.

Current/non-current distinction

10. Paragraph 60 of IAS 1 states:

> **60 An entity shall present current and non-current assets, and current and non-current liabilities, as separate classifications in its statement of financial position in accordance with paragraphs 66-76 except when a presentation based on liquidity provides information that is reliable and more relevant. […]**

11. Users have told us they value the information they can derive from a maturity analysis of the regulatory assets and regulatory liabilities' balances, including the split between current and non-current amounts.

12. When issuing IFRS 14 *Regulatory Deferral Accounts*, the Board decided that regulatory deferral balances should not be presented as current or non-current, noting the amount of judgement and detailed information that such classification could require from entities.[6] IFRS 14 did not, however, prohibit an entity from identifying current and non-current amounts within the disclosure notes if the information was available.[7]

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6 IFRS 14 is a temporary Standard that permits particular first-time adopters of IFRS Standards to continue to apply, with some limitations, their previous GAAP accounting policies for the recognition and measurement of 'regulatory deferral account balances' (see Agenda Paper 9B for this meeting for further information).

7 Paragraph BC47 of IFRS 14.

13. At the meeting we held with the Consultative Group for Rate Regulation (CGRR) in October 2017,[8] we asked members whether it is feasible to disaggregate information about individual rate-adjustment account balances and to track when the balances are included in amounts billed to customers. Members suggested that, because of the level of detail needed to comply with record-keeping requirements in regulatory agreements, typically it is, enabling disaggregation of regulatory balances between current and non-current amounts.

14. Consequently, we recommend an entity classifies regulatory assets and regulatory liabilities as current and non-current in its statement of financial position except when a presentation of the entity's statement of financial position is based on liquidity in accordance with IAS 1.

Questions for the Board

Statement of financial position
1. Does the Board agree that an entity should: (a) present regulatory assets separately from regulatory liabilities as separate line items in its statement of financial position; (b) offset regulatory assets and regulatory liabilities if, and only if, these assets and liabilities are reflected in the same adjustment to the rate(s) charged to customers and, consequently, have the same pattern and timing of reversal, arise in the same regulatory regime and the entity has a legally enforceable right to offset them; (c) by applying IAS 1, classify regulatory assets and regulatory liabilities as current or non-current, except when a presentation based on liquidity provides information that is reliable and more relevant.

8 The Board discussed a summary of information received from the CGRR at the December 2017 Board meeting—see Agenda Paper 9A from that meeting, which can be found: https://www.ifrs.org/-/media/feature/meetings/2017/december/international-accounting-standards-board/ap09a-rra.pdf

Profit or loss section

15. We have considered the following aspects of the profit or loss section of the statement(s) of profit or loss and other comprehensive income:
    (a) number of line items (paragraphs 17–37); and
    (b) position of the line item(s) (paragraphs 38–41).

16. The analysis and recommendations in this section of the paper have been developed considering our disclosure recommendations in Agenda Paper 9D that entities should be required to provide a breakdown, in the disclosure notes, of the regulatory income/ (expense) line item in the profit or loss section into the following components, as appropriate:
    (a) origination of regulatory assets;
    (b) origination of regulatory liabilities;
    (c) recovery of regulatory assets;
    (d) fulfilment of regulatory liabilities;
    (e) changes in the carrying amount of regulatory assets and regulatory liabilities due to changes in estimates; and
    (f) transfers from other comprehensive income to profit or loss.

Number of line items

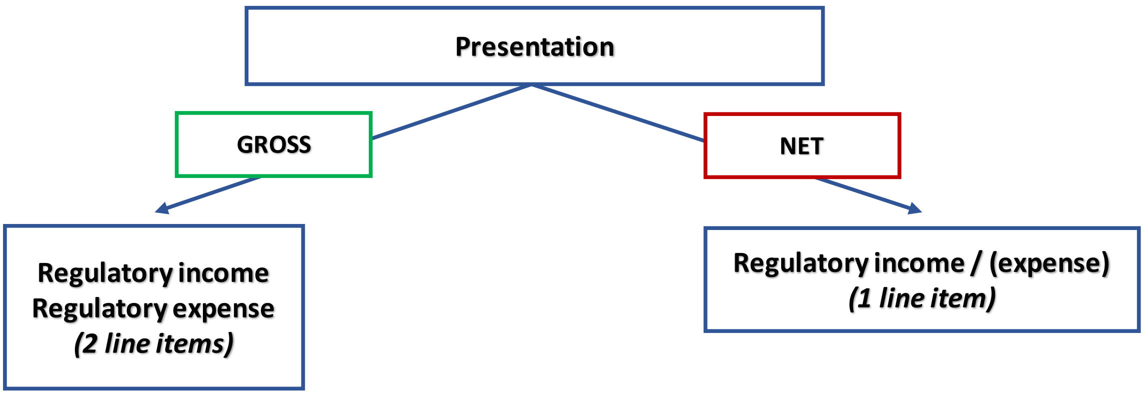
17. The origination of, reversal of and other changes in the regulatory timing differences[9] (for example, changes in estimates) have an impact in profit or loss, with:
    (a) regulatory income being recognised when regulatory assets originate, or regulatory liabilities are fulfilled;
    (b) regulatory expense being recognised when regulatory liabilities originate, or regulatory assets are recovered; and

[9] A regulatory timing difference is a timing difference that arises through the operation of the rate-adjustment mechanism when an entity fulfils service requirements in a different period than the period in which those service requirements are charged to customers through the regulated rate.

(c) changes in estimates resulting in either regulatory income or regulatory expense.

18. As discussed in Agenda Paper 9A, the supplementary feature of the model means that existing IFRS Standards will continue to be applied without modification. This leads to presenting the effect of the changes in the regulatory timing differences separately from line items presenting revenue from contracts with customers and other sources of revenue and separately from line items presenting expenses. We considered the two presentation approaches shown in Chart 1. The gross presentation approach would result in the presentation of two separate line items—one for regulatory income and one for regulatory expense; the net presentation option would result in a single line item—ie regulatory income and regulatory expense presented netted.

Chart 1—Presentation of regulatory income and regulatory expense



19. Chart 1 excludes, for the moment, discussion about how any regulatory interest or return included in the rate(s) charged to customers should be presented. This matter is addressed in paragraphs 25–37.

20. We use Table 1 to help us identify advantages of presenting regulatory income and regulatory expense in two separate line items in the profit or loss section. Table 1 aims to link regulatory income or regulatory expense with:

(a) the period in which the entity carries out the regulated activities; and

(b) the period in which the compensation for the activities is included in the rate billed to customers.

Table 1			
Activities		**Depiction**	
Delivery period	***Billing period***	***Transaction or event***	***Element in P&L***
Current period	Future period(s)	Origination of regulatory asset	Regulatory income
	Previous period(s)	Fulfilment of regulatory liability	
Previous period(s)	Current period	Recovery of regulatory asset	Regulatory expense
Future period(s)		Origination of regulatory liability	

21. An advantage identified in Table 1 of presenting two line items for regulatory income and regulatory expense is that this presentation would allow users to distinguish:

    (a) compensation for activities carried out during the current period (ie amounts reflected in regulatory income) but included, or to be included, in the rate in a different period from

    (b) compensation included in the rate in the current period (ie amounts reflected in regulatory expense) for activities carried out, or to be carried out, in a different period.

22. However, separate presentation of regulatory income and regulatory expense in the profit or loss section would still not enable users to distinguish whether:

    (a) the amounts recognised in regulatory income will affect the billings in future period(s) (ie origination of regulatory assets) or have already affected the billings in previous period(s) (ie fulfilment of regulatory liabilities); and

    (b) the amounts recognised in regulatory expense relate to activities delivered in previous periods (ie recovery of regulatory assets) or whether they relate to activities that will be delivered in future period(s) (ie origination of regulatory liabilities).

23. We learnt that users need information about how regulatory timing differences have arisen and how and when they will reverse. In other words, they need information about the different components of regulatory income and regulatory expense listed in paragraph 16. However, we think that providing that granularity in the primary financial statements would contribute to clutter and confusion. Consequently, we recommend that regulatory income and regulatory expense is presented netted as a

separate line item and that further granularity is provided through disclosures in the notes (see paragraph 16 and Agenda Paper 9D).

24. We do not propose, however, an exception to IAS 1 that would prohibit an entity from presenting regulatory income and regulatory expense in more than one separate line item if the entity considered such presentation to be relevant to an understanding of its financial performance.[10]

Interest or return

25. In previous meetings the Board has discussed the fact that regulators typically compensate or charge entities for the time lag between the origination and reversal of regulatory timing differences.

26. The existence of regulatory interest or return raises the question of whether this compensation or charge should be presented separately from other components of regulatory income and regulatory expense (paragraph 19).

27. We have structured the analysis as follows:

    (a) elements of interest or return rates for which consideration is provided; and

    (b) users' needs.

Elements of interest or return rates

28. The Board has previously discussed that the objectives of defined rate regulation is to protect:

    (a) current and future customers by ensuring stability and affordability of pricing; and

    (b) the entity by ensuring the rate established supports the entity's financial viability.

[10] Paragraph 85 of IAS 1 states: 'An entity shall present additional line items (including by disaggregating the line items listed in paragraph 82), headings and subtotals in the statement(s) presenting profit or loss and other comprehensive income when such presentation is relevant to an understanding of the entity's financial performance.'

29. To achieve these objectives, the regulatory agreement establishes a basis for setting the rate(s) that enable(s) a reasonably efficient entity to recover operating expenses and the costs of assets utilised in providing regulated services and to earn interest or a return on the cost of these assets.

30. This compensation or charge will be based on an interest rate or return rate established by the regulator, which will vary depending, amongst other factors, on the type and length of the regulatory timing difference.[11] However, the regulatory agreement is trying to achieve wider objectives (see paragraph 28) and uses an overall return that aims to encourage the entity to achieve them. That overall return is applied to amounts invested in assets used in providing regulated services as well as to some regulatory timing differences.

31. Consequently, that overall return provides the entity compensation not only for the time value of money and for costs of bearing uncertainty in the cash flows of the regulatory timing differences, but also provides compensation intended to encourage and support the entity's ongoing activities to achieve the regulatory objectives, including incentivising continuous investment and protecting the financial viability of the entity (ie compensation for 'other factors'). In other words, compensation provided through the regulatory interest or return rates is related to an entity's principal revenue-producing activities (ie operating activities)[12] rather than to its financing activities. This compensation is built into the 'stand-alone selling price'[13] for the regulated goods or services the entity delivers. The entity does not have the ability to adjust the regulated rate(s) charged to customers to incentivise customers to purchase its goods or services by using a financing component within the price charged to customers. In addition, neither the entity nor its customers are 'providers of finance' because they are both subject to the decisions that the regulator consider best achieves its objectives.

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11 Agenda papers 9B discussed at the May and July 2018 Board meetings can be found at: https://www.ifrs.org/-/media/feature/meetings/2018/may/iasb/ap09b-rra.pdf and https://www.ifrs.org/-/media/feature/meetings/2018/july/iasb/ap09b-rra.pdf

12 IAS 7 *Statement of Cash Flows* defines 'operating activities' as 'the principal revenue-producing activities of the entity and other activities that are not investing or financing activities.'

13 Appendix A of IFRS 15 defines the stand-alone selling price as the 'price at which an entity would sell a promised good or service separately to a customer'.

32. This contrasts with the ability of non-regulated entities to include financing amounts within the price they offer customers for goods or services, reflecting two distinct performance obligations—the provision of the goods or services and the provision of finance. Consequently, IFRS 15 requires an entity to adjust the promised amount of consideration for the effects of the time value of money when the price contains a significant financing component. The purpose of this adjustment is that an entity recognises revenue at an amount that reflects the price that a customer would have paid for the promised goods or services if the customer had paid cash for those goods or services.[14]

33. We think that requiring an entity to split the regulatory interest or return rates provided by the regulatory agreement between components with financing and operating features will cause costs that will outweigh the related benefits. This is because it will be a highly judgmental process –ie it will require the identification and quantification of all possible components of the interest or return rate.

Users' needs

34. When undertaking outreach with users of financial statements in the past, they have told us that they need information about how regulatory timing differences have arisen and about how and when those regulatory timing differences will reverse. This information helps them to distinguish fluctuations in revenue and expenses compensated for through the rate-adjustment mechanism from fluctuations for which there is no compensation. The information also helps them to understand the relationship between the revenue recognised during the period and the related expenses incurred for activities carried out in the period. Consequently, users need separate identification of the regulatory interest or return included in revenue only when the amount of that interest or return could distort or obscure the relationship between revenue and expenses during the period.

35. We note that currently the entire amount billed during the period, including any interest or return on the amounts invested in assets used in providing regulated services as well as on all regulatory timing differences, is recognised in the amount presented as revenue for the period. We understand that, in many cases, the

[14] Paragraphs 60–61 of IFRS 15.

component of the rate(s) charged to customers during the period that reflects regulatory interest or return on the regulatory timing differences existing during the period is unlikely to be material.

36. In some cases, it is possible that a material amount of regulatory interest or return on a regulatory timing difference accrues and is not included in the rate(s) charged to customers in the same period (ie the accrual of interest or return originates a new regulatory timing difference). Our recommendations for disclosure requirements in Agenda Paper 9D would trigger disclosure of such a material regulatory timing difference origination to help users identify and understand the effect in profit or loss for the period.

37. As a result of the matters described in paragraphs 25–36, we recommend that any amounts relating to regulatory interest income/interest (expense) are presented within the regulatory income/(expense) line item in the profit or loss section of the statement(s) of profit of loss and other comprehensive income.

Position in the profit or loss section

38. When analysing what would be an appropriate position of the single line item regulatory income/(expense) within the profit or loss section, we think the following points are pertinent:

(a) revenue recognised using IFRS 15 *Revenue from Contracts with Customers* reflects the customer perspective (amounts that the entity is entitled to bill using the regulated rate);

(b) as reflected in Table 1 in paragraph 20, regulatory timing differences arise when the rate setting basis results in compensation being included in the rate(s) and, therefore, in revenue in a different period than the period in which the entity carries out the activities related to that compensation; and

(c) regardless of the existence of any regulatory timing differences, the expenses incurred in carrying out activities are recognised using IFRS Standards in the period when they are incurred.

39. Consequently, the regulatory income/(expense) line reflects differences in the timing of revenue recognition rather than the timing of expense recognition. As a result, we think that locating the regulatory income/ (expense) line item close to the revenue line item will help reflect an entity's performance more completely by giving information that supplements the revenue line item.

40. In addition, when relating the amounts in the regulatory income/(expense) line item to the activities of an entity, we think these amounts, predominantly, form part of the entity's principal revenue-producing activities—ie its operating activities (see paragraph 31).

41. Consequently, we recommend entities should present the regulatory income/ (expense) line item immediately below the revenue line item required by IAS 1.

Subtotals incorporating the regulatory income/ expense line item

42. We think the use of any subtotal incorporating the regulatory income/ (expense) line item should be based on management judgement when applying paragraph 85 of IAS 1. That paragraph requires an entity to present additional subtotals in profit or loss when such presentation is relevant to an understanding of the entity's financial performance.[15]

43. We think that separate presentation of the regulatory income/ (expense) line item and the related disclosures proposed in Agenda Paper 9D would normally be sufficient to help users of financial statements to understand the effects of regulatory timing differences on the entity's financial performance. As a result, we do not recommend the Board require an entity to present a subtotal of revenue and regulatory income/ (expense). Nor do we recommend the Board prohibits the use of such a subtotal.

44. Paragraph 113 of IFRS 15 requires disclosure of revenue from contracts with customers separately from other sources of revenue, unless those amounts are presented separately in the statement of comprehensive income. This requirement, together with our recommendation to require presentation of a separate regulatory income/ (expense) line item would prohibit an entity from including regulatory income/ (expense) within the amounts reported for revenue from contracts with

[15] See paragraph 85 of IAS 1 reproduced in footnote 10 of this paper.

customers and other sources of revenue. However, it would not prohibit an entity from presenting a subtotal of revenue and regulatory income/ (expense).

45. Consequently, we recommend that the Board does not add guidance on whether or when it is appropriate to present in the profit or loss section an additional subtotal comprising revenue and regulatory income/(expense).

Question for the Board

Profit or loss section
2. Does the Board agree with the staff recommendation that: (a) regulatory income and regulatory expense should be presented netted as a separate line item (labelled in this paper as the regulatory income/(expense) line item); (b) regulatory income/(expense) should include any regulatory interest income and regulatory interest expense; and (c) regulatory income/(expense) should be presented immediately below the revenue line item. 3. Does the Board agree with the staff recommendation not to require or prohibit an entity from presenting an additional subtotal comprising revenue and regulatory income/(expense), thus requiring entities to apply the general requirement in paragraph 85 of IAS 1?

Other comprehensive income section

46. In some cases, a regulatory timing difference relates to an event or transaction that caused the recognition of income or expense presented in other comprehensive income. The inclusion in the rate(s) charged to customers of amounts that reimburse costs relating to an entity's pension benefits or cash flow hedges are examples of these types of regulatory timing differences. In such cases, we think that the movement (or part of the movement) between opening and closing balances of regulatory timing differences relating to underlying items recognised in other

comprehensive income in accordance with other IFRS Standards should also be reflected in other comprehensive income.

47. Paragraph 82(A)(a) of IAS 1 requires items of other comprehensive income to be presented separately according to their nature and grouped depending on whether they will be reclassified subsequently to profit or loss.[16]

48. In our view, the nature of any regulatory income/ (expense) recognised in other comprehensive income is different from the nature of the underlying items to which they relate (for example, pension costs or cash flow hedges)—ie the predominant nature is regulatory. This is consistent with the Board's conclusion that the nature of regulatory assets (and regulatory liabilities) is sufficiently different that they do not fit neatly into any of the defined categories of assets accounted for using existing IFRS Standards (paragraph 7).

49. Consequently, we recommend that an entity should be required to present separate line items for amounts of regulatory income/ (expense) relating to items presented in other comprehensive income, classified according to whether the underlying item to which the regulatory income/ (expense) relates will be reclassified subsequently to profit or loss.

50. In some cases, an entity may have regulatory income/ (expense) relating to more than one type of underlying item classified within the same presentation category in other comprehensive income, for example cash flow hedges and exchange differences. In such cases, we do not propose requiring or prohibiting the presentation of regulatory income/ (expense) in more than one separate line item, if an entity considered such presentation to be relevant to an understanding of its financial performance. This is consistent with our recommendation in paragraph 24 relating to regulatory income/ (expense) presented in the profit or loss.

[16] Paragraph 82A of IAS 1 states: 'The other comprehensive section shall present line items for the amounts for the period of: (a) Items of other comprehensive income […], classified by nature and grouped into those that, in accordance with other IFRSs: (i) will not be reclassified subsequently to profit or loss; (ii) will be reclassified subsequently to profit or loss when specific conditions are met. […]'

Question for the Board

Other comprehensive income section
4. Does the Board agree with the staff recommendation that an entity should be required to present separate line items for amounts of regulatory income/ (expense) relating to items presented in other comprehensive income, classified according to whether the underlying item to which the regulatory income/ (expense) relates will be reclassified subsequently to profit or loss? 5. Does the Board agree with the staff recommendation to neither require nor prohibit disaggregation of the separate line item in each category into additional line items, thus requiring entities to apply the general requirement in paragraph 85 of IAS 1?