KASB DISCUSSION PAPER

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Accounting Standards Advisory Forum

Project	**Rate-regulated Activities**
Paper topic	Cover paper

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Purpose of the session

1. The purpose of this session is to obtain advice and comment from ASAF members on conceptual basis for revenue recognition of rate-regulated activities, expecting to:
   - explore rationales for recognising regulatory assets and liabilities based on revenue approach;
   - contribute to the IASB's development of a new standard for rate-regulated activities; and
   - share and exchange ideas on improving accounting for rate-regulated activities.

Purpose of this paper

2. This agenda paper (Agenda Paper 3B) is a cover note that provides the scope of discussion and an overview of the agenda papers (Agenda Papers 3Ba to 3Bc) on the issues relating to Rate-Regulated Activities project.

Scope of discussion

3. It is expected that the IASB will undertake the Rate-Regulated Activities project as a major project and publish a second Discussion Paper. The discussion for this project up to now can be summarised as three approaches: (a) **revenue approach**; (b) cost deferral approach; and (c) disclosure in foot notes only approach.

4. As the revenue approach was supported by the majority of IASB members, the discussion at the IASB meeting in July 2015 revolved around accounting treatments based on the revenue approach. One of the key issues that the IASB discussed at that meeting relates to the case in which revenue requirement includes consideration for performance obligations that are not directly relevant to the transfer of goods or services to the individual customers.

5. The KASB supports the revenue approach, and on the basis of the revenue approach, proposes developing a new revenue recognition model for rate-regulated entities, which would reflect the unique natures of rate-regulated environment. A new model based on the revenue approach would be consistent with the definition of asset and the definition of liability in the current *Conceptual Framework for Financial Reporting*(hereinafter referred to as '*Conceptual Framework*') as well as with the requirements of IFRS 15 *Revenue from Contracts with Customers*. The KASB thinks that the new model would enhance the intercompany comparability among rate-regulated entities and non-regulated entities.

Overview of Agenda Papers

6. The agenda papers (Agenda Papers 3Ba to 3Bc) are summarised as follows.

   (a) **Agenda Paper 3Ba—**examines differing views on how to account for regulatory revenue requirement in the light of the current *Conceptual Framework* and IFRS 15.

   (b) **Agenda Paper 3Bb**—addresses the differing views in Agenda Paper 3A, using an illustrative example of raw material cost for the adjustment of revenue requirement (simple case).

   (c) **Agenda Paper 3Bc**—addresses the differing views in Agenda Paper 3A, using an illustrative example of construction cost for the adjustment of revenue requirement (complex case).

7. **Agenda Paper 3Ba** compares differing views as to how to account for the difference between regulatory revenue requirement (ie revenue in accordance with rate regulation) and contract revenue (ie revenue in accordance with contracts with customers). Agenda Paper 3Ba explores and assesses the rationales for each differing views in the light of the current *Conceptual Framework* and IFRS 15.

8. To put the scope of **Agenda Papers 3Bb** and **3Bc** in perspective, regulatory revenue requirement can be expressed as the sum of 'required costs' and 'required margin' (ie regulatory revenue requirement = required costs + required margin). Also, for the convenience of discussion, 'required costs' is divided into 'required costs that are currently expensed' and 'required costs to be expensed in future periods' (ie required costs = required costs that are currently expensed + required costs that will be expensed in future periods).

9. In the case of 'required costs that are currently expensed', when there is a difference between the amount billed to and collected from customers and 'required costs that are currently expensed',

the difference (ie the 'revenue requirement adjustment'[1]) is collected or settled through the contracts with customers in the subsequent periods. **Agenda Paper 3Bb** addresses differing views on how to account for this 'adjustment', using a simple example of raw material cost.

10. In the case of 'required costs to be expensed in the future period', there is a rate regulation that allows a rate-regulated entity to collect a certain amount of money to acquire a related asset from customers in advance and the related asset is put to use in future periods. **Agenda Paper 3Bc** addresses differing views on how to account for this revenue requirement adjustment, using an example of construction costs.

[1] See the definition in Appendix 1 of Agenda Paper 3Ba.