KASB DISCUSSION PAPER

29 September 2016

Accounting Standards Advisory Forum

Project	**Rate-regulated Activities**
Paper topic	Conceptual basis for revenue recognition

CONTACT(S)	Sungsoo Kwon	sskwon@kasb.or.kr	+82 (0)2 6050 0152
	Daehyun Kim	dhkim@kasb.or.kr	+82 (0)2 6050 0172
	Haneul Kim	hnkim@kasb.or.kr	+82 (0)2 6050 0149

Background

1. The IASB published a first Discussion Paper in September 2015. The Discussion Paper defined the term, 'defined rate regulation' and limited the scope of discussion to defined rate regulation. In defined rate regulation, it is believed that there exist unique rights and obligations that would affect the recognition of assets and liabilities. The Discussion Paper considered the following possible approaches:

   (a) recognising the package of rights and obligations established by the regulatory agreement as an intangible asset;

   (b) reporting using the regulatory accounting requirements;

   (c) developing specific IFRS requirements to defer/accelerate the recognition of costs and/or revenue; and

   (d) prohibiting the recognition of regulatory deferral account balances in IFRS financial statements.

2. Among the four approaches, it appears that the most widely supported approach has been 'developing specific IFRS requirements to defer/accelerate the recognition of revenue (ie revenue approach)'. The KASB supports this approach because defined rate regulation gives rise to unique rights and obligations in addition to those created by contracts with customers. Hence the KASB thinks that a new revenue recognition criteria should be developed to reflect unique rights and obligations arising from defined rate regulation.

Overview of this paper

3. This Agenda Paper purports to offer a conceptual basis for a new revenue recognition model for defined rate regulation, drawing upon the definition of assets and liabilities in *the Conceptual Framework for Financial Reporting* (hereinafter referred to as *' Conceptual Framework'*) and the requirements of IFRS 15 *Revenue from Contracts with Customers*.

4. The Agenda Paper consists of three analyses as follows.

   (a) (**Analysis 1**) The economic substance of rate-regulated activities under defined rate regulation

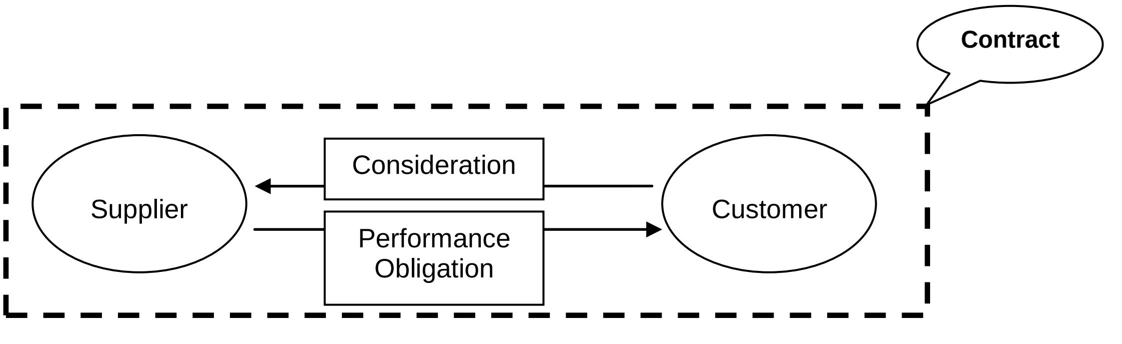
   (b) (**Analysis 2**) Regulatory assets and liabilities in the context of the *Conceptual Framework*

   (c) (**Analysis 3**) Revenue recognition model for rate-regulated activities derived from IFRS 15

Analysis 1–The economic substance of rate-regulated activities under defined rate regulation

5. To consider the economic substance of rate-regulated activities in the context of the revenue approach mentioned above, it would be necessary to understand the accounting requirements in IFRS 15. IFRS 15 addresses accounting treatments based on the **contract** between the supplier and the customer. Specifically, it requires that the supplier recognise the consideration it receives for transferring goods or services to the customer as revenue when the supplier satisfies the performance obligation that is contained in the bilateral contract between the supplier and the customer.

<Fig. 1> Relationship between supplier and customer in IFRS 15

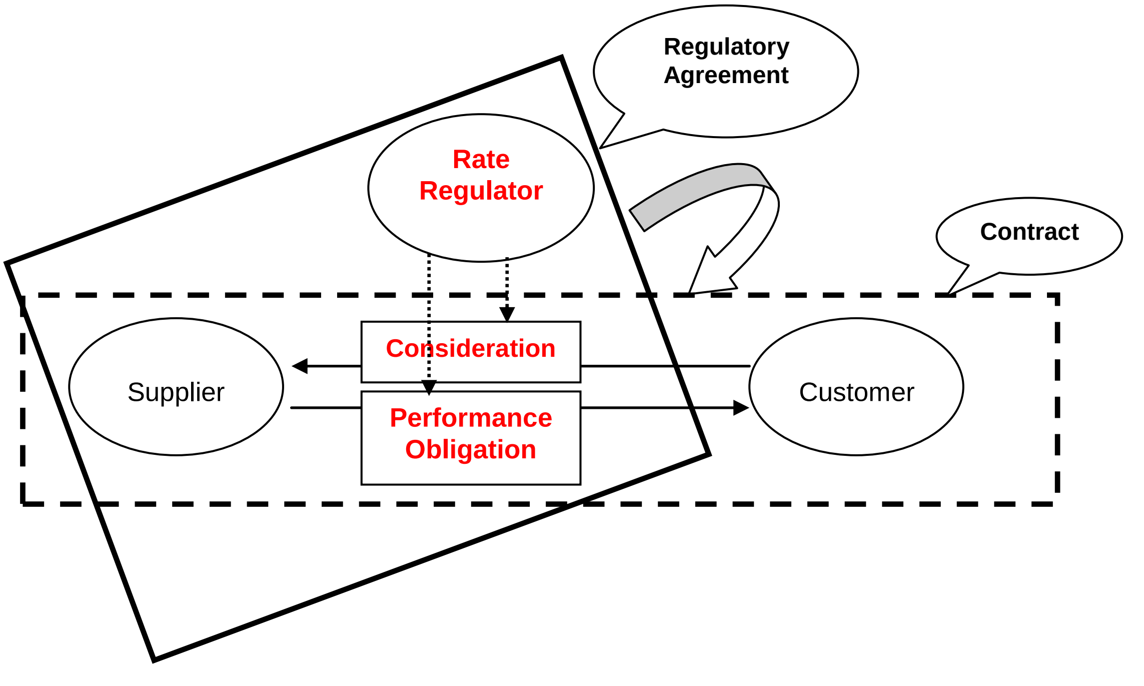


6. The accounting for rate-regulated activities in accordance with IFRS 15 would not fully represent the economic substance because the tripartite (the supplier, the customer and the regulator) relationship of rate-regulated activities affects the mechanism of determining the

consideration for transferring goods or services to customers. The regulatory agreement changes the nature of a contract between the supplier and the customer; it considerably changes the amount, timing, and uncertainty of future cash flows of the supplier. Accordingly, it is necessary to develop a new IFRS standard to faithfully represent the economic substance of rate-regulated activities.

7. As will be discussed further below, the KASB believes that the rate regulator essentially involves the whole process of executing the contract between the supplier and the customer. This means that the effect of the rate regulation should be addressed in terms of the effect on the entire consideration that the supplier receives until the supplier transfers goods or services to the customer in order to satisfy the performance obligation. In other words, the effect of the rate regulation should not be separately addressed in terms of the effect on the part of the consideration that the supplier receives in the input process, for example, repair or construction of a PPE to generate goods or services. Figure 2 illustrates the interaction among the supplier, customer and rate regulator and also the effect of the rate regulation on the relationship between the supplier and the customer.

<Fig. 2> Tripartite relationship among supplier, customer and rate regulator



Analysis 2– Regulatory assets and liabilities in the context of the *Conceptual Framework*

8. Most respondents to the Discussion Paper[1] on rate-regulated activities agreed to recognise the financial effect of rate regulation in IFRS financial statements. However, many respondents maintained that there should be an examination on whether rights and obligations of a rate-regulated entity arising from enforceable rate regulation would meet the definition of asset and liability under the *Conceptual Framework*.

9. There are differing views on this issue. Specifically, the issue is whether the recognition of a regulatory asset would be consistent with the concept of 'control' in the *Conceptual framework* and whether the recognition of a regulatory liability would be in line with the concept of 'present or conditional obligation' in the *Conceptual Framework*.[2] The analysis below looks at how regulatory assets and regulatory liabilities would meet the definition of an asset and the definition of a liability, respectively.

Control in terms of definition of asset

10. The defined rate regulation (ie no effective competition to supply) has the following characteristics:

    (a) the regulatory agreement is enforceable and the rate-setting mechanism therein ensures that the rate-regulated entity recovers a determinable amount of consideration (the 'revenue requirement') from customers.

    (b) the customer has little or no choice but to purchase the rate-regulated goods or services from the rate-regulated entity.

    (c) the rate-regulated entity has an exclusive right to provide the rate-regulated goods or services and is entitled to recover the revenue requirement.

11. The rate-regulated entity would have an enforceable right for the revenue requirement that is not recovered from customers. This is because the rate-regulated entity is able to collect such revenue requirement by adjusting future rates as the revenue requirement represents the consideration that the rate-regulated entity receives in exchange for goods or services it has already provided.

[1] Discussion Paper, Reporting the Financial Effects of Rate Regulation, September 2014.
[2] See the paragraph 5.14-5.31 of IASB Discussion Paper, Reporting the Financial Effects of Rate Regulation, September 2014.

12. The rate-regulated entity operates in an environment different from the non-regulated entity's: (1) there is a rate regulator; and (2) the regulatory agreement between the rate regulator and the rate-regulated entity entitles the rate-regulated entity to have an exclusive rights to provide goods or services and recover the revenue requirement. Accordingly, the rate-regulated entity has 'control' that could justify the recognition of the revenue requirement for the goods or services transferred to customers as an asset.[3] (See Agenda Paper 3Bb for a relevant illustrative example.)

Present or conditional obligation to transfer an economic resource in terms of definition of liability

13. In defined rate regulation, the rate-regulated entity has an obligation that the entity has no practical ability to avoid through the enforceable regulatory agreement or laws when the entity collected the amount from customers that exceeds the revenue requirement (ie the sum of the current year's required cost and required margin). The collected amount that exceeds the revenue requirement is an amount received in advance that will be part of the next year's revenue requirement (ie the sum of the next year's required actual cost and required margin). When the rate-regulated entity sets the rate for goods and services to provide in future periods, it deducts the overly-charged amount in prior periods from the rate. (See Agenda Paper 3Bb for a relevant illustrative example.)

14. In other words, as the rate-regulated entity is obliged to provide goods or services in future periods, the amount it received that exceeds the revenue requirement (See Agenda Paper 3Bb) or the amount related to consideration for future performance obligation (See Agenda Paper 3Bc) is similar to unearned revenue, which represents an obligation to provide goods or services in future periods.[4]

Analysis 3– Revenue recognition model for rate-regulated activities derived from IFRS 15

15. There are two differing views as to the revenue recognition for rate-regulated activities. **View 1** is that the requirements of IFRS 15 should be applied to rate-regulated activities and thus no new revenue recognition model is necessary. On the other hand, **View 2** is that the revenue recognition for rate-regulated activities should reflect the regulatory agreement in addition to the

---

[3] Paragraph 3.27 of the Conceptual Framework Discussion Paper, which notes that: ‘For an entity to control an economic resource, the economic benefits arising from the resource must flow to the entity (either directly or indirectly) rather than to another party’.

[4] See paragraph 106 of IFRS 15 Revenue from Contracts with Customers

contract with customers and therefore a new revenue recognition model should be established. View 2 supports developing a new revenue recognition model drawing upon the requirements in IFRS 15.

16. The analysis below looks at how the two views (ie View 1 and View 2) are different in the case of unbilled revenue requirement and overbilled revenue requirements. The analysis also addresses how View 2 is split into two sub-views (ie View 2A and View 2B) in the case where the rate-regulated entity has an obligation relating to input activities, which could also be referred as 'indirectly related to delivering goods or services'.

Timing of revenue recognition for unbilled revenue requirement

17. There are two views with respect to how the effect of rate regulation should be considered in terms of timing of revenue recognition for unbilled revenue requirement:

    - **View 1—**Recognise in the **future periods** the revenue requirement that is not reflected in the contract with customers in the current period because such revenue requirement will be billed to, and collected from, customers in future periods; and
    - **View 2—**Recognise in the **current period** the revenue requirement that is not reflected in the contract with customers in the current period because such revenue requirement is the consideration for transferring goods or services to customers in the current period.

18. **View 1** focuses only on the contract between the supplier and the customers and thus supports that the supplier recognises its revenue when it reflects the 'revenue requirement adjustment'[5] on the contract with customers. According to View 1, an entity recognises its revenue in the period when it satisfies the performance obligation established in the contract with customers. Accordingly the rate-regulated entity should recognise the revenue requirement adjustment in the future periods when it reflects the adjustment in the contract with customers in the future periods; the revenue is a consideration for satisfying the performance obligation in the future periods.

19. **View 2** focuses on the interaction of regulatory agreement and contract with customers. View 2 holds that in the rate regulation, revenue amount should not be determined only by contracts with customers but also by reflecting the revenue requirement adjustment established in the regulatory agreement.

[5] See the definition in Appendix 1 of this paper.

20. The KASB supports View 2 (ie the supplier recognises revenue when it satisfies the performance obligation to the customer) by analogising to the requirements in IFRS 15. There are two aspects to look at the requirements in IFRS 15.

21. The first aspect is the requirements for **progressive revenue recognition over time** in IFRS 15. The KASB notes that the supplier can recognise revenue before the payment is contractually billable to the customer. According to IFRS 15, an entity recognises revenue with a corresponding entry of 'contract asset' to the extent of the progress of construction (for example, up to 25% of the progress when 30% is the contractually billable point), provided the revenue recognition criteria are met, though it is not contractually billable. When the progress of construction reaches up to the contractually billable point (ie 30% in this case), the contract asset that was recognised for the portion of 25% of progress can be replaced with a receivable (ie financial asset).

22. This means that revenue can be recognised even before a financial asset is recognised. In other words, if the supplier satisfies a performance obligation to the customer and has a right to receive a consideration from the customer, the supplier recognises revenue before it bills to the customer.

23. How the rate regulation can be analogised to this requirement in IFRS 15 will be addressed in conjunction with the second point explained below.

24. The second aspect is that the case of adjusted revenue requirements in the rate regulation can be analogised to the concept of **variable consideration** in IFRS 15. The adjusted revenue requirements in the rate regulation means that the amount of the consideration that was set at the beginning of Year 1 is adjusted at the end of Year 1. According to the regulatory agreement at the beginning of Year 1, such adjusted consideration is, by nature, a post-adjustment to the consideration in return for the performance obligation during Year 1. In other words, such post-adjustment represents a variable consideration that is adjusted in response to unexpected changes in circumstances during the year, which was not considered in setting up the revenue requirements at the beginning of the year. In this sense, the adjusted consideration is conceptually similar to the variable consideration described inIFRS 15. And this adjusted consideration is not contractually billable in Year 1, but is contractually billable in Year 2 by adjusting the amount of consideration in the contract.

25. When the first aspect mentioned above is brought into the context of the rate regulation, it can be said that although the adjusted consideration is not billable in Year 1, revenue for that adjusted

consideration can be recognised in Year 1 because it is a consideration in return for satisfying the performance obligation in Year 1. Therefore, a regulatory asset and regulatory revenue will be recognised in Year 1; the regulatory asset recognised in Year 1 will be replaced with a receivable (ie financial asset) and the regulatory revenue recognised in Year 1 will adjust the contract revenue in Year 2 because this adjusting accounting entry should be recorded not to duplicate the revenue.

26. Incidentally, recognising a regulatory asset in Year 1 would not require that there should be the same customer group to bill in Year 1 and Year 2. That is, if the supplier can bill to the customer in Year 2, the regulatory asset that is recognised in Year 1 would meet the definition of asset, regardless of whether the customer group in Year 2 is different from that in Year 1.

Timing of revenue recognition for overbilled revenue requirement

27. In **View 1**, although the entity may have an obligation to reverse the overbilled revenue requirement by lowering the rate for future sales, this does not involve the transfer of an economic resource. Instead, the entity will earn a lower profit for its future sales. Accordingly, the rate-regulated entity should recognise the overbilled revenue requirement as revenue in the current period.

28. In **View 2,** overbilled revenue requirement is not a consideration for transferring goods or services to customers in the current period; it is a consideration relating to performance obligation in the future periods and an over-charged amount. Accordingly, the rate-regulated entity should recognise the amount as revenue in the future period.

29. Analogising to the requirements in IFRS 15[6], the rate-regulated entity should recognise the amount billed to customers as revenue by allocating the amount to current period and future periods. The portion that the entity has satisfied the performance obligation for transferring goods or services in the current period is allocated to the current period and the portion that the entity has to satisfy the performance obligation in the future periods is allocated to the future periods.

30. The method of allocation would be based on the required cost and required margin established in the regulatory agreement, matching the revenue requirement (See Agenda Paper 3Bb and 3Bc). Accordingly, after allocating the amount to the current period, the unallocated amount should be

[6] IFRS 15.73 The objective when allocating the transaction price is for an entity to allocate the transaction price to each performance obligation (or distinct good or service) in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer.

presented as unearned revenue that represents a consideration for performance obligation in the future periods because the unallocated amount is carried over to the contract with customers in the future periods through the rate-setting mechanism.

Timing of revenue recognition for input activities costs(performance obligation)

31. In defined rate regulation, the rate-regulated entity often has an obligation for indirect activities (hereinafter referred to as 'input activities') as well as direct activities (hereinafter referred to as 'output activities') (ie to transfer goods or services to customers). Examples of the obligation for input activities are: an obligation to construct a PPE to produce goods or services; and an obligation of restoration after a disaster.

32. Assuming that View 2 is taken, there are two views on this issue. **View 2A** is that the rate-regulated entity should separately identify performance obligation for input activities and thus allocate consideration for those activities. **View 2B** is that the rate-regulated entity should regard that performance obligation is satisfied when it ultimately satisfies the obligation for output activities (ie to transfer goods or services to customers). (See Agenda Paper 3Bc for a relevant illustrative example.)

33. From the standpoint of the tripartite relationship, the two views can be summarised as follows:

- **View 2A—**The rate-regulated entity recognises its revenue when it satisfies the performance obligation to the **rate regulator**; and
- **View 2B—**The rate-regulated entity recognises its revenue only when it satisfies the performance obligation to the **customer.**

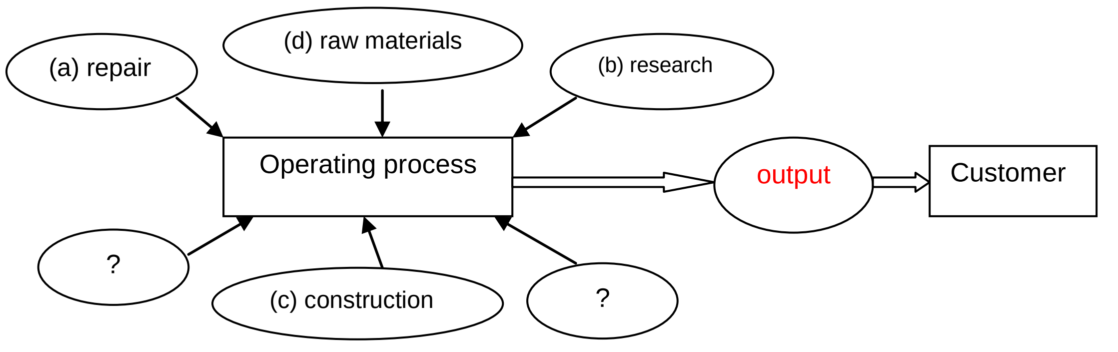
34. **View 2A** focuses on the relationship between the rate-regulated entity and the rate regulator and thus supports that the rate-regulated entity recognises its revenue when it satisfies the performance obligation to the rate regulator.

35. **View 2B** focuses on the whole process of the rate-regulated entity's operating activity until the entity transfers goods or services to the customer and thus supports that the entity recognises its revenue when it satisfies the performance obligation to the customer.

36. The KASB is in favour of **View 2B** because View 2A would give rise to the following issue. If the rate-regulated entity recognises its revenue when it completes the input process of the operating activity, each of the separate input process would become the unit for recognising revenue. This could lead to the complexity of accounting and conceptual inconsistency because

the rate-regulated entity would need to separately identify revenue from input operating process and revenue from output operating process.

<Fig. 3> Input and output operating process of a supplier



37. The KASB thinks that the effect of the rate regulation does not just relate to the input operating activity of the rate-regulated entity. The input operating activity is **a necessary condition** for the entity performing the obligation to transfer the final output to the customer, but **not a sufficient condition** for that. The KASB thinks that the effect of the rate regulation should relate to the entire consideration that the rate-regulated entity receives in exchange for performing the obligation to the customer.

38. Accordingly, the rate-regulated entity should not recognise its revenue when it completes the input operating activity (eg. the construction of a PPE) for providing the output to the customer because the obligation to construct the PPE is not a final obligation. This would also be the case even if the amount for the cost to construct the PPE is billed to the customer because the final output has yet to be transferred to the customer. In our view, the rate-regulated entity should recognise its revenue when the whole process is completed, that is, when the entity transfers goods or services to the customer and thus the costs that incurred during the input activities are expensed.

39. The KASB believes that View 2B (ie the rate-regulated entity recognises revenue when it satisfies the performance obligation to the customer) can be supported by analogising to the requirements in IFRS 15. Paragraph 29 of IFRS 15 states:

> ...
>
> Factors that indicate that two or more promises to transfer goods or services to a customer are not separately identifiable include the following:

(a) the entity provides a significant service of integrating the goods or services with other goods or services promised in the contract into a bundle of goods or services that represent the combined output or outputs for which the customer has contracted. In other words, the entity is using the goods or services as inputs to produce or deliver the combined output or outputs specified by the customer. A combined output or outputs might include more than one phase, element or unit.

(b) ...

(c) the goods or services are highly interdependent or highly interrelated. In other words, each of the goods or services is significantly affected by one or more of the other goods or services in the contract. For example, in some cases, two or more goods or services are significantly affected by each other because the entity would not be able to fulfill its promise by transferring each of the goods or services independently.

40. Analogising rate regulated activity to paragraph 29(a) of IFRS 15 above, the input activity that the regulator requires the rate-regulated entity to perform would be similar to the obligation for 'a bundle of goods or services' that is combined with the obligation to transfer goods or services to customers. By this analogy, View 2B would be more appropriate because the obligation for input activities should not be identified as a distinct performance obligation.

41. Analogising the rate regulation to paragraph 29(c) of IFRS 15 above, it can be said that the obligation for input activities that the regulator requires the rate-regulated entity to perform and the obligation to transfer goods or services to customers are highly interdependent or highly interrelated. In other words, each of the goods or services relating to input activity and output activity is significantly affected by one or more of the other goods or services. By this analogy, View 2B would be more appropriate because the obligation for input activities should not be identified as a distinct performance obligation.

Conclusion

42. The requirements of IFRS 15 would not fully represent the economic substance of rate-regulated activities because the revenue recognition requirements of IFRS 15 are only based on contracts with customers and thus cannot properly consider the effect of the rate regulation. A transaction under the rate regulation would be different from that only based on contracts with customers because the rate regulation would affect the amount, timing and uncertainty of future cash flows of the transaction.

43. The rate regulator engages in the input activities of the entity's operation: (1) it may require a rate-regulated entity to perform a certain type of input obligations; or (2) it may determine the amount and timing of consideration that the entity receives from the customer.

44. This engagement of the rate regulator occurs by virtue of a regulatory agreement. The regulatory agreement between the rate regulator and the entity affects the entity's contracts with customers. This effect results in a timing difference between the receipt of consideration from the customer and the satisfaction of the entity's performance of obligation to the customer; that is, the regulatory agreement requires the entity to satisfy the performance obligation before receiving a consideration and vice versa. Accordingly, it would be necessary to develop a new Standard to reflect the timing difference arising from the existence of the rate regulation.

45. The KASB tentatively views that a new IFRS standard can be developed drawing upon the requirements in IFRS 15. Specifically, the KASB thinks that the accounting for rate-regulated activities can be considered by analogising to the concept of **progressive revenue recognition over time** and **variable consideration** in IFRS 15.

46. On the basis of the analyses above, The KASB proposes developing a new accounting model for rate-regulated activities as follows:

    (a) the rate-regulated entity recognises its revenue reflecting the revenue requirement adjustment when it satisfies the performance obligation to transfer goods or services to customers;

    (b) the timing of revenue recognition is not dependent on when the consideration for transferring goods or services is billed or contractually billable to a customer; and

    (c) the obligation for input activities that the rate regulator requires the rate-regulated entity to perform (for example, the construction of a PPE to produce goods or services to transfer) is not separately identified for revenue recognition, and the revenue requirement (ie consideration) for those input activities will be recognised as revenue when the cost of the related asset is expensed (for example, as the PPE is depreciated).

Questions for ASAF members

1. Do you think that the regulatory agreement affects the timing, amount and uncertainty of revenue recognition from contracts with customers?

2. Do you support View 2 (ie recognise regulatory assets and liabilities) and also View 2B (ie revenue is recognised when the rate-regulated entity completes the whole process of operating activity to transfer goods or services to customers)?

3. Do you have any comments on the proposal of a revenue recognition model for rate-regulated activities provided in Appendix 2 of this paper?

APPENDIX 1 — Defined terms

billable revenue[7]

That is the amount of revenue that the entity bills(invoices) to customers, using the established rate per unit, in exchange for the actual quantity of rate-regulated goods or services delivered in the period

(**Notes**) Billable revenue is the same as 'receivable' that is billed to customer through contracts with customers.

billable revenue[8]

That is the amount of revenue that the entity bills(invoices) to customers, using the established rate per unit, in exchange for the actual quantity of rate-regulated goods or services delivered in the period

(**Notes**) Billable revenue is the same as 'receivable' that is billed to customer through contracts with customers.

defined rate regulation[9]

Defined rate regulation involves a regulatory pricing (ie rate-setting) framework that includes all of the following:

(a) it applies in situations in which customers have little or no choice but to purchase the goods or services from the rate-regulated entity because: (i) there is no effective competition to supply; and (ii) the rate-regulated goods or services are essential to customers (such as clean water or electricity).

(b) it establishes parameters to maintain the availability and quality of the supply of the rate-regulated goods or services and other rate-regulated activities of the entity.

(c) it establishes parameters for rates (sometimes referred to as prices or tariffs) that provide regulatory protections that: (i) support greater stability of prices for customers; and (ii) support the financial viability of the rate-regulated entity.

(d) it creates rights and obligations that are enforceable on the rate-regulated entity and on the rate regulator.

rate regulation[10]

A framework for establishing the prices that can be charged to

7 IASB Discussion Paper, Reporting the Financial Effects of Rate Regulation, September 2014.
8 IASB Discussion Paper, Reporting the Financial Effects of Rate Regulation, September 2014.
9 IASB Discussion Paper, Reporting the Financial Effects of Rate Regulation, September 2014.

customers for goods or services and that framework is subject to oversight and/or approval by a rate regulator.

rate regulator[11] An authorised body that is empowered by statute or regulation to establish the rate or a range of rates that bind an entity. The rate regulator may be a third-party body or a related party of the entity, including the entity's own governing board, if that body is required by statute or regulation to set rates both in the interest of the customers and to ensure the overall financial viability of the entity.

rate-regulated activities[12] An entity's activities that are subject to rate regulation.

regulated rate per unit[13] The entity charges to customers for delivering the rate-regulated goods or services during the regulatory period

(**Notes**) Regulated rate per rate is similar to 'stand-alone selling price (of a good or service)' in IFRS 15. It is the rate set by the regulator through the rate-setting mechanism.

revenue requirement[14] That is the amount of consideration to which the entity is entitled in exchange for carrying out the required rate-regulated activities during the period, including those both directly and indirectly related to delivering the rate-regulated goods or services. The regulatory agreement establishes the total amount of consideration (commonly called the 'revenue requirement', 'allowable revenue' or 'authorised revenue') to which the entity is entitled in exchange for all of its rate-regulated activities. This revenue requirement reflects a targeted rate of return, which is established in the defined rate regulation. The entity is not paid directly by the rate regulator or the government for carrying out these activities. Instead, it receives consideration for these activities through the amounts billed to customers.

(**Notes**) Revenue requirement is a combination of 'transaction price' defined in **IFRS 1**5 (ie The amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third

---

10 IFRS 14 *Regulatory Deferral Accounts*
11 IFRS 14 *Regulatory Deferral Accounts*
12 IFRS 14 *Regulatory Deferral Accounts*
13 IASB Discussion Paper, Reporting the Financial Effects of Rate Regulation, September 2014.
14 IASB Discussion Paper, Reporting the Financial Effects of Rate Regulation, September 2014.

parties) and 'revenue requirement adjustment' that is added or subtracted through the rate-setting mechanism. Put differently, revenue requirement is similar to the transaction price that includes 'variable consideration' defined in IFRS 15.

revenue requirement adjustment	That is the difference between the revenue requirement established in the regulatory agreement during the regulatory period and the actual amount that has been collected from customers. Revenue requirement adjustment will be collected or reimbursed through the adjustment in the rate in the future periods. (**Notes**) Revenue requirement adjustment is similar to variable consideration. While the amount of consideration in IFRS 15 is contingent due to discount, rebate, reimbursement, credits, price concessions, incentive, etc, an adjustment of the revenue requirement in the rate regulation is contingent due to a change in purchasing prices, volume different, etc. An adjustment of the revenue requirement occurs when the revenue requirement is adjusted in accordance with the requirements of the regulatory agreement between the regulator and the rate-regulated entity.

APPENDIX 2 — Proposal of a revenue recognition model for rate-regulated activities

The following table is a proposal of revenue recognition model for rate-regulated activities based on IFRS 15. In the table below, the texts added to IFRS 15 are underlined and highlighted.

IFRS 15	A proposal for rate-regulated activities
The core principle of IFRS 15 is that an entity recognises revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. An entity recognises revenue in accordance with that core principle by applying the following steps:	The core principle of NEW MODEL is that a regulated entity recognises revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services based on the contracts with a customer and the regulatory agreement with a regulator. A regulated entity recognises revenue in accordance with that core principle by applying the following steps:
Step 1: Identify the contract(s) with a customer—a contract is an agreement between two or more parties that creates enforceable rights and obligations. The requirements of IFRS 15 apply to each contract that has been agreed upon with a customer and meets specified criteria. In some cases, IFRS 15 requires an entity to combine contracts and account for them as one contract. IFRS 15 also provides requirements for the accounting for contract modifications.	Step 1: Identify the contract(s) with a customer and the regulatory agreement with a regulator—A contract is an agreement between two or more parties that creates enforceable rights and obligations. A regulatory agreement is an agreement between the regulated entity and the regulator that creates enforceable rights and obligations. The requirements of NEW MODEL apply to each contract and regulatory agreement that has been agreed upon with a customer and with a regulator, and meets specified criteria. The regulated entity should take both the contract and the regulatory agreement into account together. In some cases, NEW MODEL requires a regulated entity to combine contracts and account for them as one contract. NEW MODEL also provides requirements for the accounting for contract or regulatory agreement modifications.
Step 2: Identify the performance obligations in the contract—a contract includes promises to transfer goods or services to a customer. If those goods or services are distinct, the promises are performance obligations and are accounted for separately. A good or service is distinct if the customer can benefit from the good or service on its own or together with other resources that are readily available to the customer and the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract.	Step 2: Identify the performance obligations in the contract and the promises in the regulatory agreement. A contract includes promises to transfer goods or services to a customer. A regulatory agreement may include promises to perfor the activities directly or indirectly relevant to transferring goods or services to a customer. If those goods or services are distinct, the promises are performance obligations and are accounted for separately. A good or service is distinct if the customer can benefit from the good or service on its own or together with other resources that are readily available to the customer and the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract.
Step 3: Determine the transaction price—the transaction price is the amount of consideration in a contract to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer. The transaction price can be a fixed amount of customer consideration, but it	Step 3: Determine the transaction price and revenue requirement adjustment is the amount of consideration in a contract to which a regulated entity expects to be entitled in exchange for transferring promised goods or services to a customer. The transaction price and revenue

IFRS 15	A proposal for rate-regulated activities
may sometimes include variable consideration or consideration in a form other than cash. The transaction price is also adjusted for the effects of the time value of money if the contract includes a significant financing component and for any consideration payable to the customer. If the consideration is variable, an entity estimates the amount of consideration to which it will be entitled in exchange for the promised goods or services. The estimated amount of variable consideration will be included in the transaction price only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved.	requirement adjustment can be a fixed amount of customer consideration, but it may sometimes include variable consideration (when a regulator adjusts the amount of consideration, the adjustment may be reflected in the recognition of revenue) or consideration in a form other than cash. The transaction price and revenue requirement adjustment are also adjusted for the effects of the time value of money if the contract includes a significant financing component and for any consideration payable to the customer. If the consideration is variable, a regulated entity estimates the amount of consideration to which it will be entitled in exchange for the promised goods or services. The estimated amount of variable consideration will be included in the transaction price or revenue requirement adjustment only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved.
Step 4: Allocate the transaction price to the performance obligations in the contract—an entity typically allocates the transaction price to each performance obligation on the basis of the relative stand-alone selling prices of each distinct good or service promised in the contract. If a stand-alone selling price is not observable, an entity estimates it. Sometimes, the transaction price includes a discount or a variable amount of consideration that relates entirely to a part of the contract. The requirements specify when an entity allocates the discount or variable consideration to one or more, but not all, performance obligations (or distinct goods or services) in the contract.	Step 4: Allocate the transaction price or the adjusted revenue requirement to the performance obligations in the contract—a regulated entity typically allocates the transaction price or the adjusted revenue requirement to each performance obligation on the basis of the relative stand-alone selling prices of each distinct good or service promised in the contract. If a stand-alone selling price is not observable, a regulated entity estimates it. Sometimes, the transaction price or the adjusted revenue requirement includes a discount or a variable amount of consideration that relates entirely to a part of the contract. The requirements specify when a regulated entity allocates the discount or variable consideration to one or more, but not all, performance obligations (or distinct goods or services) in the contract.
Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation—an entity recognises revenue when (or as) it satisfies a performance obligation by transferring a promised good or service to a customer (which is when the customer obtains control of that good or service). The amount of revenue recognised is the amount allocated to the satisfied performance obligation. A performance obligation may be satisfied at a point in time (typically for promises to transfer goods to a customer) or over time (typically for promises to transfer services to a customer). For performance obligations satisfied over time, an entity recognises revenue over time by selecting an appropriate method for measuring the entity's progress towards complete satisfaction of that performance obligation.	Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation—a regulated entity recognises revenue when (or as) it satisfies a performance obligation by transferring a promised good or service to a customer (which is when the customer obtains control of that good or service). The amount of revenue recognised is the amount allocated to the satisfied performance obligation. A performance obligation may be satisfied at a point in time (typically for promises to transfer goods to a customer) or over time (typically for promises to transfer services to a customer). For performance obligations satisfied over time, a regulated entity recognises revenue over time by selecting an appropriate method for measuring the entity's progress towards complete satisfaction of that performance obligation. Performance obligation may include some activities to be performed according to requirement by a regulator. Obligations of those activities related directly or indirectly to the

IFRS 15	A proposal for rate-regulated activities
	performance obligation also should be satisfied to recognise the related revenue. Obligations of those activities would be satisfied when the related expenditures are expensed for the purpose of revenue recognition. When there exists a difference between the regulatory asset or liability/regulatory revenue and the contract asset or liability /contract revenue, the contract asset or liability /contract revenue should be reconciled to reflect the difference.