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Project	**Rate-regulated Activities**		
Paper topic	Recognition of regulatory assets and regulatory liabilities		
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Purpose of the paper

1. This paper analyses criteria for recognising regulatory assets and regulatory liabilities using the accounting model being developed to more faithfully represent the financial effects of **defined rate regulation**. It asks the Board whether it agrees with our analysis.

2. The paper should be read in conjunction with Agenda Paper 9A *The model's general approach* and Agenda Paper 9D *Illustrative examples*. Paper 9D illustrates how the model's principles and the recognition criteria developed in this paper would apply to a range of common circumstances.

Summary of conclusions of the staff's analysis

3. Our analysis suggests that the model include criteria that results in an entity recognising a regulatory asset or regulatory liability only when:

   (a) the regulatory adjustment represents a right or obligation arising from the extent to which the performance of the entity exceeds, or has been exceeded by, the performance of the customer base, ie the extent to which the regulatory agreement is no longer executory;

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(b) the resulting regulatory asset or regulatory liability has not already been recognised as an asset or a liability by applying other IFRS Standards, and

(c) it is highly probable that a significant reversal in the amount of cumulative compensation recognised will not occur.

Overview

4. This paper contains the following information:

(a) Background (paragraphs 5-18), including stakeholder recoverability concerns (paragraphs 14-18);

(b) Staff analysis—recognition criteria and guidance to reinforce the model's core principle (paragraphs 19-27);

(c) Staff analysis—regulatory obligations related to the entity's own assets (paragraphs 28-42);

(i) Recognising assets from activities related to increasing the entity's own assets—comparison with IFRS 15 *Revenue from Contracts with Customers* (paragraphs 34-35); and

(ii) Recognising liabilities from activities related to increasing the entity's own assets—comparison with IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* (paragraphs 36-42).

(d) Staff analysis—a recoverability criterion (paragraphs 43-51);

(e) Staff conclusions and questions for the Board; and

(f) Appendix: Types of regulatory adjustments.

Background

5. We describe in Agenda Paper 9A how we have developed the model to reflect stakeholders' feedback received in responses to the Discussion Paper *Reporting the Financial Effects of Rate Regulation* (the DP) and subsequent outreach. As a

result, the core principle of the model is consistent with that of IFRS 15. This core principle is that

> an entity recognises 'regulatory performance adjustments' to depict the transfer of rate-regulated goods or services to the customer base in an amount that reflects the compensation to which the entity expects to be entitled in exchange for those goods or services.[1]

6. In addition, the model applies a supplementary approach. This means that an entity will apply other IFRS Standards without modification before applying the model.

7. The scope criteria we suggest in Agenda Paper 9B *Scope of the model* to be included in the model are designed around the core principle. In our view, those scope criteria will provide an effective hurdle to capture only those entities that are subject to regulatory agreements that are expected to give rise to some regulatory assets and regulatory liabilities.

8. However, we cannot anticipate all possible regulatory terms and conditions. This is because they will reflect the rate regulator's objectives, which will vary depending on circumstances. A common objective is for the rate regulator to act as a substitute for an effective competitive market, which prevents abusive monopolistic pricing but provides, for reasonably efficient entities, an acceptable return to capital providers. If this was the rate regulator's only objective, then, as suggested in the DP, it is likely that the rate regulation would take the form of 'market regulation' rather than defined rate regulation.

9. However, in a defined rate regulation environment, rate regulators commonly have additional objectives that result in adjustments, through the rate-setting mechanism, to the timing of cash flows for both the entity and the customer base. Such adjustments may result, for example, from objectives to:

   (a) deal in an equitable way (for the entity and customers) with:

      (i) differences in costs of supply between different sub-groups of the customer base, for example those in remote locations;

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[1] See paragraph 3 of Agenda Paper 9A *The model's general approach*.

(ii) unforeseen changes in circumstances that may result in additional activities being required, such as repairing storm damage;

(iii) changes in input prices that the entity cannot control; and

(iv) under or over recovery due to unanticipated changes in demand for the goods or services.

(b) encourage the construction of new property, plant and equipment to protect the security of supply or to encourage the use of new technologies; and

(c) encourage more sustainable consumption.

10. In imposing these regulatory adjustments on the entity and the customer base, the rate regulator is going beyond standing in for a competitive market. In effect, the regulator is transferring compensation between different periods and between different sections of the customer base that may not arise in a purely competitive market.

11. The purpose of the model is recognise the effects of these transfers when they result in a timing difference or imbalance between the entity's performance (by satisfying, or partially satisfying, its regulatory obligations) and the performance of the customer base and the rate regulator (by making payments). This means that a regulatory asset or regulatory liability is recognised only when it arises from a past event or transaction. Regulatory adjustments that relate to other changes in the regulated rate that anticipate future performance by the entity or the customer base are not recognised; for example, an increase in the regulated rate that reflects an anticipated increase in future input costs.

12. Consequently, we suggest that, in addition to scope criteria, the model needs to include:

(a) recognition criteria to clarify that only regulatory adjustments relating to imbalances in performance are recognised; and

(b) guidance that demonstrates how the model's recognition criteria interact with the recognition criteria of other IFRS Standards.

13. We analyse the reasons for this conclusion in paragraphs 19-42.

Stakeholders' recoverability concerns

14. In addition to the stakeholders' feedback described in Agenda Paper 9A, we received further feedback from stakeholders who are concerned about a perceived risk of overstating profit through the recognition of regulatory assets that may not be recoverable. This concern is heightened when dealing with:

    (a) items that have not yet been formally approved by the rate regulator to be included in the regulated rate; and

    (b) longer-term items that are intended to be recovered through rates over several years, particularly when that scheduled recovery period extends beyond the next regulatory rate review date.

15. Amounts that have been approved to be *included* in the rate(s) that can be charged to the customer base are usually evidenced in a formal notice from the rate regulator. This formal notice may take different forms but typically is included in a final 'rate order' or 'rate determination' document, which sets out the findings of fact and law supporting the rate regulator's decisions. In some cases, the rate order is merely issued by the rate regulator but in other cases it may be signed by both the rate regulator and the entity, forming a contractual agreement.

16. However, at the time an entity is finalising its financial statements, it will commonly be 'between rate reviews'. This means that, although the entity will have been tracking variances and other potential regulatory rate adjustment amounts, the adjustments will not have been formally approved by the rate regulator. Such adjustments will be included in the entity's next rate review application. Some stakeholders expressed concern that an entity may recognise revenue (or regulatory income) and a related regulatory asset prior to approval, which would later be reversed if the rate regulator rejected the entity's application to include such an amount in the regulated rate.

17. Although we did not hear the same level of concern being raised about a perceived risk of understating profit through the recognition of regulatory liabilities that may not be settled through delivery of future goods or services at a restricted rate, we consider the concern to be also valid for regulatory liabilities. This is because, in principle, there is no reason to view regulatory assets and

regulatory liabilities differently when they arise from the same rate-setting mechanism.

18. In response to this concern, we suggest that the model include a recognition criterion that establishes a level of confidence threshold so that an entity recognises a regulatory asset (or a regulatory liability) only when it is highly probable that a significant reversal in the amount of cumulative compensation recognised will not occur. This means that a regulatory adjustment would only be recognised when it is included, or expected to be included in the regulated rate. We explain our reasoning in paragraphs 43-51.

Staff analysis—recognition criteria and guidance to reinforce the model's core principle

19. As noted in paragraph 5, the model's core principle is that an entity recognises 'regulatory performance adjustments' to depict the transfer of rate-regulated goods or services to the customer base in an amount that reflects the funding/compensation to which the entity expects to be entitled in exchange for those goods or services. This principle is consistent with the notion that, at inception, a regulatory agreement is executory, ie the parties to the agreement have equally unperformed.

20. As one party performs, a right or obligation is created that reflects the extent to which the agreement is no longer executory. Because the model applies a supplementary approach, some aspects of this right or obligation will already be recognised as assets or liabilities by applying other IFRS Standards. The model therefore needs, in our view, to explain how its requirements are consistent with the requirements of other IFRS Standards. We think that this will help understanding of the model and support its consistent application. We also think that a better understanding of the model will help prevent entities from recognising regulatory adjustments that do not, at the entity's reporting date, give rise to recognisable assets or liabilities as defined in the *Conceptual Framework*.

21. Consequently, we recommend that the model includes criteria that results in an entity recognising a regulatory asset or regulatory liability only when:

(a) the regulatory adjustment represents a right or obligation arising from the extent to which the performance of the entity exceeds, or has been exceeded by, the performance of the customer base (or other parties), ie the extent to which the regulatory agreement is no longer executory; and

(b) has not been recognised as an asset or liability by applying other IFRS Standards.

22. By including such criteria, the entity applies other IFRS Standards without modification before applying the model. As a result, the entity will apply IFRS 15 to recognise revenue from contracts with customers. This means that the entity will recognise revenue when (or as) the entity satisfies a performance obligation in an individual contract with a customer using the contractual rate, ie the regulated rate. This means that the amount of revenue recognised (P x Q) is based on the regulated rate (P) and the quantity (Q) of goods or services transferred to individual customers during the period.

23. However, as described in Agenda Paper 9A, the terms and conditions in the individual contracts are established by the rate regulator to reflect the payment schedule with the customer base. The payment schedule is designed to compensate the entity in exchange for the entity satisfying its wider regulatory obligations, which reflect the rate regulator's objectives. When the rate regulator's objectives go beyond that of a substitute for an effective competitive market, imbalances in the performance of the entity and the customer base arise (see paragraphs 9-10). In such cases, the entity will recognise a regulatory performance adjustment in profit or loss, together with a related regulatory asset or regulatory liability.[2]

24. In the education session held with the Board in December 2016, we looked at three generic types of regulatory adjustments that we conclude represent imbalances in performance (see the appendix, which reproduces the brief summary of each type that was contained in the December 2016 agenda paper).

[2] In the summary of the model in the appendix of Agenda Paper 9 *Cover note and summary of the model*, we suggest that the regulatory performance adjustment is presented separately from the revenue recognised using IFRS 15. We will bring a paper to a future meeting to discuss presentation in more detail.

Consequently, we consider that each type could lead to the recognition of a regulatory asset or a regulatory liability.

25. The regulatory adjustments identified in the December session are:

	Entity performs to a greater extent than the customer base: regulatory asset recognised to reflect right to increase rate in future for past entity performance	**Entity performs to a greater extent than the customer base: regulatory liability recognised to reflect obligation to provide future entity performance for reduced/ no compensation/ funding.**
estimation adjustments (variance corrections)	Entity is entitled to recover amounts related to goods or services delivered to the customer base that are measured at a variable amount, which is higher than the estimated amount charged to the customer base.	Entity is entitled to recover amounts related to goods or services delivered to the customer base that are measured at a variable amount, which is lower than the estimated amount charged to the customer base.
bonus/penalty adjustments	Entity delivers goods or services at a higher specification than the customer base has been charged—entity is entitled to further compensation/ funding for the higher performance level.	Entity delivers goods or services at a lower specification than the customer base has been charged—entity is obliged to compensate the customer base for the lower performance level.
performance timing differences	Entity has performed but customers have not yet paid.	Entity has not yet performed but customers have paid.

26. As discussed in paragraphs 26-29 of Agenda Paper 9A, the model uses a ‘transfer’ approach to recognise regulatory performance adjustments, in the same way that IFRS 15 uses a transfer approach to recognise revenue. Consequently, the construction or enhancement of an entity’s own asset is not considered to be ‘performance’ by the entity. Instead, the costs incurred in the construction/ enhancement activity increases the entity’s own asset. Those costs are recognised, if appropriate, as part of the cost of the entity’s own assets, such as inventories or property, plant and equipment (PPE). In our view, the relevant performance will occur when the entity uses the asset to transfer goods or services to the customer base.

27. This aspect of the model has been the subject of several discussions with the Accounting Standards Advisory Forum (ASAF). We think it is worth explaining in more detail the model's approach to costs incurred in acquiring, constructing or enhancing the entity's own assets. In particular, we comment about how the model's approach compares to, and is consistent with, the requirements of both IFRS 15 and IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*.

Staff analysis—regulatory obligations related to the entity's own assets

28. A significant aspect of the entity's regulatory obligation is to be able to deliver specified goods or services to customers *on demand*. This means that the entity needs to ensure that it has the assets and infrastructure in place to ensure that it is able to transfer rate-regulated goods or services to customers without disruption to supply. This typically requires significant investment in the maintenance, replacement and enhancement of assets required to produce and/or deliver the regulated goods or services.

29. When establishing the regulated rate, the rate regulator considers the programme of maintenance, replacement and enhancement of assets needed to ensure the continuity of supply. The rate regulator ensures that the entity is provided with sufficient funding for such investment activities by using the regulated rate and/or other funding sources, such as government grants.

30. As well as establishing how much funding an entity requires to carry out the investment activities that maintain, replace or enhance the entity's own assets, the rate regulator also determines when that funding will be provided. The funding might be provided in advance or in arrears of the investment occurring. In such cases, there is a timing difference or imbalance between the entity's performance (by satisfying, or partially satisfying, its regulatory obligations) and the performance of the customer base (by making payments).

31. As noted in paragraphs 26-29 of Agenda Paper 9A *The model's general approach*, compensation from the customer base is recognised when an entity transfers goods or services to the customer base. It is not recognised when an entity incurs costs that increase the entity's own assets but instead, should be

recognised when, or as, the entity uses the asset to deliver goods or services to the customer base.

32. As explained in paragraphs 34-42, we think that this conclusion is consistent with the principles supporting the requirements:

    (a) in IFRS 15 dealing with the recognition of 'costs incurred to fulfil a contract'; and

    (b) in IAS 20 dealing with the recognition of a government grant related to the entity's own assets.

33. These requirements are relevant because the model applies a 'supplementary approach' to other IFRS standards. Explaining how the requirements of the model are consistent with those of related IFRS Standards will help with understanding the model and support its consistent application.

Recognising assets from activities related to increasing the entity's own assets—comparison with IFRS 15

34. Paragraphs 91-104 of IFRS 15 establish the requirements for the recognition and subsequent amortisation and impairment of both 'incremental costs of obtaining a contract' and 'costs to fulfil a contract'. Such costs would normally be expensed as incurred unless they are included in the cost of another asset by applying other IFRS Standards, such as IAS 2 *Inventories*, IAS 16 *Property, Plant and Equipment*, and IAS 38 *Intangible Assets*. However, if such costs are not included in the cost of another asset, an entity applying IFRS 15 recognises them as a contract asset if the costs can be specifically identified, are explicitly chargeable to the customer through the contract and are expected to be recovered. Such an asset is then amortised on a systematic basis that is consistent with the transfer to the customer of the goods or services to which the asset relates.

35. In our view, it is appropriate to apply a similar principle in the context of the regulatory agreement. If the regulatory agreement specifies that the entity is entitled to recover specified costs through the rate to be charged to the customer base and the amounts are not included in the cost of another asset by applying other IFRS Standards (including IFRS 15), the amounts will be recognised as an expense in profit or loss. Using the model, the entity then considers whether those

additional costs are included, or are expected to be included, in the regulated rate. If so, they are recognised as a regulatory performance adjustment in profit or loss and as a regulatory asset. This asset is similar to an IFRS 15 'costs to fulfil a contract' asset and represents the entity's right to recover the costs through the regulated rate. Such an asset is then amortised in the same way as an IFRS 15 'costs to fulfil a contract' asset, ie on a systematic basis that is consistent with the transfer to the customer of the goods or services to which the asset relates.

Recognising liabilities from activities related to increasing the entity's own assets—comparison with IAS 20

36. When an entity receives a government grant that funds, or partially funds, the purchase or construction of an entity's own asset, paragraph 24 of IAS 20 permits the entity to recognise the grant and the asset using either a net presentation or gross presentation approach.

    (a) In the net presentation approach, the grant is deducted from the carrying amount of the asset.

    (b) In the gross presentation approach, the asset is recognised at its cost. The grant is initially recognised in the balance sheet and then is recognised in profit or loss on a systematic basis, usually on the same basis as the depreciation of the asset to which it relates.

37. In a defined rate regulation environment, an entity needs to assess the consequences of receiving the grant on the amount that is chargeable to the customer base through the regulated rate. If there are no consequences for the amounts billed to the customer base in the future for the services delivered using the asset, then there is no regulatory accounting consequence. The grant received and its recognition through profit or loss is accounted for by applying IAS 20.

38. However, a common consequence of receiving a grant is that the entity is obliged by the regulator to use the asset (funded by the grant) to deliver goods or services without further compensation for the cost of the asset being billed to the customer base, ie the cost of the asset that the entity has already been compensated for through the government grant is excluded from the regulated rate. This creates an imbalance in performance because the government, as a substitute for the

customer base, has performed before the entity. In such circumstances, the entity has a regulatory liability for its obligation to use the asset to deliver future goods or services because, in effect, the rate regulator's intervention in setting the rate(s) treats the government grant as a prepayment of the revenue that the entity would otherwise have received from the customer base.

39. However, in this case, the entity recognises the liability as a government grant liability, instead of as a regulatory liability because the entity applies IAS 20 before applying the model. By applying IAS 20, the compensation received will be recognised through profit or loss on the same basis that the cost of the related asset is recognised as an expense.[3]

40. In our view, it is appropriate to apply a similar principle in the context of the regulatory agreement when the customer base makes payments, through the regulated rate, to fund the construction of the entity's asset. This creates an imbalance because the customer base has performed (by making payments) before the entity has performed. In this case, the entity does not perform when it incurs costs that increase the entity's own assets but, instead, performs when, or as, the entity uses that asset to transfer goods or services to the customer base (see paragraph 31). The rate applied to the transfer of goods or services will be reduced to reflect the amount already charged. Consequently, the entity recognises a regulatory liability for the pre-funded contribution to the construction costs already charged to the customer base. This represents a regulatory obligation to transfer goods or services to the customer base in the future at a reduced rate.

41. When the entity starts to use the asset to transfer goods or services to the customer base, the performance imbalance reduces. As a result, the entity subsequently reduces the carrying amount of the regulatory liability by recognising the amount pre-funded by the customer base in profit or loss on a systematic basis.[4]

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[3] See paragraphs 12 and 15-18 of IAS 20.

[4] We will bring a paper to a future meeting which will discuss how an entity identifies a 'systematic basis' for subsequently recognising the regulatory liability through profit or loss.

42. The model is, therefore, consistent with the gross presentation approach used in IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* for the treatment of grants related to assets.

Staff analysis—a recoverability criterion

43. We think that the formal approval of an amount to be included in the rates supports the initial recognition of the related regulatory asset or regulatory liability when that amount also satisfies the recognition criteria suggested in paragraph 21. Such approval confirms that the rate regulator agrees that the adjustment has arisen in compliance with the rate-setting mechanism and, therefore, reflects a confirmed right or obligation for the entity.

44. However, there is some uncertainty about the recovery of regulatory assets (or settlement of regulatory liabilities) that:

    (a) have not yet been formally approved for inclusion in the rate; or

    (b) may be included in the rate but are not expected to be fully recovered (or settled) through rates before the next rate review. In this case, there is a risk that the rate regulator may renegotiate the recoverability of the remaining balance if facts and circumstances have changed since the previous rate review.

45. Preventing an entity from recognising a regulatory asset subject to such uncertainty would, in our view, be excessively prudent. Consequently, we have considered the requirements of IFRS 15 dealing with 'variable consideration'. This is because we think that many of the causes of variable consideration noted in paragraph 51 of IFRS 15 are applicable to the rate-setting mechanisms found in defined rate regulation. That paragraph notes that:

> An amount of consideration can vary because of discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties or other similar items. . . [and] if an entity's entitlement to the consideration is contingent on the occurrence or non-occurrence of a future event. . .

46. In addition, paragraph 56 of IFRS 15 states:

> An entity shall include in the transaction price some or all of an amount of variable consideration estimated in accordance with paragraph 53 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.[5]

47. Paragraph BC204 of the Basis for Conclusions on IFRS 15 notes that the constraint on variable consideration was included in IFRS 15 because users of financial statements explained that 'it is critical that estimates of variable consideration be included in revenue only when there is a *high degree of confidence* that revenue will not be reversed in a subsequent reporting period' (emphasis added). We have heard similar views in outreach on this project.

48. Consequently, we think that it is reasonable to include a recognition threshold in the model designed to prevent a significant reversal in the amount of cumulative compensation/ funding recognised (through revenue and through a regulatory adjustment). We also suggest that it will be helpful to include in the model some factors that an entity could consider in deciding whether it is highly probable that a significant reversal will not occur when the uncertainty associated with the regulatory adjustment is subsequently resolved.

49. Paragraph 57 of IFRS 15 includes a list of factors that could increase the likelihood and the magnitude of a revenue reversal. An entity will consider those factors because the model requires an entity to apply other IFRS Standards before applying the model. As a result, the factors do not need to be repeated in the model. However, we think it would be helpful to cross refer to those factors as being relevant to the consideration of regulatory performance adjustments. We also think that is would be useful to add some additional factors that are more specific to a rate-regulated environment and provide evidence that could reduce the likelihood of a reversal. Such factors could include:

[5] See BC 209-213 of the Basis for Conclusions on IFRS 15 for a fuller discussion of the meaning of 'highly probable'.

(a) statutes or regulations that specifically provide for the recovery of such items in rates;

(b) previous rate orders from the rate regulator specifically authorising recovery of similar items in rates (precedents) for the entity or other entities in the same jurisdiction; and

(c) tentative decisions from the rate regulator (although not a formal rate order) giving 'approval in principle' for future recovery in rates.

50. In addition, the entity should consider whether the common features of 'defined rate regulation' described in paragraph 4 of Agenda Paper 9B exist. As we noted in paragraph 19 of that paper, we think that their existence supports the effectiveness and enforceability of the rate regulation. Effectiveness of the rate regulation has a role in the recoverability of regulatory assets and settlement of regulatory liabilities. This is because it strongly influences the ability of the rate regulator to predict:

(a) the level of demand for the rate-regulated goods and services; and

(b) the strength of the customer base and its ability to provide the entity with the funding/ compensation needed in exchange for the entity satisfying its regulatory obligations.

51. If an entity considers that a regulatory balance is not expected to be included in establishing the future rate, it is not recognised as a regulatory asset or regulatory liability until such time that there is sufficient evidence to indicate that it will be included in the rate.[6]

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[6] At a future meeting, staff will present a paper for the Board to consider what disclosure requirements to include in the model.

Staff conclusions and questions for the Board

Staff conclusions and questions for the Board
1. Paragraph 21 suggests that the model include criteria that results in an entity recognising a regulatory asset or regulatory liability only when: (a) the regulatory adjustment represents a right or obligation arising from the extent to which the performance of the entity exceeds, or has been exceeded by, the performance of the customer base, ie the extent to which the regulatory agreement is no longer executory; and (b) the resulting regulatory asset or regulatory liability has not already been recognised as an asset or a liability by applying other IFRS Standards. Do you agree? If yes, why; if not, why not? 2. Paragraph 48 suggests that the model include a recognition threshold that results in an entity recognising a regulatory asset (or regulatory liability) only when it is highly probable that a significant reversal in the amount of cumulative compensation recognised will not occur. Do you agree? If yes, why; if not, why not?

Appendix A: Types of regulatory adjustments [extract from Agenda Paper 9A *Overview of core features of the model*, December 2016 Board meeting

A1. The following paragraphs outline how the three types of adjustments referred to in paragraph 25 arise. The remaining contents of this appendix were included in Agenda Paper 9A *Overview of core features of the model* discussed by the Board in its December 2016 meeting.

Estimation adjustments/ variance corrections

A2. The rate regulator uses estimates of input costs for a given quantity of goods or services expected to be transferred to the customer base to determine the regulated rate to be charged to the customer base during the regulatory period. Estimation adjustments can arise due to variances between actual and estimated costs or actual and estimated quantities or both. Estimation adjustments are commonly included in the regulated rate a year or two after the period in which they arise.

A3. If the rate-setting mechanism adjusts the regulated rate to be charged to the customer base in future periods to 'correct' for specified variances between these estimates and actuals, this transfers the variance risk from the entity to the customer base. Consequently, the regulatory agreement operates in a similar way to a cost-plus contract. From the perspective of the entity, the original regulated rate is a preliminary transaction price, which is adjusted to reflect the actual costs that are specified in the regulatory agreement as being reimbursable from the customer base.

Bonus/ penalty adjustments

A4. The rate-setting mechanism may include specified adjustments to be made to the future regulated rate to reflect the entity's achievement or failure in meeting specified performance targets established through the regulatory agreement. The model recognises the bonus or penalty in the period in which it is earned, rather than the period in which it is included in the regulated rate that is charged to the

customer base. The bonus or penalty is commonly included in the regulated rate a year or two after the period in which it is earned, eg year n+2.

Performance timing difference adjustments

A5. At the start of the regulatory agreement, both parties, the entity and the customer base, have equally unperformed under the agreement and so the regulatory agreement is executory. The customer base performs by making payments to the entity. The entity performs by satisfying its regulatory obligations, resulting in it transferring goods, services or other economic benefits to the customer base, the rate regulator or other designated parties.