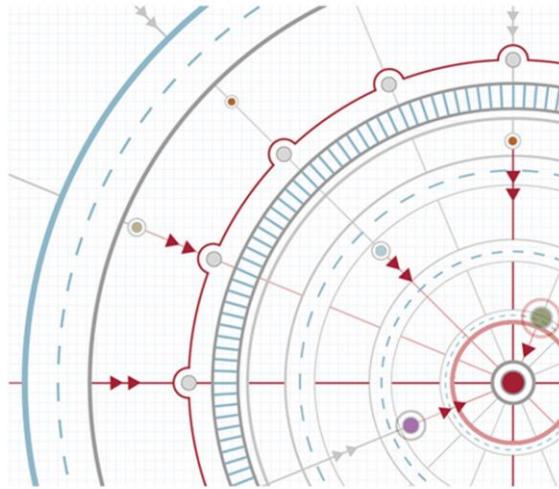


Rate-regulated Activities: Measurement

Important Note:

The notes to these slides form an integral part of the presentation. We advise printing these slides in colour.



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Project	Rate-regulated Activities		
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Objectives of the session

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- To discuss aspects of the measurement of regulatory assets at initial recognition and subsequently.
- The slides that follow have been prepared with regulatory assets in mind. However, we think the same analysis would apply to regulatory liabilities.
- If we identify any aspect of the measurement of regulatory liabilities that would significantly differ from regulatory assets, we will bring it to your attention at a future meeting (see next steps in slide 47).

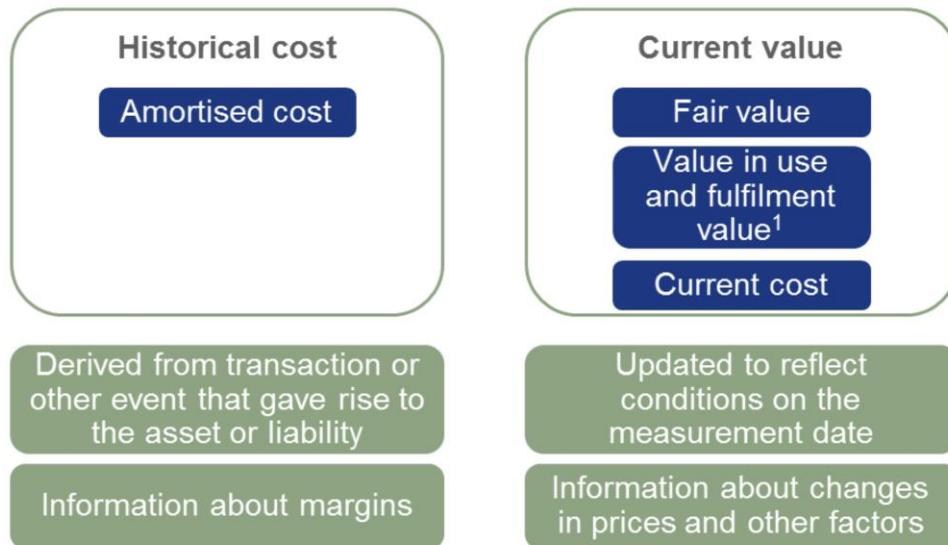
- Background
 - Conceptual Framework (slides 6–8)
 - Building block approach to setting the regulated rate (slides 9–13)
 - Regulatory assets (slides 14–16)
- Regulatory assets—Characteristics, nature and users' feedback (slides 17–22)
- Measuring regulatory assets
 - Features of the proposed measurement technique (slides 23–26)
 - Examples assuming no significant financing component (slides 27–32)
 - Examples assuming significant financing component (slides 33–39)
- Conclusions (slides 40–43)
- Questions for the Board (slides 44–45)
- Next steps (slides 46–47)

Background

Conceptual Framework

Overview of measurement bases

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¹: Fulfilment value is a current value measurement basis applicable to liabilities only.



Chapter 6 of the *Conceptual Framework for Financial Reporting (the Conceptual Framework)* states that:

a) Historical cost of an asset:

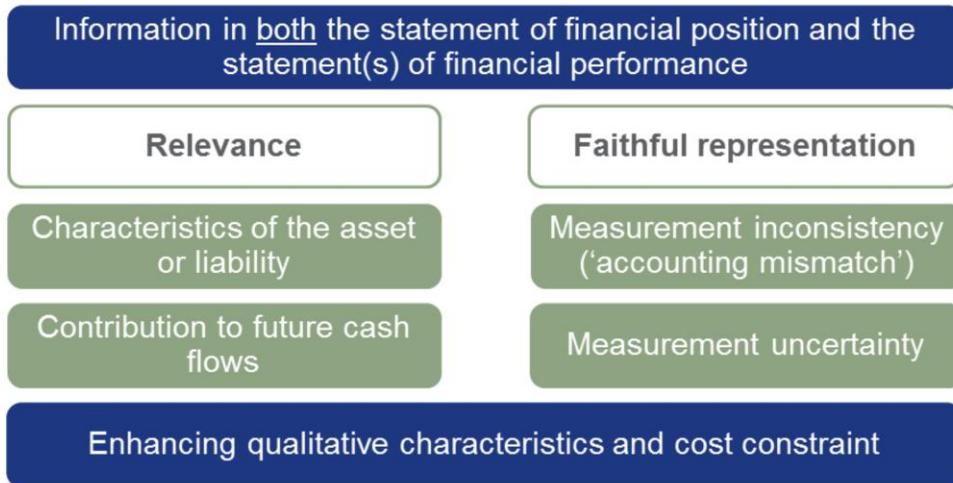
- provides monetary information about the asset using information derived, at least in part, from the price of the transaction or other event that gave rise to it. The difference between income arising from the sale of an asset and the related expense is the margin resulting from the sale. Information about the cost of assets consumed and consideration received may have predictive value (ie an input in predicting an entity's future margins and prospects for future cash flows);
- is updated to reflect consumption, payments received, the effects of impairment, accrual of interest on any financing component of the asset; and
- is reduced to reflect impairment, so the remaining historical cost is expected to be recovered.

b) Current value of an asset:

- provides monetary information about the asset using information updated to reflect conditions at the measurement date; and
- reflects changes, since the previous measurement date, in estimates of cash flows and other factors reflected in those current values.

The *Conceptual Framework* discusses three current value measurement bases for an asset: fair value, value in use and current cost. Regulatory assets are not typically bought or sold in a market but reflect an entity's rights arising from timing differences originating from past events. As a result, Level 1 inputs are not available and so any current value measurement basis would most probably be implemented using cash-flow-based measurement techniques. Such techniques would require the following inputs:

- estimate of the amount and timing of the cash flows;
- adjustments to reflect possible variations in the amount and timing of the cash flows (the uncertainty inherent in the cash flows);
- the time value of money;
- the price for bearing the uncertainty inherent in the cash flows (for example, non-performance risk when measuring the fair value of liabilities); and
- other factors, for example, liquidity.



When selecting a measurement basis, it is important to consider the nature of the information that the resulting measures will produce in both the statement of financial position and the statement(s) of financial performance. When selecting a measurement basis, the usefulness of the resulting information will need to be considered:

- a) What is the **most relevant information** about the economic phenomenon (ie regulatory asset)? This is affected by:
 - (i) *characteristics of the asset*—variability of cash flows and sensitivity of the asset value to market factors or other risks. The more variability there is in the cash flows and the higher the sensitivity of the asset value to market factors or other risks, the less likely historical cost will result in relevant information; and
 - (ii) how the asset *contributes to future cash flows*—how the asset is used and how it produces cash flows, which in part depends on the nature of the activities conducted by the entity. Current value measurements such as fair value may result in more relevant information when assets produce cash flows directly and when these cash flows are sensitive to market factors.
- b) Would a measurement basis result in **faithful representation** of the asset? Consider:
 - (i) whether measurement inconsistencies could arise in the financial statements; and
 - (ii) the level of measurement uncertainty associated with that measurement basis.

Comparability, understandability, verifiability and the **cost constraint** also need to be considered when selecting a measurement basis:

- (a) Historical cost—Typically simpler and less costly than current value measurements. Historical cost measures are generally well understood and verifiable although estimating consumption and identifying and measuring impairment losses can be subjective. When using historical cost measurement basis, identical assets acquired at different times can be reported in the financial statements at different amounts.
- (b) Current value:
 - (i) The measurement of assets classified as Level 3 in the fair value hierarchy by using valuation techniques may be costly and complex, with inputs into the process being subjective and difficult to verify and validate. However, current value may still be the most relevant – or only relevant – information about such assets.
 - (ii) Value in use (VIU) reflects an entity-specific perspective, which could differ for identical assets in different entities. VIU may reduce comparability, particularly if the assets contribute to cash flows in a similar manner.
 - (iii) Identical assets acquired at different times are reported in the financial statements at the same amount using current cost, which enhances comparability. However, the measurement can be complex, subjective and costly, resulting in measures that may lack verifiability and understandability.

Building block approach to setting the regulated rate

Reminder—objectives of defined rate regulation

10

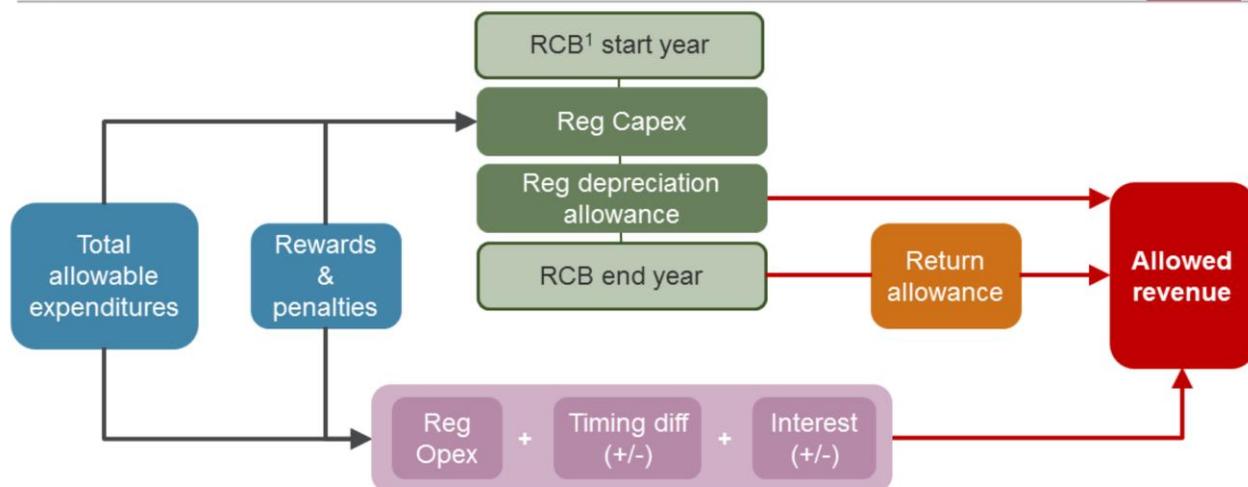
- The **nature of the goods or services** is such that the rate regulator has objectives to **protect customers** by ensuring:
 - **quality, quantity and availability of supply** (done through establishing service requirements in the regulatory agreement); and
 - **stability and affordability of pricing** (done through the basis for establishing rates set out in the regulatory agreement).
- To achieve these objectives, the regulatory agreement establishes a basis for setting the rate(s) that enables a reasonably efficient entity:
 - to recover the cost **of** assets and operating expenses utilised in providing regulated services; and
 - to earn a return **on** the cost of assets utilised in providing regulated services.



The return on the cost of assets utilised in providing regulated services is considered by many rate regulators (regulators) essential to facilitate an entity's continuing investment in the infrastructure that it uses to provide the regulated services. This is because entities need to be able to finance the activities needed to deliver the service requirements established in the regulatory agreement.

Typical building block approach to setting the rate

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The **allowed revenue** is used to calculate the regulated rate **P**, based on estimated quantity **Q**.

¹: Regulatory capital base (RCB) is a term used to describe the carrying amount of assets utilised in providing the regulated services. Note: Diagram based on UK Regulators Network (UKRN) information paper *Cost of Capital – Annual Update Report*, May 2017.

As mentioned in slide **10**, the basis for setting the rate(s) typically enables a reasonably efficient entity:

- to recover the cost **of** assets utilised and operating expenses incurred in providing regulated services; and
- to earn a return **on** the cost of assets utilised in providing regulated services

Consequently, the rate formula typically calculates the rate(s) using a 'building block' approach. This approach identifies:

- the total expenditure that the entity is allowed to include within the regulated rate—such expenditure is then treated as:
 - 'regulatory operating expenditure' (reg opex), intended to pass through the rate in the same period as the expenses are incurred with typically no interest rate or margin applied; and
 - 'regulatory capital expenditure' (reg capex), intended to pass through the rate over a longer period together with an allowed return on the cost of assets utilised in providing regulated services.
- any incentive rewards earned or penalties incurred, which are commonly passed through 'opex' but may also be passed through 'capex'.

The bases used by the regulator for distinguishing capex from opex may differ from the bases used in IFRS Standards to distinguish between expenditure included in the cost of acquiring, constructing or enhancing assets and expenditure recognised as an expense in profit or loss when incurred. In addition, the depreciation pattern used for regulatory purposes may be different than the depreciation pattern used for IFRS purposes. These differences between regulatory and IFRS criteria are another source of timing differences, alongside timing differences that may arise from opex.

- Entities typically have a right to earn a rate of return on the cost of assets utilised in providing regulated services (see slide 11).
- Return is typically based on a cost of capital, which is typically expressed as:
 - a return on equity (RoE); or
 - a weighted average cost of capital (WACC), using either the entity's actual debt : equity ratio or, increasingly, a deemed debt : equity ratio.
- Return can be expressed:
 - in real terms (applied to an inflation-indexed asset carrying value) or in nominal terms (applied to historical cost asset carrying value)
 - pre-tax rate or post-tax rate (with tax cash flows treated as allowable operating expenses).

The allowed return for entities subject to defined rate regulation regimes around the world is most commonly based on a return on the cost of assets utilised in providing regulated services. This return reflects a cost of capital, which is typically expressed as RoE or WACC. For both, estimated cost of equity is a key input.

Cost of capital (expressed either as RoE or WACC) is one of the most important inputs that regulators (and entities) have to estimate. Consequently, how best to calculate the most appropriate cost of capital for rate regulated industries has been extensively debated but no single methodology has been adopted. However, when trying to assess the reasonableness of the rate calculated, many regulators benchmark results—typically with other regulators within the same country, although sometimes with regulators in other countries and with other sectors.

Various methods are used by regulators to calculate the allowed return. The most common method uses the capital asset pricing model (CAPM) to derive the cost of equity and from there to find a WACC, using either the entity's actual debt : equity ratio or, increasingly, a deemed debt : equity ratio. The increasing use of a deemed debt : equity ratio reflects some regulators' concerns about financial capital structures that over-rely on debt, which may risk the financial sustainability of regulated entities.

Typically, the return reflects the length of the time lag between origination of the regulatory asset and the period when it is consumed by being included in the rate charged to customers, as well as other factors, including the time value of money, regulatory objectives and various risks.

Types of timing differences	Common returns given
Short-term (within 24 months—typically operating variance allowances or rewards/penalties)	0% interest rate or interest rate above risk-free, close to borrowing rate appropriate for the relevant period
Medium-term (approx. 2–5 years—operating expenses triggered by a specific event such as a storm)	Rate above risk-free, close to borrowing rate appropriate for the relevant period
Long-term (approx. 5 years or more—capital expenditures)	WACC or RoE

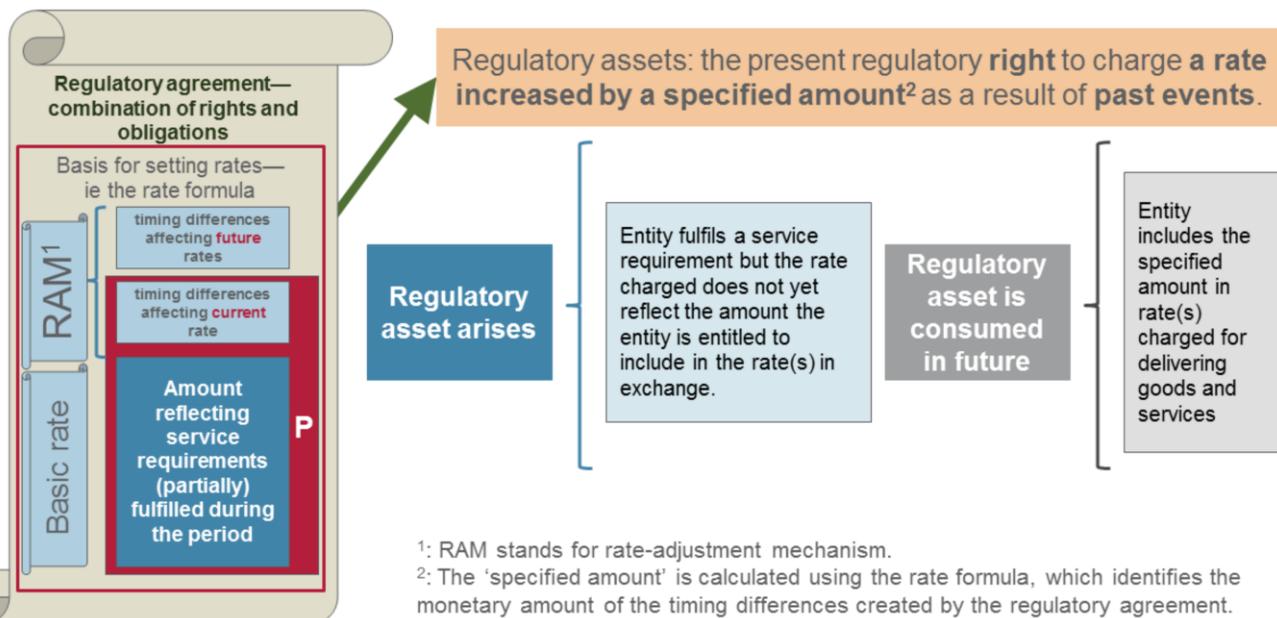
As described in slide [12](#), during the research carried out in this project we learnt that entities are typically compensated (or charged) for the time-lag between the transaction or event that originates a rate adjustment and the reversal of that adjustment through amounts billed to customers. In addition to establishing a WACC rate to be applied to long-term qualifying regulatory assets and regulatory liabilities, for other types of timing differences, regulators typically assign:

- specific compensation (or charge) to medium-term timing differences arising from specific events, such as a timing difference arising from a storm, based on borrowing rates that are appropriate for the relevant period; and
- compensation (or charge), based on bank borrowing rates for prime borrowers that are appropriate for the period-length of some short-term regulatory assets and regulatory liabilities.

Regulators have typically established procedures or policies to update regularly the interest or rates of return. When this happens, the new rates apply to both old and new regulatory assets and regulatory liabilities.

Regulatory assets

Regulatory assets—timing differences affecting future rates



The regulatory agreement establishes the service requirements the entity is obliged to fulfil. The regulatory agreement also sets out the rate formula that establishes **how much** compensation the entity is entitled to include in the regulated rate (rate) **in exchange** for fulfilling its service requirements, and establishes **when** the compensation is to be included in the rate(s). Consequently, the rate formula creates a direct and specific **cause-and-effect** relationship between a rate-regulated activity and amounts included in the rate(s).

Regulatory assets arise when an entity carries out an activity to fulfil its regulatory service requirements in an earlier period than the period in which the entity can charge customers for that activity through the rate(s). This creates an incremental right to charge a rate increased by a specified amount as a result of past events. The model recognises this incremental right as a regulatory asset because revenue recognised during the period using the rate does not include compensation for all activities carried out to fulfil service requirements during the period, whereas all related expenses incurred for those activities are recognised in the statement of financial performance during the period.

When do regulatory assets arise?

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Regulatory assets arise when an entity carries out an activity to fulfil its regulatory service requirements in an earlier period than the period in which the entity can charge customers for that activity through the rate(s).

Regulatory assets could arise from a variety of past transactions, activities or events, such as the entity:

- having incurred expenses to deliver services that the entity has a right to bill through future rate(s) (allowable expenses);
- having incurred a higher amount of actual allowable expenses than the estimated amount already included in the rate (ie an allowable estimation variance); or
- having met a bonus target (eg timing or quality of performance).

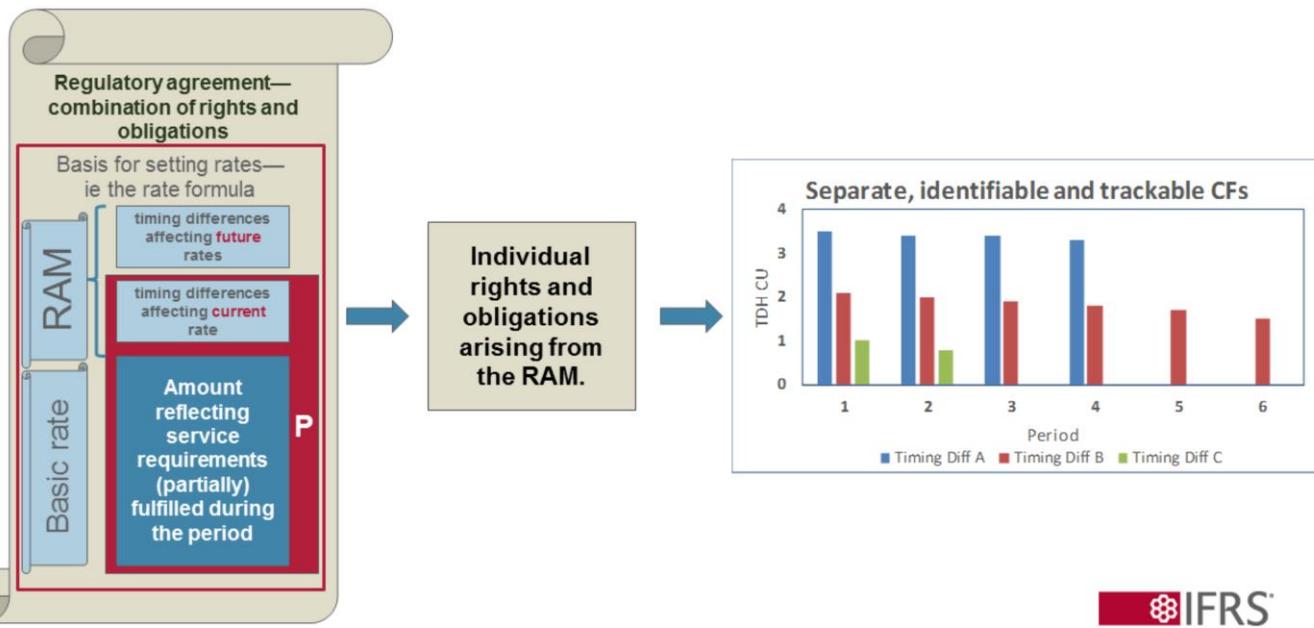


As a result of the past event, the allowable expenses not included already in the rate(s), the allowable estimation variance or the bonus originates an incremental right to a specified amount that will be included in the rate(s) to be charged in a future period(s).

The entity consumes the regulatory asset at a future time when the entity includes the specified amount in the rate charged for delivering regulated goods or services. At that time, the entity recognises revenue and a trade receivable using IFRS 15 *Revenue from Contracts with Customers* and derecognises the regulatory asset consumed.

Regulatory assets— Characteristics, nature and users' feedback

Regulatory assets: separate, identifiable and trackable cash flow streams



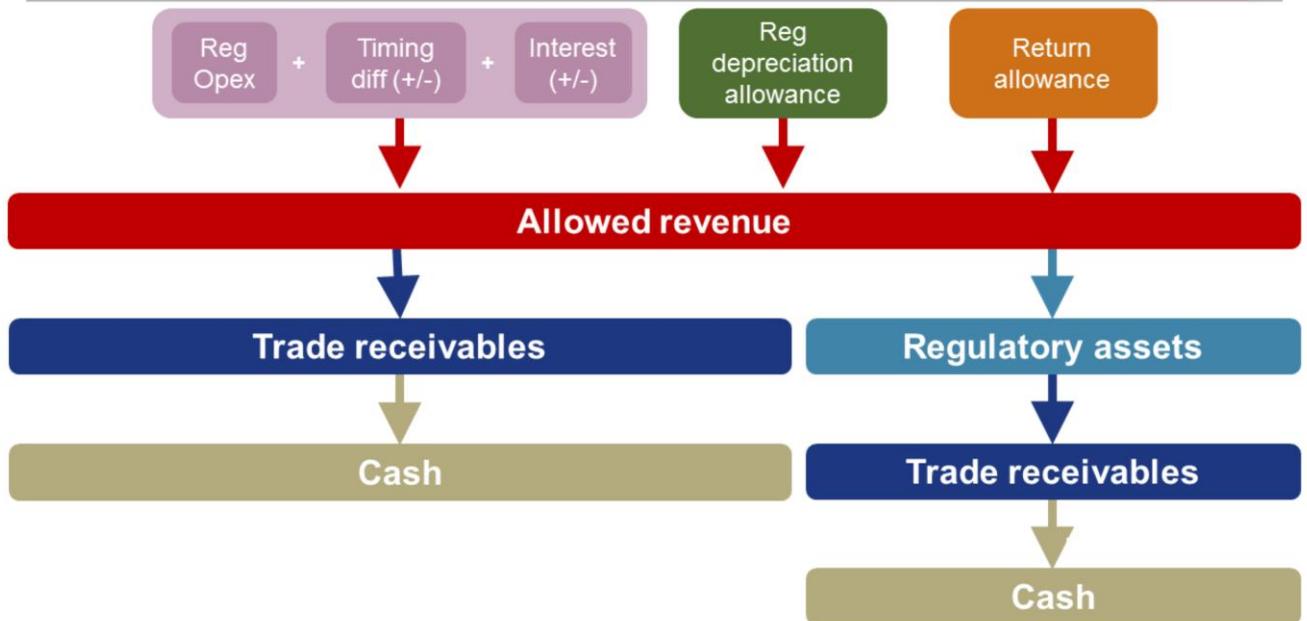
The regulatory agreement gives the entity various rights and obligations, most of which are appropriately accounted for using existing IFRS Standards. However, not all of the rights and obligations contained in the regulatory agreement are recognised as assets and liabilities. For example, the regulatory agreement as a whole gives the entity a right to operate in the rate-regulated market. The value of that right is part of the overall value of the business, ie internally generated goodwill or a brand. Consequently, the Board has previously rejected developing a model using the regulatory agreement as the unit of account.

We have identified regulatory assets and regulatory liabilities as incremental rights and obligations that arise from the operation of the **rate-adjustment mechanism** contained in the basis for setting the rates established in the regulatory agreement. In February 2018, the Board tentatively decided that the model will use as its unit of account the individual timing differences that cause those incremental rights and obligations to originate.

Regulatory agreements require entities to track the individual timing differences separately. The individual timing differences are assessed separately by the entity and the regulator so that the effect of each timing difference on future rate calculations and cash flows can be identified. Consequently, **each individual timing difference results in a separately identifiable regulatory asset that has a separately identifiable effect on the future rate and related cash flows.**

Nature of regulatory assets

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The regulatory agreement establishes the allowable expenses and return that the entity can include in the rates charged to customers (see slide [11](#)). Amounts included in the rate charged during the period are recognised in profit or loss as revenue and the entity's right to collect from customers is recognised in trade receivables, and subsequently is collected in cash. Any amounts not yet included during the period in the rate are recognised using the model as regulatory income and the entity's related right to include those amounts in the future rate is recognised as a regulatory asset. This is illustrated in the top half of the slide.

Regulatory assets are typically held until they are consumed by being included in the future rate(s) charged to customers. At that time, the entity includes the specified amount in amounts charged to customers, which are recognised as revenue and a trade receivable, using IFRS 15.

When examining the nature of regulatory assets, we note that it does 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, 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, however, that regulatory assets have characteristics that are similar to:

- contract assets (reflecting the transaction price for service requirements already fulfilled);
- assets arising from the costs incurred to fulfil a contract (reflecting the costs recoverable through the contract); and
- trade receivables.

Because regulatory assets do not fit neatly into existing categories of assets, we need to consider the *Conceptual Framework* guidance outlined in slide [8](#) to consider what measurement basis could provide the most useful information for users of financial statements, in terms of relevance (slide [20](#)) and faithful representation (slide [21](#)).

Characteristics of regulatory assets

Variability of cash flows

The timing and amount of resulting cash flows are highly predictable.

Value sensitivity to market factors or other risks

The cash flows resulting from regulatory assets are subject to credit risk, demand risk and performance risk but the level of sensitivity to market factors will be typically low.

Contribution to cash flows

A regulatory asset is not typically sold to produce cash flows directly, nor is it used with other assets to generate cash flows. It is held by the entity until the entity subsequently includes the specified amount in the rate(s) charged for delivering regulated goods / services to customers. At that time, the regulatory asset is consumed and is replaced by a trade receivable.



The nature of the regulation means that the stream of cash flows expected to result from the regulatory assets is fairly stable and predictable and the level of variability of those cash flows will be generally low.

Future cash flows arising from regulatory assets will be affected by, for example, changes in demand or credit risks. Consequently, any technique aiming to measure regulatory assets will need to update the cash flows to reflect any changes in the estimates. We think, however, that the variability of the cash flows will be low because the effects of risks such as demand or credit risks on the cash flows will also be typically low. For example, in the case of demand and credit risks, the following provides entities with a degree of protection against these risks:

- *Demand risk*—in many rate-regulated environments, the regulator will use government statistics to evaluate the sensitivity of demand estimates and the design of the rate formula takes into account the expected level of demand for the rate-regulated goods or services. Also, the entity’s customers collectively form a sufficiently large base and, individually, have typically sufficiently limited ability to seek alternatives to buying the regulated goods or services from the entity, contributing to the inelasticity of demand. In addition, the rate formula, including the rate-adjustment mechanism, typically offers the entity some protection from demand risk when changes in demand are unexpectedly greater than those anticipated in the rate calculation.
- *Credit risk*—the rate formula, including the rate-adjustment mechanism, typically recognises credit losses as an allowable expense that is included in the rate chargeable to customers.

Regulatory assets will also be exposed to performance risk. By performance risk we mean that for an entity to obtain the economic benefits produced by a regulatory asset, it needs to deliver goods or services in the future (ie delivering goods or services in the future is the way through which the entity, by exercising its right to include a higher amount in the rate(s), obtains economic benefits). However, as long as the entity’s operating activities do not suffer any major disruption and it is highly likely that it will continue to be a going concern, the level of performance risk to which regulatory assets will be exposed will also be typically low.

Measurement inconsistency

As shown in slide 19, regulatory assets and trade receivables form part of the same transaction cycle. This suggests that similarities in their nature and risks to which they are exposed should translate in their measurements being, to some extent, aligned. For example:

- (a) trade receivables without a significant financing component are measured at transaction price in accordance with IFRS 15; and
- (b) the measurement of trade receivables with a significant financing component does not require the discount rate used at contract inception to be updated subsequently.

Measurement uncertainty

There is typically little measurement uncertainty about the cash flows resulting from regulatory assets.



Measurement inconsistency

As stated in the *Conceptual Framework*, the selection of a measurement basis needs to ensure the faithful representation of the asset by considering, for example, the potential for measurement inconsistencies arising in the financial statements. Using the same measurement basis for related assets or related liabilities may provide more useful information than the information that would result from using dissimilar measurement bases.

In the case of regulatory assets, these assets form part of the same transaction cycle as trade receivables (see slide 19), with regulatory assets preceding trade receivables in that cycle. We think this indicates that their natures and the risks to which they are exposed, even though not identical, are similar. As a result, we would expect the information content resulting from the measurement of these assets to be similar. This would lead to the measurement requirements that would apply to them needing to be fairly comparable.

For example, it may be helpful to consider the following existing measurement requirements for trade receivables as a reference when developing the measurement technique for regulatory assets:

- (a) trade receivables without a significant financing component are measured at transaction price in accordance with IFRS 15;
- (b) the measurement of trade receivables with a significant financing component does not require the discount rate used at contract inception to be updated subsequently.

Measurement uncertainty

The measurement of regulatory assets cannot be determined directly by observing prices in an active market and, as a result, will be exposed to a degree of measurement uncertainty. The explicit terms detailed in the regulatory agreement, together with the detailed record-keeping requirements needed to provide supporting evidence, would enable a reasonable estimate to be made of the effect of timing differences on the regulated rate and related future cash flows.

Users are interested in information:

- about amounts, timing and certainty of cash flows;
- that helps them distinguish between:
 - variability in performance compensated for through the rate-adjustment mechanism; and
 - variability in performance for which there is no compensation;
- about the rate-regulatory environment and its impact on the entity's financial position and performance; and
- about the relationship between regulator and entity, track record of the entity in recovering costs and earning the return allowed by the regulator.

This feedback was gathered as part of the comments received on the Request for Information *Rate Regulation* published in March 2013 and the Discussion Paper *Reporting the financial Effects of Rate Regulation* published in September 2014.

Measuring regulatory assets

Features of the proposed measurement technique

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Considering...	... the proposed measurement technique reflects...
1 ... cash flows fairly stable and predictable but subject to some variability (slide 20)...	... estimates of future cash flows, updated if necessary.
2 ... entities are compensated for the time lag between origination of the timing difference and its reversal (slides 11–13)...	... any interests or returns granted by the regulator.
3 ... when a financing component is significant, IFRS Standards typically require future estimates of future cash flows to be discounted...	... discounting future estimates of cash flows if necessary.
4 ... users will not benefit from changes in the measurement arising from changes in the discount rate...	...an unchanged discount rate.

The table above illustrates the main features of the proposed measurement technique and the considerations that triggered them:

- (1) *Future estimate of cash flows, updated if necessary*—In slide [20](#), we described that even though cash flows arising from regulatory assets are fairly stable and predictable they could be subject to variability arising from various risks. This would mean that updating estimates of future cash flows will contribute to the information arising from the measurement continuing being relevant. Updating the estimates of future cash flows would also mean that any changes in the measurement due to impairment would already be factored in and, consequently, no separate impairment procedures would be required.
- (2) *Interests and returns granted by the regulator*—In slides [11–13](#), we described that regulators typically compensate entities for the time-lag between the transaction or event that originates a timing difference and the reversal of that timing difference through amounts billed to customers.
- (3) *Existence of significant financing component*—IFRS Standards typically require discounting estimates of future cash flows when there is a significant financing component in a transaction or a contract.
- (4) *Discount rate established at initial recognition and not changed subsequently*—On the basis of the feedback received from users, we conclude they are not interested in changes in value of regulatory assets due to mere changes in the discount rate. Users are more interested in understanding changes in future cash flows as a result, for example, of changes in performance or in the regulatory environment. In addition, we note that the measurement of similar assets such as contract assets or trade receivables with a significant financing component does not require the discount rate to be updated (see slide [43](#)).

Approach followed

Considering the features of the proposed measurement technique in slide 24, we illustrate the proposed measurement technique using the following examples:

- **Initial fact pattern** showing **no differences** between accounting and regulatory criteria or estimated and actual quantities (slide 26). As a result, there are **no timing differences** to be considered in the model. This initial fact pattern is modified in the examples that follow.
- Examples assuming **no significant financing component** (Examples 1 and 2—slides 27–32) ¹
- Examples assuming **significant financing component** (Examples 1A, 2A and 3—slides 33–39) ¹

A description of the proposed measurement technique is provided on slide 41.

¹: At a future meeting we will discuss how to assess whether a significant financing component exists and related accounting implications—see next steps (slide 47).

Initial fact pattern—No timing differences

	In THD CU ¹ – IFRS balances	Year X0	Year X1	Year X2	Year X3	Total ²
	PPE	150.00				
	Operating expenses		67.00	67.00	67.00	201.00
	Depreciation expense		15.00	15.00	15.00	45.00
A	Total operating expenses		82.00	82.00	82.00	246.00
	PPE @ end of year	150.00	135.00	120.00	105.00	105.00
B	Return (5% on PPE @ end of year)		6.75	6.00	5.25	18.00
A + B	Revenue (amounts billed)		88.75	88.00	87.25	264.00
	Total operating expenses		(82.00)	(82.00)	(82.00)	(246.00)
	Profit / (loss)		6.75	6.00	5.25	18.00

Assume **no differences** between:

- estimated and actual operating expenses;
- carrying amount of PPE for IFRS and regulatory purposes;
- depreciation allowance for IFRS and regulatory purposes; and
- estimated and actual quantities of goods and services delivered.

As a result, **no timing differences** to be considered in the model.

¹: In these slides, currency amounts are denominated in 'currency units' (CU) and expressed in thousands (THD).

²: In these slides, the 'Total' column shows the cumulative balances of years X1–X3.

In year X0, the regulator sets the rate for Entity A for the following three-year period (ie X1–X3). The fact pattern in this example assumes that:

- there are no differences between the estimated operating expenses for the period X1–X3 and the actual operating expenses incurred during that period.
- the opening regulatory capital base (RCB) balance refers to an item of PPE that Entity A constructed during year X0. The initial costs and subsequent carrying amount of the RCB equals the initial cost and subsequent carrying amount determined using IFRS Standards, with depreciation being charged straight-line over the ten-year useful life of the item of PPE. Consequently, in this case, there are no timing differences relating to the RCB.
- there are no differences between estimated and actual quantities of goods and services delivered during the period X1–X3.

In this initial fact pattern, there are no timing differences to be accounted for.

The regulatory agreement gives Entity A the right to be compensated for the following items, by including them in the rate charged to customers:

- allowable operating expenses incurred plus a 0% margin;
- the depreciation of the RCB balance (straight line over 10 years); and
- a return of 5% on the outstanding RCB balance at the end of each year.

Using existing IFRS Standards:

- revenue reflecting the full amount of compensation to which the entity is entitled is recognised during the period when the related service requirements are fulfilled;
- operating expenses and depreciation expenses are recognised in the period when they are incurred; and
- as a consequence, the return based on the outstanding balance of the RCB arises when the balance of RCB is outstanding.

Examples

*Assuming no significant
financing component*

Example 1—Variance with 0% margin on operating expenses

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	In THD CU – IFRS balances	Year X0	Year X1	Year X2	Year X3	Total
	PPE	150.00				
	Operating expenses		73.00	67.00	67.00	207.00
	Depreciation expense		15.00	15.00	15.00	45.00
A	Total operating expenses		88.00	82.00	82.00	252.00
	PPE @ end of year	150.00	135.00	120.00	105.00	105.00
B	Return (5% on PPE @ end of year)		6.75	6.00	5.25	18.00
A + B	Revenue		88.75 ⁽¹⁾	88.00	93.25 ⁽²⁾	270.00
	Regulatory income / (expense) (timing diff)		6.00	-	(6.00)	-
	Operating expenses		(88.00)	(82.00)	(82.00)	(252.00)
	Profit / (loss)		6.75	6.00	5.25	18.00
	Regulatory asset / (liability)		6.00	6.00	-	-

¹: Amounts billed in year X1 consist of total estimated operating expenses of CU82.00 and return on PPE @ end of year of CU6.75.

²: Amounts billed in year X3 consist of total estimated operating expenses of CU82.00, return on PPE @ end of year of CU5.25 and timing difference of CU6.00.

Continuing with the fact pattern in slide [26](#), the regulatory agreement establishes that any variance between estimated and actual allowable operating expenses arising in any one period 'n' is included in the rate charged to customers in period 'n+2'. As before, Entity A has the right to charge a 0% margin on allowable operating expenses and so has the right to charge a 0% margin on any estimation variances for allowable operating expenses.

In this example, instead of actual allowable operating expenses equalling the estimated amounts used in calculating the rate, during year X1, allowable operating expenses are CU6,000 higher than estimated. No further allowable operating expense variances arise during the remaining three-year period.

At 31 December X1, Entity A has a right to include the allowable estimation variance of CU6,000 in the rate to be charged to customers during year X3. As a result, Entity A recognises a regulatory asset of CU6,000. The demand in year X3 is estimated to be sufficient to ensure that the regulatory asset originated in year X1 is recovered in year X3, when it is consumed by being included in the rate charged to customers. That amount charged to customers is recognised as part of the revenue for year X3:

In year X1:

	Dr	(Cr)
Regulatory asset	6,000	
Regulatory income		6,000

In year X3:

	Dr	(Cr)
Regulatory asset		6,000
Regulatory expense	6,000	

Note: we will consider the presentation and terminology for the regulatory adjustment to income / (expense) in profit or loss at a future meeting.

What does the measurement of the regulatory asset at CU6,000 mean in Example 1?

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Applying the model to recognise the regulatory asset at CU6,000 would provide the following information in the statement(s) of financial performance:

	Year X1	Year X3
Revenue	CU88,750	CU93,250
Regulatory income / (expense)	CU6,000	(CU6,000)
Total operating expenses incurred (estimated + variance)	(CU88,000)	(CU82,000)
Profit / (loss)	CU6,750	CU5,250
<i>Profit fully arising from 5% return on PPE @ end of year (operating expenses attract 0% margin).</i>		

In addition, measuring the regulatory asset at CU6,000 in the statement of financial position at 31 December X1 provides information about the effect of the regulatory asset on future cash flows.

Derecognising the regulatory asset at 31 December X3 reflects the complete consumption of the regulatory asset during X3, when it was included in the rate charged to customers. That amount charged to customers is recognised as part of revenue for X3.

In this example, the entity fulfils its regulatory service requirements and by doing so establishes its right to include the amount of allowable operating expenses plus a 0% margin in the rate charged to customers. During year X1, the financial effects of the entity's performance are depicted by recognising:

- actual operating expenses incurred,
- revenue equal to the amount included in the rate charged to customers,
- plus regulatory income equal to the entity's right to include an additional CU6,000 in the rate for year X3.

The consumption of the regulatory asset in year X3 takes place as the allowable estimation variance is reflected in the rate charged to customers during that year. During year X3, the financial effects of the entity's performance are depicted by recognising:

- actual operating expenses incurred,
- revenue equal to the amount included in the rate charged to customers,
- less regulatory expenses (the entity consumed the regulatory asset, reflecting the fact that CU6,000 of the revenue for year X3 relates to a right generated by expenses recognised in year X1).

Example 2—Variance with 5% margin on total operating expenses

30

In THD CU – IFRS balances		Year X0	Year X1	Year X2	Year X3	Total
PPE		150.00				
Operating expenses			73.00	67.00	67.00	207.00
Depreciation expense			15.00	15.00	15.00	45.00
A	Total operating expenses (totex)		88.00	82.00	82.00	252.00
Margin (5% on estimated totex)			4.10	4.10	4.10	12.30
B	Margin (amounts billed)		4.10	4.10	4.40	12.60
A + B	Revenue		86.10 ⁽¹⁾	86.10	92.40 ⁽²⁾	264.60
Regulatory income / (expense) (timing diff)			6.30	-	(6.30)	-
Operating expenses			(88.00)	(82.00)	(82.00)	(252.00)
Profit / (loss)			4.40	4.10	4.10	12.60
Regulatory asset / (liability)			6.30	6.30	-	-

1: Amounts billed in year X1 consist of estimated totex of CU82.00 and 5% margin on estimated totex of CU4.10.

2: Amounts billed in year X3 consist of estimated totex of CU82.00, 5% margin on estimated totex of CU4.10 and timing difference of CU6.30.

This example, although not that frequent in practice, is designed to explore the measurement of a regulatory asset when the underlying right is not only to bill operating expenses incurred on the fulfilment of service requirements during the period but also to bill a margin on these expenses. In this example, the regulatory agreement gives Entity A the right to earn a 5% margin on total allowable operating expenses incurred during the period when fulfilling service requirements.

When the rate was set up in year X0, allowable operating expenses were estimated at CU67,000 for each year during the three-year period X1–X3. Consequently, in year X1, Entity A recognises revenue on the basis of the estimated total operating expenses of CU82,000 with a 5% margin, ie CU86,100. As in example 1, the regulatory agreement includes any variance between estimated and actual amounts arising in any one period 'n' in the rate charged to customers in period 'n+2'.

During year X1, Entity A incurred allowable operating expenses of CU73,000, which was CU6,000 higher than estimated. Consequently, at 31 December X1, Entity A has a right to include an allowable estimation variance of CU6,300 in the rate to be charged to customers during year X3. The CU6,300 allowable estimation variance consists of:

- additional allowable operating expenses incurred of CU6,000; plus
- margin of 5% on those additional allowable operating expenses incurred of CU300.

In this case, the right to set a rate that includes the 5% margin on the allowable operating expenses arises as Entity A incurs on those allowable operating expenses when delivering the regulated services.

At 31 December X1, Entity A recognises a regulatory asset of CU6,300. The demand in year X3 is estimated to be sufficient to ensure that the regulatory asset is recovered in year X3, when it is consumed by being included in the rate charged to customers. That amount charged to customers is recognised as part of the revenue for year X3:

In year X1:	Dr	(Cr)
Regulatory asset	6,300	
Regulatory income		6,300
In year X3:	Dr	(Cr)
Regulatory asset		6,300
Regulatory expense	6,300	

What does the measurement of the regulatory asset at CU6,300 mean in Example 2?

31

Applying the model to recognise the regulatory asset at CU6,300 would provide the following information in the statement(s) of financial performance:

	Year X1	Year X3
Revenue	CU86,100	CU92,400
Regulatory income / (expense)	CU6,300	(CU6,300)
Total operating expenses incurred	CU88,000	CU82,000
Profit / (loss)	CU4,400	CU4,100
<i>Profit fully arising from 5% margin on total operating expenses</i>		

In addition, measuring the regulatory asset at CU6,300 in the statement of financial position at 31 December X1 provides information about the effect of the regulatory asset on future cash flows.

Derecognising the regulatory asset at 31 December X3 reflects the complete consumption of the regulatory asset during X3, when it was included in the rate charged to customers. That amount charged to customers is recognised as part of revenue for X3.

In this example, the entity fulfils its regulatory service requirements and by doing so establishes its right to include the amount of allowable operating expenses plus a 5% margin in the rate charged to customers. During year X1, the financial effects of the entity's performance are depicted by recognising:

- actual operating expenses incurred,
- revenue equal to the amount included in the rate charged to customers,
- plus regulatory income equal to the entity's right to include an additional CU6,300 in the rate for year X3.

The consumption of the regulatory asset in year X3 takes place as the allowable estimation variance is reflected in the rate charged to customers during that year. During year X3, the financial effects of the entity's performance are depicted by recognising:

- actual operating expenses incurred,
- revenue equal to amount included in the rate charged to customers,
- less regulatory expenses (the entity consumed the regulatory asset, reflecting the fact that CU6,300 of the revenue for year X3 relates to a right generated by expenses recognised in year X1).

The following is the main difference between Examples 1 and 2:

- (a) In Example 1, the timing difference creates a right to bill in year X3 only the allowable estimation variance of CU6,000. That is the only effect of the timing difference.
- (b) In Example 2, the timing difference creates a right to bill not only the allowable estimation variance of CU6,000 but also the resulting additional margin of CU300. The measurement of the regulatory asset captures both those effects.

Including margins at initial recognition

32

Measuring the regulatory asset at CU6,300 during year X1 would mean...

In TDH CU	Year X1
Input cost variance	6.00
Margin of 5%	0.30
Regulatory asset	6.30



Where	What
IFRS 9	Trade receivables at transaction price
IFRS 15	Contract assets
IFRIC 12	Financial asset or intangible asset for construction services



Items measured on the basis of 'transaction price' in IFRS 15 would include any margin the entity is entitled to under the contract. IFRS 15 defines 'transaction price' as '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 parties'.

Examples

*Assuming significant
financing component*

Examples 1A and 2A

- The following slides revisit examples 1 and 2 in slides 27–32. In each case, the fact pattern is changed such that:
 - the regulatory agreement provides interest at 3% on the balance of the timing difference outstanding at the beginning of the year;
 - the risk-free interest rate is 2.7%; and
 - the 3% interest rate established by the regulatory agreement is used to discount the scheduled cash flows when measuring the regulatory asset both initially and subsequently.

By using the 3% interest rate established by the regulatory agreement to discount the cash flows when measuring the regulatory asset, we have assumed the 0.3% difference between that rate (3%) and the risk-free rate (2.7%) is an acceptable risk premium to compensate for the risks in the cash flows that the regulatory asset will produce.

We will explore at a future meeting what to do if that assumption is not valid.

Example 1A—Variance with 0% margin on operating expenses

	In THD CU – IFRS balances	Year X1	Year X2	Year X3	Total
	Operating expenses	73.00	67.00	67.00	207.00
	Depreciation expense	15.00	15.00	15.00	45.00
A	Total operating expenses	88.00	82.00	82.00	252.00
	PPE @ end of year	135.00	120.00	105.00	105.00
B	Return (5% on PPE @ end of year)	6.75	6.00	5.25	18.00
A + B	Revenue	88.75 ⁽¹⁾	88.00	93.62 ⁽²⁾	270.37
	Regulatory income / (expense) (timing diff)	6.00	-	(6.00)	-
	Regulatory interest income	-	0.18	0.19	0.37
	Regulatory expense (interest included in revenue)	-	-	(0.37)	(0.37)
	Operating expenses	(88.00)	(82.00)	(82.00)	(252.00)
	Profit / (loss)	6.75	6.18	5.44	18.37
	Regulatory asset / (liability)	6.00	6.18	-	-

¹: Amounts billed in year X1 consist of estimated totex of CU82.00 and 5% return on PPE @ end of year of CU6.75.

²: Amounts billed in year X3 consist of estimated totex of CU82.00, 5% return on PPE @ end of year of CU5.25, timing difference of CU6.00 and cumulative interest of CU0.37.

Starting with the fact pattern of Example 1 in slide [28](#), this example modifies the fact pattern by assuming there is a significant financing component.

The amount of the allowable estimation variance (CU6,000) arising in year X1 is to be included in the rate to be charged in year X3, together with any interest accrued on the balance. The regulatory agreement compensates the entity for the effects of the time lag between the origination and reversal of timing differences, by applying annual interest of 3% on the balance of the regulatory asset outstanding at the beginning of each period.

Consequently, the regulatory asset accrues interest of CU180 (6,000 x 3%) during year X2 and CU190 (6,180 x 3%) during year X3. (These have been rounded up to the nearest CU10).

The cumulative interest of CU370 (ie 180 + 190) is included in the rate charged during year X3, together with the CU6,000 timing difference reversing in that year.

The extract from the financial statements in the slide assumes that the 3% interest rate established by the regulatory agreement is a reasonable rate to use to discount the estimated cash flows when measuring the regulatory asset at each year end.

Example 2A—Variance with 5% margin on total operating expenses

	In THD CU – IFRS balances	Year X1	Year X2	Year X3	Total
	Operating expenses	73.00	67.00	67.00	207.00
	Depreciation expense	15.00	15.00	15.00	45.00
A	Total operating expenses (totex)	88.00	82.00	82.00	252.00
	Margin (5% on estimated totex)	4.10	4.10	4.10	12.30
B	Margin (amounts billed)	4.10	4.10	4.40	12.60
A + B	Revenue	86.10 ⁽¹⁾	86.10	92.79 ⁽³⁾	264.99
	Regulatory income / (expense)	6.30	-	(6.30)	-
	Regulatory interest income	-	0.19	0.20	0.39
	Regulatory expense (interest included in revenue)	-	-	(0.39)	(0.39)
	Operating expenses	(88.00)	(82.00)	(82.00)	(252.00)
	Profit / (loss)	4.40	4.29	4.30	12.99
	Regulatory asset / (liability)	6.30	6.49	-	-

¹: Amounts billed in year X1 consist of estimated totex of CU82.00 and 5% margin on estimated totex of CU4.10.

²: Amounts billed in year X3 consist of estimated totex of CU82.00, 5% margin on estimated totex of CU4.10, timing difference of CU6.30 and cumulative interest of CU0.39.

Starting with the fact pattern of Example 2 in slide [30](#), this example modifies the fact pattern by assuming there is a significant financing component.

The amount of the allowable estimation variance **plus margin** (CU6,300) arising in year X1 is to be included in the rate to be charged in year X3, together with any interest accrued on the balance. The regulatory agreement compensates the entity for the effects of the time lag between the origination and reversal of timing differences, by applying annual interest of 3% on the balance of the regulatory asset outstanding at the beginning of each period.

In this case, the CU300 margin was generated during year X1 when the entity fulfilled its service requirements and its right to charge the additional CU6,300 arose. As a result, the margin of CU300 forms part of the timing difference balance on which interest accrues in this example, when the regulatory agreement provides interest on the balance to compensate for the effects of the time lag between origination and reversal of the timing difference.

Consequently, the regulatory asset accrues interest of CU190 (6,300 x 3%) during year X2 and CU200 (6,490 x 3%) during year X3.

The cumulative interest of CU390 (ie 190 + 200) is included in the rate during year X3, together with the CU6,300 timing difference reversing in that year.

The extract from the financial statements in the slide assumes that the 3% interest rate established by the regulatory agreement is a reasonable rate to use to discount the estimated cash flows when measuring the regulatory asset at each year end.

Timing differences added to the RCB

37

- In some cases, the rate formula adds the timing difference to the RCB so that:
 - the regulatory asset is consumed as the depreciation of the RCB is included in the rate charged to customers; and
 - the timing difference attracts the same rate of return as the return that applies to the RCB.

Example 3—Variance is added to the RCB

38

In THD CU – IFRS balances		Year X1	Year X2	Year X3	Total
	Operating expenses (as estimated)	67.00	67.00	67.00	201.00
	Depreciation expense (PPE)	15.00	15.00	15.00	45.00
	Additional operating expense	18.00	-	-	18.00
	Total operating expenses	82.00 + 18.00	82.00	82.00	264.00
	RCB @ end of year (PPE only)	135.00	120.00	105.00	105.00
A	Return (5% on RCB @ end of year—PPE only)	6.75	6.00	5.25	18.00
	Operating expense variance added to RCB (timing difference)	-	18.00	-	
	Reversal of timing difference	-	(2.00)	(2.00)	
	Timing difference @ end of year	-	16.00	14.00	14.00
B	Return (5% on timing difference @ end of year)	-	0.80	0.70	1.50
A + B	Total allowed return	6.75	6.80	5.95	19.50

This example starts with the fact pattern in Example 1A in slide [35](#), modified as follows:

- in year X1, an allowable operating expense estimation variance of CU18,000 arises, rather than the CU6,000 seen in Example 1A;
- the allowable estimation variance (CU18,000) arising in year X1 is added to the RCB at the beginning of year X2, instead of being included in full in the rate to be charged in year X3; and
- the timing difference will be reversed by including CU2,000 in the rate each year for the next nine years, starting in year X2 (ie the timing difference will be reversed by consuming the adjusted RCB balance in the rate on a straight-line basis over the remaining nine year useful life of the RCB).

As noted in the initial fact pattern (slide [26](#)), the 5% return is assumed to be a nominal rate applied to the historical cost of the assets utilised in providing regulated services (ie the RCB).

By adding the allowable estimation variance amount to the RCB, the regulatory agreement treats the regulatory asset in the same way as other assets within the RCB, ie the regulatory agreement compensates the entity for the effects of the time lag between the origination and reversal of this timing differences by providing interest at 5% on the balance of the regulatory asset outstanding at the end of each period.

Example 3—Variance is added to the RBC— Measuring the regulatory asset (continued)

39

Cash flows discounted using 5% discount rate				
In THD CU	Year X1	Year X2	Year X3	Total
Revenue	88.75 ⁽¹⁾	90.80 ⁽²⁾	89.95 ⁽³⁾	269.50
Regulatory income / (expense) (timing difference)	18.00	(2.00)	(2.00)	14.00
Operating expenses	(100.00)	(82.00)	(82.00)	(264.00)
Profit / (loss)	6.75	6.80	5.95	19.50
Regulatory asset / (liability)	18.00	16.00	14.00	14.00

¹: Amounts billed in year X1 consist of estimated totex of CU82.00 and 5% return on RCB @ end of year (PPE only) of CU6.75.

²: Amounts billed in year X2 consist of estimated totex of CU82.00, 5% return on RCB @ end of year (PPE only) of CU6.00, reversal of timing difference of CU2.00 and 5% return on timing difference @ end of year of CU0.80.

³: Amounts billed in year X3 consist of estimated totex of CU82.00, 5% return on RCB @ end of year (PPE only) of CU5.25, reversal of timing difference of CU2.00 and 5% return on timing difference @ end of year of CU0.70

In this slide, the cash flows resulting from the inclusion of the timing difference in the rate charged to customers are discounted to measure the regulatory asset, both initially and subsequently, using the 5% return established by the regulatory agreement. Consequently, no gain or loss arises on initial recognition of the regulatory asset.⁽¹⁾

Please note that the profit for years X1–X3 equals the return allowed by the regulatory agreement (see line A + B on the table in slide [38](#)).

We will discuss whether to use the return established by the regulatory agreement as the discount rate at a future meeting (see slide [47](#)).

Conclusions

Description of the proposed measurement technique

41

The measurement of the regulatory assets in Examples 1, 2, 1A, 2A and 3 reflects:

- a) estimates of future cash flows that the regulatory assets will generate which include:
 - i. the costs of assets utilised and operating expenses incurred in providing goods or services;
 - ii. any margins on the operating expenses incurred in providing goods or services; and
 - iii. any interests on the operating expenses incurred or returns on the costs of assets utilised in provided goods or services; and
- b) discounted estimates of future cash flows, if there is significant financing component.¹

The measurement technique will require entities to:

- a) update estimates of future cash flows if changes occur¹; and
- b) keep discount rate established at initial recognition unchanged.¹

¹: We will discuss these aspects of the measurement at a future Board meeting. See next steps in slide 47.

We think that the proposed measurement technique for regulatory assets is appropriate because it enables the resulting measurement to factor:

- variability of cash flows arising from regulatory assets (slides [20](#) and [24](#));
- the value sensitivity to market factors and other risks (slide [20](#));
- measurement inconsistency and uncertainty (slide [21](#)); and
- existence of significant financing component (slide [24](#)).

In addition, we think it will result in useful information (see slide [42](#)).

Please note that we are proposing the discount rate established at initial recognition should be kept unchanged. At a future meeting we will discuss circumstances that may trigger changes in the discount rate as a result of changes in the estimates of future cash flows (see next steps in slide [47](#)).

Measurement resulting in useful information

42

Considering the *Conceptual Framework* guidance, we think that the proposed measurement technique described in slide 41 is most appropriate for regulatory assets [at initial recognition] because:

- it provides **relevant information** in both the statements of financial performance and financial position about:
 - the transaction or event that gave rise to the timing difference that resulted in the regulatory asset;
 - the margin generated by the activity that gave rise to the regulatory asset; and
 - the entity's right to increase future amounts billed as a result of past timing differences.
- it provides a **faithful representation**:
 - of the entity's performance during the period; and
 - of the effects of the entity's incremental right on resulting future cash flows.
- it results in a measure that is generally well understood and verifiable.

The proposed measurement technique results in information that is useful to users of financial statements because the measurement will provide information about:

- the amounts, timing and certainty of the cash flows arising from the transaction or event that gave rise to the timing difference; and
- the variability in performance that is compensated for through the rate-adjustment mechanism. This will help users distinguish it from the variability in performance for which there is no compensation.

The proposed measurement technique is a cash-flow-based measurement technique. Paragraph 6.91 of the *Conceptual Framework* states that cash-flow-based measurement techniques are not measurement bases but are rather used when applying a measurement basis. Paragraph 6.92 of the *Conceptual Framework* further states that cash-flow-based measurement techniques can be used in applying a modified measurement basis.

The proposed measurement technique could be viewed as the application of either:

- a historical cost measurement basis modified to update it for changes in estimates of future cash flows; or
- a current value measurement basis modified to keep the discount rate established at initial recognition unchanged.

We think that these modifications to historical and current value measurement bases result in information that is useful to users because:

- users are interested in estimates of future cash flows and changes in these estimates. On the other hand, information about value changes in the regulatory assets or regulatory liabilities that do not arise from changes in cash flows may complicate users' analysis and provide them with little benefit.
- the proposed measurement technique would limit the need for judgement (for example, judgement to update the discount rate applicable to the future estimates of cash flows).

Comparing regulatory assets with contract assets and trade receivables

Model for defined rate regulation



IFRS 15



Measurement		
	Estimate of future cash flows	Discount rate
Regulatory assets	Update if changes occur	Unchanged
Contract assets/ Trade receivables	Do not update unless to reflect impairment ¹	Unchanged

¹: This excludes the case of variable consideration.



In previous slides we have mentioned that the nature of regulatory assets, contract assets and trade receivables and the risks they bear share some similarities. In addition, these assets also form part of the same transaction cycle (slide 19 illustrates the case of regulatory assets and trade receivables). We observe the same in the case of contract assets and trade receivables, ie they also belong to the same transaction cycle. These similarities indicate that the measurement of these assets should translate into the provision of similar information to users of the financial statements and, consequently, the measurement requirements themselves should also share some similarities. The table aims to reflect this point.

As discussed in slide 42, the proposed measurement technique for regulatory assets aims to reflect the transaction or event that gave rise to the timing difference. This objective is shared by ‘transaction price’ in the case of contract assets and trade receivables. Transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer. This measurement reflects the nature, timing and amount of consideration promised by a customer. The main difference with the proposed measurement technique for regulatory assets is that IFRS 15 requires an entity to assess a contract asset or a trade receivable for impairment in accordance with IFRS 9. In the case of regulatory assets, any updates of the estimates of the future cash flows would already reflect any impairment of the asset.

In the case of contract assets and trade receivables with a significant financing component, after contract inception an entity should not update the discount rate for changes in interest rates or other circumstances. The proposed measurement technique for regulatory assets also shares this feature (see slide 24).

Questions for the Board

1. Does the Board agree that the measurement technique for regulatory assets should reflect:
 - a) estimates of future cash flows arising from the regulatory assets which include:
 - i. the costs of assets utilised and operating expenses incurred in providing goods or services;
 - ii. any margins on the operating expenses incurred in providing goods or services; and
 - iii. any interests on the operating expenses incurred or returns on the costs of assets utilised in provided goods or service;
 - b) changes, if any, in the estimates of the future cash flows?
 - c) any significant financing component by discounting estimates of future cash flows?¹
2. Does the Board agree the discount rate established at initial recognition should remain unchanged?²

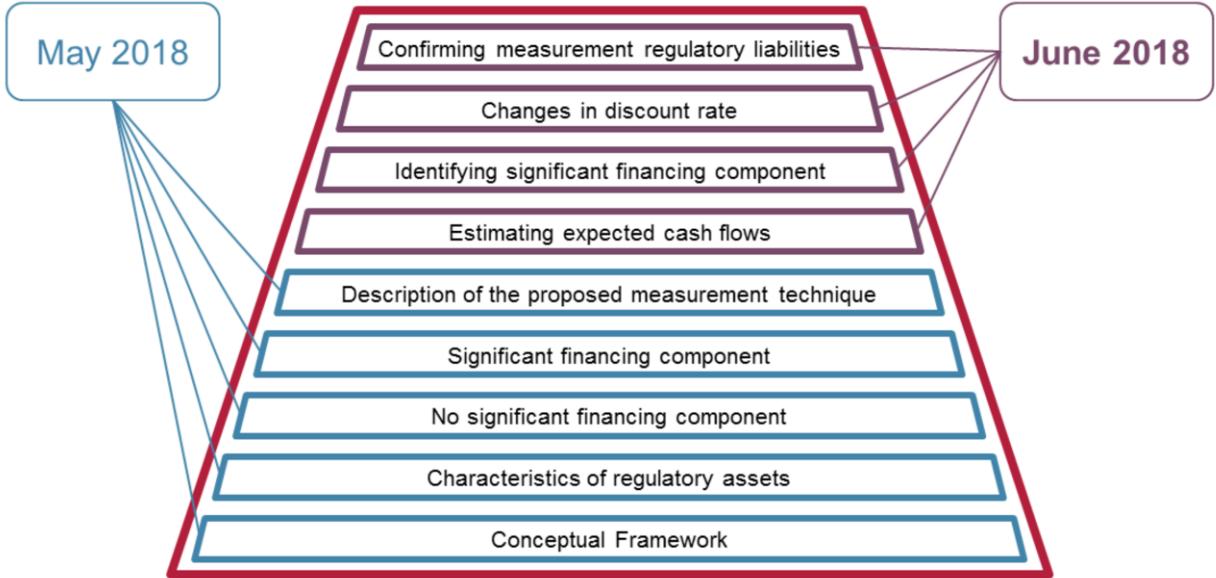
Footnotes to the slide:

¹: At a future meeting we will ask the Board to discuss how to assess whether a significant financing component exists and related accounting implications—see next steps (slide [47](#)).

²: At a future meeting we will ask the Board to discuss whether the discount rate should change if a change in estimates of cash flows is triggered by a change in the interest rate or return allowed by the regulatory agreement—see next steps (slide [47](#)).

Next steps

Next steps—measurement



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