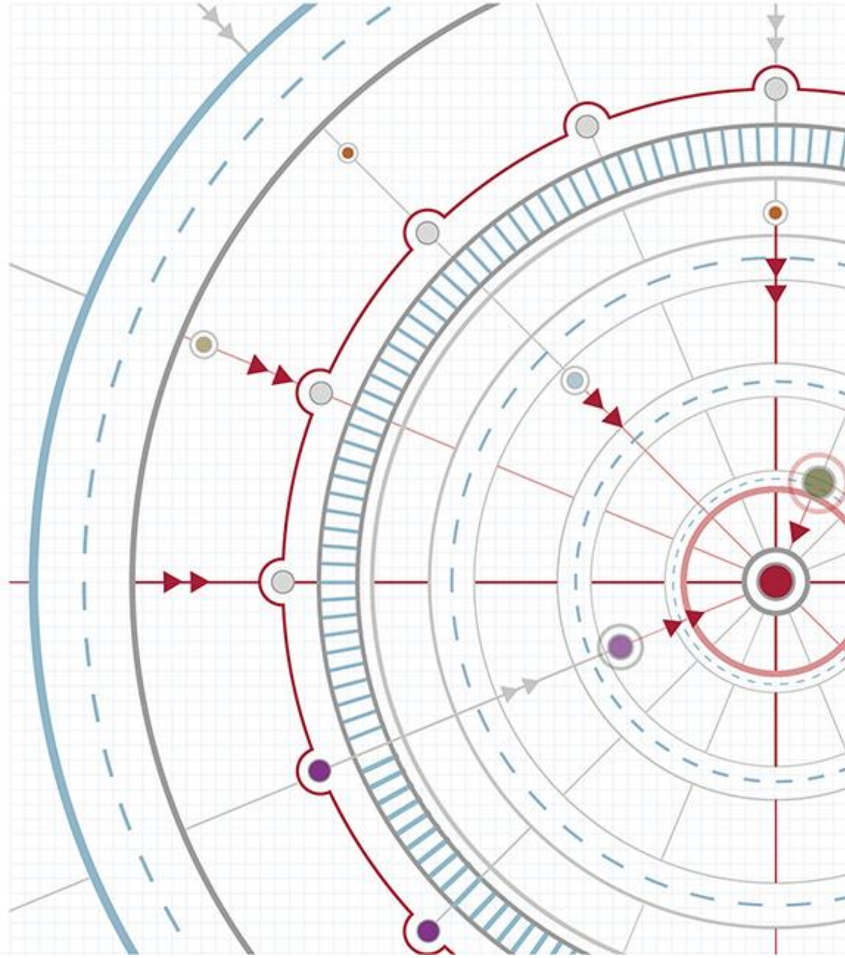

AP1C

Rate-regulated Activities

Recognition

EEG meeting

March 2019

The views expressed in this presentation are those of the presenter, not necessarily those of the International Accounting Standards Board or the IFRS Foundation.

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Board’s tentative decision

The Board tentatively decided that the accounting model:

(a) should require the recognition of regulatory assets or regulatory liabilities if it is more likely than not that they exist—the model sets a symmetrical recognition threshold in cases of existence uncertainty; and

(b) should not set thresholds that would prevent recognition of a regulatory asset or regulatory liability for which there is:

   (i) low probability of an inflow or outflow of economic benefits; or

   (ii) high measurement uncertainty.

Conceptual Framework	Model’s proposed requirements
Relevance ✓	Affects recognition
Faithful representation ✓	Affects measurement

✓: fundamental qualitative characteristics of **useful financial information.**

Board’s considerations—usefulness of information

According to the *Conceptual Framework for Financial Reporting* (the *Conceptual Framework*), an asset or liability is recognised only if recognition of that asset or liability and of any resulting income, expenses or changes in equity provides users of financial statements with information that is useful, ie with:

(a) **relevant information** about the asset or liability and about any resulting income, expenses, or changes in equity; and

(b) a **faithful representation** of the asset or liability and of any resulting income, expenses or changes in equity.

Board's considerations—relevance (1/3)

The ***Conceptual Framework*** states that recognition of an asset, liability and any resulting income, expenses or changes in equity may not result in **relevant information** if:

(a) it is uncertain whether an asset or liability **exists**; or

(b) an asset or liability exists, but the **probability of an inflow or outflow** of economic benefits is **low**.

Regulatory timing differences

Existence—see slides 5 and 6

Probability of an inflow or outflow of economic benefits is low

There is typically a high probability that an inflow or outflow of economic benefits will flow from the regulatory asset or regulatory liability. Although those flows are sometimes subject to the risk of unexpected falls in demand, it is rare for that demand risk to be so severe that there is only a low probability that flows will occur.

Consequently, the **model does not include specific requirements** for entities to assess whether to recognise regulatory assets or regulatory liabilities **if the probability of an inflow or outflow of economic benefits is low.**

Board's considerations—relevance (2/3)

Existence—terms of the regulatory agreements are typically clear to identify most regulatory timing differences; the time period for their reversal and any return/interest for the time-lag.

Assessing existence uncertainty will depend on whether the timing differences are:

(a) items approved by the regulator—no existence uncertainty;

(b) items not formally approved that relate to 'automatic' rate adjustments mentioned explicitly in the regulatory agreement—little or no existence uncertainty;

(c) items not formally approved that are not mentioned explicitly in the regulatory agreement—consider a hierarchy of different factors when assessing probability that a timing difference will be approved:

- (i) existence of explicit requirements or guidance in legislation or regulation;
- (ii) direct precedents—ie the entity's past experience with the regulator in similar circumstances;
- (iii) indirect precedents—such as the experience of other entities regulated by the same regulator or the decisions of other regulators in similar circumstances; and
- (iv) advice from legal or experienced advisors.

Board's considerations—relevance (3/3)

Existence threshold

- We have heard concerns about the perceived risk that recognising a regulatory asset or regulatory liability when one does not exist could mislead users of financial statements.
- Our research has not provided us with strong evidence to support setting a threshold higher than more likely than not. Nor has our research provided evidence to support setting a threshold that is higher for the recognition of regulatory assets than for regulatory liabilities—that is, setting an asymmetrical threshold.
- The model requires the recognition of regulatory assets or regulatory liabilities if it is **more likely than not that they exist**.

Board's considerations—faithful representation

The *Conceptual Framework*:

(a) states that the level of **measurement uncertainty** affects whether recognition of an asset or a liability provides a **faithful representation** of that asset or liability and of any resulting income, expenses or changes in equity; and

(b) discusses situations when all available measurements of an asset or liability may be subject to such a **high level of measurement uncertainty** that recognising the asset or liability would not provide useful information.

Regulatory timing differences

Measurement uncertainty

It will be unusual to observe regulatory assets or regulatory liabilities with a level of measurement uncertainty that is so high that their recognition might not provide useful information. The nature of the regulation, and the evidence needed to support the existence of a regulatory asset or regulatory liability, means that an entity should be able to make a reasonable estimate of its measurement.

Consequently, the **model does not include specific requirements** for entities to assess whether to recognise regulatory assets or regulatory liabilities **in conditions of high measurement uncertainty.**

Board’s tentative decision

The Board tentatively decided that the accounting model:

(a) should require the recognition of regulatory assets or regulatory liabilities if it is more likely than not that they exist—the model sets a symmetrical recognition threshold in cases of existence uncertainty; and

(b) should not set thresholds that would prevent recognition of a regulatory asset or regulatory liability for which there is:

(i) low probability of an inflow or outflow of economic benefits; or

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Conceptual Framework	Model’s proposed requirements
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