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Purpose of this paper

1. The purpose of this paper is to assess whether the tentative decisions made to date by the Board for measuring regulatory assets and regulatory liabilities are consistent with the principles summarised in Agenda Paper 9A *Principles of the model: a summary*.

2. This paper is structured as follows:

   (a) background—total allowed compensation and the regulatory interest rate or return rate (paragraphs 4-10);

   (b) the Board's previous tentative decisions (paragraphs 11-15)

   (c) the model's measurement principles (paragraphs 16-19);

   (d) applying the measurement principles to regulatory assets (paragraphs 20-38);

   (e) applying the measurement principles to regulatory liabilities (paragraphs 39-45);

   (f) description of the measurement basis (paragraphs 46-55); and

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(g) measuring regulatory assets and regulatory liabilities that relate to expenses or income that will be included in/ deducted from the future rate(s) when cash is paid/ received (paragraphs 56-62).

3. The appendices include flowcharts to illustrate application of the discounting principles to regulatory assets and regulatory liabilities.

Background—total allowed compensation and the regulatory interest rate or return rate

4. As mentioned in paragraph 4 of Agenda Paper 9A, the total allowed compensation typically consists of allowable expenses incurred plus a target profit. The regulatory interest rate or return rate is a component of the target profit that is not directly related to the supply of goods or services. In contrast, other components of the target profit such as margins on allowable expenses and incentives are more directly related to goods or services supplied (see paragraphs 22-24 of Agenda Paper 9A).

5. The regulatory interest rate or return rate is applied to a base specified by the regulatory agreement. Regulatory assets and regulatory liabilities typically form a relatively small portion of that base. The base is typically based on regulatory carrying amounts (regulatory capital base, RCB)—reflecting amounts invested in the regulated business in, for example, property, plant and equipment (PPE)—but may differ from the carrying amounts of those items determined using IFRS Standards.

Interest rate or rate of return for different categories of regulatory assets and regulatory liabilities

6. When considering the interest rate or return rate applied to a regulatory asset or regulatory liability, we previously considered three categories of regulatory assets/ (regulatory liabilities):[1]

(a) those treated by the regulatory agreement as part of the RCB;

[1] Further information about these three categories and the types of interest rate or return rate applied to them was provided in Agenda Paper 9B for the Board's December 2018 meeting.

(b) those treated by the regulatory agreement as operating items; and

(c) those that relate to expenses payable/ (income receivable) in the future and that will be added to/ (deducted from) the future rate(s) when the resulting cash is paid/ (received). The natures of regulatory assets and regulatory liabilities in the third category are sufficiently distinct that we consider them separately (paragraphs 56-62).

7. Regulatory assets/ (regulatory liabilities) in the first two categories differ mainly in the:

(a) interest rate or return rate that the regulatory agreement provides the entity between the time a regulatory asset or a regulatory liability arises and the time it is recovered or fulfilled through the future rate(s) charged to customers (ie the time between the origination of a regulatory asset or regulatory liability and its reversal); and

(b) duration—with those treated as part of the RCB typically having a longer duration than those treated as operating items.

8. Each category (RCB and operating items) may be broken down into different time bands. The regulatory agreement typically applies the same interest rate or return rate to all regulatory assets and all regulatory liabilities within the same time band and within the same category. Therefore, the rate applied to the time band is not specific to the characteristics of the cash flows resulting from any individual regulatory asset or regulatory liability but is instead a blended rate for the whole time band. Table 1 illustrates the common interest or return rates typically provided for different categories of regulatory assets/ (regulatory liabilities).

Table 1

Categories of regulatory assets (RA) / regulatory liabilities (RL)	**Typical duration**	**Common interest or return rates given/charged**	**Comments**
Treated as part of the RCB	Long-term (approx. 5 years or more—	Weighted average cost of capital (WACC)	Interest or return rate is typically higher than rate that would reflect the characteristics of the

	typically capital expenditures)		cash flows arising from RA/RL. This return is key to achieve the regulator's objectives.[2]
Treated as operating items	Short-term (within 24 months—typically operating variances or incentives) Medium-term (approx. 2–5 years—typically allowable expenses triggered by a specific event such as a storm)	0% or rate above risk-free, typically reflecting corporate borrowing rates or the entity's incremental borrowing rate	Interest or return rate is typically adequate to provide compensation/ charge that at least compensates/charges the entity for the time value of money plus a premium to reflect the risks inherent in the resulting cash flows.

9. For some short-term items, the regulatory interest rate is explicitly a variable rate because it is linked to an index or quoted borrowing rate. For other items, the regulatory interest rates and return rates are reviewed intermittently (typically whenever the rate-review is carried out) and are reset to reflect changing conditions.

10. For items in the third category (paragraph 6(c)), ie those that arise from expenses payable/ (income receivable) in the future and that will be added to/ (deducted from) the future rate(s) when the resulting cash is paid/ (received), the regulatory agreement does not specify an interest or return rate. For further explanation, please see paragraphs 56-57.

Previous tentative decisions

11. In December 2018, staff recommended that for items forming part of the RCB, an entity should include only the estimated net future cash receipts arising from the

[2] This component of the overall return is intended to enable the entity to earn a target profit and support the entity's ongoing rate-regulated activities, including incentivising continuous investment and protecting the financial viability of the entity. In the document titled *'Financeability and financing the asset base – a discussion paper'* published in 2010, Ofwat, the regulator of the water sector in England and Wales, showed that 'return on capital' represented approximately 26.8 per cent of the revenue requirement for 2010-2015.

regulatory asset (ie the estimated cash flows, excluding the interest or return) and discount those net cash receipts at a rate of 0%.[3] The recommendation was intended to simplify the model and provide some relief in cases in which there is a gap period(s) between the time when a regulatory asset arises and the time when the entity starts to recover that asset (including the interest or return) through the rate(s) charged to customers—even if the financial effect of that gap period is material.

12. Board member views on the staff recommendation were mixed. Although the Board tentatively decided to accept the recommendation with a narrow majority, Board members expressed the following concerns during the meeting, which we have considered during our subsequent review of the consistency of the Board's tentative decisions with the model's principles:

    (a) some Board members were not convinced that items treated as part of the RCB and those treated as operating items were sufficiently distinct in nature to support different approaches to their measurement (the relief recommended for items forming part of the RCB was not recommended for items treated as operating items);

    (b) the lack of clear reasoning supporting two different approaches to measuring regulatory assets was confusing and obscured the principles behind the measurement technique—which was perceived as adding to the complexity of the model; and

    (c) applying the relief would delay the recognition of the interest or return that accrues during the gap period referred to in paragraph 11 and could result in a loss of relevant information in such gap periods.

13. In view of the concerns outlined in paragraph 12, we have reconsidered our previous analysis and now combine the two categories into a single category for the analysis in this paper. We consider the distinction between regulatory assets treated as part of the RCB and those treated as operating items is insufficient to support different approaches to measurement.

[3] Alternative approaches to measurement of regulatory assets treated as part of RCB, together with a summary description of advantages and disadvantages of the approaches, are set out in paragraphs 44-51 of Agenda Paper 9B, December 2018.

14. We remain convinced that the nature of regulatory assets/ (regulatory liabilities) that arise from expenses payable/ (income receivable) in the future and that will be added to/ (deducted from) the future rate(s) when the resulting cash is paid/ (received) is sufficiently different to support a different approach to measurement. In this paper, we clarify that our previous recommendation for these items represent an exception to the model's measurement principles (paragraphs 56-62).

Next step

15. As a result of our review of the consistency of the Board's tentative decisions with the model's principles, we plan to ask the Board in a future meeting:

    (a) to consider a revised recommendation proposing a single approach for the measurement of all regulatory assets treated as either part of the RCB or as operating items; and

    (b) to reconsider its tentative decision to reject the staff's recommendation to require a different measurement approach for regulatory assets/ (regulatory liabilities) that arise from expenses payable/ (income receivable) in the future and that will be added to/ (deducted from) the future rate(s) when the resulting cash is paid/ (received).

The model's measurement principles

16. The model uses a cash-flow-based measurement technique that would require an entity to:

    (a) estimate the future cash flows arising from regulatory assets or regulatory liabilities, updating those estimates if changes occur; and

    (b) discount the estimated future cash flows, keeping the discount rate established at initial recognition unchanged, unless the regulatory agreement changes the future cash flows by changing the interest rate or return rate.

17. Once an entity has estimated the amount and timing of the future cash flows arising from a regulatory asset or regulatory liability, the entity would then consider the effects of the time value of money and risks inherent in the cash

flows between the time the regulatory asset or regulatory liability arises and the time it is recovered or fulfilled through the future rate(s) charged to customers (ie between the origination of the regulatory asset (regulatory liability) and its reversal).

18. Board members have expressed mixed views about the mechanics of the measurement technique previously recommended by staff,[4] but we have identified some principles from the Board's discussions to date:

    (a) discounting of the estimated cash flows is not required if the effects of the time value of money and risks inherent in the cash flows are not significant.

    (b) if the interest rate or return rate provided (charged) by the regulatory agreement is adequate to sufficiently compensate (charge) the entity for the effects of time value of money and risks inherent in the cash flows between origination and reversal of the regulatory asset (regulatory liability), the compensation (charge) is recognised in the statement(s) of financial performance **over time unless** the interest rate or return rate provides excess compensation to the entity that **relates to an identifiable transaction or event.** In the latter case, the excess compensation is accounted for separately in the corresponding period to which it relates.

    (c) **for regulatory assets only**, if the regulatory interest rate or return rate is inadequate to sufficiently compensation for the effects of time value of money and risks inherent in the cash flows between origination and reversal of a regulatory asset, the entity will not fully recover the regulatory asset and so should recognise an expense immediately in profit or loss for the partial disallowance.

19. We have summarised these principles in the flowchart in appendix A, which focuses on the application of the discounting principles to regulatory assets. The same assessment is applicable for regulatory assets treated as operating items and

[4] The measurement technique has evolved through Board discussions in May 2018, July 2018 and December 2018.

for those treated as part of the RCB (paragraph 13). We consider the application of the discounting principles to regulatory liabilities separately (paragraphs 39-45).

Applying the measurement principles to regulatory assets

20. The starting point for measuring a regulatory asset or a regulatory liability is to identify the amount that will be added to or deducted from the future rate(s) because the total allowed compensation for goods or services already supplied exceeds, or is lower than, the amount already charged to customers for those goods or services (see paragraph 21 of Agenda Paper 9A). An entity would then estimate when those additions or deductions will be made to or from the future rate(s) to be charged to customers.

21. Our analysis and discussions in this section focus on the measurement of regulatory assets, except as stated otherwise, and relate to:

    (a) estimating the future cash flows (paragraphs 23-26); and

    (b) assessing the adequacy of the regulatory interest rate or return rate to determine whether it can be used for discounting estimates of future cash flows (paragraphs 27-34).

22. For discussions on measurement of regulatory liabilities, please refer to paragraphs 39-45.

Estimating the future cash flows

23. The model requires an entity to estimate future cash flows arising from each regulatory asset recognised using either the **'most likely amount'** method or the **'expected value'** method, depending on which method the entity concludes would better predict the amount of the cash flows arising from a particular timing difference or group of timing differences (see paragraph 8). The Board has also

tentatively decided that the entity would apply the same method consistently from the origination of the timing difference until its reversal.[5, 6]

24. When estimating future cash flows, an entity would consider the risks associated with those cash flows. The amount and timing of cash flows resulting from regulatory assets and regulatory liabilities are typically highly predictable, although they could be subject to credit risk, demand risk and non-performance risk (including own-credit risk) and, consequently, be subject to some variability. These risks are, however, typically low:

(a) Demand risk—typically, 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.

(b) Customer credit risk—the regulatory agreement typically treats credit losses as an allowable expense that is compensated for through the rate(s) charged to customers.

(c) Non-performance risk—typically entities that are subject to defined rate regulation have low non-performance risk and maintain a high credit rating. This is partly due to the typically low risk environment in which they operate and partly due to the regulatory objective of establishing rate(s) that are designed with the aim of making it viable for the entity to fulfil the requirements specified in the regulatory agreement for the quality, quantity and supply of goods and services.

[5] Agenda Paper 9B and Agenda Paper 9D discussed at the July 2018 Board meeting.

[6] When measuring assets (or liabilities) by reference to estimates of uncertain future cash flows, IFRS 15 *Revenue from Contracts with Customers* and IFRIC 23 *Uncertainty over Income Tax Treatments* require the use of either the most likely amount or the expected value.

Updating estimated cash flows

25. The model requires an entity to update the estimated cash flows at each reporting date and to account for changes in estimates of future cash flows in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Consequently:

    (a) the effect of a change in estimated future cash flows would be recognised prospectively in profit or loss in:

        (i) the period of change, if the change affects only that period; or
        (ii) the period of change and future periods, if the change affects both; and

    (b) if the change in estimated cash flows gives rise to a change in a regulatory asset, the change would be recognised by adjusting the carrying amount of the related asset in the period of change.

26. The model does not require separate impairment procedures because updating the estimates of future cash flows would capture any downward remeasurements.

Assessing the adequacy of the interest rate or return rate

27. Once an entity has estimated the amount and timing of the future cash flows arising from a regulatory asset or regulatory liability, the entity would then consider the effects of the time value of money and risks inherent in the cash flows between the time the regulatory asset or regulatory liability comes into existence and it is recovered or fulfilled through the future rate(s) charged to customers.

28. If an entity concludes that the effects of the time value of money and risks inherent in the cash flows between the origination of a regulatory asset and its recovery through the future rate(s) charged to customers are significant, an entity would need to assess the adequacy of the regulatory interest or return rate to sufficiently compensate the entity for the time value of money and the risks inherent in the cash flows (paragraph 18). Table 1 in paragraph 8 outlines the types of interest rates and return rates typically applied to regulatory assets.

29. As noted in paragraph 8, the regulatory agreement typically applies the same blended interest or return rate to all regulatory assets and all regulatory liabilities within the same time band and within the same category. The regulatory assets and regulatory liabilities within the time band have the same pattern and timing of reversal and are typically subject to the same risks. Consequently, each item is treated in the same way for regulatory purposes. Therefore, it may also be appropriate for an entity to consider that grouping when assessing the adequacy of the regulatory interest rate or return rate.

30. For longer-term items, return rates based on the regulator's estimate of the entity's weighted average cost of capital (WACC) include an equity component that provides a return to investors as well as providing compensation to the entity for the time value of money and risks inherent in the estimated cash flows. Consequently, a rate that includes such an equity component would typically be expected to be adequate.

31. For shorter-term items, the regulatory agreement typically applies an interest rate that is based either on corporate borrowing rates or the entity's incremental borrowing rate. The corporate borrowing rates selected typically reflect the time value of money plus a relatively small risk premium, reflecting the typically low risk environment in which entities subject to defined rate regulation operate. However, it may be necessary to factor in higher risk premium(s) if there are any unusual risks inherent in the cash flows arising from the regulatory assets, for example significant uncertainty about the outcome of the regulatory rate approval process.

32. In most cases, we expect that the assessment of the adequacy of the interest rate or return rate provided by the regulatory agreement would be straightforward and would typically conclude that the regulatory interest rate or return rate is adequate to sufficiently compensate the entity of the time value of money and risks inherent in the cash flows. In such typical cases, the interest or return provided by the regulatory interest rate or return rate, in accordance with the model's principle described in paragraph 18(b), would be recognised over time.

33. However, in limited circumstances, an entity may need to identify a different rate for discounting estimated cash flows than the regulatory interest rate or return

rate. Such circumstances are not expected to occur frequently and are listed here in descending expected order of frequency:

(a) the interest rate or return rate established by the regulatory agreement is inadequate to compensate the entity for the time value of money and risks inherent in the cash flows between when a regulatory asset arises and when it is recovered through the rate(s) charged to customers, resulting in a partial disallowance of the regulatory asset; and

(b) the interest rate or return rate established by the regulatory agreement provides an additional return that relates to an identifiable transaction or event, such as a performance bonus.

34. We plan to bring our further analysis of this issue to the Board at a future meeting to ask whether the model should specify what discount rate to use in these limited circumstances and, if so, what that discount rate should be.

Changes in regulatory interest rates or return rates

35. As noted in paragraph 9, the interest rate or return rate established by the regulatory agreement is typically reviewed intermittently and updated to reflect changed circumstances. When the interest rate or return rate changes, it affects the estimated future cash flows resulting from the regulatory asset.

36. When the interest rate or return rate changes, the entity would need to reassess the adequacy of the revised rate. Typically, the change affects all items within the same time band and, in such cases, we would expect the updated interest rate or return rate to remain adequate to compensate the entity for the time value of money and risks inherent in the cash flows. Consequently, we would expect the interest or return to continue to be recognised over time.

37. However, if the change results in a partial disallowance or other change in the measurement of a regulatory asset, the model requires the change to be accounted for in a manner consistent with the requirements for changes in the estimates of future cash flows (paragraph 25). As a result, the model requires an entity to:[7]

[7] Agenda Paper 9B and Agenda Paper 9D discussed at the July 2018 Board meeting.

(a) measure the outstanding regulatory asset balance using the revised discount rate to discount the estimated revised future cash flows; and

(b) recognise any resulting change in the carrying amount of the regulatory asset in the period of change.

Disclosures

38. In November 2018, the Board tentatively decided that an entity should disclose, among other items, a breakdown of the regulatory income or regulatory expense line item in profit or loss into originations of regulatory assets and some other specified changes.[8] In limited circumstances, there is a gap between the time when a regulatory asset arises and the time when the entity starts to recover that asset (including the interest or return) through the rate(s) charged to customers **and** the financial effects of that gap are material. In such cases, the accrual of interest on the balance of the regulatory asset would not be included (entirely or in part) in the rate(s) charged to customers in the same period. As a result, the accrual of interest or return in the gap period would give rise to an addition to the regulatory asset that could be viewed by some as an origination of a new regulatory asset for disclosure purposes. We intend to revisit this issue in a future Board meeting.

Question for the Board

Measurement principles and measurement of regulatory assets
1. Does the Board have any questions or comments on our analysis of the measurement principles of the model and their application to the measurement of regulatory assets (paragraphs 16-37)?

[8] Agenda Paper 9D discussed at the November 2018 Board meeting.

Applying the measurement principles to regulatory liabilities

39. Much of the Board's discussion about the measurement technique to date has focused on regulatory assets. In July 2018, the Board tentatively decided that the model should apply the same measurement requirements for regulatory liabilities as for regulatory assets.[9] However, Board members asked staff to consider whether any further analysis and development of the measurement technique would require different requirements for regulatory liabilities. We provide our initial findings in the following paragraphs.

40. We see no reason to apply different requirements for the estimation of future cash flows (paragraphs 23-26) and so we focus our analysis on the discount rate. We suggest that the measurement principles set out in paragraph 18 for regulatory assets are equally applicable to regulatory liabilities, except for partial disallowance (paragraph 43). The flowchart in appendix B is applicable to regulatory liabilities for which the effects of the time value of money and risks inherent in the cash flows are significant and so covers the assessments required in paragraph 18.

41. Considering the principle for regulatory assets in paragraph 18(b)—ie the interest rate or return rate should be adequate to sufficiently **compensate** the entity for the time value of money and risks inherent in the cash flows—the equivalent principle for regulatory liabilities would be that the interest rate or return rate should be adequate to sufficiently **charge** the entity for the time value of money and risks inherent in the cash flows.

42. If the regulatory interest rate or return rate is inadequate to charge the entity for the time value of money and risks inherent in the cash flows, the entity is effectively being provided with an additional return over the life of the regulatory liability. We think that in those cases it is appropriate to follow the principle in paragraph 18(b)—additional return (ie compensation in excess of the rate that compensates for time value of money and risks inherent in the cash flows) should be recognised over time unless it relates to an identifiable transaction or event.

[9] Agenda Paper 9B and Agenda Paper 9D discussed at the July 2018 Board meeting.

43. In some cases, the regulatory interest rate or return rate applied to a regulatory liability may be higher than the interest rate or return rate that the entity might have to pay if it obtained funding elsewhere in the form of a financial liability for the same amount and duration. However, we do not consider that this automatically makes a regulatory liability onerous. As noted in paragraph 8, the regulatory agreement typically applies the same blended interest rate or return rate to all regulatory liabilities and all regulatory assets within the same time band, rather than identifying an interest rate or return rate for each individual item within the time band. Consequently, an interest rate or return rate applied to a regulatory liability within a time band may merely reduce the excess interest or return related to a regulatory asset within the same time band, with the result that the entity concludes the interest rate or return rate applied to that time band is adequate to sufficiently compensate the entity for an overall net regulatory asset position. Applying the principles of the model, the entity would consequently recognise the interest or return charged on the regulatory liability over time.

44. We would expect an excess charge on a time band with a net liability position to be rare because regulatory interest rates and return rates are set with the aim of achieving the regulatory objective of making it financially viable for the entity to fulfil its requirements for the supply of the goods or services (see paragraph 3 of Agenda Paper 9A). However, an excess interest or return charged on a regulatory liability or net regulatory liability position could be an indication that the regulator is imposing a penalty on the entity. If so, the imposing of a penalty represents an identifiable transaction or event that would result in an entity immediately recognising the penalty charge as an expense, rather than recognising the whole of the regulatory interest or return over time (see paragraph 18(b)).

45. We consider the situation described in paragraphs 43-44 to be an application of the principles outlined in paragraph 18. Consequently, we have found no reason for the model to apply different measurement requirements for regulatory liabilities than for regulatory assets.

Question for the Board

Measurement principles and measurement of regulatory liabilities
2. Does the Board have any questions or comments on our analysis of the measurement principles of the model and their application to the measurement of regulatory assets (paragraphs 39-45)?

Description of the measurement basis

46. The *Conceptual Framework* distinguishes:

    (a) a measurement basis: an identified feature—for example historical cost, fair value or fulfilment value—of an item being measured; from[10]

    (b) a cash-flow-based measurement technique: a technique used when applying a measurement basis.[11]

47. Paragraph 6.91 of the *Conceptual Framework* states:

> In some such cases, one way to estimate the measure is by using cash-flow-based measurement techniques. Such techniques are not measurement bases. They are techniques used in applying a measurement basis. Hence, when using such a technique, it is necessary to identify which measurement basis is used and the extent to which the technique reflects the factors applicable to that measurement basis.

48. The cash-flow-based measurement technique described in this paper has been developed to reflect the nature of regulatory assets (and regulatory liabilities), which do 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 (ie it is not a right to receive cash or another financial asset, but a right to add an amount

[10] Paragraph 6.1 of the *Conceptual Framework*.
[11] Paragraph 6.91 of the *Conceptual Framework*.

in the future rate(s) charged to customers), nor is it an intangible asset or an item of property, plant, equipment or inventory.[12]

49. As mentioned in paragraph 35 of Agenda Paper 9A, the measurement technique for regulatory assets and regulatory liabilities could be viewed as the application of either:

    (a) a modified historical cost measurement basis—modified to update it for changes in estimates of future cash flows; or

    (b) a modified current value measurement basis—modified to use a historical discount rate.

50. We previously noted that we considered both descriptions to be valid and did not previously propose the Board select one to use in the model. However, some Board members have suggested that it would be helpful to do so.

Modified historical cost measurement basis

51. We understand that updating estimates of future cash flows could be argued by some as not representing (strictly) a historical cost measurement basis. However, paragraphs 6.7-6.8 of the *Conceptual Framework* indicate that the historical cost of an asset or a liability is updated over time to depict, if applicable, changes such as payments received or made, accrual of interest, and the effects of events that cause all or part of an asset to be no longer recoverable (impairment).

Modified current value measurement basis

52. A key feature of a current value measurement is that it provides monetary information about assets and liabilities using information updated to reflect entity-specific assumptions or assumptions of market participants about conditions at the measurement date. As a result of updating the measurement to reflect current information, paragraph 6.10 of the *Conceptual Framework* notes that, '[u]nlike historical cost, the current value of an asset or liability is not derived, even in part, from the price of the transaction of other event that gave rise to the asset or liability.'

[12] Agenda Paper 9B discussed at the May 2018 Board meeting.

The model's cash-flow-based measurement technique

53. The measurement technique requires an entity to update estimates of cash flows but to keep the discount rate established at initial recognition unchanged (unless the regulatory agreement changes the future cash flows by changing the interest rate or return rate). Consequently, the measurement technique omits the key feature of a current value measurement basis.

54. Accordingly, we suggest that, if the Board decide to specify the measurement basis that the model's cash-flow-based measurement technique applies, it would be more suitable to describe it as a modified historical cost measurement basis—modified to update it for changes in estimates of future cash flows.

55. We plan to ask the Board in a future meeting which description should be used to describe the measurement technique going forward.

Question for the Board

Measurement basis
3. Does the Board have any questions or comments on our analysis of the measurement basis for the model presented in this section (paragraphs 46-55)?

Measuring regulatory assets and regulatory liabilities that relate to expenses or income that will be included in/ deducted from the future rate(s) when cash is paid/ received

56. As noted in paragraph 6(c), regulatory assets (regulatory liabilities) arising from expenses payable/ (income receivable) in the future and that will be added to/ (deducted from) the future rate(s) when the resulting cash is paid/ (received) are sufficiently distinct in nature that we consider them separately from other regulatory assets (regulatory liabilities). Such expenses payable/ (income receivable) are recognised in financial statements in accordance with existing IFRS Standards, but the regulatory agreement does not include such items in 'allowable expenses' until a future period when the entity pays or receives the related cash. Example of items typically treated in this way include pension costs,

deferred taxation, asset retirement obligations, environmental clean-up provisions and derivatives used for hedging. In many such cases, these items are, in accordance with IFRS Standards, measured explicitly or implicitly on a present value basis.

57. In such cases, a regulatory asset[13] (for example) comes into existence when the entity incurs the allowable expense and recognises the resulting amount payable as a liability in IFRS financial statements. The regulatory agreement does not split the cash payment into an amount of compensation for the expense to be recovered and separate compensation for the time value of money and risks inherent in the cash flows between the allowable expense being incurred and the resulting cash payment. Consequently, there is no need for the regulatory agreement to specify an interest or return rate for the related regulatory asset before the allowable expenses are paid.

58. Once the cash is paid, the regulatory agreement treats the item as either an operating item or an RCB item and the interest rate or return rate applicable to the items in that category then applies (paragraph 8).

Exception to the measurement principles

59. The staff recommended in December 2018 that regulatory assets and regulatory liabilities in this (third) category should be measured at the same amount as the underlying liability or asset.[14] This approach is an exception to the measurement approach used in the model for all other regulatory assets and regulatory liabilities. In the staff's view, this exception:

    (a) would provide the most users with the most relevant and understandable information because it uses the same measurement basis for the underlying liability or asset and for the regulatory asset or regulatory liability that generates (almost exactly) the same cash flows and is subject to (almost exactly) the same risks;

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[13] For simplicity, the discussion focuses on regulatory assets. Similar considerations apply to regulatory liabilities.

[14] If the regulatory asset is subject to additional risks that do not affect the underlying liability, the measurement of the regulatory asset may need to be adjusted to reflect those additional risks (see paragraph 60 in Agenda Paper 9B for the Board's December 2018 meeting).

(b) is consistent with the discussion of measurement inconsistencies in paragraph 6.58 of the *Conceptual Framework*, and particularly the discussion there of 'cash flows from one asset or liability [that] are directly linked to the cash flows from another asset or liability'; and

(c) is consistent with an exception that already exists in IFRS 3 *Business Combinations* (for indemnification assets).

60. In December 2018, Board members had mixed views about applying this approach, particularly for regulatory assets or regulatory liabilities arising from deferred tax liabilities or deferred tax assets. However, we accept that we had not highlighted this recommendation as an exception to the principles of the model, which was confusing. Consequently, we plan to ask the Board to reconsider the staff's recommendation for this exception in the light of the refined description of the model and its principles.

Presentation

61. In some cases, changes in the measurement of the regulatory liability or regulatory asset result from changes in the measurement of the related asset/ liability that are presented in other comprehensive income. In November 2018, the staff recommended that the regulatory income/ expense resulting from such changes in the measurement of the regulatory liability or regulatory asset should also be presented in other comprehensive income.[15] However, the Board tentatively decided to reject that proposal and instead, tentatively decided to present all regulatory income/ expense in profit or loss.

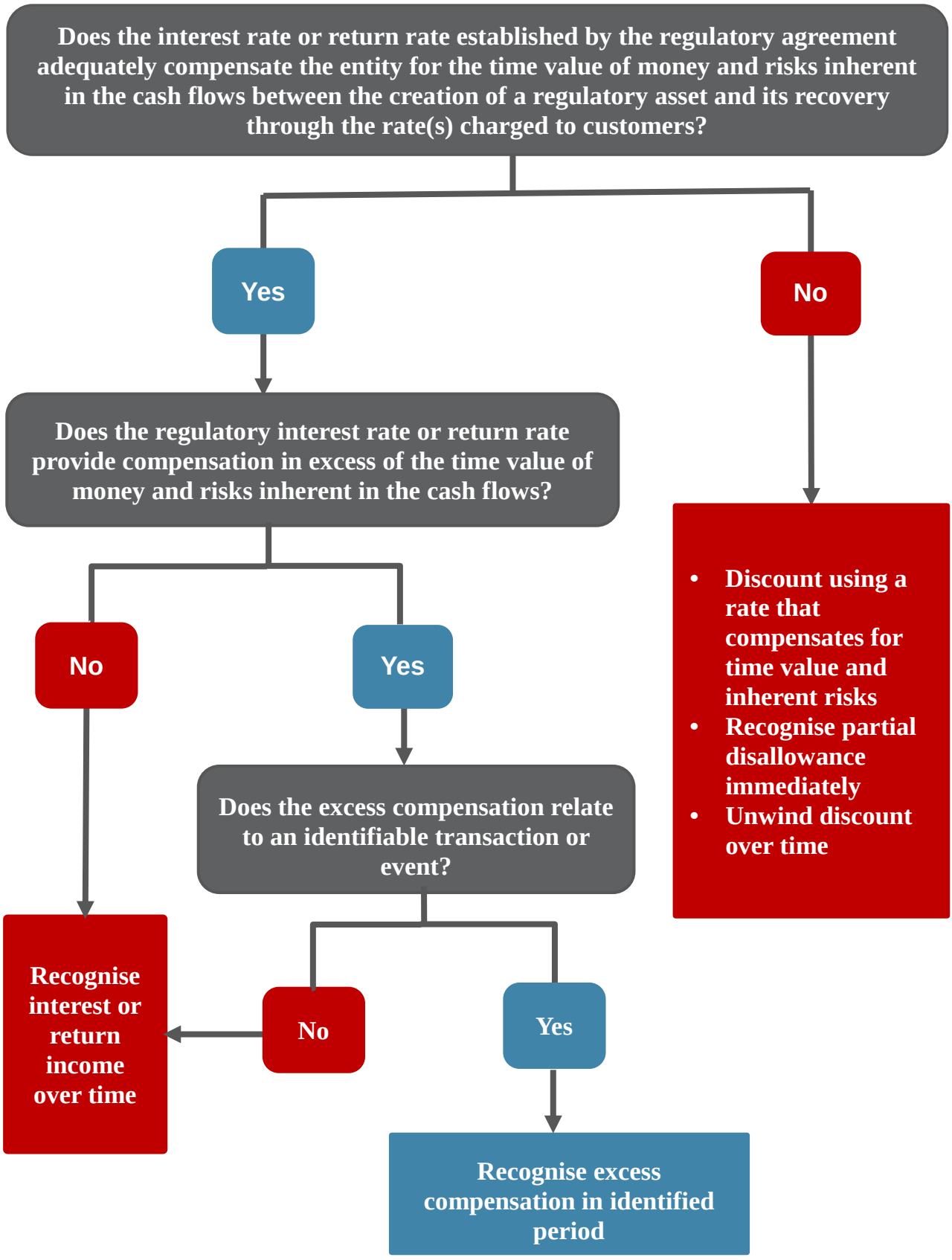
62. As noted in paragraph 42 of Agenda Paper 9A, we plan to ask the Board to consider this issue further in a future meeting.

[15] Agenda Paper 9C discussed at the November 2018 Board meeting.

Question for the Board

Regulatory assets and regulatory liabilities that relate to expenses or income that will be included in/ deducted from the future rate(s) when cash is paid/ received
4. Does the Board have any questions or comments on our analysis of the measurement of regulatory assets/regulatory liabilities that relate to expenses or income that will be included in/ deducted from the future rate(s) when cash is paid/ received (paragraphs 56–62)?

APPENDIX A: Regulatory assets—assessing the adequacy of the discount rate



APPENDIX B: Regulatory liabilities—assessing the sufficiency of the discount rate