IFRS® Foundation

Regulatory Assets and Regulatory Liabilities

Accounting Standards Advisory Forum meeting

ASAF Agenda Paper 4

June 2021

Purpose of this session

Purpose

- Ask ASAF members to share feedback from their jurisdictions on the Exposure Draft *Regulatory Assets and Regulatory Liabilities* published in January 2021.

Questions for ASAF members

- Questions 1–3 about the scope of the proposals are included in slide 9.
- Questions 4–6 about the proposals on total allowed compensation for goods or services supplied in a period are included in slide 15.
- Questions 7–10 about the proposed measurement requirements are included in slide 19.
- Question 11 about the interaction between the proposals and IFRIC 12 is included in slide 22.

Agenda

- Problem definition
- Feedback on Board’s proposals
- Next steps

Problem definition

What is the problem?

A regulatory agreement establishes

HOW MUCH a company can charge for supplying goods or services to customers

&

WHEN the company can charge that compensation to customers through the rates

In the period of supply

Compensation in rates

Supply of goods or services

No difference in timing

In a **different period** than the period of supply

Past period

Current period

Future period

Difference in timing arises—reported financial performance and financial position is INCOMPLETE

Board's proposals

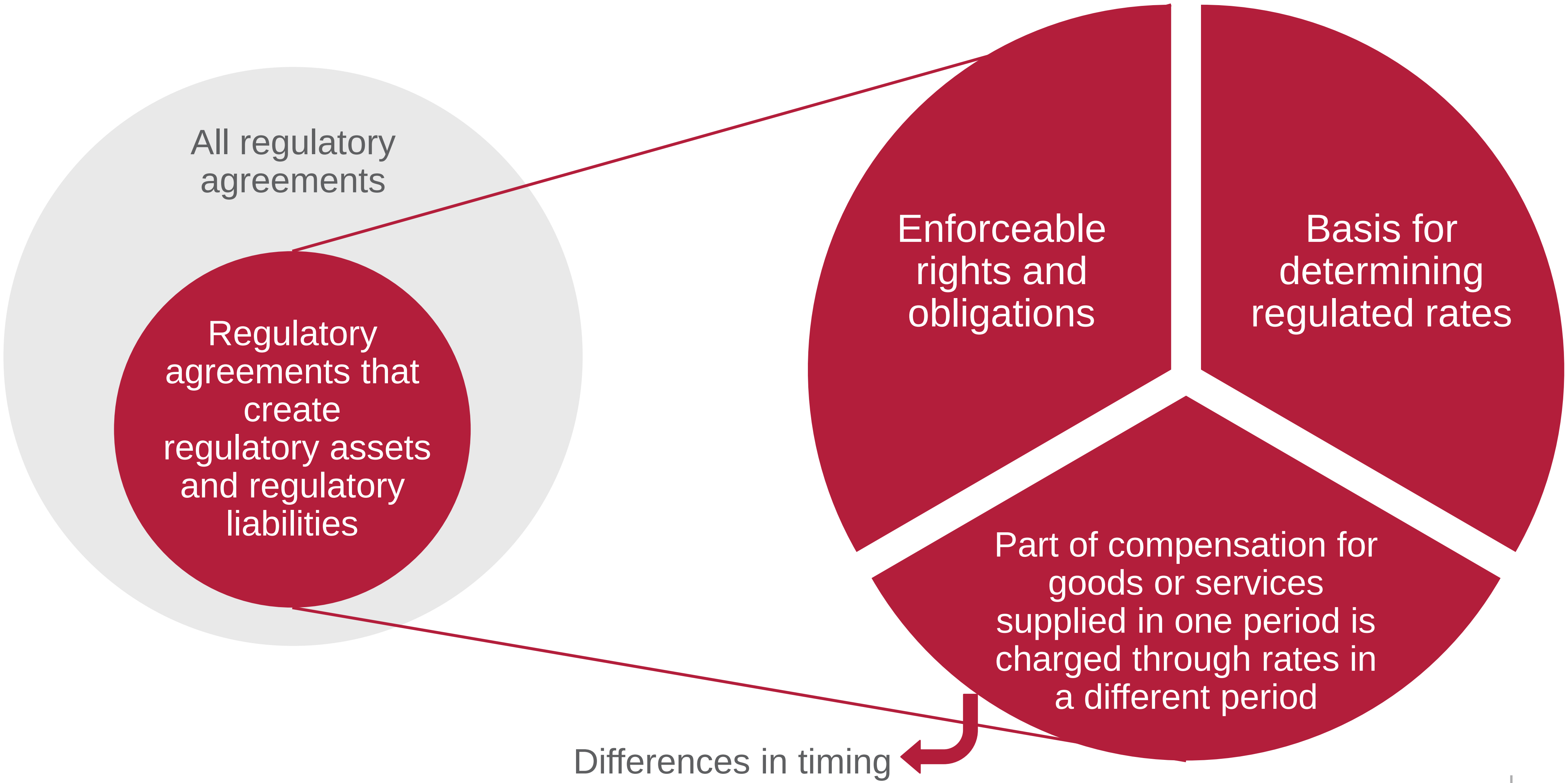
Problem	Without information about **differences in timing**, investors have an **insufficient basis** for understanding their effects on a company's **financial performance, financial position and prospects for future cash flows**.
Proposals	A company should report **regulatory income** and **regulatory expense** in its income statement, and **regulatory assets** and **regulatory liabilities** in its balance sheet. That information would supplement the information that companies already provide by applying IFRS Standards, including IFRS 15 *Revenue from Contracts with Customers*.
Principle	A company should **reflect compensation* for goods or services supplied** as part of its reported financial performance **for the period in which it supplies those goods or services**.

*The ED calls this compensation 'total allowed compensation' and defines it as:
The full amount of compensation for goods or services supplied that a regulatory agreement entitles an entity to charge customers through the regulated rates, in either the period when the entity supplies those goods or services or a different period.

Feedback on Board's proposals

Scope

Scope


All regulatory agreements
Regulatory agreements that create regulatory assets and regulatory liabilities
Enforceable rights and obligations
Basis for determining regulated rates
Part of compensation for goods or services supplied in one period is charged through rates in a different period
Differences in timing

Questions—Scope

1. Do you agree with the proposed scope?

2. Are the scope proposals clear enough to enable an entity to determine whether a regulatory agreement gives rise to regulatory assets and regulatory liabilities?

3. Do you foresee assessing whether rights and obligations are enforceable would be challenging? If so, what are the circumstances that make such assessment challenging?

Feedback on Board’s proposals

Total allowed compensation

Total allowed compensation (TAC)

Components of total allowed compensation (TAC)

- **Allowable expenses less chargeable income**
- **Target profit**
  - Regulatory returns
  - Performance incentives
- **Regulatory interest income (expense)**

  (for *time lag*)

The proposals specify **when** these components affect profit

When components of TAC affect profit?

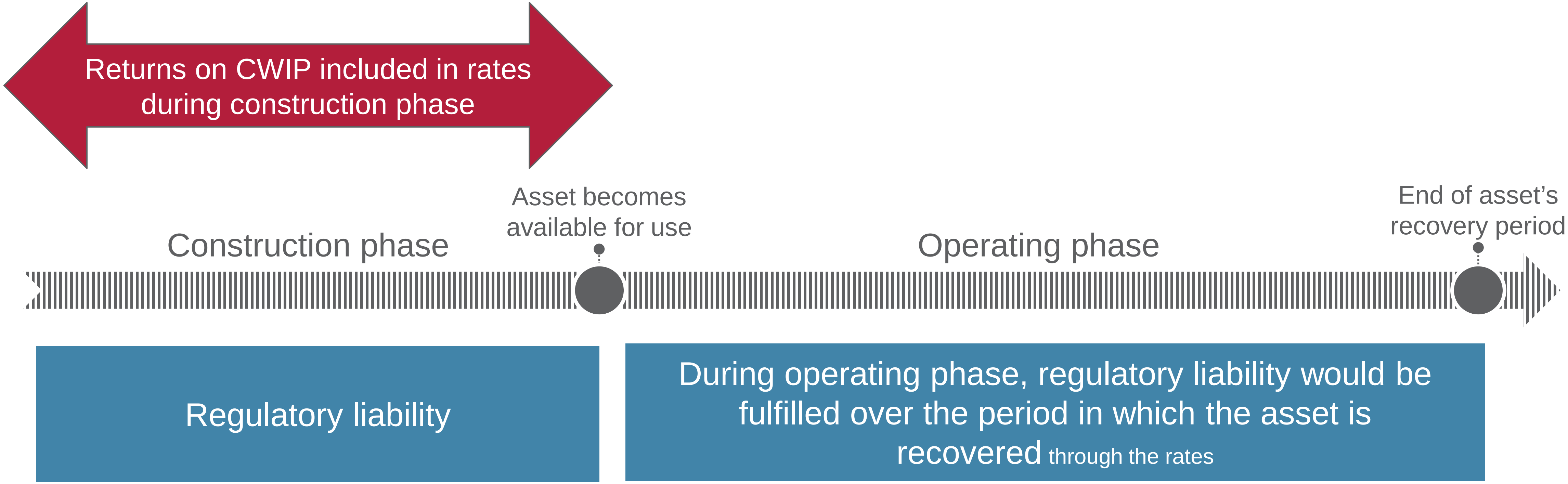
Allowable expenses less chargeable income	Target profit		Regulatory interest income (expense) (for *time lag*)
	Regulatory returns*	Performance incentives	
When a company recognises the expense or income by applying IFRS Standards	When the regulatory agreement entitles a company to add these in determining a regulated rate	In the period in which a company's performance gives rise to the incentive bonus or penalty	As the discount unwinds until recovery of the regulatory asset (or fulfilment of the regulatory liability)

* Regulatory returns on an asset not available for use affect profit:

- only once the asset is available for use; and
- then over the remaining periods in which the asset is recovered through the regulated rates

Regulatory returns on assets not yet available for use (1/2)

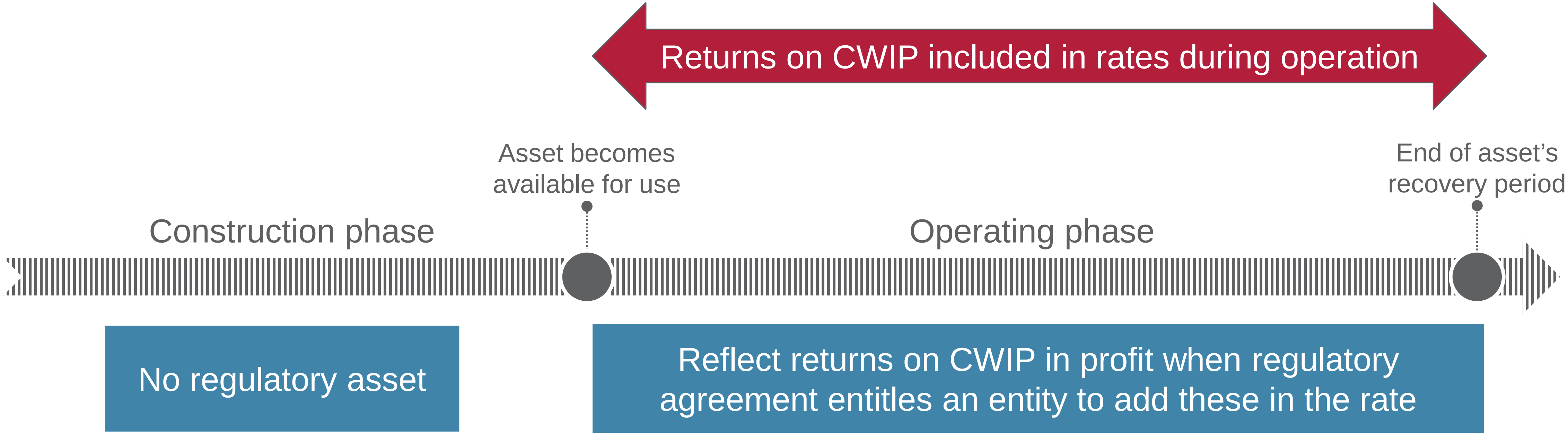
Regulatory returns on an asset not yet available for use (returns on CWIP*) affect profit ONLY during the operating phase of that asset



* CWIP: construction work in progress

Regulatory returns on assets not yet available for use (2/2)

Regulatory returns on an asset not yet available for use (returns on CWIP*) affect profit ONLY during the operating phase of that asset



* CWIP: construction work in progress

Questions—Total allowed compensation

4 Do you agree with the focus of the proposals on total allowed compensation for goods or services supplied in a period?

5 Do you agree with the proposals on how an entity would determine total allowed compensation for goods or services supplied in a period?

6 Is there a need for further guidance on how to apply the concept of total allowed compensation for goods or services?

Feedback on Board’s proposals

Measurement

Cash-flow-based measurement

	Future cash flows	Discount rate
Initial measurement	**Include all future cash flows** • if uncertain, estimate using 'most likely amount' method or 'expected value' method • the cash flows include those from regulatory interest	**Discount estimated future cash flows** • using the *regulatory interest rate* • unless this rate for a regulatory asset is insufficient*
Subsequent measurement	**Update estimates of future cash flows** • to reflect recovery of regulatory asset or fulfilment of regulatory liability • for changes in estimates	**Continue to use discount rate** • as determined at initial recognition • unless regulatory agreement changes the regulatory interest rate

* For a regulatory asset only, if the regulatory interest rate compensates an entity insufficiently for the time value of money and uncertainty, the discount rate would instead be the **(minimum) rate** that would be sufficient to provide that compensation.

IFRS

Discount rate—the minimum interest rate

For **regulatory assets:**

If there is an **indication** the **regulatory interest rate is insufficient** to compensate the company for:

- the time value of money; and
- for the uncertainty in the amount or timing of future cash flows arising from a regulatory asset

Estimate **minimum rate**

If the regulatory interest rate is < the minimum rate, discount the estimated future cash flows at the **minimum rate**

Use the **minimum rate** to:

(a) **discount** the estimated future cash flows; and

(b) **recognise regulatory interest income** as the discount unwinds **over time**

Questions—Measurement

7 Do you agree with the proposed cash-flow-based measurement technique?

8 Do you agree with the proposals that an entity should estimate uncertain future cash flows using whichever of the two methods (‘most likely amount’ or ‘expected value’) the entity expects to better predict the cash flows?

9 Do you agree with the proposals for discounting the estimated future cash flows using the regulatory interest rate, except in specified circumstances?

10 Do you agree with the proposals for cases when the regulatory interest rate provided for a regulatory asset is insufficient?

Feedback on Board’s proposals

Interaction with IFRIC 12

IFRIC 12

- Service concessions within the scope of IFRIC 12 are subject to some form of rate regulation, because the grantor regulates the price to be charged for the services.
- A service concession arrangement may be the form that a regulatory agreement takes.
- Service concession arrangements may create regulatory assets and regulatory liabilities.

Question—IFRIC 12

11

Do you think some service concession arrangements in your jurisdiction may create regulatory assets and regulatory liabilities?

Next steps

Next steps

Outreach

Jan 2021

Exposure Draft

Regulatory Assets and Regulatory Liabilities

Jul 2021

Comments due 30 July

H2 2021

Comment letter analysis

202X

IFRS X

Regulatory Assets and Regulatory Liabilities

If issued, would replace IFRS 14

Quick links

For more information, please refer to the following materials on www.ifrs.org:

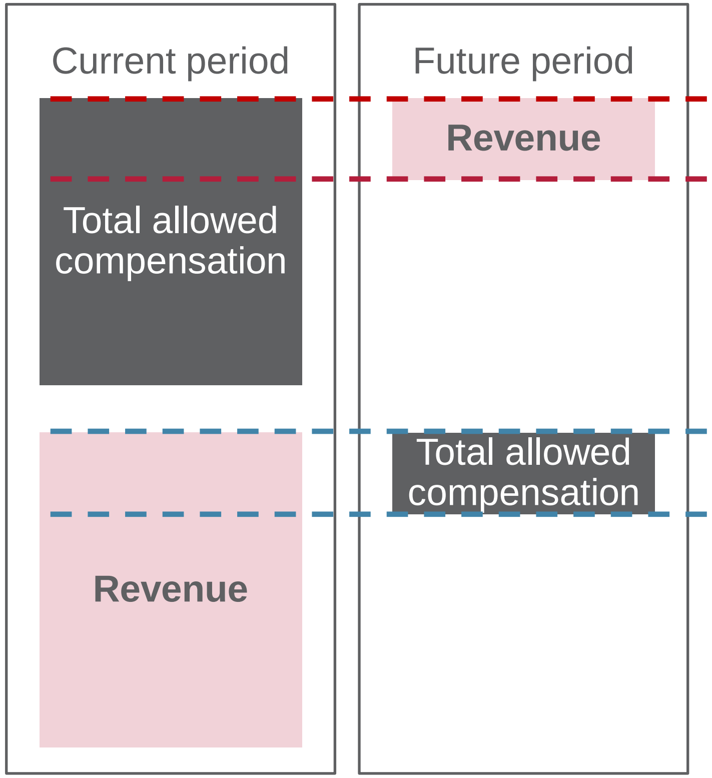
- Webinar: Explaining the Exposure Draft Regulatory Assets and Regulatory Liabilities
- Exposure Draft *Regulatory Assets and Regulatory Liabilities*
- Illustrative Examples on *Regulatory Assets and Regulatory Liabilities*
- Basis for Conclusions on Exposure Draft *Regulatory Assets and Regulatory Liabilities*
- Snapshot: *Regulatory Assets and Regulatory Liabilities*

Appendix

Summary of the model

Difference in timing arising because	On initial recognition	On recovery/fulfilment	Discounted cash flow measurement	Presentation	Disclosure
Compensation for goods or services already supplied will be included in setting rates, and hence in revenue, for future →	Recognise Regulatory Asset and Regulatory Income →	*When amount is added in setting rate* Derecognise Regulatory Asset and recognise Regulatory Expense	**Regulatory asset** Incremental cash inflows from charging customers a higher rate Discount rate specified in regulatory agreement used unless it is insufficient	All Regulatory Income minus all Regulatory Expense presented immediately below revenue Unwinding of discount is also a component of Regulatory Income or Regulatory Expense	Components and causes of Regulatory Income and Regulatory Expense Inputs used in measuring Regulatory Assets and Regulatory Liabilities
Amounts included in rates charged, and hence in revenue already recognised, provides part of the compensation for goods or services to be supplied in future →	Recognise Regulatory Liability and Regulatory Expense →	*When amount is deducted in setting rate* Derecognise Regulatory Liability and recognise Regulatory Income	**Regulatory liability** Lower cash inflows from charging customers a lower rate Discount rate specified in regulatory agreement used	In one situation, some Regulatory Income or Regulatory Expense presented in OCI Regulatory Assets and Regulatory Liabilities presented as separate line items	Risks and uncertainties Reconciliation of Regulatory Asset and Regulatory Liability balances

Total allowed compensation and regulatory assets and regulatory liabilities



Total allowed compensation

Total allowed compensation for goods or services supplied is the full amount of compensation for those goods or services that a regulatory agreement entitles an entity to charge customers through the regulated rates, in either the period when the entity supplies those goods or services or a different period.

Regulatory asset

An enforceable present right, created by a regulatory agreement, **to add an amount** in determining a regulated rate to be charged to customers in future periods because part of the **total allowed compensation for goods or services already supplied** will be included in **revenue in the future**

Regulatory liability

An enforceable present obligation, created by a regulatory agreement, **to deduct an amount** in determining a regulated rate to be charged to customers in future periods because the **revenue already recognised** includes an amount that will provide part of the **total allowed compensation for goods or services to be supplied in the future**

Regulatory assets

Example RA1	Example RA2	Example RA3
The rate a company charges customers during the current period includes an estimated amount of input costs. Actual input costs incurred in that period exceeded this estimate. The regulatory agreement gives the company the right to add that under-recovery of input costs in the rates to be charged to customers in the future.	A company incurs an obligation for environmental clean-up costs during the current period. The rates charged to customers during the current period did not include the environmental costs incurred. The regulatory agreement gives the company the right to recover those costs by adding them in the rates only when it pays the related cash in the future.	A regulatory agreement entitles a company to a bonus because it met specified performance criteria in the current period. The rates charged to customers during the current period did not include the bonus. The regulatory agreement gives the company the right to recover the bonus by adding it in the rates to be charged to customers in the future.

Under-recovery of compensation in the current period creates a regulatory asset

Generates cash inflows when regulated rates are increased in the future period

In the current period, recognition of:

- Regulatory asset
- Regulatory income

In the future period:

- Recognition of revenue and regulatory expense
- Stop recognising regulatory asset

Regulatory liabilities

Example RL1	Example RL2	Example RL3
The rate a company charges customers during the current period includes an estimated amount of input costs. Actual input costs incurred in that period were lower than this estimate. The regulatory agreement obliges the company to deduct that over-recovery of input costs in the rates to be charged to customers in the future.	A regulatory agreement entitles a company to recover part of the construction cost of an asset through the rates charged to customers ('pre-funding') in the current period. The asset was not yet available for use in the current period. The regulatory agreement obliges the company to deduct the amount of the pre-funding in the rates to be charged to customers in the future.	A regulatory agreement imposes a penalty on a company because it failed to meet specified performance criteria in the current period. The rates charged in the current period did not reflect the penalty. The regulatory agreement obliges the company to deduct the amount of the penalty in the rates to be charged to customers in the future.

Over-recovery of compensation in the current period creates a regulatory liability

→ Generates lower cash inflows when regulated rates are decreased in the future period

In the current period, recognition of:
- Regulatory liability
- Regulatory expense

→ In the future period:
- Recognition of lower amount of revenue and regulatory income
- Stop recognising regulatory liability

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