

STAFF PAPER

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Project	Rate-regulated Activities		
Paper topic	Feedback summary—Regulatory Assets and Regulatory Liabilities		
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Objective

1. This paper analyses the feedback from comment letters and outreach events on the proposed definitions of regulatory assets and regulatory liabilities set out in the Exposure Draft *Regulatory Assets and Regulatory Liabilities* (Question 2 of the Invitation to Comment).

Key messages

2. Most respondents agreed with:
 - (a) the proposed definitions for regulatory assets and regulatory liabilities;
 - (b) the focus of the proposals on the concept of total allowed compensation;
 - (c) regulatory assets and regulatory liabilities meeting the definitions of assets and liabilities in the *Conceptual Framework for Financial Reporting (Conceptual Framework)*; and
 - (d) accounting for regulatory assets and regulatory liabilities arising separately from the rest of the regulatory agreement.
3. However, some respondents—preparers and national standard-setters in Europe and Asia-Oceania and accounting firms—qualified their support to the proposed

definitions and the focus of the proposals on total allowed compensation because they disagreed with some of the regulatory assets or regulatory liabilities that would arise when applying paragraphs B3–B9 and B15 of the Exposure Draft, namely:

- (a) regulatory assets or regulatory liabilities arising when the regulatory recovery period is longer or shorter than the assets' useful lives; and
 - (b) regulatory liabilities arising when returns on assets not yet available for use are included in rates charged to customers during the period the asset is not yet available for use (for example, the construction period).
4. According to these respondents, these regulatory assets and regulatory liabilities:
- (a) do not represent enforceable rights and enforceable obligations arising from the regulatory agreements;
 - (b) would not meet the definitions of regulatory assets and regulatory liabilities; and
 - (c) would not result in useful information for users of financial statements if recognised in the financial statements.
5. No respondents identified other situations, except for those mentioned in paragraphs 3–4, in which the proposed definitions would result in entities recognising regulatory assets or regulatory liabilities that would fail to provide information that is useful to users of financial statements.

Structure of the paper

6. The feedback received on the proposed definitions of regulatory assets and regulatory liabilities is structured as follows:
- (a) Question 2(a)—Proposed definitions (paragraphs 7–15);
 - (b) Question 2(b)—Focus on total allowed compensation (paragraphs 16–23);
 - (c) Question 2(c)—Meeting the *Conceptual Framework* definitions of an asset and a liability (paragraphs 24–31);
 - (d) Question 2(d)—Accounting for regulatory assets and regulatory liabilities separately (paragraphs 32–38); and

- (e) Question 2(e)—Unintended consequences of the proposed definitions (paragraphs 39–43).

Question 2(a)—Proposed definitions

Proposed requirements

7. The Exposure Draft defines a regulatory asset as 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.
8. The Exposure Draft defines a regulatory liability as 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.

Summary of comments received

9. The Board asked stakeholders whether they agree with the proposed definitions.
10. Most respondents agreed with the proposed definitions. A few respondents said that the definitions capture the fact that regulatory agreements create enforceable present rights or enforceable present obligations for the entity.
11. A few respondents who agreed with the proposed definitions—mainly European preparers—disagreed that some of the items that would arise from the application of paragraphs B3–B9 and B15 of the Exposure Draft would meet the definition of regulatory assets or regulatory liabilities, namely:
 - (a) regulatory assets or regulatory liabilities arising when the regulatory recovery period is longer or shorter than the assets' useful lives; and
 - (b) regulatory liabilities arising when returns on assets not yet available for use are included in rates charged to customers during the period the asset is not yet available for use (for example, the construction period).

12. These respondents did not think these regulatory assets or regulatory liabilities meet the proposed definitions because, according to them, they do not represent an entity's right to add an amount to, or an entity's obligation to deduct an amount from, the regulated rates in the future. In other words, the cash flows from those regulatory assets and regulatory liabilities do not correspond to adjustments that the regulatory agreement will consider when determining the future rates. Consequently, these respondents do not think these regulatory assets and regulatory liabilities represent enforceable rights or enforceable obligations for the entity.
13. Similar views were expressed by a higher number of respondents when answering question 2(b) of the Invitation to Comment (paragraphs 20(a) and 40). Agenda Paper 9C also includes similar comments.
14. A few respondents requested further clarifications of the proposed definitions:
 - (a) an accounting firm said that it would be useful if the final Standard clarifies the term 'customers' in the proposed definitions of regulatory assets and regulatory liabilities to understand whether regulatory assets and regulatory liabilities could arise when an entity charges the regulated rate to parties that are not its own customers. Agenda Paper 9A discusses similar comments in the context of the proposed scope.
 - (b) a few European preparers requested clarification of the term 'part' in the sentence 'part of the total allowed compensation for goods or services already supplied' of the proposed definition for regulatory asset. These respondents said that, in some cases, the *entire* total allowed compensation for goods or services already supplied will be included in revenue in the future (ie 'all' instead of 'part'). These respondents thought the implementation of the proposed definition may not be clear in these cases.
 - (c) a European national standard-setter wondered whether balances arising from a merger, that are recoverable by an entity, would meet the definition of a regulatory asset as they do not arise from the supply of goods or services.
 - (d) a few national standard-setters in Europe and Asia-Oceania said that, in applying the definitions, might be difficult for some entities to assess whether the rights and obligations in a regulatory agreement are enforceable and

requested the final Standard provides further clarifications on this point.

These comments are similar to those included in the section ‘the assessment of enforceability’ in Agenda Paper 9A.

15. A few respondents disagreed with the proposed definitions of regulatory assets and regulatory liabilities:
- (a) a national standard-setter in Asia-Oceania said that the rights and obligations arising from regulatory assets and regulatory liabilities should rather be explained as:
 - (i) a right to increase the regulated rate arising because sales have been lower than expected or costs of goods sold have been higher than expected (or both).
 - (ii) an obligation to decrease the regulated rate arising because sales have been higher than expected or costs of goods sold have been lower than expected (or both).
 - (b) a preparer in Asia-Oceania disagreed with the definition of regulatory assets and regulatory liabilities for the reasons described in paragraphs 11–12.
 - (c) an accounting firm disagreed with the sentence ‘to add an amount in determining a regulated rate’ in the regulatory asset definition because, in some circumstances, amounts may never be added to a regulated rate—for example, unrealised losses on a forward contract. According to this respondent, an entity may never add that particular amount in a future rate. In addition, that amount does not specifically relate to goods or services already supplied.
 - (d) an individual suggested replacing the term ‘enforceable’ in the definition of regulatory asset with the term ‘exclusive’. According to this respondent, ‘exclusive rights’ can be established by law or by contractual obligation, whereas enforceability will depend upon the extent to which others are bound by the instrument or contract establishing the exclusive right. Consequently, recognising rights when these are established by law (ie ‘exclusive rights’, according to this respondent) is more prudent than recognising rights that are enforceable.

Question 2(b)—Focus on total allowed compensation***Proposed requirements***

16. The proposed definitions of regulatory asset or regulatory liability refer to the concept of total allowed compensation for goods or services. Total allowed compensation would include the recovery of allowable expenses and a profit component.
17. This concept differs from the concepts underlying some current accounting approaches for the effects of rate regulation, which focus on cost deferral and may not involve a profit component.

Summary of comments received

18. The Board asked stakeholders whether they agreed with the focus of the proposals on total allowed compensation, including both the recovery of allowable expenses and a profit component.
19. Most respondents agreed with the proposed focus on total allowed compensation and its components. A few preparers in North America said that the focus of the proposals on total allowed compensation is aligned with the way in which their regulators determine the compensation to be charged to customers. A few respondents—mainly national standard-setters in Asia-Oceania—agreeing with the proposed focus on total allowed compensation and its components noted that the profit component may be present in some regulatory schemes but may not be present in others.
20. However, some respondents who generally agreed with the proposed focus on total allowed compensation qualified their support or requested further clarity:
 - (a) some respondents—mainly preparers in Europe, accounting firms and a regulator in Asia-Oceania—disagreed with how the Exposure Draft proposes to determine total allowed compensation (paragraphs B3–B9 and B15 of the Exposure Draft). Consequently, these respondents disagreed with some of the regulatory assets or regulatory liabilities that would arise from the application of the proposals (see paragraph 11), with some of them sharing the view these regulatory assets or regulatory liabilities do not fulfil the definitions of

regulatory assets or regulatory liabilities in the Exposure Draft. See Agenda Paper 9C.

- (b) a few respondents requested the final Standard provide further clarity on the practical application of total allowed compensation in specific situations.
21. A few respondents—mainly few preparers in North America and Europe (with operations in North America)—suggested the following advantages of a cost deferral approach:
- (a) it provides useful information by allowing the recognition of relevant regulatory assets and regulatory liabilities;
 - (b) it is much easier to implement than the proposed approach and, consequently, would result in less operational challenges; and
 - (c) the proposals could reduce comparability with industry peers reporting under US GAAP, with expected costs of implementing them outweighing any benefits.
22. An individual disagreed that total allowed compensation should include target profit. According to this respondent, profit should only be recognised upon realisation (ie, according to this respondent, when services or obligations are supplied or fulfilled).
23. An accounting firm said that the proposals assume all components of total allowed compensation proposed in the Exposure Draft would be present in all regulatory agreements. However, some regulatory agreements are based on these components, but others are not. For example, some regulatory agreements allow entities to recover volume variances in future periods to achieve their allowed revenue. These volume variances however bear no relation to allowable expenses, consequently, it is not clear how the proposals would treat these regulatory agreements.

Question 2(c)—Meeting the Conceptual Framework definitions of an asset and a liability

Proposed requirements

24. The Exposure Draft proposes an entity applies the [draft] Standard to all its regulatory assets and all its regulatory liabilities.
25. Paragraphs BC37–BC47 of the Basis for Conclusion on the Exposure Draft includes the rationale for the Board’s conclusion that regulatory assets and regulatory liabilities meet the definitions of assets and liabilities in the *Conceptual Framework*:
 - (a) regulatory asset—the Board concluded it meets the definition of an asset in the *Conceptual Framework* because (**emphasis added**):
 - (i) it is a **right** that has the potential to **produce economic benefits**; and
 - (ii) an entity **controls** that right and it exists because of a **past event**.
 - (b) regulatory liability—the Board concluded it meets the definition of a liability in the *Conceptual Framework* because (**emphasis added**):
 - (i) it represents an **enforceable obligation** to **transfer economic benefits**; and
 - (ii) the obligation exists as a result of a **past event**.

Summary of comments received

26. The Board asked whether stakeholders agree regulatory assets and regulatory liabilities meet the definitions of assets and liabilities within the *Conceptual Framework*.
27. Most respondents agreed regulatory assets and regulatory liabilities meet the definitions of assets and liabilities in the *Conceptual Framework*.
28. A regulator in Asia-Oceania and a standard-setter in Europe agreed that regulatory assets and regulatory liabilities meet the definitions of assets and liabilities in the *Conceptual Framework*. However, they noted that when the regulatory recovery pace of an asset is longer or shorter than the asset’s useful life there would be no differences in timing and the definitions of assets and liabilities would not be met.

The European standard-setter questioned whether a regulatory liability arising when the regulatory recovery period of an asset is shorter than its useful life would meet the definition of a liability because, according to this respondent, the entity's present right to recover the asset is not dependent on the timing of recognition of the related IFRS depreciation expense. Consequently, the entity has no further obligation.

29. An accounting firm, despite agreeing regulatory assets and regulatory liabilities meet the definitions of assets and liabilities, said they have some concerns that entities may use paragraph 11 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to apply the proposals by analogy to situations not envisaged in the proposals. They recommended the final Standard include a prohibition from applying it by analogy.
30. A few respondents disagreed with the Board's conclusions that regulatory assets and regulatory liabilities meet the definition of assets and liabilities in the *Conceptual Framework*:
- (a) a national standard-setter and accountancy body in Africa were of the view that the Basis for Conclusions on the Exposure Draft provides insufficient justification for the conclusion that regulatory assets and regulatory liabilities meet the definitions of assets and liabilities. In particular, these respondents thought the proposals do not adequately explain what is the 'past event' that gives rise to regulatory assets and regulatory liabilities. In their view, the proposals could be interpreted as implying that regulatory assets or regulatory liabilities are recognised based on the existence of future revenue or future costs. Because of this, one of these respondents was concerned the proposals could be used by analogy to inappropriately recognise assets or liabilities relating to future revenue or future costs.
 - (b) a preparer in Europe argued a regulated entity only becomes entitled to collect, or obliged to deduct, the corresponding cash flows if and when it supplies goods or services to customers. This respondent is of the view that the entity should only recognise revenue at the regulated rate applicable when goods or services are supplied (ie without recognising the effect of regulatory assets or regulatory liabilities in the statement of financial performance).

31. An individual suggested that the Board should better explain how the 2018 changes to the *Conceptual Framework* support the proposals to account for regulatory assets and regulatory liabilities.

Question 2(d)—Accounting for regulatory assets and regulatory liabilities separately

Proposed requirements

32. The Exposure Draft proposes an entity recognises regulatory assets and regulatory liabilities separately from the rest of the regulatory agreement.
33. The Board noted the cash flows that arise from a regulatory asset or regulatory liability are:
- (a) incremental—they occur because the entity has that asset or liability; and
 - (b) largely independent of the cash flows that result from the other rights and obligations created by the regulatory agreement.
34. In the Board's view:
- (a) an entity can measure regulatory assets and regulatory liabilities separately by reference to estimates of their cash flows; and
 - (b) recognising regulatory assets and regulatory liabilities separately by reference to estimates of their cash flows would provide useful information to users of financial statements.

Summary of comments received

35. The Board asked stakeholders whether they agree that an entity should account for regulatory assets and regulatory liabilities separately from the rest of the regulatory agreement.
36. Most respondents agreed regulatory assets and regulatory liabilities should be accounted for separately from the rest of the regulatory agreement, with many of them explicitly agreeing with the rationale developed by the Board.

37. An accounting firm disagreed with the rationale developed by the Board because in their view:
- (a) a specified regulation should lead to a single regulatory asset or regulatory liability in line with the regulatory agreement rather than several regulatory assets and regulatory liabilities linked to individual differences in timing; and
 - (b) cash flows arising from regulatory assets and regulatory liabilities are *not* largely independent of the cash flows that result from the other rights and obligations created by the regulatory agreement because they are highly interrelated with the cash flows arising from supplying goods or services in the future. This is because regulatory assets or regulatory liabilities will be recovered or fulfilled through the regulated rate charged to goods or services that will be supplied in future periods.
38. A few national standard-setters in Asia-Oceania and Europe said the Board should clarify which ‘other rights and obligations’ are being referred to in paragraph BC60 of the Basis for Conclusions on the Exposure Draft (**emphasis added**):

Other rights and obligations created by a regulatory agreement typically generate cash flows only in combination with other assets and liabilities, such a property, plant and equipment or recognised or unrecognised intangible assets. As a result, an entity typically does not recognise those other rights and obligations as assets and liabilities, because doing so would not provide users of financial statements with the most useful information. [...]

Question 2(e)—Unintended consequences of the proposed definitions

39. The Board asked stakeholders if they have identified any situations that would result in regulatory assets or regulatory liabilities being recognised when their recognition would provide information that is not useful to users of financial statements.
40. Many respondents said that they had not identified any situation in which the recognition of regulatory assets or regulatory liabilities would not provide information that is useful to users of financial statements. However, some respondents—mainly

preparers in Europe and Asia-Oceania, a few national standard-setters in Asia-Oceania and in Europe, a regulator in Asia-Oceania and an accounting firm—said they had identified situations in which the application of the guidance on total allowed compensation in paragraphs B3–B9 and B15 of the Exposure Draft would give rise to regulatory assets or regulatory liabilities that:

- (a) do not represent rights and obligations arising from the regulatory agreements;
- (b) would not result in adjustments to future rates; and
- (c) would result in confusing or misleading information for users of financial statements. See paragraphs 11, 20(a) and Agenda Paper 9C.

41. Some of these respondents said that the recognition of these regulatory assets or regulatory liabilities may:

- (a) cause users of financial statements to ‘look through’ these regulatory assets and regulatory liabilities in order to reconcile the reported revenue to the regulatory agreements and cash positions;
- (b) increase the provision of non-IFRS disclosures to remove the effect of the recognition of these regulatory assets and regulatory liabilities; and
- (c) affect financial covenants or credit metrics, which may necessitate amendments to financing documents and create legal and compliance costs.

42. A few national standard-setters in Asia-Oceania and in Europe said some of their stakeholders have reservations about the usefulness of recognising regulatory assets or regulatory liabilities when they are subject to significant estimation uncertainty, particularly when:

- (a) regulatory periods (price determination periods) within a regulatory agreement are not stable or foreseeable; or
- (b) regulated rates are based on sectoral average costs (rather than on an entity’s costs), which may be made public after the date of preparation of the financial reports.

43. A national standard-setter in Asia-Oceania said they are concerned the complexity and professional judgment required in the recognition and measurement of regulatory

assets and regulatory liabilities may lead to the recognition of inaccurate balances, which may reduce understandability and comparability of financial statements. They also understand from investors that the financial information arising from the recognition or disclosure of regulatory assets and regulatory liabilities would have limited usefulness.

Question for the Board

Does the Board have any questions or comments on the feedback discussed in this paper? Specifically:

- a. Is there any feedback that is unclear?
- b. Are there any points you think the Board did not consider in developing the Exposure Draft but should consider in the re-deliberations?
- c. Are there any points you would like staff to research further for the re-deliberations?