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STAFF PAPER

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Project	**Rate-regulated Activities**
Paper topic	Feedback summary—Recognition

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Objective

1. This paper analyses the feedback from comment letters and outreach events on the proposed recognition requirements, set out in paragraphs 25–28 of the Exposure Draft *Regulatory Assets and Regulatory Liabilities* (Question 4 of the Invitation to Comment).[1]

Key messages

2. Most respondents who commented agreed with the Board's proposal that:
   (a) an entity should recognise all its regulatory assets and regulatory liabilities; and
   (b) if it is uncertain whether a regulatory asset or regulatory liability exists, an entity should recognise that regulatory asset or regulatory liability if it is more likely than not that it exists.

3. A few respondents, mostly preparers from Europe and Asia-Oceania, disagreed with the Board's proposal and suggested the Board require recognition of some but not all regulatory assets and regulatory liabilities.

[1] https://www.ifrs.org/content/dam/ifrs/project/rate-regulated-activities/published-documents/ed2021-rra.pdf

4. A few respondents, mostly preparers, asked the Board:

   (a) to require an entity, in situations of existence uncertainty, to recognise a regulatory asset or regulatory liability only if it is highly probable that it exists; and

   (b) to preclude an entity from recognising regulatory assets and regulatory liabilities if there is a significant outcome uncertainty or significant measurement uncertainty.

5. A few respondents (accounting firms, national standard-setters and preparers) asked the Board to develop:

   (a) explicit requirements on the timing of initial recognition of a regulatory asset or regulatory liability; and

   (b) requirements for derecognising regulatory assets and regulatory liabilities.

Structure of the paper

6. This paper is structured as follows:

   (a) Question 4(a)—Recognising all regulatory assets and regulatory liabilities (paragraphs 7–19);

   (b) Question 4(b)—Existence uncertainty (paragraphs 20–28);

   (c) other related matters:

      (i) unit of account (paragraphs 29–33); and

      (ii) derecognition (paragraphs 34–36).

Question 4(a)—Recognising all regulatory assets and regulatory liabilities

Summary of proposals in the Exposure Draft

7. Paragraph 25 of the Exposure Draft proposes that an entity should recognise:

   (a) all regulatory assets and all regulatory liabilities existing at the end of the reporting period; and

(b) all regulatory income and all regulatory expense arising during the reporting period.

8. Paragraph 27 of the Exposure Draft provides an indicative list of facts and circumstances that an entity may consider in assessing whether a regulatory asset or regulatory liability exists.

Comment letter and outreach feedback

9. The Board asked stakeholders whether they agree that an entity should recognise all its regulatory assets and regulatory liabilities.

10. Most respondents who commented agreed with the proposal because the resulting information helps meet the objective of the Exposure Draft.

11. A few respondents (a national standard-setter and a preparer) who agreed with the proposal asked the Board to develop explicit requirements on the timing of initial recognition of a regulatory asset or regulatory liability for the following reasons:

    (a) if the financial reporting period does not align with the regulatory reporting period, aligning the timing of recognition of regulatory assets and regulatory liabilities with the regulatory reporting period would help eliminate the burden of gathering information and making judgements at the financial reporting year-end.

    (b) the date of initial recognition of a regulatory asset or regulatory liability is an important reference date for applying, for example, IAS 21 *The Effects of Changes in Foreign Exchange Rates*.

12. An accounting firm asked the Board to provide explicit guidance and examples on how to deal with new regulatory agreements for previously unregulated businesses.

13. A few respondents, mostly preparers from Europe and Asia-Oceania, drew a distinction between:

    (a) regulatory assets and regulatory liabilities arising from rights and obligations explicitly stated in a regulatory agreement, such as those associated with cost or volume variances; and

(b) regulatory assets and regulatory liabilities that are implicit in the determination of a regulated rate, such as those associated with differences between the regulatory capital base and the carrying amount of property, plant and equipment. These include any regulatory liability associated with regulatory return on assets not yet available for use and any regulatory asset or regulatory liability arising because of the regulatory recovery period being longer or shorter than the useful life of an asset.

14. Those respondents did not support the recognition of regulatory assets and regulatory liabilities described in paragraph 13(b) for reasons explained in Agenda Paper 9C *Feedback summary—Total allowed compensation*.

15. Of the few respondents who disagreed with the Board's proposal, most respondents (national standard-setters and preparers) said that recognising regulatory assets and regulatory liabilities when there is a significant outcome uncertainty or significant measurement uncertainty would not provide useful information to the users of financial statements.

16. For example, in some rate-regulatory schemes, regulated rates set for a block of years (say, five years) include compensation based on an efficient level of spending that will allow an entity to deliver goods or services to a standard that customers expect. If the entity is more efficient, it is allowed to retain most of the resulting savings and pass back a part of those savings to customers through the rates for the next five years (a regulatory liability). Conversely, if the entity is inefficient, it must absorb most of the resulting over-spend and charge customers a part of that over-spend through the rates for the next five years (a regulatory asset). At the end of the five-year period, the regulator assesses whether any savings or over-spend are a result of the entity's efficiency or inefficiency, approves the amount of compensation that the entity must pass back to, or charge, customers through the rates for the next five years.

17. When preparing financial statements in the years before the regulator assesses an entity's efficiency, the entity may be uncertain whether it has a regulatory liability or a regulatory asset. If the entity concludes it has a regulatory liability or regulatory asset, it may be uncertain whether and how much to pass back to, or charge, customers. Entities using their judgement and expectations alone to decide when and how to recognise regulatory liabilities or regulatory assets could lead to volatility in

earnings and could reduce the quality and reliability of the resulting financial information. Such financial information may be of little use to users of financial statements.

18. Consequently, some of those respondents asked the Board to consider precluding an entity from recognising a regulatory asset or regulatory liability if there is a significant outcome uncertainty or significant measurement uncertainty.

19. A few respondents (national standard-setters and preparers) who disagreed with the Board's proposal said that disclosure in the notes of the financial effects of regulatory assets and regulatory liabilities without recognition would be a cost-effective approach to providing useful information to the users of financial statements. Publicly-available regulatory reports submitted by entities to a regulator may already contain some information about regulatory assets and regulatory liabilities. Recognising and presenting regulatory assets and regulatory liabilities in the statement of financial position would draw more questions about, and requests for reconciling, the differences between financial statements and regulatory reports.

Question 4(b)—Existence uncertainty

Summary of proposals in the Exposure Draft

20. Paragraph 28 of the Exposure Draft proposes that if it is uncertain whether a regulatory asset or regulatory liability exists, an entity should recognise that regulatory asset or regulatory liability if it is more likely than not that it exists. It could be certain that a regulatory asset or regulatory liability exists even if it is uncertain whether that asset or liability will ultimately generate any inflows or outflows of cash.

21. Paragraphs BC122–BC129 of the Basis for Conclusions on the Exposure Draft describe the reasoning behind the Board's proposals.[2]

[2] https://www.ifrs.org/content/dam/ifrs/project/rate-regulated-activities/published-documents/ed2021-rra-bc.pdf

Comment letter and outreach feedback

22. The Board asked the stakeholders whether they agree that a 'more likely than not' recognition threshold should apply when it is uncertain whether a regulatory asset or regulatory liability exists.

23. Most respondents agreed with the Board's proposal for the reasons explained in the Basis for Conclusions. An accounting firm said that the 'more likely than not' threshold is better understood in practice than other thresholds such as 'highly probable' or 'reasonably certain'.

24. A few respondents (accounting firms, national standard-setters and preparers) asked the Board:

    (a) to clarify the interaction between the scope and recognition requirements. The proposals as drafted might lead an entity to conclude that the 'more likely than not' threshold should also be applied in determining whether there is a regulatory agreement. If it is the Board's intention that the 'more likely than not' threshold should also be applied in determining whether there is a regulatory agreement, that threshold is too low and a higher threshold should be required to conclude that an entity has enforceable rights and obligations.

    (b) to provide more guidance on applying the 'more likely than not' recognition threshold in different situations.

    (c) to modify the wording of some of the facts and circumstances listed in paragraph 27 of the Exposure Draft to strengthen the evidence required for establishing the existence of regulatory assets and regulatory liabilities. For example, if an entity asserts the existence of a regulatory asset based on legal advice, that advice should have been received from an 'independent' qualified and experienced legal advisor.

25. While agreeing with the Board's proposal, an accounting firm said that the proposal to require an entity to apply the 'more likely than not' recognition threshold is a departure from the *Conceptual Framework for Financial Reporting* (*Conceptual Framework*) and asked the Board to further explain the reason for the departure and the potential consequences.

26. Of the few respondents who disagreed with the Board's proposal, most respondents (accounting firms, national standard-setters and preparers) said that the Board should require a 'highly probable' recognition threshold, especially if there is a significant outcome uncertainty or significant measurement uncertainty. Those respondents gave the same reasons as explained in paragraphs 16–17, and said that a 'highly probable' recognition threshold would:

    (a) help create a natural safeguard against accumulating regulatory asset balances that may have significant uncertainty associated with them;

    (b) have the same effect as imposing a constraint on measuring regulatory asset similar to that imposed on variable consideration by IFRS 15 *Revenue from Contracts with Customers* (see paragraph 35(g) of Agenda Paper 9E *Feedback summary—Measurement*); and

    (c) significantly alleviate the burden of tracking recognition and measurement differences between the financial statements of entities prepared applying IFRS Standards and the consolidated financial statements of their parent entities prepared applying US GAAP.

27. An academic, an individual and a national standard-setter said that the 'highly probable' recognition threshold should be applied only to a regulatory asset.

28. In contrast, an accounting body and an accounting and auditing regulator said that no recognition threshold is required because such threshold is not required by the *Conceptual Framework*.

Other related matters

Unit of account

29. Paragraph 24 of the Exposure Draft states that:

> An entity shall account for the right or obligation arising from each individual difference in timing described in paragraph 12(a) as a separate unit of account. However, if rights, obligations, or rights and obligations arising from the same regulatory agreement have similar expiry patterns and are subject to

> similar risks, they may be treated as arising from the same individual difference in timing.

30. A few respondents, mainly preparers, expressed concerns that the Board's proposal may be onerous to apply in practice because an entity may need more granular information than that currently used in setting regulated rates. For example:

    (a) regulatory return on assets not yet available for use is not tracked separately for each item of property, plant and equipment that is not yet available for use;

    (b) regulatory returns computed on a broader regulatory capital base may not be tracked separately for assets in use and for assets not yet available for use; and

    (c) if the regulatory recovery period of capital expenditure is different from the useful lives of assets, regulatory capital base is not tracked at the level required by IAS 16 *Property, Plant and Equipment*.

31. A few of them asked the Board to provide more guidance and examples to assist entities in applying the proposed requirement.

32. An accounting firm asked the Board to consider changing paragraph 24 of the Exposure Draft along the lines of paragraph 4 of IFRS 15 to allow an entity to apply the Standard to a portfolio of differences in timing if the entity reasonably expects that the effects on the financial statements of applying the Standard to the portfolio would not differ materially from applying the Standard to the individual differences in timing.

33. A preparer asked the Board to clarify that a regulatory asset or regulatory liability associated with volume variances should be accounted for separately from other regulatory assets or regulatory liabilities.

Derecognition

34. Paragraph BC129 of the Basis for Conclusions on the Exposure Draft states that:

> When an entity recovers part or all of a regulatory asset, or fulfils part or all of a regulatory liability, by adding or deducting an amount in determining future regulated rates (paragraphs BC50–BC51), the entity would derecognise that part of the

regulatory asset or regulatory liability, and recognise regulatory expense or regulatory income accordingly (paragraph BC31). Furthermore, because the Board's measurement proposals would require an entity to update its estimates of future cash flows, measurement of regulatory assets and regulatory liabilities would be nil if estimated future cash flows were nil (paragraphs BC140–BC141). The Board therefore considers that the Exposure Draft contains sufficient proposals to explain when and how regulatory assets and regulatory liabilities should be derecognised. The Exposure Draft does not contain a separate section on derecognition.

35. A few respondents, mainly accounting firms and national standard-setters, asked the Board to incorporate in the Standard the discussion in paragraph BC129 of the Basis for Conclusions on the Exposure Draft. They also suggested the Board develop requirements to clarify whether:

(a) a regulatory asset or regulatory liability no longer meeting the 'more likely than not' recognition threshold is a remeasurement event or a derecognition event;

(b) the proposed guidance on derecognition of regulatory assets and regulatory liabilities in the context of cancellation of a regulatory agreement applies equally to situations in which an entity has the right to compensation from a regulator throughout the term of the regulatory agreement or at the end of the term; and

(c) an entity applies the derecognition requirements in IFRS 9 *Financial Instruments* or follows some other approach when it transfers the right to collect future cash flows from a regulatory asset to a third party.

36. An accounting firm asked the Board to provide explicit guidance and examples on how to deal with overall effects of discontinuing regulatory accounting.

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?