
IASB[®] meeting

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Project	Rate-regulated Activities
Topic	Regulatory assets and regulatory liabilities arising from differences between the regulatory recovery period and the assets' useful lives
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Objective

1. This paper sets out staff analysis and recommendations on the proposals for accounting for regulatory assets and regulatory liabilities arising from differences between the regulatory recovery period and the assets' useful lives in the Exposure Draft [Regulatory Assets and Regulatory Liabilities](#) (Exposure Draft).
2. This paper:
 - (a) summarises feedback received on the Exposure Draft;
 - (b) analyses the feedback; and
 - (c) recommends how the final Standard could address the comments received.

Staff recommendations

3. We recommend the final Accounting Standard:
 - (a) retains the proposals in the Exposure Draft for entities to account for regulatory assets or regulatory liabilities arising from differences between the regulatory recovery period and assets' useful lives when there is a direct relationship between an entity's regulatory capital base and its property, plant and equipment.
 - (b) provides guidance to help entities determine when there is no direct relationship between their regulatory capital base and their property, plant and equipment.
 - (c) requires entities that have concluded there is no direct relationship between their regulatory capital base and their property, plant and equipment to provide disclosures to enable users of financial statements to understand the reasons for their conclusion.

Structure of the paper

4. This paper is structured as follows:
 - (a) proposals in the Exposure Draft (paragraphs 6–9);
 - (b) summary of comments received (paragraphs 10–19);

- (c) assumptions made in the Exposure Draft and feasibility of the proposals (paragraphs 20–32);
 - (d) addressing the concerns raised (paragraphs 33–45); and
 - (e) conclusions (paragraphs 46–48).
5. This paper includes two appendices:
- (a) Appendix A—this appendix includes a numerical example that illustrates the difference between differences in measurement bases and differences in timing.
 - (b) Appendix B—this appendix includes possible disclosure requirements for entities that have concluded there is no direct relationship between their regulatory capital base and their property, plant and equipment.

Proposals in the Exposure Draft

6. The Exposure Draft defines allowable expense as

An expense, **as defined in IFRS Standards**, that a regulatory agreement entitles an entity to recover by adding an amount in determining a regulated rate.

7. Paragraph B4 of the Exposure Draft says that that:

If an expense is allowable under the terms of a regulatory agreement, that fact establishes that the expense relates to the supply of goods or services in some period. In applying this [draft] Standard, an entity shall treat that allowable expense as relating to the supply of goods or services in the period when the entity recognises the expense applying IFRS Standards. Thus, the amount that recovers that allowable expense forms part of total allowed compensation for goods or services supplied in that period. [...]

8. Paragraph B7 of the Exposure Draft says:

[...] If a regulatory agreement allows an entity to recover the cost of an item of property, plant and equipment through the regulated rates charged to customers, the depreciation expense recognised in a period, by applying IAS 16, is an allowable expense and the amount that recovers that depreciation expense forms part of the total allowed compensation for goods or services supplied in the period. That is the case even if, under the terms of the regulatory agreement, the recovery of the depreciation expense occurs in a different period—for example, if the regulatory agreement uses a longer or shorter period of recovery than the asset's useful life.

9. Some illustrative examples accompanying the Exposure Draft deal with fact patterns in which the regulatory agreements entitle an entity to recover depreciation expense incurred when supplying goods or services (for example, Illustrative Examples 2A–C, 7A.4 and 7B.4)). In those examples, an entity's regulatory capital base consists of only one asset and the entity would recognise a:
- (a) regulatory asset when the recovery period of the entity's regulatory capital base is longer than the asset's useful life; and
 - (b) regulatory liability when the recovery period of the entity's regulatory capital base is shorter than the asset's useful life.

Summary of comments received

10. Many respondents disagreed with the proposal for accounting for regulatory assets and regulatory liabilities when the recovery period of the regulatory capital base is longer or shorter than the assets' useful lives determined applying IFRS Accounting Standards.
11. Some respondents—mainly preparers in Europe and Asia-Oceania—said that the proposals are not aligned with incentive-based schemes. According to these respondents, these schemes set an 'allowed revenue' amount made up of different components. One of these components is the regulatory depreciation, which is set as a fixed proportion of an entity's regulatory capital base.
12. According to these respondents, an entity's regulatory capital base is not a regulatory asset register that can be linked or reconciled to the fixed asset register used for accounting purposes because:
- (a) the asset classes in the regulatory capital base and corresponding recovery periods are different from the asset classes and useful lives in the accounting fixed asset register.
 - (b) the regulatory capital base is adjusted for inflation annually, whereas fixed assets are measured mainly at cost for accounting purposes.¹
 - (c) the regulatory capital base may include items that would not qualify for capitalisation under IAS 16 *Property, Plant and Equipment* (for example, bonuses and penalties and operating expenditures). In addition, costs capitalised for accounting purposes may not have been included in the regulatory capital base (for example, contributed assets).
 - (d) the initial values of the regulatory capital base may have been set at entities' market values at the time these entities were privatised.
 - (e) fair value adjustments made to the accounting cost base due to business combinations may not have been included in the regulatory capital base.

¹ Public sector entities in the water industry in Australia measure property, plant and equipment using the revaluation model in IAS 16.

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13. According to these respondents, any attempt to analyse the regulatory capital base as if it was a fixed asset register would be highly subjective, complex and costly. Consequently, according to these respondents, regulatory depreciation cannot be compared to accounting depreciation.
14. These respondents think, the recognition of the compensation for incentive-based regulatory schemes should be based on an entity's regulatory agreement and not based on when related costs are recognised as an expense in accordance with IFRS Accounting Standards. Consequently, these respondents are of the view that:
- (a) an entity does not have enforceable present rights or enforceable present obligations to adjust the regulated rates in the future for differences between regulatory and accounting depreciation. Therefore, those differences would not give rise to assets or liabilities that would meet the proposed definitions of regulatory assets and regulatory liabilities. A regulator in Asia-Oceania and a European standard-setter said the regulatory assets or regulatory liabilities that an entity is required to account for would not meet the definitions of assets and liabilities in the *Conceptual Framework for Financial Reporting* (the *Conceptual Framework*).
 - (b) the proposals would not result in useful information to users of the financial statements, who would need further information, potentially increasing the use of alternative performance measures.
15. A few of these respondents said that their users (debt providers, equity investors, rating agencies and market analysts) do not focus on differences between the regulatory capital base's recovery period and the assets' useful lives because the allowed revenue and, ultimately, future cash flows of the businesses are determined based on entities' regulatory capital base and not based on accounting balances. A respondent representing a group of preparers in the electricity sector in Asia-Oceania suggested requiring disclosures such as a reconciliation of the opening to closing regulatory capital base, regulatory recovery periods and average useful lives. According to this respondent, this would result in more useful information to users of the financial statements than recognising the proposed regulatory assets and regulatory liabilities.
16. A few respondents—mainly preparers and a regulator in Asia-Oceania—said that entities in the public sector may carry their assets using the revaluation model in IAS 16. These respondents thought it would be useful if the final Standard provides examples illustrating how the model would work if assets are measured at fair value. A few of these respondents thought having assets measured at fair value could exacerbate the practical challenges of trying to link regulatory depreciation to accounting depreciation.
17. During the comment period of the Exposure Draft we discussed this topic with a few users:
- (a) an equity analyst covering the utility sector in Europe said that in some jurisdictions there are significant differences between the regulatory recovery periods and assets' useful lives.
According to this user, these differences should be taken into consideration when analysing an

entity's profit or loss. This user thought the recognition of regulatory assets and regulatory liabilities arising from these differences would result in useful information.

- (b) an analyst working at a ratings company covering the utility sector primarily in Europe also said that although information about the differences between the regulatory recovery pace and the assets' useful lives would be useful, recognising them as regulatory assets and regulatory liabilities would not provide useful information. This is because, their analysis focuses on an entity's ability to generate cash flows. This user said that in users' minds, the economics of these businesses is 'steered by the regulator'—that is, what the regulator approves affects the entity's ability to generate future cash flows. According to this user, if the final requirements result in the recognition of regulatory assets and regulatory liabilities they would be adjusted for in their analysis, because they are non-cash items.

18. After the comment period of the Exposure Draft, the users to whom we spoke had views aligned with the analyst in paragraph 17(b)—see paragraph 31.
19. We discussed this topic with the members of the Consultative Group on 28 March 2022. The feedback received from these members is included in Agenda Paper 9C.

Assumptions made in the Exposure Draft and feasibility of the proposals

20. During this project we have learned that regulatory schemes vary across jurisdictions and industries. The terms of individual regulatory agreements reflect different trade-offs between cost recoverability and efficiency incentives to ensure different regulatory objectives are met. This means that because individual regulatory schemes include different terms, those individual regulatory schemes will give rise to different differences in timing.
21. The paragraphs that follow analyse the feasibility of the proposals in the Exposure Draft when applied to the features of the two main types of regulatory scheme—cost-based schemes and incentive-based schemes:²
- (a) assumptions made in the Exposure Draft (paragraphs 22–24);
 - (b) features of cost-based schemes and the feasibility of the proposals when applied to these schemes (paragraphs 25–27); and
 - (c) features of incentive-based schemes and the feasibility of the proposals when applied to these schemes (paragraphs 28–32).

² The IASB discussed features of different regulatory schemes at its May 2022 meeting. See [Agenda Paper 9A](#).

Assumptions made in the Exposure Draft

22. At the July 2022 meeting, the IASB discussed that the proposed application guidance on total allowed compensation assumes there is a mapping between different types of compensation in the regulator's calculation of allowed revenue and different types of expenses incurred by an entity.³ This assumed mapping is also reflected in many of the illustrative examples accompanying the Exposure Draft.
23. For example, some Illustrative Examples accompanying the Exposure Draft assume there is a one-to-one relationship between regulatory compensation and accounting expense (for example, regulatory depreciation can be traced back to accounting depreciation). These Illustrative Examples do so by using the following simplifications:
- (a) the regulatory capital base consists of a single asset, which implies an entity's regulatory capital base can be reconciled with the entity's fixed asset register; and
 - (b) the measurement basis of the regulatory capital base coincides with that used to measure property, plant and equipment in accordance with IAS 16 (that is, at cost).
24. As discussed with the IASB at its May 2022 meeting, this mapping between regulatory compensation (regulatory depreciation) and accounting expense (depreciation expense) exists in cost-based schemes but it is not always present in incentive-based schemes.⁴

Features of cost-based schemes and the feasibility of the proposals when applied to these schemes

25. In cost-based schemes, regulated rates are determined so as to match an entity's revenue requirements with its expenses. Consequently, regulatory accounting requirements in cost-based schemes are generally aligned to accounting requirements, with any deviations from the accounting requirements made to meet public interest objectives. This means that:
- (a) the componentisation of assets recorded for regulatory purposes is broadly aligned with that used for accounting purposes. Any differences in componentisation are tracked separately.
 - (b) the measurement basis and capitalisation policies used for regulatory purposes are broadly aligned with those used for accounting purposes with any differences tracked separately.
 - (c) depreciation rates used for regulatory purposes are broadly aligned with those used for accounting purposes, with regulators requiring depreciation rates that are different from those used for accounting if necessary to meet a public interest objective.

³ [Agenda Paper 9A](#) discussed by the IASB at its July 2022 meeting.

⁴ [Agenda Paper 9A](#) discussed by the IASB at its May 2022 meeting.

- (d) regulatory agreements require regulatory information to be reconciled to audited financial statements—although the reconciliation may be at a high-level.
26. We think that when regulatory schemes have features similar to those in paragraph 25, the costs entities would need to incur to apply the proposals would not be expected to be significant. This is because the regulatory accounting and the accounting reporting requirements are aligned. Such an alignment means that there is a direct relationship between the regulatory capital base and the entity's property, plant and equipment, and therefore, a direct relationship between the regulatory compensation (regulatory depreciation) and the related expense (accounting depreciation).
27. Having said that, we do not think the proposals would have significant effects on entities subject to cost-based schemes. This is because, our understanding is that in many cases, the recovery period of the regulatory capital base in cost-based schemes is the same as the assets' useful lives. Consequently, in many cases, we do not expect regulatory assets or regulatory liabilities to arise.

Features of incentive-based schemes and the feasibility of the proposals when applied to these schemes

28. The following features of incentive-based schemes make the regulatory capital base different from an entity's property, plant and equipment:⁵
- (a) componentisation of the regulatory capital base—the regulatory capital base may not consist exclusively of capital expenditures but may also include operating expenditures, performance incentives and other movements in working capital. For example, we have learned that regulatory schemes in the electricity sector in a few jurisdictions in Europe determine the regulatory capital base as a percentage of an entity's total expenditures.⁶ As a result, for entities subject to these schemes, the link between their regulatory capital base and their property, plant and equipment is less direct. In other schemes, the regulatory capital base may be split into asset classes that are different from those used for accounting purposes. In addition, in some cases:
- (i) the movements of the regulatory capital base—mainly amounts of capital expenditure and regulatory depreciation—may be based on forecasts made for a period. In such cases, regulatory agreements may adjust that base to reflect actual amounts. Both the forecasted amounts of capital expenditure and the adjustments are lump sum amounts and would not be broken down by individual assets.

⁵ In most cases, capital expenditure included in entities' regulatory capital base would mainly relate to property, plant and equipment. However, we have also learned capital expenditure included in the regulatory capital base may also relate to intangible assets. For simplicity, this paper uses the term 'property, plant and equipment' but this should be read as encompassing other types of assets.

⁶ This regulatory approach is known as 'totex'.

- (ii) the regulatory capital base may include assets that are being constructed (construction work in progress). In these cases, regulatory agreements may not distinguish construction work in progress from assets in operation, with regulatory depreciation calculated so as to recover both assets that are in operation and assets that are being constructed. Because of this, regulatory depreciation may start on a different date from accounting depreciation. For example, the depreciation of regulatory capex may start when there is a cash outflow, not when the asset is placed in service.
 - (iii) regulators disallow amounts of capital expenditure on efficiency and prudence grounds. When they do this, the amounts disallowed would not be broken down at an asset level making it difficult to reconcile the regulatory capital base to the entity's property plant and equipment.
 - (iv) different treatment of disposals. Disposals may be deducted from the regulatory capital base using the sales proceeds, not based on the assets' net book values.
- (b) measurement of the regulatory capital base—the regulatory capital base may be measured using measurement bases other than historical cost (for example, replacement cost). In addition, regulators may index the regulatory capital base to reflect inflation.
- (c) depreciation rate of the regulatory capital base—this may differ from the assets' useful lives.
29. Entities subject to incentive-based schemes recover the regulatory capital base by including regulatory depreciation in the regulated rates charged. The main component of the regulatory capital base will be, in most cases, capital expenditures. Because of this, there will be a relationship between the regulatory capital base and an entity's property, plant and equipment and, ultimately, a relationship between the regulatory depreciation and the accounting depreciation.
30. However, for entities subject to incentive-based schemes with features similar to those in paragraph 28, the relationship between their regulatory capital base and their property, plant and equipment is not as direct as for entities subject to cost-based schemes. Consequently, the relationship between regulatory depreciation and accounting depreciation is also not as direct. To apply the proposals such entities would need to reconcile their regulatory capital base to their property, plant and equipment. Such a reconciliation would be subjective and require significant estimates. In some cases, a full reconciliation may be impracticable—for example, for those cases when the initial values of the regulatory capital base were set when the entity was privatised (paragraph 12(d) or when capital expenditures are added to the regulatory capital base as a lump sum or subsequent adjustments to that base are not broken down at an individual asset level (paragraph 28(a)(i)). Consequently, for entities subject to incentive-based schemes, we think the cost of applying the proposals would be significant.
31. In addition, all users we spoke to after the comment period—mainly rating agencies and buy-side investors in Asia-Oceania and Europe—have said that the accounting for regulatory assets and

regulatory liabilities arising from differences between the regulatory recovery pace and the assets' useful lives for entities subject to incentive-based schemes would:

- (a) make the understanding of financial performance more difficult;
 - (b) not result in useful information. Users would not consider these regulatory assets and regulatory liabilities in their analyses; and
 - (c) affect entities' earnings before interest, tax, depreciation and amortisation (EBITDA), which is a measure considered in many covenants. This may require entities to renegotiate covenants with their creditors.
32. This brings into question whether, for entities subject to schemes with features similar to those in paragraph 28, the benefits of accounting for any regulatory assets and regulatory liabilities arising from differences between the recovery pace of the regulatory capital base and the assets' useful lives would outweigh the related costs. The following section explores how the final Standard could address the concerns raised by these entities.

Addressing the concerns raised

33. A difference in timing arises when part or all of the total allowed compensation for goods or services supplied in a period is included in regulated rates charged in a different period.
34. In the case of depreciation expense, a difference in timing would arise when the regulatory depreciation (that is, the regulatory compensation) is included in regulated rates charged in a period that is different from the period in which the entity recognises the depreciation expense of assets used to supply the goods or services.
35. As mentioned in paragraphs 29–30 and 34, for a difference in timing to arise there is a need for:
- (a) the regulatory compensation and accounting expense to be related; and
 - (b) the regulatory compensation and accounting expense to be reflected in profit or loss in different periods.
36. For entities subject to schemes with the features described in paragraph 25 (that is entities subject to cost-based schemes) there is a direct relationship between regulatory depreciation and accounting depreciation. Consequently, recognising regulatory assets and regulatory liabilities when there is a difference in timing between regulatory depreciation and accounting depreciation provides information that would be useful for users to assess an entity's financial performance, financial position and prospects for future cash flows.
37. There is also a relationship between regulatory depreciation and accounting depreciation for schemes with the features described in paragraph 28 (that is entities subject to incentive-based schemes). This is because capital expenditure will be the main component of the regulatory capital base (paragraph 29).

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38. However, for entities subject to schemes with the features in paragraph 28 the relationship between regulatory depreciation and accounting depreciation is much less direct than for entities subject to cost-based schemes. This is because:
- (a) regulatory depreciation does not only compensate an entity for its depreciation expense. This is particularly the case when the regulatory capital base includes items other than capital expenditure, for example, operating expenditure and other items—paragraph 28(a).
 - (b) the recovery pace of an entity's regulatory capital base and the pace at which the entity depreciates its assets are often significantly different. This would normally indicate that there is a difference in timing that should be accounted for. However, identifying the part of the regulatory depreciation that compensates the entity for its depreciation expense would require the entity to carry out a reconciliation between the regulatory capital base and its property, plant and equipment to make these bases comparable (see paragraph 12 for possible differences between these two bases). We think that performing this reconciliation could be complex, subjective and costly for the reasons described in paragraphs 28 and 30. The members of the Consultative Group discussed an approach that involved making the two bases (regulatory capital base and property, plant and equipment) comparable. However, they generally did not support such an approach for reasons similar to the difficulties explained in paragraphs 28 and 30—see Agenda 9C for further details.
39. In addition, accounting for regulatory assets or regulatory liabilities arising from differences between the regulatory recovery period and the assets' useful lives is more complex when the regulator measures the regulatory capital base using a measurement basis that is different from that used by the entity for IFRS Accounting. The example in the Appendix A illustrates this situation.
40. Consequently, linking regulatory depreciation with accounting depreciation for the purpose of determining differences in timing may not provide useful information (paragraph 38(a)) or may be complex, subjective and costly (paragraph 38(b)).
41. We think the proposals in the Exposure Draft should only apply when an entity's regulatory capital base has a direct relationship with its property, plant or equipment. This recommendation would:
- (a) mean that entities with no direct relationship between their regulatory capital base and their property, plant and equipment would not be required to account for regulatory assets or regulatory liabilities arising from differences between the regulatory recovery pace and assets' useful lives;⁷ and

⁷ If an entity determines the recoverable amount of a cash-generating unit that includes regulatory assets and regulatory liabilities, not accounting for regulatory assets or regulatory liabilities arising from differences between the regulatory capital base and property, plant and equipment could affect whether an impairment is recognised. We plan to discuss this matter with the IASB at a future meeting.

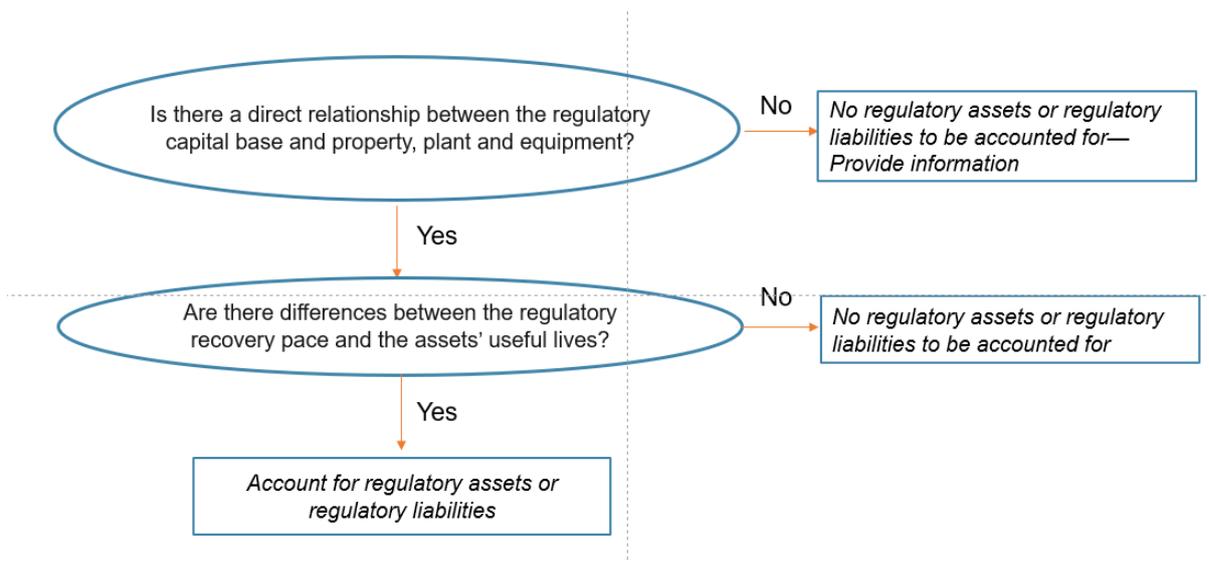
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- (b) require that the final Standard provides guidance to help entities determine when such a direct relationship does not exist.
42. As part of this guidance, we think the final Standard could state that a direct relationship may not exist when:
- (a) the regulatory depreciation included in regulated rates charged does not aim to compensate an entity for its accounting depreciation—that is, the determination of the regulatory depreciation is not based on the entity’s accounting depreciation;
 - (b) factors other than the useful life of the assets (for example, the duration of the bonds an entity uses to finance its operations) have a significant effect on the determination of the regulatory depreciation; and
 - (c) the regulator does not require the entity to track differences between the regulatory and accounting requirements nor does the regulator require the entity to reconcile its regulatory capital base and its property, plant and equipment.
43. The final Standard would not provide an exhaustive list of indicators. An entity may also need to put more weight on some indicators than on others to make this determination. If an entity concludes its regulatory capital base does not have a direct relationship with its property, plant and equipment, the entity would not account for any regulatory assets or regulatory liabilities arising from differences between the regulatory recovery period and the assets’ useful lives.
44. Instead, we think the final Standard could require entities that conclude their regulatory capital base does not have a direct relationship with their property, plant and equipment to disclose additional information. The objective of that additional information would be to enable users of financial statements to understand why the entity has concluded there is no direct relationship between its regulatory capital base and its property, plant and equipment. This information is intended to help users understand the different regulatory schemes to which entities are subject and to help them compare the financial position and financial performance of different regulated entities.
45. Appendix B illustrates possible disclosure requirements that support this disclosure objective. We plan to discuss specific disclosure requirements with the IASB at a future meeting.

Conclusion

46. We think the proposals in the Exposure Draft should only apply when there is a direct relationship between an entity’s regulatory capital base and its property, plant and equipment for the reasons described in paragraphs 33–41.
47. Consequently, we think the final Standard should:
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- (a) provide guidance to help entities determine when there is no direct relationship between their regulatory capital base and their property, plant and equipment.
- (b) require entities that have concluded there is no direct relationship between their regulatory capital base and their property, plant and equipment to provide disclosures to enable users of financial statements to understand why the entity has concluded that there is no direct relationship between its regulatory capital base and its property, plant and equipment.

48. The flowchart below shows the decision path that illustrates our recommendations.



Questions for the IASB

1. Does the IASB agree the final Accounting Standard retains the proposals in the Exposure Draft for entities to account for regulatory assets or regulatory liabilities arising from differences between the regulatory recovery period and assets' useful lives when there is a direct relationship between an entity's regulatory capital base and its property, plant and equipment? (paragraph 46)
2. Does the IASB agree the final Accounting Standard:
 - a. provides guidance to help entities determine when there is no direct relationship between their regulatory capital base and their property, plant and equipment (paragraph 47(a)); and
 - b. requires entities that have concluded there is no direct relationship between their regulatory capital base and their property, plant and equipment to provide disclosures to enable users of financial statements understand the reasons for their conclusion (paragraph 47(b)).

Appendix A—Different measurement bases

- A1. This appendix includes an example that illustrates the case when a regulator measures the regulatory capital base using a measurement basis that is different from that used by the entity when measuring its assets applying IFRS Accounting Standards. The purpose of the example is to illustrate the difference between differences in timing and differences in measurement bases.
- A2. Assume an entity builds an asset during year 1 and starts to use it to supply goods or services on 1 January year 2.
- A3. The cost of the asset is CU1,000.⁸ Applying IFRS Accounting Standards it has a useful life of four years. Table 1 shows the IFRS carrying amount of the asset and accounting depreciation for years 2 to 5:

Table 1—IFRS carrying amount of the asset					
<i>In CU</i>	Year 1	Year 2	Year 3	Year 4	Year 5
Opening balance	-	1,000	750	500	250
Additions	1,000	-	-	-	-
Depreciation expense	-	(250)	(250)	(250)	(250)
Closing balance	1,000	750	500	250	-

- A4. The regulator measures this asset at replacement cost and allows the entity to recover the asset over five years, from years 2 to 6.⁹ The main driver of the replacement cost computed by the regulator is the value of a specific price index at the end of the year. Table 2 shows the regulatory carrying amount of the asset and the regulatory depreciation for years 2 to 6:¹⁰

Table 2—Regulatory carrying amount and regulatory depreciation							
<i>In CU</i>	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	TOTAL
Replacement cost end of year	1,040	1,060	1,120	1,140	1,160	1,160	
Regulatory depreciation	-	212	236	236	244	232	1,160
Regulatory roll-forward							
Opening balance	-	1,040	848	672	456	232	
Additions	1,000	-	-	-	-	-	
Replacement cost change	40	20	60	20	20	-	

- A5. The total allowed compensation for this asset over years 2 to 6 is CU1,160.¹¹ Table 3 shows the entity's statement of financial performance before the recognition of differences in timing:

⁸ Monetary amounts are denominated in 'currency units' (CU).

⁹ The example assumes there is no change in the replacement cost of the asset during year 6.

¹⁰ The regulatory depreciation for each period is calculated as the difference between the cumulative depreciation for the period and the cumulative depreciation for the previous period. For example, the cumulative depreciation for year 3 is: CU1,120 x (2/5) = 448 and the cumulative depreciation for year 2 is: CU1,060 x (1/5) = 212. Consequently, the regulatory depreciation for year 3 is: CU448 – CU212 = CU236.

¹¹ To simplify, the example ignores the effect of any regulatory return on the asset.

Table 3—Statement of financial performance (without differences in timing)						
<i>In CU</i>	Year 2	Year 3	Year 4	Year 5	Year 6	TOTAL
Revenue	212	236	236	244	232	1,160
Depreciation expense	(250)	(250)	(250)	(250)	-	(1,000)
Profit or loss	(38)	(14)	(14)	(6)	232	160

- A6. Table 3 shows the cumulative difference in measurement bases of CU160—that is, the difference between the regulatory compensation the entity is allowed to include in regulated rates measured at replacement cost (CU1,160) and the measurement of the asset at cost (CU1,000). That difference is not a difference in timing. Because the regulator allows the recovery of the asset over five years, the difference of CU160 is included in regulated rates charged during years 2–6.
- A7. However, a difference in timing—a regulatory asset—does arise because the regulatory compensation is included in regulated rates charged over a period (5 years) that is longer than the useful life of the asset (4 years). An entity applying the model could compute such a difference in timing by deducting from the actual revenue amounts the revenue the entity would have obtained had the regulatory depreciation been calculated to recover the asset over four years, that is years 2–5:¹²

Table 4—Computation of the regulatory asset						
<i>In CU</i>	Year 2	Year 3	Year 4	Year 5	Year 6	TOTAL
Revenue (Table 3)	212	236	236	244	232	1,160
Recalculated revenue using 4 years	265	295	295	305	-	1,160
Difference in timing	(53)	(59)	(59)	(61)	232	-
Regulatory asset	53	112	171	232	-	-

- A8. Table 5 shows the entity's statement of financial performance, including the effect of accounting for the regulatory asset:

Table 5—Statement of financial performance (including regulatory asset)						
<i>In CU</i>	Year 2	Year 3	Year 4	Year 5	Year 6	TOTAL
Revenue	212	236	236	244	232	1,160
Reg income/(Reg expense)	53	59	59	61	(232)	-
Depreciation expense	(250)	(250)	(250)	(250)	-	(1,000)
Profit or loss	15	45	45	55	-	160

- A9. The profit or loss shown in the statement of financial performance in Table 5 reflects the effect of the difference between the measurement basis used for the regulatory capital base and that used applying IFRS Accounting Standards. The difference in measurement basis can also be seen as follows:

¹² The regulatory depreciation for each of the four years is calculated using the same methodology as that described in footnote 10.

Table 6—Difference in measurement bases included in profit or loss					
<i>In CU</i>	Year 2	Year 3	Year 4	Year 5	TOTAL
Actual revenue over 4 years	265	295	295	305	1,160
Depreciation expense	(250)	(250)	(250)	(250)	(1,000)
Difference	15	45	45	55	160

- A10. The example makes a few significant simplifications:
- (a) the regulatory capital base consists of one asset that is recovered over five years—entities' regulatory capital base may consist of a large volume of assets that are recovered over much longer periods;
 - (b) the entity can estimate the changes in the replacement cost of the asset throughout the life of the asset and those estimations match the actual changes in value. Differences between estimated and actual replacement cost would affect the amount of the regulatory depreciation and the amount of the differences in timing.
 - (c) the asset is not sold and is not subject to any other changes, such as upgrades. In reality, assets may be subject to changes that would affect the regulatory compensation. These changes would need to be tracked so that they are reflected in the related difference in timing.
- A11. These simplifications above make easy to check that any resulting profit or loss amounts (Table 5) accurately reflect differences in the measurement bases (Table 6). However, in practice the situation is often much more complicated making it very difficult for entities to trace the resulting profit or loss amounts to differences in measurement bases.

Appendix B—Possible disclosure requirements

- B1. This appendix illustrates possible disclosure requirements for when an entity concludes that there is no direct relationship between its regulatory capital base and its property, plant and equipment.
- B2. The objective of the disclosures would be to enable users of financial statements to understand why the entity has concluded there is no direct relationship between its regulatory capital base and its property, plant and equipment. This information is intended to help users understand the different regulatory schemes to which entities are subject and to help them compare the financial position and financial performance of different regulated entities.
- B3. To comply with the objective in paragraph B2B2, an entity could be required to disclose the main reasons why it has concluded that its regulatory capital base does not have a direct relationship with its property, plant and equipment—and hence, there is no direct relationship between regulatory depreciation and accounting depreciation. This could include:
- (a) a description of the items forming part of the regulatory capital base, with an explanation of the main differences between the regulatory capital base and the property, plant and equipment; and
 - (b) information that compares the recovery period of the regulatory capital base with the assets' useful lives, including a description of the main factors considered in determining the regulatory recovery period that are not considered in the determination of the useful lives.
- B4. The staff is also considering other disclosures that could help users understand the financial statement effects of changes in an entity's regulatory capital base. These disclosures could include:
- (a) a reconciliation of the opening to closing regulatory capital base. An entity could accompany the reconciliation with information that would enable users to understand how changes in the entity's regulatory capital base affect the entity's financial statements (for example, the impact of the regulatory depreciation in the movement of the regulatory capital base on the revenue line etc);
 - (b) changes in the componentisation and measurement basis of an entity's regulatory capital base and the effects of these changes on the determination of the regulated rates in the current and/or future periods; and
 - (c) changes in the regulatory recovery pace during the period and, if so, the underlying reasons for the change and the effects of the change on the regulatory capital base and the determination of the regulated rates in the current and/or future periods.
- B5. The staff plans to bring this matter to the IASB when discussing disclosures at a future meeting.