IFRS Accounting

Staff paper

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Objective

1. This paper sets out staff analysis and recommendations on:

   (a) the presentation proposals, set out in paragraphs 67–68 and 70 of the Exposure Draft *Regulatory Assets and Regulatory Liabilities* (Exposure Draft); and

   (b) the proposed amendments to IAS 1 *Presentation of Financial Statements*, set out in Appendix D of the Exposure Draft.

2. This paper does not discuss the proposals on:

   (a) the presentation of regulatory income or regulatory expense in other comprehensive income in accordance with paragraph 69 of the Exposure Draft (Agenda Paper 9D discusses this proposal); and

   (b) offsetting of regulatory assets and regulatory liabilities for presentation purposes in accordance with paragraph 71 of the Exposure Draft (Agenda Paper 9A discusses this proposal).

Staff recommendations

3. We recommend that the final Accounting Standard:

   (a) specify that all regulatory income minus all regulatory expense should be classified as revenue;

   (b) require disclosure of all regulatory income minus all regulatory expense separately from an entity’s other sources of revenue, unless that amount is presented as a separate line item in the statement(s) of financial performance;

   (c) exclude the proposed amendment to paragraph 82 of IAS 1 *Presentation of Financial Statements* requiring regulatory income or regulatory expense to be presented as a separate line item below revenue;

   (d) retain the proposals to include regulatory interest income within regulatory income and regulatory interest expense within regulatory expense;

   (e) amend the prospective [draft] IFRS 18 *Presentation and Disclosure in Financial Statements* to specify that regulatory interest is excluded from the financing category and is classified in the operating category; and

   (f) retain the proposal to present line items for regulatory assets and regulatory liabilities in the statement of financial position, including the requirement to classify those regulatory assets and regulatory liabilities as current or non-current applying paragraphs 66 and 69 of IAS 1, except when the entity presents all assets and liabilities in order of liquidity.

Structure of the paper

4. The structure of this paper is as follows:

   (a) proposals in the Exposure Draft (paragraphs 5–11);

   (b) feedback (paragraphs 12–24); and

(c) staff analysis (paragraphs 25–52):

  (i) presentation of regulatory income or regulatory expense in the statement(s) of financial performance (paragraphs 26–43); and

  (ii) presentation of regulatory assets and regulatory liabilities in the statement of financial position (paragraphs 44–52).

Proposals in the Exposure Draft

5. This section is structured as follows:

  (a) proposals relating to the statement(s) of financial performance (paragraphs 6– 8); and

  (b) proposals relating to the statement of financial position (paragraphs 9–11).

Statement(s) of financial performance

6. Paragraphs 67–68 of the Exposure Draft propose that:

  (a) an entity present in the statement(s) of financial performance all regulatory income minus all regulatory expense in a separate line item immediately below revenue, except in limited circumstances[1]; and

  (b) regulatory income include regulatory interest income and regulatory expense include regulatory interest expense.

7. The Exposure Draft proposes to amend paragraph 82 of IAS 1 as follows:

> In addition to items required by other IFRSs, the profit or loss section or the statement of profit or loss shall include line items that present the following amounts for the period:
>
> (a) revenue, presenting separately:

[1] Paragraph 69 of the Exposure Draft proposes that an entity present in other comprehensive income specified remeasurements of regulatory assets and regulatory liabilities. This proposal is discussed in Agenda Paper 9D.

(i) interest revenue calculated using the effective interest method; and

(ii) insurance revenue (see IFRS 17);

…

(aza) regulatory income or regulatory expense (see [draft] IFRS X);

(aa) gains and losses arising from the derecognition of financial assets measured at amortised cost;

…

8. Paragraphs BC179–BC182 and BC264 of the Basis for Conclusions accompanying the Exposure Draft provide the IASB's rationale for these presentation proposals:

(a) the IASB considered that presenting all regulatory income minus all regulatory expense (regulatory income or regulatory expense) as a separate line item immediately below revenue would enable users of financial statements to understand how an entity's financial performance is affected by a regulatory agreement that creates differences in timing. Differences in timing arise when part or all of the total allowed compensation for goods or services supplied in one period is included in the regulated rates charged to customers, and hence in revenue, in a different period.

(b) the IASB also considered that amounts relating to regulatory interest will be included in determining the future regulated rates charged to customers—and hence included in revenue in future periods—when the related regulatory assets are recovered or related regulatory liabilities are fulfilled. Therefore, including regulatory interest within regulatory income or regulatory expense would coherently and understandably show the effects on revenue of regulatory assets and regulatory liabilities and changes in them.

Statement of financial position

9. Paragraph 70 of the Exposure Draft states:

An entity shall present in its statement of financial position:

(a) line items for regulatory assets and regulatory liabilities.

(b) current and non-current regulatory assets, and current and non-current regulatory liabilities, as separate classifications by applying paragraphs 66 and 69 of IAS 1 *Presentation of Financial Statements*, except when the entity presents all assets and liabilities in order of liquidity.

10. The Exposure Draft proposes to amend paragraph 54 of IAS 1 by including two new separate line items for regulatory assets and regulatory liabilities.

11. Paragraphs BC226 and BC264 of the Basis for Conclusions accompanying the Exposure Draft provide the IASB's rationale for these presentation proposals. The IASB proposed to require separate line items for regulatory assets and regulatory liabilities in the statement of financial position because their characteristics differ from those of other assets and liabilities. The IASB also concluded that presenting regulatory assets and regulatory liabilities as current or non-current would ensure consistency with the presentation of other assets and liabilities.

Feedback

12. This section is structured as follows:

(a) presentation of regulatory income or regulatory expense in the statement(s) of financial performance (paragraphs 13–21); and

(b) presentation of regulatory assets and regulatory liabilities in the statement of financial position (paragraphs 22–24).

Presentation of regulatory income or regulatory expense in the statement(s) of financial performance

13. Most respondents agreed with the proposals to present regulatory income or regulatory expense, including regulatory interest, as a separate line item immediately below revenue for the reasons explained in paragraphs BC179–BC182 and BC264 of the Basis for Conclusions accompanying the Exposure Draft (paragraph 8).

14. This section is structured as follows:

    (a) regulatory income or regulatory expense (paragraphs 15–18); and

    (b) regulatory interest (paragraphs 19–21).

Regulatory income or regulatory expense

15. Some respondents suggested the final Standard permit, or require, an entity to classify regulatory income or regulatory expense as revenue by either:

    (a) presenting regulatory income or regulatory expense in a separate line immediately below revenue from contracts with customers and drawing a subtotal described as 'total revenue'; or

    (b) including that amount within the revenue line item in the statement(s) of financial performance and providing a disaggregation of that line item in the notes. When providing that disaggregation, an entity would be required to disclose regulatory income or regulatory expense separately from other sources of revenue.

16. These respondents considered that regulatory income or regulatory expense meets the definition of 'revenue' in IFRS 15 *Revenue from Contracts with Customers*—that is, 'income arising in the course of an entity's ordinary activities'. They argued that revenue includes sources of revenue other than revenue from contracts with customers.

17. A few of these respondents also suggested clarifying the proposed description of the line item 'all regulatory income minus all regulatory expense' as, according to them, it is not intuitive and may lead users of financial statements to believe that the line item represents all income generated from, and all expenses incurred in, the rate-regulated activities of the entity.

18. A few respondents disagreed with the proposed presentation for regulatory income or regulatory expense and suggested the following alternatives:

(a) present regulatory income or regulatory expense associated with an allowable expense or chargeable income in the line item in which that allowable expense or chargeable income is presented, and all other regulatory income and regulatory expense in the revenue line.

(b) present changes in the carrying amount of regulatory assets immediately below cost of goods sold and changes in the carrying amount of regulatory liabilities immediately below revenue.

Regulatory interest

19. Most respondents agreed with the proposal to include regulatory interest income and regulatory interest expense within the regulatory income or regulatory expense line. A few respondents added that regulatory interest income and regulatory interest expense differ from finance income and finance expense because the regulatory interest may provide or charge compensation designed to fulfil broader regulatory objectives, such as to ensure an entity's financial viability and protecting customers' interests.

20. Almost all respondents from Latin America and a few other respondents disagreed with the proposal. These respondents said, to be consistent with the presentation of the unwinding of the discount of other assets and liabilities, regulatory interest income and regulatory interest expense should be presented within finance income and finance expense, respectively.

21. A few respondents suggested the IASB consider the interaction of the proposal to include regulatory interest in regulatory income or regulatory expense with its work on the *Primary Financial Statements* project.

Presentation of regulatory assets and regulatory liabilities in the statement of financial position

22. Although the Invitation to Comment did not specifically request feedback on the proposal to present separate line items for regulatory assets and regulatory liabilities

in the statement of financial position, a few respondents commented on these proposals. These respondents—mainly accounting firms and a preparer from Europe—explicitly agreed with that proposal.

23. A few respondents representing different types of stakeholders suggested that the final Standard provide guidance on how the proposed presentation requirements in the Exposure Draft interact with the general requirements in IAS 1 on aggregation and disaggregation of line items. Specifically, these respondents asked the IASB to clarify whether the proposals in the Exposure Draft would supersede IAS 1 general requirements if an entity's regulatory assets and regulatory liabilities, or the resulting regulatory income or regulatory expense, are not significant to an entity's business.

24. A few respondents suggested that the final Standard provide guidance on applying paragraph 69(d) of IAS 1 to classify a regulatory liability as current or non-current. Paragraph 69(d) of IAS 1 states that an entity shall classify a liability as current when it does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period.

Staff analysis

25. The staff analysis is structured as follows:

    (a) presentation of regulatory income or regulatory expense in the statement(s) of financial performance:

        (i) regulatory income or regulatory expense (paragraphs 26–36);

        (ii) regulatory interest (paragraphs 37–43); and

    (b) presentation of regulatory assets and regulatory liabilities in the statement of financial position (paragraphs 44–52).

Presentation of regulatory income or regulatory expense in the statement(s) of financial performance

Regulatory income or regulatory expense

26. During the development of the Exposure Draft, the IASB considered that regulatory income or regulatory expense and revenue arising from contracts with customers have different natures. The model uses regulatory income or regulatory expense to reflect the effect of differences in timing created by a *regulatory agreement* in an entity's statement(s) of financial performance. An entity would reflect revenue arising from its *contracts with customers* by applying IFRS 15.

27. However, regulatory assets and regulatory liabilities affect the amount of revenue that an entity recognises when differences in timing originate and will affect the amount of revenue that the entity will recognise when differences in timing reverse in future periods. Therefore, the IASB concluded that presentation of regulatory income or regulatory expense separate from but, at the same time, close to revenue, would provide information about the effect of differences in timing on the entity's financial performance that supplements the information arising from IFRS 15. This is reflected in paragraph BC179 of the Basis for Conclusions accompanying the Exposure Draft:

> The Board proposes that an entity should present all regulatory income minus all regulatory expense in a separate line item immediately below revenue. Regulatory assets and regulatory liabilities are enforceable present rights to increase, or enforceable present obligations to decrease, future regulated rates. Because they do not affect the amount of revenue in the current period, regulatory income and regulatory expense would not be presented as part of revenue. Nevertheless, regulatory assets and regulatory liabilities will affect the amount of revenue that an entity will recognise in future periods by applying IFRS 15 (paragraph BC31(h)). Accordingly, all regulatory income minus all regulatory expense would be presented in a separate line item immediately below revenue.

28. The proposals on presentation in the Exposure Draft refer to presenting regulatory income or regulatory expense as a separate line item immediately below 'revenue'. The lack of clarity about whether 'revenue' should be read as 'total revenue' or

'revenue from contracts with customers' has led to respondents having different interpretations. For example, some respondents—interpreting that 'revenue' meant 'total revenue'—disagreed with the proposal to present regulatory income or regulatory expense as a separate line item below *revenue* (paragraph 15) because they considered that regulatory income or regulatory expense meets the definition of revenue in Appendix A of IFRS 15 (that is, income arising in the course of an entity's ordinary activities).

29. We think the final Standard should clarify the classification of regulatory income or regulatory expense. IFRS 15 defines 'revenue' as 'income arising in the course of an entity's ordinary activities'. This definition is broader than just revenue from contracts with customers. Classifying regulatory income or regulatory expense as 'revenue' would provide users of financial statements with a complete picture of the income an entity has earned in the period from its ordinary activities. Consequently, we recommend that the final Standard clarify that regulatory income or regulatory expense should be classified as revenue.

30. We think it is important that the final Standard maintain the distinction between regulatory income or regulatory expense from any other sources of revenue to provide users of financial statements with an understanding of the effect of differences in timing on an entity's financial performance. Consequently, we recommend that the final Standard require an entity to disclose regulatory income or regulatory expense separately from an entity's other sources of revenue in the notes, unless the entity has concluded it should present regulatory income or regulatory expense as a separate line item in the statement(s) of financial performance.

31. In making the recommendation in paragraph 30 we considered that:

   (a) IFRS 15 does not require presentation of revenue from contracts with customers as a separate line item. Instead, paragraph 113 of IFRS 15 requires disclosure of revenue from contracts with customers separately from other sources of revenue unless an entity presents revenue from contracts with customers separately in the statement of comprehensive income. Since regulatory income or regulatory expense provides information that supplements the information provided by revenue from contracts with customers, it would be inconsistent to specify a presentation requirement in the final Standard when there is no such presentation requirement for revenue from contracts with customers in IFRS 15.

(b) when the IASB developed IFRS 15, it concluded that the general principles of IAS 1 should apply for presentation, and therefore, decided to only specify a disclosure requirement.[2] Our understanding is that the prospective [draft] IFRS 18 *Presentation and Disclosure in Financial Statements*, which will replace IAS 1, will require an entity to present an item in the primary financial statements if such presentation is necessary for the statements to provide 'useful structured summaries'[3] of the entity's income, expenses, assets, liabilities, equity and cash flows. Therefore, the entity will apply the 'useful structured summary' concept in that prospective Standard to determine whether it should present revenue from contracts with customers and regulatory income or regulatory expense as separate line items in the statement(s) of financial performance.

32. We also recommend removing the proposed amendment to paragraph 82 of IAS 1 proposing a new separate line item (*line item (aza)* in paragraph 7) for regulatory income or regulatory expense as it would raise questions about the classification of regulatory income or regulatory expense as revenue and it would be inconsistent with the requirements in IFRS 15 (paragraph 31(a)).

33. We think it would be helpful if the final Standard on regulatory assets and regulatory liabilities included an example that illustrates the application of the 'useful structured summary' concept in the context of the model proposed in the Exposure Draft.

[2] Paragraph BC332 of the Basis for Conclusions accompanying IFRS 15.

[3] Useful structured summary encompasses the three roles of the primary financial statements. The role of the primary financial statements is to provide structured summaries of a reporting entity's recognised assets, liabilities, equity, income, expenses and cash flows, that are useful for: (a) obtaining an understandable overview of the entity's recognised assets, liabilities, equity, income, expenses and cash flows; (b) making comparisons between entities, and between reporting periods for the same entity; and (c) indicating where in the notes users of financial statements may find additional information about the line items presented (see Agenda Paper 21B of the November 2023 IASB meeting).

34. As mentioned in paragraph 18, a few respondents disagreed with the proposal for presenting regulatory income or regulatory expense in a single line item. These respondents thought that the changes in regulatory assets and regulatory liabilities should be presented in different line items in the statement(s) of financial performance depending on the underlying items to which these changes relate. For example, if an amount of regulatory income is associated with a regulatory asset related to an allowable expense, these respondents suggested presenting that regulatory income in the same line item in which the entity presents the related allowable expense—this suggestion would result in netting the allowable expense with its related regulatory income.

35. We note that by recognising regulatory assets, regulatory liabilities, regulatory income and regulatory expense, an entity applies the principle underlying the model—that is, an entity should reflect the total allowed compensation for goods or services supplied as part of its reported financial performance for the period in which those goods or services are supplied.[4] We think that the presentation suggested by respondents in paragraph 18 would be inconsistent with the underlying principle in the model because rather than reflecting the total allowed compensation to which the entity is entitled, the statement(s) of financial performance would reflect a reduction of expenses incurred. Therefore, we do not recommend taking this suggestion forward.

36. We recommend that the final Accounting Standard:

(a) specify that all regulatory income minus all regulatory expense should be classified as revenue (paragraph 29);

(b) require disclosure of all regulatory income minus all regulatory expense separately from an entity's other sources of revenue, unless that amount is presented as a separate line item in the statement(s) of financial performance (paragraph 30); and

[4] Paragraph 16 of the Exposure Draft.

(c) exclude the proposed amendment to paragraph 82 of IAS 1 requiring regulatory income or regulatory expense to be presented as a separate line item below revenue (paragraph 32).

Questions for the IASB
1. Does the IASB agree with the staff recommendations in paragraph 36?

Regulatory interest

37. As noted in paragraph 19, most respondents agreed with the proposal to include regulatory interest within the regulatory income or regulatory expense line item. Including regulatory interest within the regulatory income or regulatory expense will result in regulatory interest being classified in the operating category.

38. However, some respondents—mainly from Latin America—said that regulatory interest income and regulatory interest expense should be included within finance income and finance expense, respectively (paragraph 20).

39. A few respondents also suggested the IASB consider the interaction of the proposal on regulatory interest with its work on the *Primary Financial Statements* project (paragraph 21). We note that the prospective [draft] IFRS 18 will require an entity to classify income and expenses into five categories, one of which is the financing category. Our understanding is that the financing category could capture regulatory interest arising from regulatory liabilities unless the prospective [draft] IFRS 18 specify regulatory interest is to be classified in the operating category.

40. Paragraphs BC180–BC182 in the Basis for Conclusions accompanying the Exposure Draft explain that regulatory interest is a stream of incremental cash flows compensating or charging an entity for the time lag until recovery of regulatory assets or fulfilment of regulatory liabilities. This compensation or charge will be based on an interest rate established by the regulator, which will vary depending, amongst other factors, on the type and length of the differences in timing. Consequently, we acknowledge that regulatory interest has characteristics of financing.

41. However, when the IASB proposed to include regulatory interest within regulatory income or regulatory expense, a higher weight was given to the following matters:[5]

(a) amounts relating to regulatory interest will be included in determining the future regulated rates charged to customers—and hence, included in revenue in future periods—when the related regulatory assets are recovered or related regulatory liabilities are fulfilled. In other words, the compensation or charge for regulatory interest is built into the 'price' for the regulated goods or services the entity supplies. Consequently, the compensation or charge provided through regulatory interest rates is related to an entity's operating activities rather than its financing activities.

(b) users' needs—users value information that helps them distinguish fluctuations in revenue and expenses compensated for through adjustments to future regulated rates from fluctuations for which there is no compensation. Users need separate identification of regulatory interest included in revenue only when the amount of that interest could distort or obscure the relationship between revenue and expenses during the period.

42. We think the matters considered by the IASB during the development of the presentation proposals in paragraph 41 still hold. In relation to paragraph 41(b), all users commenting on the presentation proposals during the comment period of the Exposure Draft agreed with including regulatory interest within regulatory income or regulatory expense and presenting these items as operating.[6]

43. Consequently, we recommend that the final Accounting Standard:

(a) retain the proposal to include regulatory interest income within regulatory income and regulatory interest expense within regulatory expense; and

(b) amend the prospective [draft] IFRS 18 *Presentation and Disclosure in Financial Statements* to clarify that regulatory interest is excluded from the financing category and is classified in the operating category.

[5] Agenda Paper 9C discussed at the November 2018 IASB meeting.

[6] Agenda Paper 9 discussed at the October 2021 IASB meeting.

Questions for the IASB	
2.	Does the IASB agree with the staff recommendations in paragraph 43?

Presentation of regulatory assets and regulatory liabilities in the statement of financial position

44. As mentioned in paragraph 22, the Invitation to Comment on the Exposure Draft did not include an explicit question on the proposal to present regulatory assets and regulatory liabilities as separate line items in the statement of financial position. However, a few respondents still explicitly agreed with the proposals.

45. When the IASB developed the Exposure Draft, it examined the characteristics of regulatory assets and noted that they do not fit neatly into any of the defined categories of assets accounted for using existing IFRS Accounting Standards—a regulatory asset is not a financial asset, nor is it an intangible asset or an item of property, plant and equipment or inventory. A regulatory asset is not typically sold to produce cash flows directly, nor is it used with other assets to generate cash flows. Similar observations can be made for regulatory liabilities. Consequently, the IASB proposed to require presentation of separate line items for regulatory assets and regulatory liabilities beyond the line items required by IAS 1.[7] We think this proposal remains appropriate and recommend that the final Accounting Standard retains it.

46. As mentioned in paragraph 23, a few respondents noted there could be situations in which regulatory assets and regulatory liabilities, or resulting regulatory income or regulatory expense, are not significant to an entity's business. These respondents suggested the IASB provide guidance on the interaction between the presentation requirements in the final Standard and the general requirements in IAS 1 on aggregation and disaggregation.

[7] Agenda Paper 9C discussed at the November 2018 IASB meeting.

47. The prospective [draft] IFRS 18, which will replace IAS 1, will introduce the 'useful structured summary' concept described in paragraph 31(b). Applying the requirements in [draft] IFRS 18 an entity will be required to present separately a line item in a primary financial statement if doing so is necessary for the statement to provide a useful structured summary. If the entity concludes it is not necessary to present separately a line item required by an IFRS Accounting Standard, then [draft] IFRS 18 will require the entity to disclose the item in the notes if it is material. Consequently, we think additional guidance on this matter is unnecessary.

48. As mentioned in paragraph 24, a few respondents also suggested that the final Standard provide guidance to help entities apply paragraph 69(d) of IAS 1 in the context of regulatory liabilities. We note that paragraph 69 of IAS 1 will be carried forward into the prospective [draft] IFRS 18. Paragraph 69 of IAS 1 states:

> An entity shall classify a liability as current when:
>
> (a) it expects to settle the liability in its normal operating cycle;
>
> (b) it holds the liability primarily for the purpose of trading;
>
> (c) the liability is due to be settled within twelve months after the reporting period; or
>
> (d) it does not have the right at the end of the reporting period to defer settlement of the liability for at least twelve months after the reporting period.

49. These respondents said that when a regulatory liability is fulfilled would be generally outside the control of an entity because the regulator determines the fulfilment period and may be able to change it.

50. We note that although regulators could change when a regulatory liability is fulfilled, an entity would reflect such changes in the measurement of the regulatory liability at the end of each reporting period. The entity would be required to update the estimated future cash flows arising from that regulatory liability to reflect any changes in the amount or timing of the cash flows because of a change in facts and circumstances or because of new information.[8]

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[8] Paragraphs 56–57 of the Exposure Draft.

51. In the same manner, an entity would need to consider how the uncertainty that a regulator could change the fulfillment period of a regulatory liability may affect the classification of a regulatory liability as current. That uncertainty may depend on facts and circumstances and therefore additional guidance is unlikely to be helpful. As a result, we think that the final Standard should retain the requirement for an entity to classify current and non-current regulatory assets and regulatory liabilities and not add guidance on applying paragraph 69(d) of IAS 1.

52. Therefore, we recommend that the final Accounting Standard retain the proposal to present in the statement of financial position line items for regulatory assets and regulatory liabilities (paragraph 45), including current and non-current classifications by applying paragraphs 66 and 69 of IAS 1 except when the entity presents all assets and liabilities in order of liquidity (paragraph 51).

Questions for the IASB
3. Does the IASB agree with the staff recommendation in paragraph 52?