Staff paper

Agenda reference: 9C

IASB® meeting

Date	**December 2023**
Project	**Rate-regulated Activities**
Topic	**Items affecting regulated rates only when related cash is paid or received—Overview**
Contacts	Mariela Isern (misern@ifrs.org)

Objective

1. This paper sets out the staff's recommended approach to redeliberating the proposals in the Exposure Draft *Regulatory Assets and Regulatory Liabilities* (the Exposure Draft) dealing with items affecting regulated rates only when the related cash is paid or received (items affecting regulated rates on a cash basis).

2. We are not asking the IASB to make decisions on this paper. However, we ask the IASB to comment on any additional matters that we may need to consider.

Structure of the paper

3. This paper is structured as follows:

   (a) summary of the proposed requirements (paragraphs 5–9);

   (b) feedback—summary of key messages (paragraphs 10–17); and

   (c) redeliberations—topics and timing considerations (paragraphs 18–19).

4. The appendix contains extracts from the Basis for Conclusions and the alternative view accompanying the Exposure Draft.

Summary of the proposed requirements

5. Paragraph 59 of the Exposure Draft states that, in some cases, a regulatory asset or regulatory liability arises because a regulatory agreement treats an item of expense or income as allowable or chargeable in determining the regulated rates only once an entity pays or receives the related cash, or soon after that, instead of when the entity recognises that item as expense or income in its financial statements by applying IFRS Accounting Standards. For example, a regulatory agreement may give an entity the right to recover pension costs, environmental clean-up costs or income taxes but only once the entity pays the related cash, not when it recognises those costs by applying the relevant IFRS Accounting Standards. For such a regulatory asset or regulatory liability:

   (a) the cash flows arising from the regulatory asset or regulatory liability are a replica of the cash flows arising from the related liability or related asset, except for the effect of any uncertainty present in the regulatory asset or regulatory liability but not present in the related liability or related asset (paragraph 60 of the Exposure Draft); and

   (b) the regulatory agreement does not provide or charge a regulatory interest rate.

6. Paragraph 61 of the Exposure Draft proposes that an entity measures such a regulatory asset or regulatory liability by:

   (a) using the measurement basis used in measuring the related liability or related asset by applying IFRS Accounting Standards; and

   (b) adjusting the measurement of the regulatory asset or regulatory liability to reflect any uncertainty present in it but not present in the related liability or related asset.

7. Paragraph 66 of the Exposure Draft proposes that an entity ceases to apply paragraph 61 when the entity pays cash to settle the related liability or receives cash that recovers the related asset. From that date, the entity measures any remaining part of the regulatory asset or regulatory liability by applying the cash-flow-based

measurement technique proposed for all other regulatory assets and regulatory liabilities.

8. Paragraph 69 of the Exposure Draft proposes that when an entity remeasures a regulatory asset or regulatory liability applying the proposals in paragraph 61 of the Exposure Draft, the entity presents the resulting regulatory income or regulatory expense in other comprehensive income to the extent that the regulatory income or regulatory expense results from remeasuring the related liability or related asset through other comprehensive income.

9. The alternative view accompanying the Exposure Draft disagreed with both the proposed measurement and the proposed presentation.[1] According to this view:

   (a) the cash-flow-based measurement technique proposed for all other regulatory assets and regulatory liabilities should also apply to this case.

   (b) the presentation proposed for all other regulatory assets and regulatory liabilities—that is, to present in the statement(s) of financial performance all regulatory income minus all regulatory expense in a separate line item immediately below revenue—should also apply to this case.

Feedback—Summary of key messages

10. The summary is structured as follows:

   (a) measurement proposals (paragraphs 11–13); and

   (b) presentation proposals (paragraphs 14–17).

[1] Paragraphs AV2–AV6 of the alternative view accompanying the Exposure Draft.

Measurement proposals

11. Most respondents agreed with the proposed measurement requirements described in paragraph 6 of this paper. Many of these respondents said that the proposals would:

    (a) avoid creating accounting mismatches that would arise when using bases to measure a regulatory asset or regulatory liability that differ from the bases used to measure its related liability or related asset;

    (b) simplify the measurement of the regulatory assets or regulatory liabilities by using the same judgements that were applied to the measurement of the related liabilities or related assets;

    (c) reflect that the cash flows arising from the regulatory asset or regulatory liability are a replica of the cash flows arising from the related liability or related asset; and

    (d) be consistent with the requirements in IFRS Accounting Standards for indemnification assets and reimbursement assets.

12. A few respondents disagreed with the proposed measurement requirements:

    (a) an accounting firm, a preparer and a regulator in Asia-Oceania said the model in the Exposure Draft would give rise to the recognition of regulatory assets and regulatory liabilities that would represent differences in timing between the criteria used in IFRS Accounting Standards (for example, accrual basis) and those used in the regulatory agreements (for example, cash basis). These respondents disagreed that these differences in timing represent an entity's enforceable rights or enforceable obligations to adjust future regulated rates in accordance with the regulatory agreements.

    (b) an individual expressed explicit support for the alternative view (paragraph 9).

    (c) an accountancy body in Asia-Oceania was concerned that the proposals would add complexity to the model in the Exposure Draft.

13. Some respondents raised questions and concerns about:

(a) enforceability—in addition to those who disagreed with the measurement proposals (paragraph 12(a)), a few respondents questioned whether an entity would have enforceable present rights or enforceable present obligations before the cash for a related liability or a related asset is paid or received.

(b) the scope of the proposals—the proposals in paragraph 61 of the Exposure Draft are limited to those cases when a regulatory agreement treats an item of expense or income as allowable or chargeable only once an entity pays or receives the related cash (cash basis). A few respondents—mainly preparers from North America—stated that a regulatory agreement may treat an item of expense or income as allowable or chargeable using a criterion other than the cash basis (for example, on an accrual basis). These respondents wondered whether entities should also be able to apply the proposed requirements when items are allowable or chargeable on an accrual basis.

(c) differences between local generally accepted accounting principles (GAAP) and IFRS Accounting Standards giving rise to regulatory assets or regulatory liabilities. A few respondents said that some of the items of expense or income listed in paragraph 59 of the Exposure Draft are treated by the regulator as allowable or chargeable on an accrual basis based on local GAAP.[2] These respondents expressed different views about whether differences between local GAAP and IFRS Accounting Standards should give rise to regulatory assets or regulatory liabilities. Some who asked the IASB to consider this issue did not express a view.

(d) the interaction between the proposals and the proposed guidance on the boundary of a regulatory agreement. For example, an entity may not expect to pay the cash to settle the related liability, or to receive the cash to recover the related asset, within the boundary of the regulatory agreement, or there may be

[2] The examples in paragraph 59 of the Exposure Draft are income taxes, employee benefits and provisions.

uncertainty as to whether the cash will be paid or received within the boundary.

Presentation proposals

14. Most respondents agreed with the proposed presentation requirements (paragraph 8). Many of these respondents also agreed with the IASB's reasons for the proposals.[3] They said that the proposed presentation would be more understandable to users of financial statements because it would avoid presenting two related remeasurements (for example, the remeasurement of a liability and the remeasurement of the related regulatory asset) in different sections of the statement of comprehensive income.

15. A few respondents who agreed with the proposed presentation—a few preparers in North America, an accounting firm and a national standard-setter in Europe—expressed the view that the proposed presentation should not be limited to items treated by a regulatory agreement as allowable or chargeable *on a cash basis* but should also apply when an item is allowable or chargeable *on an accrual basis*. This would mean that, for such an item, an entity would present regulatory income and regulatory expense in other comprehensive income if it arises from a remeasurement of the related liability or related asset through other comprehensive income. According to these respondents, this would result in a presentation that would be more understandable to users of financial statements and would be consistent with previous conclusions reached by the IASB in IFRS 14 *Regulatory Deferral Accounts*.

16. A few respondents—mainly national standard-setters in Asia-Oceania and Latin America—disagreed with the presentation proposals. An individual expressed explicit support for the alternative view (paragraph 9). Many of the respondents that disagreed with the proposals supported presenting all regulatory income and regulatory expense in profit or loss. They said that presentation in profit or loss

[3] Paragraph BC185 of the Basis for Conclusions accompanying the Exposure Draft.

would better portray the total allowed compensation for the goods or services supplied to customers during the period and would be less complex than the proposals.

17. A few respondents raised questions about whether and how the cumulative amount of regulatory income or regulatory expense presented in other comprehensive income should be reclassified to profit or loss.

Redeliberations—Topics and timing considerations

18. The table sets out the topics that the staff propose to discuss with the IASB.

19. The topics, and the sequence in which they are discussed, may change. This depends on, for example, the IASB's tentative decisions at future meetings and whether redeliberations highlight links between topics.

Question for the IASB
Does the IASB have any questions or comments on the topics for redeliberation? Specifically, are there any additional matters that the IASB thinks need to be considered, including any interactions with other aspects of the proposals that may affect the sequence in which topics are redeliberated?

Topic	Comments
Proposed measurement requirements (paragraphs 11–13)	
(a) Do differences between regulatory and accounting criteria give rise to differences in timing that represent enforceable rights and enforceable obligations (paragraphs 12(a) and 13(c))? (b) Enforceability of the rights and obligations: (i) only once cash is paid or received (paragraph 13(a))? (ii) interaction with the proposals on the boundary of a regulatory agreement (paragraph 13(d)).	Items (a) and (b)(i) are included in Agenda Paper 9D discussed at this meeting. Item (b)(ii)—the IASB started its discussion on the boundary proposals at its October 2023 meeting.[4] The IASB will continue its discussion on the boundary at a future meeting.
(c) Assessing feedback relating to whether the measurement proposals should be applied to items that are allowable or chargeable using a criterion other than the cash basis (paragraph 13(b)).	Item (c) will be discussed at a future meeting.

[4] Agenda Paper 9B discussed at the IASB October 2023 meeting.

Topic	Comments
Proposed presentation requirements (paragraphs 14–17)	
(d) Reconfirm the proposed presentation requirements for items affecting regulated rates on a cash basis.	Item (d) is included in Agenda Paper 9D discussed at this meeting.
(e) Assessing feedback relating to whether the proposed presentation requirements for items affecting regulated rates on a cash basis should be extended to all regulatory income and regulatory expense that arise from a remeasurement of the related liability or related asset through other comprehensive income (paragraph 15).	Item (e) will be discussed at a future meeting.
(f) Assessing requests for more guidance on reclassification of regulatory income or regulatory expense presented in other comprehensive income to profit or loss (paragraph 17).	Item (f) is included in Agenda Paper 9D discussed at this meeting.

Appendix

A1. This appendix contains extracts from:

(a) the Basis for Conclusions accompanying the Exposure Draft regarding items affecting regulated rates only when related cash is paid or received; and

(b) the alternative view accompanying the Exposure Draft.

Extract from the Basis for Conclusions

A2. Paragraphs BC174–BC177 and paragraphs BC183–BC186 follow.

Items affecting regulated rates only when related cash is paid or received

BC174 In some cases, a regulatory agreement treats an item of expense or income as allowable or chargeable in determining the regulated rates only once an entity pays or receives the related cash, or soon after that, instead of when the entity recognises that item as expense or income in its financial statements by applying, for example, IAS 12 *Income Taxes*, IAS 19 *Employee Benefits* or IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

BC175 The Board proposes that an entity measure such a regulatory asset or regulatory liability using the measurement basis used in measuring the related liability or related asset by applying IFRS Standards, instead of using the modified historical cost measurement basis proposed for all other regulatory assets and regulatory liabilities. In the Board's view, this approach:

(a) would provide users of financial statements with the most relevant and understandable information, because the cash flows arising from the regulatory assets or regulatory liabilities are a replica of the cash flows arising from the related liabilities or related assets, except for the effect of any uncertainty present in the regulatory asset or regulatory liability but not present in the related liability or related asset.

(b) would provide users with more useful and more understandable information because it would avoid creating accounting mismatches in the statement(s) of financial performance that would result from using different measurement bases. The *Conceptual Framework* says that:

> 6.58 When assets and liabilities are related in some way, using different measurement bases for those assets and liabilities can create a measurement inconsistency (accounting mismatch). If financial statements contain measurement inconsistencies, those financial statements may not faithfully represent some aspects of the entity's

financial position and financial performance. Consequently, in some circumstances, using the same measurement basis for related assets and liabilities may provide users of financial statements with information that is more useful than the information that would result from using different measurement bases. This may be particularly likely when the cash flows from one asset or liability are directly linked to the cash flows from another asset or liability.

(c) is consistent with the requirements in IFRS Standards for indemnification assets and for reimbursement assets. IFRS 3 *Business Combinations* requires an acquirer to recognise an indemnification asset at the same time that it recognises the related indemnified item and to measure that asset on the same basis as the related indemnified item, subject to a valuation allowance for uncollectible amounts. IAS 37 requires that the amount recognised for a reimbursement asset not exceed the amount of the related provision.

BC176 Without the proposal described in paragraph BC175, these regulatory assets and regulatory liabilities would be measured by applying paragraphs 30–58 of the Exposure Draft. Because the regulatory interest rate for these items is not observable from the regulatory agreement, the Board would need to consider what discount rate an entity should apply to these items, for example whether it would be appropriate to use the minimum interest rate described in paragraph 51 of the Exposure Draft. In the Board's view, the benefit of any incremental information provided by such an approach would be unlikely to outweigh the costs for users in understanding the resulting accounting mismatches and for preparers in determining an appropriate discount rate for these regulatory assets and regulatory liabilities.

BC177 The Board also proposes that an entity adjust the measurement of these regulatory assets and regulatory liabilities to reflect any uncertainty that is present in them but not present in the related liability or related asset. That adjustment is analogous to the adjustment for uncollectible amounts that IFRS 3 requires in measuring indemnification assets.

…

Presenting some regulatory income or regulatory expense in other comprehensive income

BC183 In circumstances described in paragraphs 59–60 of the Exposure Draft, the Board proposes that an entity should measure a regulatory asset or regulatory liability using the measurement basis used in measuring the related liability or related asset (paragraph 61 of the Exposure Draft). Some remeasurements of the related liability or related asset are presented in other comprehensive income as required by the applicable IFRS Standard. The Board considered where an entity should present the regulatory income or regulatory expense resulting from remeasuring the regulatory asset or regulatory liability in these cases—in other comprehensive income, or in profit or loss.

BC184 Presentation in profit or loss would be consistent with the presentation of all other components of regulatory income or regulatory expense. As explained in paragraph BC179, regulatory assets and regulatory liabilities and changes in them affect the amount of revenue in the current or future periods. Consequently, presenting all regulatory income minus all regulatory expense — including those relating to remeasurements presented in any part of the statement(s) of financial performance—immediately below revenue would coherently and understandably show the effects on revenue of regulatory assets and regulatory liabilities and changes in them.

BC185 Nevertheless, presenting that component of regulatory income or regulatory expense in profit or loss would mean that the same underlying remeasurement would lead to two opposite effects: one in profit or loss for the regulatory asset or regulatory liability and the other in other comprehensive income for the related liability or related asset. Therefore, the Board proposes that an entity should present those remeasurements of a regulatory asset and regulatory liability in other comprehensive income.

BC186 The Board is not proposing any other presentation and disclosure requirements for the regulatory income or regulatory expense presented in other comprehensive income beyond the requirements in IAS 1 *Presentation of Financial Statements*.

Extract from the alternative view

A3. Paragraphs AV2–AV6 follow.

Focus on understanding the relationship between an entity's revenue and expenses

AV2 As described in paragraphs BC23–BC24, the problem that the Board is trying to address is that of differences in timing between when an entity supplies goods or services and when the entity charges customers the total allowed compensation for those goods or services, and hence includes that total allowed compensation in revenue. These differences impact the revenue line item of an entity conducting activities that are subject to a regulatory agreement.

AV3 Ms Tokar agrees with the Board's approach of addressing these differences in timing by requiring recognition of supplemental regulatory items (regulatory income, regulatory expense, regulatory assets and regulatory liabilities). She agrees with the Board's conclusion that applying other IFRS Standards provides useful information to users of financial statements, and that therefore no modifications should be made for when and how an entity applies other Standards, including IFRS 15 *Revenue from Contracts with Customers*, or for how an entity accounts for income and expenses generated or incurred during the period. She also agrees that regulatory income and regulatory expense should be segregated from revenue as they do not arise from contracts with customers.

AV4 However, Ms Tokar believes that the Board should provide information about the relationship between an entity's revenue and expenses by focusing solely on how the regulatory agreement impacts the timing of charging customers the total allowed compensation—identifying:

(a) how much of the amount charged to customers in the current period relates to goods or services that either were supplied in a prior period or will be supplied in a future period (regulatory expense in the current period); and

(b) how much more will be charged to customers in future periods as a result of supplying goods or services in the current period due to increases in regulated rates that will be charged when additional goods or services are supplied in the future, and how much of the amount charged to customers in prior periods relates to goods or services supplied in the current period (regulatory income in the current period).

AV5 She does not agree with the Board's broader focus on understanding the relationship between an entity's revenue and expenses, set out in paragraph 2(a) of the Exposure Draft, or the related conclusions to: (a) present some amounts of regulatory income and regulatory expense outside of profit or loss in OCI (paragraph 69 of the Exposure Draft), or (b) measure certain regulatory assets and regulatory liabilities (described in paragraphs 59–60 of the Exposure Draft) by reference to the measurement basis in IFRS Standards for the related liabilities and related assets (paragraph 61 of the Exposure Draft).

AV6 Ms Tokar acknowledges that recognising all regulatory income and regulatory expense in the statement of profit or loss could create some accounting (presentation) mismatches if the related item of expense or income is presented in OCI. She also acknowledges that measuring the items described in paragraphs 59–60 of the Exposure Draft applying the general approach in the proposed Standard might create some accounting measurement mismatches. In Ms Tokar's view, the implicit measurement objective in the proposed Standard for regulatory income and regulatory expense (and therefore regulatory assets and regulatory liabilities) is the amount of the impact of the differences in timing on the amount charged to customers. Ms Tokar believes that addressing these two sets of potential accounting mismatches is not necessary to solve the problem the Board is trying to address, and that the broader focus described in paragraph AV5 risks implying that the Board is incorporating a matching concept in this proposed Standard. Further, in her view, the usefulness and understandability of the statement of financial performance, and the proposed Standard itself, would be reduced by presenting a portion of regulatory income and regulatory expense in OCI, and by creating an exception to the measurement approach for a subset of items.