Staff paper

Agenda reference: 9A

IASB® meeting

Date	**June 2023**
Project	**Rate-regulated Activities**
Topic	**Measurement (estimating future cash flows) and unit of account—Overview**
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Objective

1. The measurement workstream includes the analysis of comments arising from the following questions in the Invitation to Comment on the Exposure Draft *Regulatory Assets and Regulatory Liabilities* (the Exposure Draft):[1]
   (a) questions 5(a)–(c) dealing with:
      (i) the proposed measurement basis;
      (ii) the proposed cash-flow-based measurement technique; and
      (iii) the proposals for estimating uncertain future cash flows; and
   (b) questions 6(a)–(d) dealing with the proposals on the discount rate.
2. This paper sets out the staff's recommended approach to redeliberating the proposals on the measurement basis, cash-flow-based measurement technique and estimating uncertain future cash flows. As part of these redeliberations, we will also discuss feedback received on the proposals relating to the unit of account (paragraph 24 of the

[1] This workstream includes initial and subsequent proposed measurement requirements (paragraphs 29–58 of the Exposure Draft).

Exposure Draft) and the boundary of the regulatory agreement (paragraphs 33–35 and B28–B40 of the Exposure Draft).

3. We will discuss our recommended approach to redeliberating the proposals on the discount rate at a future meeting.

4. Feedback on the proposals relating to the measurement of items affecting regulated rates only when related cash is paid or received (paragraphs 59–66 of the Exposure Draft—question 7 of the Invitation to Comment) will be considered as part of a separate work stream.

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

Structure of the paper

6. This paper is structured as follows:

   (a) summary of the proposed requirements (paragraphs 8–19);

   (b) feedback—summary of key messages (paragraphs 20–36); and

   (c) redeliberations—topics and timing considerations (paragraphs 37–38).

7. The appendix contains extracts from the Basis for Conclusions accompanying the Exposure Draft.

Summary of the proposed requirements

8. Paragraph 29 of the Exposure Draft specifies the measurement basis for regulatory assets and regulatory liabilities as historical cost, modified for subsequent measurement by using updated estimates of the amount and timing of future cash flows. An entity would implement that measurement basis by applying a cash-flow-based measurement technique.

9. Paragraphs BC130–BC134 of the Basis for Conclusions accompanying the Exposure Draft describe the reasoning behind the proposed measurement basis and the proposal to refer to that basis as modified historical cost (see appendix).

10. Paragraph 30 of the Exposure Draft proposes that measuring regulatory assets and regulatory liabilities using a cash-flow-based measurement technique would involve:

    (a) estimating future cash flows that are within the boundary of a regulatory agreement—including future cash flows arising from regulatory interest—and updating those estimates at the end of each reporting period to reflect conditions existing at that date; and

    (b) discounting those estimated future cash flows to their present value.

11. Paragraphs 31–44 of the Exposure Draft contain the proposed requirements on estimating future cash flows.

12. When estimating future cash flows, an entity would consider only those cash flows arising from a regulatory asset or a regulatory liability that are within the boundary of a regulatory agreement. The boundary of a regulatory agreement is the point beyond which a regulatory agreement confers no enforceable present rights and imposes no enforceable present obligations. Paragraphs B28–B40 of the Exposure Draft provide guidance on determining the boundary of a regulatory agreement.

13. Paragraphs BC135–BC158 of the Basis for Conclusions describe the reasoning behind the IASB's proposals on estimating future cash flows.

14. If cash flows arising from a regulatory asset or regulatory liability are uncertain, paragraph 39 of the Exposure Draft proposes that an entity estimate those cash flows applying whichever of two methods—the 'most likely amount' method or 'expected value' method—better predicts the cash flows.

15. Paragraph 40 of the Exposure Draft states that in assessing whether the 'most likely amount' method or the 'expected value' method:

    > […] better predicts the uncertain cash flows, an entity shall also assess whether a better prediction will result from considering each regulatory asset and each

> regulatory liability separately, or from considering any of them together with other regulatory assets or regulatory liabilities.

16. Paragraph 42 of the Exposure Draft proposes that an entity apply the chosen method for estimating uncertain future cash flows consistently from initial recognition to recovery or fulfilment.

17. Paragraphs BC136–BC139 of the Basis for Conclusions describe the reasoning behind the IASB's proposal on estimating uncertain future cash flows.

18. In relation to the unit of account, paragraph 24 of the Exposure Draft states:

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

19. Paragraphs BC114–BC121 of the Basis for Conclusions describe the reasoning behind the proposed unit of account.

Feedback—Summary of key messages

20. The summary is structured as follows:

    (a) proposed measurement basis (paragraphs 21–26);

    (b) proposed cash-flow-based measurement technique (paragraphs 27–31);

    (c) estimating uncertain future cash flows (paragraphs 32–34);

    (d) boundary of a regulatory agreement (paragraph 35); and

    (e) unit of account (paragraph 36).

Proposed measurement basis

21. Most respondents who commented on the proposed measurement basis (that is, modified historical cost) agreed with the IASB's proposal, with many commenting that the proposed measurement basis would provide useful information.

22. A few respondents, mainly European preparers with operations in the United States, disagreed with the proposed cash-flow-based measurement technique mainly due to concerns about the cost of applying the proposals. These respondents mainly disagree with discounting estimates of future cash flows to their present values. We plan to analyse ways of alleviating some of these concerns when we discuss the proposals on discounting at a future meeting.

23. Consequently, given the widespread support for the proposed measurement basis, we do not think the IASB needs to redeliberate the proposal to measure regulatory assets and regulatory liabilities at modified historical cost.

24. A few respondents—mainly national standard-setters—disagreed with the description of the measurement basis as modified historical cost. They thought the description was inconsistent with the description of historical cost in the *Conceptual Framework for Financial Reporting* because historical cost does not reflect changes in values. These respondents saw the cash-flow-based measurement technique as being closer to current value measurement bases than historical cost measurement bases.

25. In developing the Exposure Draft the IASB considered whether to refer to the proposed measurement basis as modified historical cost or modified current value and concluded that modified historical cost is more appropriate (see appendix).

26. Given that the description of the measurement basis has no practical effect on the requirements in the Standard, we do not think the IASB needs to redeliberate this proposal.

Proposed cash-flow-based measurement technique

27. Most respondents who commented on the proposed cash-flow-based measurement technique agreed with the proposal for the reasons explained in the Basis for Conclusions.

28. As mentioned in paragraph 22, a few respondents, mainly European preparers with operations in the United States, disagreed with the cash-flow-based measurement technique mainly due to concerns about the cost of applying the proposals. These respondents thought the proposals for discounting estimates of future cash flows—particularly, the proposals for discounting using the minimum interest rate (paragraphs 50–53 of the Exposure Draft) and the proposals for translating uneven regulatory interest rates into a single discount rate (paragraph 54 of the Exposure Draft)—were complex and would not result in useful information. They preferred the measurement requirements in US generally accepted accounting principles (GAAP). US GAAP generally prohibits measurement of regulatory balances at discounted present value.[2]

29. Some respondents—mainly national standard-setters and preparers—outlined practical challenges with the cash-flow-based measurement technique and suggested that the IASB provide more guidance on estimating uncertain cash flows.

30. In relation to estimating future cash flows, respondents also stated that:

    (a) uncertainties relating to the period in which the regulatory assets and regulatory liabilities will be recovered or fulfilled may involve the use of significant judgement leading to subjective outcomes; and

    (b) factoring demand risk and credit risk into the estimates of uncertain future cash flows can be difficult, with some stakeholders asking specific questions or requesting further guidance.

[2] Under US GAAP regulatory assets are measured at the amount of incurred costs, with, in most cases, no resulting regulatory interest and no discounting. There are specific requirements for discounting in limited circumstances (for example, abandoned plants).

31. Respondents also raised challenges and made suggestions in relation to the proposals on discounting. As mentioned in paragraph 22, we will analyse comments on these proposals at a future meeting.

Estimating uncertain future cash flows

32. Most respondents who commented agreed with the proposals on estimating uncertain future cash flows.

33. A few respondents—mainly accounting firms—questioned the interaction between the 'more likely than not' recognition threshold with the proposed methods for estimating uncertain future cash flows—that is, the 'most likely amount' method or the 'expected value' method—in specific circumstances. For example, those respondents asked whether the 'expected value' method should reflect only those outcomes in which the regulatory asset or regulatory liability is more likely than not to exist. Other respondents questioned, for example, the appropriateness of using the 'most likely amount' method when the probability of existence is at, or slightly above, the 'more likely than not' recognition threshold.

34. A few European national-standard setters explicitly supported the proposal in paragraph 42 of the Exposure Draft to require that an entity continue to apply the same method of estimating uncertain future cash flows until the entity has recovered the regulatory asset or fulfilled the regulatory liability. However, a few other respondents suggested that the IASB require a change of method when circumstances change, such that the method selected at initial recognition no longer better predicts the future cash flows.

Boundary of a regulatory agreement

35. The main comments on the boundary of a regulatory agreement were:

    (a) some respondents (mainly preparers, national standard-setters and accounting firms) said it was unclear whether an entity has enforceable rights and enforceable obligations only in the periods for which the regulator determines the regulated rates or whether the boundary of a regulatory agreement goes beyond those periods. Regulated rates may be set for relatively short periods compared to the period covered by a licence period (for example rates may be set for 5 years but a licence may be for 25 years).

(b) some respondents (mainly preparers) asked the IASB to provide additional guidance on how the probability of renewal affects the boundary of a regulatory agreement.

(c) a few respondents (mainly preparers and national standard-setters) commented that the useful lives of assets are often longer than the period of a regulatory agreement (for example, an infrastructure asset may have a useful life of 40 years but a licence may be for 25 years). They also stated that the investment in these assets is expected to be recovered in periods beyond the period of the licence. These respondents suggested that the IASB clarify the boundary of the regulatory agreement in these cases.

Unit of account

36. A few respondents, mainly preparers and national standard-setters:

(a) asked the IASB to provide more guidance to help entities apply the unit of account proposals in paragraph 24 of the Exposure Draft. Some of these respondents questioned the interaction between:

(i) the unit of account proposal (that the unit of account is the right or obligation arising from each individual difference in timing); and

(ii) the proposal in paragraph 40 of the Exposure Draft to consider whether a better prediction of the cash flows will result from considering specific regulatory assets and regulatory liabilities together.

According to these respondents, the fact that an entity may consider a group of regulatory assets or regulatory liabilities as the unit of account for measurement purposes appears to contradict the requirement to account for the right or obligation arising from each individual difference in timing as a separate unit of account.

(b) were concerned about the interaction between the proposed unit of account and other proposals in the Exposure Draft—mainly regulatory returns on an asset not yet available for use and the accounting for regulatory assets and regulatory liabilities arising from differences between the regulatory recovery period and the assets' useful lives.

Redeliberations—Topics and timing considerations

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

38. The topics for redeliberation, 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 linkages 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 basis (paragraphs 21–26)		
(a)	Assessing feedback received relating to the proposed measurement basis.	Discussed at this IASB meeting, does not need to be redeliberated (paragraphs 21–26)
Proposed cash-flow-based measurement technique (paragraphs 27–31)		
(b)	Assessing feedback received relating to the proposed cash-flow-based measurement technique.	Discussed at this IASB meeting—(paragraphs 27–31). This topic has interactions with the proposals dealing with estimating uncertain future cash flows (see items (c)–(e) below) and discounting future cash flows. The staff will analyse feedback on discounting and provide corresponding recommendations at a future meeting.
Estimating uncertain future cash flows (paragraphs 32 and 34)		
(c)	Interaction between existence uncertainty and the methods for estimating uncertain future cash flows.	Discussed at this IASB meeting—Agenda Paper 9B
(d)	Assessing feedback relating to whether the chosen method for estimating uncertain future cash flows should be applied consistently from initial recognition to recovery of a regulatory asset or fulfilment of a regulatory liability.	Discussed at this IASB meeting—Agenda Paper 9B
(e)	Application questions relating to uncertainties and risks (credit risk and demand risk) affecting the estimates of future cash flows.	The staff will analyse feedback received on uncertainties and risks affecting the estimates of future cash flows and will provide corresponding recommendations for the IASB at a future meeting.

Topic	Comments
Boundary of a regulatory agreement (paragraph 35)	
(f) Clarifying the proposals on the boundary of a regulatory agreement.	The staff will analyse feedback received on the boundary of a regulatory agreement and will provide corresponding recommendations for the IASB at a future meeting.
Other topics	
(g) Unit of account (paragraph 36).	We will analyse feedback received on the interaction between the unit of account proposals and the proposals dealing with estimating uncertain future cash flows at a future meeting. We will also analyse the extent to which the concerns about the unit of account may have been addressed by the IASB's tentative decisions on: • the accounting for regulatory returns on an asset not yet available for use; and • the accounting for regulatory assets and regulatory liabilities arising from differences between the regulatory recovery period and the assets' useful lives.[3]

[3] Agenda Papers 9B and 9C discussed by the IASB at its meeting in July 2022 and Agenda Paper 9B discussed in October 2022.

Appendix

A1. This appendix contains extracts from the Basis for Conclusions accompanying the Exposure Draft regarding the selection of modified historical cost as the proposed measurement basis.

BC132 The Board selected modified historical cost as the measurement basis because, in the Board's view, using that measurement basis would provide useful information about an entity's regulatory assets and regulatory liabilities, and about regulatory income and regulatory expense recognised as a result. That information, together with information required by other IFRS Standards, would enable users of financial statements to understand the entity's regulatory assets and regulatory liabilities and understand the relationship between revenue and expenses as completely as they can when no regulatory assets or regulatory liabilities exist.

BC133 The measurement basis could also have been described as a current value measurement basis, modified to use a historical discount rate. However, the Board proposes to describe it as a historical cost measurement basis, modified by updating it for changes in estimates of future cash flows. The Board proposes that description because the proposed measurement basis:

(a) depends on cash flows that result from total allowed compensation for goods or services and from regulated rates for goods or services. Both total allowed compensation and regulated rates can be viewed as forms of price. The *Conceptual Framework* says that 'historical cost uses information derived, at least in part, from the price of the transaction or other event that gave rise to the asset or liability'.

(b) requires an entity not to update the discount rate unless the regulatory agreement changes the regulatory interest rate, resulting in a change in the cash flows from regulatory interest.

BC134 Describing that measurement basis as historical cost has some analogies to the treatment of contract assets and contract liabilities, applying IFRS 15. The measurement of regulatory assets reflects total allowed compensation for goods or services already supplied, which includes target profit when applicable. This measurement is similar to measurements of contract assets based on transaction price, applying IFRS 15. The measurement of regulatory liabilities reflects an amount included in regulated rates already charged to customers, and as a result, included in revenue already recognised. This measurement is similar to measurements of contract liabilities based on consideration received in advance, applying IFRS 15.