
IASB[®] Meeting

Date **October 2023**
Project **Rate-regulated Activities**
Topic **Boundary of a regulatory agreement**
Contacts Mariela Isern (misern@ifrs.org)

This paper has been prepared for discussion at a public meeting of the International Accounting Standards Board (IASB). This paper does not represent the views of the IASB or any individual IASB member. Any comments in the paper do not purport to set out what would be an acceptable or unacceptable application of IFRS[®] Accounting Standards. The IASB's technical decisions are made in public and are reported in the IASB[®] *Update*.

Objective

1. This paper sets out staff analysis and recommendations on the proposals on the boundary of a regulatory agreement in the Exposure Draft [Regulatory Assets and Regulatory Liabilities](#) (Exposure Draft).

Staff recommendations

2. The staff recommend that the final Accounting Standard:
 - (a) specify the process by which an entity would identify and measure the cash flows that are within the boundary of a regulatory agreement and, hence, included in the measurement of a regulatory asset (regulatory liability) as described in paragraphs 68 and 69(a) and in flow chart 1 in Appendix A.
 - (b) retain the proposed guidance on compensation for cancellation of a regulatory agreement in paragraphs B35–B38 of the Exposure Draft, but clarify that that guidance also applies to other circumstances in which termination occurs and an entity has a right to receive compensation for unrecovered regulatory assets or an obligation to pay compensation for unfulfilled regulatory liabilities;
 - (c) include the principles underlying an entity's right to payment for performance completed to date, as described in paragraph 35(c) of IFRS 15 *Revenue from*

- Contracts with Customers*, to help an entity assess the existence of an enforceable present right to receive compensation (enforceable present obligation to pay compensation) for unrecovered regulatory assets (unfulfilled regulatory liabilities) when the regulatory agreement does not include an explicit right to receive compensation (obligation to pay compensation);
- (d) retain the proposed guidance on rights to renew or cancel a regulatory agreement in paragraphs B31–B34 of the Exposure Draft, but clarify that rights to renew or cancel an agreement may be explicit or implicit;
 - (e) require an entity to consider how its current expectations of future conditions would affect its practical ability to renew (and other parties' practical ability to cancel) a regulatory agreement when determining the boundary of a regulatory agreement; and
 - (f) retain the proposals in paragraphs B39–B40 of the Exposure Draft on reassessments and changes to the boundary.

Structure of the paper

- 3. This paper is structured as follows:
 - (a) proposals in the Exposure Draft (paragraphs 7–16);
 - (b) feedback received (paragraphs 17–26); and
 - (c) staff analysis (paragraphs 27–73):
 - (i) is the boundary of a regulatory agreement determined by the boundary of a regulatory period? (paragraphs 28–32);
 - (ii) determining the boundary of a regulatory agreement (paragraphs 33–71); and
 - (iii) reassessment and changes to the boundary (paragraphs 72–73).

4. The flow charts in Appendix A set out possible processes by which an entity would identify and measure the cash flows that are within the boundary of a regulatory agreement. Flow chart 1 in Appendix A is the recommended process (paragraph 71).
5. Appendix B includes a numerical example that illustrates the possible measurement differences between two processes for identifying and measuring the cash flows that are within the boundary of a regulatory agreement.
6. Appendix C contains extracts from the Exposure Draft and from IFRS 15 *Revenue from Contracts with Customers*.

Proposals in the Exposure Draft

7. The Exposure Draft proposes that an entity measure regulatory assets and regulatory liabilities using a cash-flow-based measurement technique. That technique would involve:
 - (a) estimating future cash flows and updating those estimates at the end of each reporting period to reflect conditions existing at that date; and
 - (b) discounting the estimated future cash flows to their present value.
8. These cash flows must be within the boundary of the regulatory agreement.¹ The Exposure Draft proposes that cash flows are within the boundary of a regulatory agreement only if:
 - (a) those cash flows would result from an enforceable present right or an enforceable present obligation that the entity has at the end of the reporting period to add or deduct amounts in determining a future regulated rate; and
 - (b) that addition or deduction would occur **on or before the latest future date** at which that right or obligation permits the addition or requires the deduction.²

¹ Paragraph 33 of the Exposure Draft.

² Paragraph 34 of the Exposure Draft.

-
9. The boundary is therefore the point beyond which a regulatory agreement confers no enforceable present rights, and imposes no enforceable present obligations, on an entity.³
10. The Exposure Draft provides guidance to help entities determine the boundary of a regulatory agreement:
- (a) in the case of a present right to increase regulated rates, an entity must have a right (under the regulatory agreement) to supply goods or services at that future date. The entity must also be entitled to compensation if any party other than the entity cancels the agreement before that date.
 - (b) in the case of a present obligation to decrease regulated rates, the entity must have an obligation (under the regulatory agreement) to supply goods or services at that future date. The entity must also be required to provide compensation to the party that will fulfil the regulatory obligation if the entity cancels the agreement before that date.⁴
11. The Basis for Conclusions accompanying the Exposure Draft explains that disregarding rights that are not substantive is consistent with the *Conceptual Framework for Financial Reporting (Conceptual Framework)*, IFRS 17 *Insurance Contracts* and IFRS 10 *Consolidated Financial Statements*.⁵ It also explains how the focus on the existence of rights and obligations in the definitions of assets and liabilities in the *Conceptual Framework* informed the boundary proposals (**emphasis added**):

BC146 The focus of the definitions of assets and liabilities is on determining whether **rights and obligations exist**, not on determining how likely it is that they will lead to cash flows (paragraphs BC4.3–BC4.14 and paragraph BC4.53 of the Basis for Conclusions on the *Conceptual Framework*). Thus, the proposed definitions of regulatory assets and regulatory liabilities adopt the same focus. This focus helped the Board to decide where the boundary of a regulatory agreement is. ...

³ Paragraph BC142 of the Basis for Conclusions accompanying the Exposure Draft.

⁴ Paragraphs B28–B34 of the Exposure Draft.

⁵ Paragraphs BC144 and BC145 of the Basis for Conclusions accompanying the Exposure Draft.

-
12. The Exposure Draft also provides guidance for entities in assessing whether the right to renew or the right to cancel a regulatory agreement affects the boundary of the regulatory agreement. It proposes that in assessing whether such rights affect the boundary of the regulatory agreement, an entity should disregard a right held by any party if there are no circumstances in which that party has the **practical ability** to exercise that right.⁶ In addition, when assessing whether the holder of a right to renew or a right to cancel has the practical ability to exercise that right, the IASB also proposes that (**emphasis added**):

BC146 [...] an entity should **not consider whether it is likely that the holder will exercise the right, nor whether the holder intends to exercise the right.** Instead, the entity should focus only on whether there are circumstances in which the holder has the practical ability to exercise the right.

13. Paragraphs B35–B38 of the Exposure Draft explain that, if a regulatory agreement provides for compensation for unrecovered regulatory assets or unfulfilled regulatory liabilities on cancellation of a regulatory agreement, such compensation is within the boundary of the regulatory agreement if it depends ‘solely on the monetary amount of unrecovered regulatory assets or unfulfilled regulatory liabilities.’⁷ Paragraph B37 says that if the cash flows arising from unrecovered regulatory assets (unfulfilled regulatory liabilities) would differ depending on whether the regulatory agreement continues or is cancelled, the cash flows are uncertain and an entity should use whichever of the two methods—the ‘most likely amount’ method or the ‘expected value’ method—the entity expects to better predict the cash flows.
14. Paragraphs BC151–BC152 of the Basis for Conclusions accompanying the Exposure Draft explain why cash flows arising from a right to receive compensation for unrecovered regulatory assets or an obligation to pay compensation for unfulfilled regulatory liabilities are regarded as arising within the boundary of the regulatory

⁶ Paragraph B33 of the Exposure Draft.

⁷ Paragraph BC144 of the Basis for Conclusions accompanying the Exposure Draft outlines the rationale for including cash flows arising from such compensation in the boundary of the regulatory agreement.

agreement and included in the measurement of the related regulatory assets or regulatory liabilities.

BC151 The presence within a cancellation right of a requirement to provide compensation, discussed in paragraphs B35–B38 of the Exposure Draft, results in uncertainty about how an entity will recover a regulatory asset—by increasing future regulated rates, or by receiving such compensation. As long as this uncertainty persists, it could be argued that the entity has both a regulatory asset and a financial asset, each recovered in different scenarios. Nevertheless, the Board considers that accounting for those two assets separately would not provide users of financial statements with useful information and would cause needless complexity for both users and preparers. Moreover, the right to receive compensation does not exist in isolation. It exists only to protect an entity's right to recover part of the total allowed compensation for goods or services already supplied to customers. Similar considerations apply to an entity's obligation to pay compensation if a regulatory agreement is cancelled before the entity fulfils a regulatory liability.

BC152 For the reasons given in paragraph BC151, the Exposure Draft proposes that cash flows arising from **a right to receive compensation for unrecovered regulatory assets or an obligation to pay compensation for unfulfilled regulatory liabilities be regarded as arising within the boundary of the regulatory agreement**, and thus be included in the measurement of the related regulatory assets or regulatory liabilities.

15. The Exposure Draft requires that an entity reassess the boundary of a regulatory agreement at the end of each reporting period and update the carrying amount of regulatory assets or regulatory liabilities for any additional cash inflows or outflows resulting from the reassessment.⁸ Such updates could result from recognising new regulatory assets or regulatory liabilities or from remeasuring existing regulatory assets or regulatory liabilities.
16. Paragraph 78(f) of the Exposure Draft proposes that an entity disclose in the notes changes in the carrying amount of a regulatory asset or regulatory liability caused by a change in the boundary of a regulatory agreement, and the reasons for that change in the boundary. Paragraph B40 of the Exposure Draft states that paragraph 78(f) 'does not require an entity to specify whether the effect of that change should be viewed as the recognition or a new regulatory asset or regulatory liability, or the remeasurement

⁸ Paragraphs B39 and B40 of the Exposure Draft.

of an existing regulatory asset or regulatory liability because making such a distinction would have no practical consequence.’

Feedback

17. Although the Invitation to Comment did not specifically request feedback on the proposals relating to the boundary of a regulatory agreement, some respondents commented on those proposals when answering questions 5 and 7 of the Invitation to Comment.

The boundary of a regulatory agreement

18. Some respondents—mainly preparers of financial statements, national standard-setters and accounting firms—said it was unclear whether the boundary of a regulatory agreement is limited to the current ‘regulatory period’ (the period over which the regulated rate is required to be applied) or whether it can go beyond the current regulatory period.⁹ A few respondents—mainly European preparers—thought the boundary should be limited to the current regulatory period (for example, five years). In contrast, a few respondents—mainly European and North American preparers—thought the boundary should go beyond the current regulatory period. They suggested the boundary should be at least as long as a licence period (for example, 25 years) or even longer.
19. Some respondents—mainly preparers and national standard-setters—commented that the regulatory recovery period of assets or the assets’ useful lives are often longer than the period of a licence agreement. For example, a licence may be for 25 years but an infrastructure asset may have a regulatory recovery period of 40 years and a useful life that is even longer than the regulatory recovery period. They stated that the investment in these assets is expected to be recovered in periods beyond the licence. These respondents suggested that the IASB clarify the boundary of the regulatory

⁹ Respondents referred to the regulatory period using various terms including the price control period, the tariff period, the rate case period and the rate application period.

- agreement in these cases. They sought confirmation that the boundary of the regulatory agreement could be longer than the licence period.
20. Some respondents—mainly preparers—asked for additional guidance on how the probability of renewal of an agreement affects the boundary of a regulatory agreement. A few respondents also commented that the process of renewing an agreement may take some time, with the entity being required to continue supplying goods and services during that time. They requested guidance on how to deal with such transitional periods.
21. A few respondents requested clarification of how the boundary proposals would be applied to:
- (a) agreements with no explicit renewal terms, such as licences that are continually renewed, or that continually roll over (sometimes referred to as perpetual licences).
 - (b) agreements that provide for compensation for unrecovered regulatory assets or charges for unfulfilled regulatory liabilities on termination, regardless of whether the cause of such termination is a cancellation.
22. A few respondents seeking confirmation that the boundary of the regulatory would not be limited to the regulatory period or the licence period:
- (a) stressed the importance of considering the combined effect of rights to renew and rights to compensation. They stated that regulatory agreements (particularly those with continually renewing or perpetual licences) cannot be cancelled without the entity receiving compensation. According to these respondents, that right for compensation gives an entity assurance that it will recover long-lived regulatory assets.
 - (b) said that their regulatory agreements do not have renewal or cancellation rights, or do not include explicit compensation mechanisms for non-renewal. Consequently, these respondents also queried how entitlements to, or valid expectations of, compensation for unrecovered (unfulfilled) long-term regulatory assets (regulatory liabilities) affect boundary assessments.

-
23. A few respondents shared the following suggestions or approaches for addressing these concerns:
- (a) requirements should be applied in the context of a **continually rolling regulatory agreement** if there is a supportable basis for expecting that licences to operate will continue to be renewed because it would be impracticable that another entity would take over these activities.
 - (b) linking the concept of the boundary of a regulatory agreement to the **remaining useful life of the assets** may be appropriate in circumstances in which there is a reasonable expectation of a balancing payment if the licence were to be cancelled, despite the fact that this may not be reflected in the currently enforceable regulatory agreement.¹⁰
 - (c) linking the concept of the boundary of a regulatory agreement with the **going concern** assumption. These respondents argued that the probability of renewal of the licence is very high, which means that in practice it would not be practicable that another entity takes over the activities. Consequently, these respondents think the boundary would be reached only if there are objective indications that the activities will be discontinued.
24. Paragraph 59 of the Exposure Draft says that, in some cases, a regulatory asset or a regulatory liability arises 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, rather than when the entity recognises the item as expense or income in its financial statements. Some respondents requested that the IASB clarify the application of the boundary proposals to long-term regulatory assets related to long-term liabilities such as pension liabilities, deferred taxes and provisions when the regulator treats these costs as allowable only once the entity pays the related cash. These respondents wanted to know, for example:

¹⁰ The staff infers that the suggestion implies that the remaining regulatory recovery period is closely aligned with the remaining useful lives of the assets.

-
- (a) which cash flows arising from these long-term regulatory assets would fall within the boundary of the regulatory agreement—only those cash flows within the current regulatory period or cash flows beyond that period.
 - (b) whether, in determining which cash flows fall within the boundary, an entity should consider valid expectations that a licence will be renewed or the possibility that a licence will be cancelled.
25. A few respondents suggested the IASB require disclosure of significant judgements made in determining the boundary of a regulatory agreement and how the boundary affects the recognition or measurement of regulatory assets and regulatory liabilities. We will discuss feedback on disclosure at a future IASB meeting.

Reassessment and changes to the boundary

26. Stakeholders did not raise concerns about the proposals on reassessments and changes to the boundary or the rationale for these proposals.¹¹ A European academic expressed support for the proposed disclosure of changes in the estimates of future cash flows resulting from a change in the boundary of the regulatory agreement.

Staff analysis

27. The analysis is structured in the following sections:
- (a) is the boundary of a regulatory agreement determined by the boundary of a regulatory period? (paragraphs 28–32);
 - (b) determining the boundary of a regulatory agreement (paragraphs 33–71); and
 - (c) reassessment and changes to the boundary (paragraphs 72–73).

¹¹ Paragraphs B39 and B40 of the Exposure Draft and paragraphs BC154–BC158 of the Basis for Conclusions accompanying the Exposure Draft.

Is the boundary of a regulatory agreement determined by the boundary of a regulatory period?

28. Some respondents said it was unclear whether the boundary of a regulatory agreement is limited to the current regulatory period or whether the boundary can go beyond the current regulatory period (paragraph 18). We think that previous discussions on what constitutes a regulatory agreement are relevant when considering these comments.
29. The Exposure Draft defines a regulatory agreement as ‘a set of enforceable rights and obligations that determine a regulated rate to be applied in contracts with customers.’
30. The IASB considered requests for clarification about the regulatory agreement in its redeliberations on the scope proposals in February 2022.¹² A few respondents commenting on the scope proposals had asked whether a regulatory agreement:
- (a) needs to be a standalone arrangement (for example, a contractual licencing agreement), or whether it can refer to rights and obligations specified by legislation or regulations (that is, rights and obligations subsumed within a regulatory framework).
 - (b) refers to the broader regulatory framework that entitles an entity to charge a regulated rate (for example, a contractual licencing agreement or a regulatory framework established by law), or whether it refers to the regulatory period (that is, the period over which the regulated rate is required to be applied).
31. In February 2022 staff expressed the following views:
- (a) the Exposure Draft is sufficiently clear that the set of enforceable rights and enforceable obligations that determine a regulated rate can be established in standalone arrangements (such as contractual licensing agreements or service concession arrangements), or can be specified by statute, legislation or regulations (paragraph 8 of the Exposure Draft).

¹² [Agenda Paper 9B](#) discussed at the IASB February 2022 meeting.

- (b) the proposed definition of a regulatory agreement would not limit the set of enforceable rights and enforceable obligations to only those that would result in adjustments to the regulated rates charged within the current regulatory period. Instead, that definition would also encompass those enforceable rights and enforceable obligations that arise from a broader regulatory framework that entitles an entity to charge a regulated rate beyond the current regulatory period.
- (c) some regulatory agreements give rise to enforceable rights and enforceable obligations that result in adjustments to future regulated rates beyond the current regulatory period (for example, a regulatory agreement may allow adjustments to future regulated rates for recovery of pension costs only when cash is paid in future regulatory periods). Financial statements should reflect enforceable rights and enforceable obligations to adjust future regulated rates, even if the adjustments are made to regulated rates beyond the current regulatory period.
32. The IASB agreed with the staff views in paragraph 31 and tentatively decided to clarify in the final Standard that a regulatory agreement may include enforceable rights and enforceable obligations to adjust the regulated rate beyond the current regulatory period.¹³ This tentative decision clarifies that the boundary of the regulatory agreement does not refer to the end of the current regulatory period, and that the boundary is not determined by the end of the current regulatory period. Given the IASB's tentative decision in February 2022, we do not think any further action is required in relation to comments about whether the boundary of a regulatory agreement is limited to the current regulatory period.

Question for the IASB

1. Does the IASB have any comments on the staff analysis in paragraphs 28–32?

¹³IASB Update for February 2022 can be found [here](#)

Determining the boundary of a regulatory agreement

33. According to the feedback received, some respondents were unable to conclude how the proposals in the Exposure Draft would be applied to their long-term regulatory assets or regulatory liabilities. They expressed concern that the boundary proposals in the Exposure Draft would preclude some of the future cash flows arising from these long-term regulatory assets or regulatory liabilities from being included in their related measurements.
34. Some respondents suggested that the boundary of a regulatory agreement should be at least as long as the licence period, but others implied the boundary of the regulatory agreement should go beyond the period of the licence (paragraph 19).
35. We think that the end of a licence would be an important factor for an entity to consider when determining the boundary of a regulatory agreement. However, a contractual licence may not be the only source of enforceable rights and enforceable obligations—legislation or other agreements could establish enforceable rights and enforceable obligations that may affect the boundary of a regulatory agreement (paragraph 45). In addition, the Exposure Draft proposed that other factors may affect boundary determinations:
- (a) mechanisms that stipulate that an entity would be compensated or charged for any outstanding amounts of regulatory assets or regulatory liabilities if the regulatory agreement is cancelled (paragraphs B35–B38 in the Exposure Draft)—paragraphs 36–47; and
 - (b) rights to renew or cancel the agreements (paragraphs B30–B34 in the Exposure Draft)—paragraphs 48–65.

Mechanisms that stipulate compensation on cancellation

36. Paragraphs B35–B38 of the Exposure Draft propose that compensation for cancellation of a regulatory agreement affects the boundary of the agreement—that is, which cash flows would fall within the boundary—if an entity concludes it has a present enforceable right or present enforceable obligation to be compensated or

charged for any outstanding amounts of regulatory assets or regulatory liabilities if the regulatory agreement is cancelled. The Exposure Draft says that such cash flows fall within the boundary of the regulatory agreement if they ‘depend solely on the monetary amount of unrecovered regulatory assets or unfulfilled regulatory liabilities’.¹⁴ The rationale for this proposal is set out in paragraphs BC151–BC152 of the Basis for Conclusions accompanying the Exposure Draft (paragraph 14). A few respondents asked the IASB to clarify the interaction between these proposals and the determination of the boundary of a regulatory agreement (paragraph 21(b)).

37. The analysis in this section is structured as follows:
- (a) application of guidance in paragraphs B35–B38 for compensation on termination of a regulatory agreement rather than on cancellation (paragraph 38);
 - (b) assessing the existence of an enforceable present right to receive compensation (obligation to pay compensation)—(paragraphs 39–46); and
 - (c) staff recommendation (paragraph 47).

Compensation on termination of a regulatory agreement rather than on cancellation

38. The Exposure Draft addresses cash flows from compensation or charges on *cancellation* of a regulatory agreement. However, there may be other situations (for example, non-renewal of an agreement or termination of an agreement by mutual consent) in which an entity is entitled to compensation for unrecovered regulatory assets or obliged to pay compensation for unfulfilled regulatory liabilities. We think the final Standard should clarify that the proposals in the Exposure Draft regarding the inclusion of cash flows from compensation for cancellation in the boundary of a regulatory agreement also apply to other circumstances in which an entity has a right to receive compensation (obligation to pay compensation) for unrecovered regulatory assets (unfulfilled regulatory liabilities) on termination of the agreement.

¹⁴ Paragraph B36 of the Exposure Draft.

Assessing the existence of an enforceable present right to receive compensation (obligation to pay compensation)

39. We think assessing the existence of an enforceable present right to receive compensation (obligation to pay compensation) for any outstanding amounts of regulatory assets or regulatory liabilities can be helpful:
- (a) when an entity has long-term regulatory assets or regulatory liabilities and needs to determine which cash flows to consider when measuring those assets and liabilities; or
 - (b) when the regulatory agreement does not have explicit renewal or cancellation rights.
40. A few respondents queried whether rights to compensation had to be explicit rights in a licence agreement to be enforceable. A few respondents also said their regulatory agreements do not include compensation rights.
41. Although the proposed guidance on the boundary in the Exposure Draft requires that rights to compensation be enforceable, the Exposure Draft does not require that rights to compensation be contractual, nor does it require that rights be explicit. An entity could have enforceable rights to compensation through legislation or there may be legal precedents that supplement or override contractual terms.
42. In February 2023 the IASB discussed whether an entity could have an enforceable present right for a portion of a long-term performance incentive before the end of the performance period.¹⁵ The IASB discussed that if events beyond the control of the entity led to the termination of the regulatory agreement before the end of the performance period, the entity might have an enforceable present right for an amount of compensation that relates to its performance up to the termination of the agreement.
43. Similarly, an entity could assess whether it has an enforceable present right (obligation) for the amounts outstanding relating to long-term regulatory assets (regulatory liabilities) whether or not the regulatory agreement states explicitly the

¹⁵ [Agenda Paper 9C](#) discussed at the IASB February 2023 meeting.

- entity's compensation rights (obligations) on termination for reasons other than the entity failing to perform as promised.
44. In February 2023, the IASB tentatively decided to help entities assessing the existence of enforceable present rights or enforceable present obligations for long-term performance incentives by incorporating, in the final Standard, the principles in paragraph 35(c) of IFRS 15 that relate to an entity's right to payment for performance completed to date.¹⁶ We think those principles could also help entities assess the existence of enforceable present rights (obligations) to compensation (to pay compensation) for unrecovered regulatory assets (unfulfilled regulatory liabilities).
45. Paragraph 35(c) of IFRS 15 requires that entities assess whether they have an enforceable right to payment for performance completed to date. Paragraphs 37, B10 and B12 of IFRS 15 also require that, in assessing the existence and enforceability of a right to payment for performance completed to date, an entity considers:
- (a) whether it has an enforceable right to demand or retain payment for performance completed to date if the contract were to be terminated before completion for reasons other than the entity's failure to perform as promised.
 - (b) the contractual terms as well as any legislation or legal precedent that could supplement or override those contractual terms.
46. Incorporating the principles of paragraph 35(c) of IFRS 15 in the final Standard would not necessarily lead entities to conclude that they should include the full amount of compensation for unrecovered regulatory assets or unfulfilled regulatory liabilities in the measurement of regulatory assets and regulatory liabilities. Paragraph B37 of the Exposure Draft proposes that an entity consider whether 'the cash flows arising from unrecovered regulatory assets or unfulfilled regulatory liabilities would differ depending on whether the regulatory agreement continues or is cancelled [...]'. If the cash flows would differ, the cash flows are uncertain, and an entity would need to estimate them using the method that would better predict them—being the most likely

¹⁶ IASB Update for February 2023 can be found [here](#).

amount method or the expected value method. We think the guidance in paragraph B37 of the Exposure Draft is appropriate and we recommend retaining that guidance.

47. We recommend that the final Accounting Standard:
- (a) retain the proposed guidance on compensation for cancellation of a regulatory agreement in paragraphs B35–B38 of the Exposure Draft, but clarify that that guidance also applies to other circumstances in which termination occurs and an entity has a right to receive compensation for unrecovered regulatory assets or an obligation to pay compensation for unfulfilled regulatory liabilities (paragraph 38); and
 - (b) include the principles underlying an entity’s right to payment for performance completed to date, as described in paragraph 35(c) of IFRS 15, to help an entity assess the existence of an enforceable present right to receive compensation (enforceable present obligation to pay compensation) for unrecovered regulatory assets (unfulfilled regulatory liabilities) when the regulatory agreement does not include an explicit right to receive compensation (obligation to pay compensation)—(paragraphs 39–46).

Question for the IASB

2. Does the IASB agree with the recommendations in paragraph 47?

Rights to renew or cancel a regulatory agreement

48. The Exposure Draft proposes that enforceable rights to renew or cancel the regulatory agreement may affect the boundary determination. This section considers the feedback from respondents and assesses whether the proposals remain appropriate.
49. The analysis in this section is structured as follows:
- (a) principles (paragraphs 50–51);
 - (b) implicit renewal or cancellation rights (paragraphs 52–55);

- (c) practical ability to renew (paragraphs 56–58);
- (d) regulatory recovery period or useful lives of assets (paragraph 61);
- (e) going concern assumption (paragraph 62);
- (f) assessments while agreements are being renewed (paragraphs 63–64); and
- (g) staff recommendations (paragraph 65).

Principles

50. The proposed guidance in the Exposure Draft on enforceable rights to renew or cancel a regulatory agreement is based on two main principles:
- (a) rights to renew or cancel need to be *substantive*. For a right to be substantive, the holder must have the *practical ability* to exercise that right. Periods covered by renewal options may fall within the boundary of a regulatory agreement if an entity has an enforceable right to renew the agreement and ‘no other party has an enforceable right to prevent the renewal without arranging compensation for the entity to recover its regulatory asset.’¹⁷ An entity would consider its enforceable right to renew an agreement unless there are no circumstances in which it would have the practical ability to exercise that right.¹⁸
 - (b) assessments about whether a holder has the practical ability to exercise a right do *not* consider *whether it is likely* that the holder will exercise the right, nor *whether the holder intends* to exercise the right.¹⁹
51. We think that the proposed guidance on enforceable rights to renew or cancel is appropriate and consistent with the definitions of assets and liabilities in the *Conceptual Framework*. These definitions focus on whether rights and obligations exist, not on determining how likely it is that they will lead to cash flows. For example, there could be a high probability that an agreement will be renewed and the

¹⁷ Paragraph B31 of the Exposure Draft.

¹⁸ Paragraph B33 of the Exposure Draft.

¹⁹ Paragraph BC146 of the Basis for Conclusions accompanying the Exposure Draft.

entity will receive future cash flows but this does not necessarily mean that the entity has a right to renew. The IASB decided to use that same focus in the proposed definitions of regulatory assets and regulatory liabilities and its proposals to determine the cash flows that would fall within the boundary of a regulatory agreement (paragraph 11). Consequently, we recommend retaining the principles on which the proposed guidance on enforceable rights to renew or cancel a regulatory agreement is based.

Implicit renewal or cancellation rights

52. The proposed guidance in the Exposure Draft does not address circumstances when regulatory agreements do not have *explicit* renewal or cancellation rights. However, a few respondents said that their regulatory agreements do not have explicit renewal or cancellation rights, or do not include explicit compensation mechanisms for non-renewal (paragraph 23).
53. Paragraph 4.60 of the *Conceptual Framework* states ‘that all terms in a contract—whether explicit or implicit—are considered unless they have no substance.’
54. Based on the feedback received on the Exposure Draft, explicit renewal or cancellation terms or options may be less common in the case of entities running their operations with licences and more common in the case of entities running their operations through service concession arrangements. However, some respondents have said that the expectation is that licences to operate will continue to be renewed because it would be impracticable that another entity would take over these activities. For example, in many cases, entities are the owners of the assets that are used to supply the goods or services. If the regulator decided to change the supplier, the regulator may put the security of the system and the stability of the supply at risk. From the entity’s perspective, a regulator’s decision to change supplier would mean that it would most likely have to sell some or all of its assets to the new supplier and would cease to trade.
55. We think that in determining the boundary of a regulatory agreement, in the absence of explicit renewal or cancellation terms, an entity should assess whether it has an

implicit right to renew. It could do this by assessing whether it has the practical ability to renew the regulatory agreement (with any other party not having the practical ability to cancel the regulatory agreement). Paragraph B34 of the Exposure Draft explains that the holder of a right (to cancel) may not have the practical ability to exercise the right if, for example exercising that right would lead to major disruption in the provision of an essential public service. Similarly, an entity could argue that it has an implicit right to renew an agreement if renewing the regulatory agreement is in all parties' best interests because it would otherwise lead to major disruption in the provision of an essential public service. Consequently, we recommend the final Standard clarify that rights to renew or cancel an agreement may be explicit or implicit.

Practical ability to renew

56. If an entity concludes it has a practical ability to renew the regulatory agreement outlined in a contractual licencing arrangement (and that no other party has the practical ability to cancel the agreement), the cash flows occurring in the period after renewal would fall within the boundary.
57. Some regulatory assets (for example, regulatory assets associated with pension obligations) have particularly long lives and might have cash flows that are expected to occur beyond the current licence period and the next licence period. To address those cases, the boundary guidance would need to be sufficiently clear to assist entities measuring such regulatory assets and making boundary determinations over more than one licence renewal. We think that when considering whether the cash flows associated with long-term regulatory assets fall within the boundary of a regulatory agreement, the final Standard should require an entity to consider how its current expectations of future conditions would affect its practical ability to renew (and other parties' practical ability to cancel) the licence. Its assessment of future conditions would include consideration of:
 - (a) changes in the regulatory and legal framework;

- (b) changes in market structure (for example, the likelihood of increased competition that could challenge an entity's monopolistic position);
 - (c) technological, economic and political changes; and
 - (d) other relevant conditions.
58. As mentioned in paragraph 21, some respondents said that licences can be perpetual. In subsequent follow-up one respondent confirmed that its licences are perpetual unless there is a breach in any of the conditions of the licence. That is, the expectation is that if the entity operates the activities in accordance with the requirements in the licence, the licence will be renewed. Even though perpetual licences may be regarded as indefinite, we do not think that an entity's practical ability to renew (with no other parties having the practical ability to cancel) a licence would be indefinite—economic, political and technological conditions change and any of these changes could trigger regulatory and legal framework changes affecting the parties' practical ability to renew or cancel.
59. We think that an entity with a perpetual licence should be required to apply the same requirements as other entities in determining the boundary of the regulatory agreement. That is, it should be required to consider how its current expectations of future conditions would affect its practical ability to renew (and other parties' practical ability to cancel) the licence (paragraph 57).
60. We think that an entity should be required to disclose the significant judgements made in determining the boundary of the regulatory agreement, including its assessment of its practical ability to renew an agreement. We will consider disclosure of judgements made in determining the boundary when redeliberating the disclosure proposals at a future meeting.

Regulatory recovery periods or useful lives of assets

61. A few respondents suggested linking the boundary with the remaining regulatory period (or remaining useful lives) of the assets (paragraph 23(b)). Different factors affect the determination of the regulatory recovery period of the assets. For example, when determining the regulatory recovery period, a regulator may not only consider

assets' useful lives but also financial needs of the entities and protection of customers. This means that that regulatory recovery period may not always be directly linked to the boundary of the regulatory agreement. Instead, it may be influenced by considerations that aim to ensure that the regulated rates set in a specified regulatory period safeguard the financial viability of the entity and protect customers. We think that the assessment of whether an entity would have an enforceable present right (obligation) to receive compensation (to pay compensation) for outstanding unrecoverable regulatory assets (unfulfilled regulatory liabilities) is a more appropriate way of addressing the issues raised by respondents than linking the boundary to the remaining regulatory period or remaining useful lives of the assets.

Going concern assumption

62. A few respondents suggested linking the boundary of the regulatory agreement with management's assessment of an entity's ability to continue to operate as a going concern (paragraph 23(c)). We think in many cases the discontinuation of the regulated activities would mean that the entity's going concern assumptions are also challenged. However, this may not always be the case—an entity whose activities are being deregulated might still be able to continue as a going concern. For example, an entity's regulated activities might form only part of its activities, or the entity might be able to continue operating its regulated activities on a non-regulated basis. Consequently, the going concern assessment may not always provide a good indication of the boundary of the regulatory agreement.

Assessments while agreements are being renewed

63. A few respondents requested guidance on boundary assessments during the time that a regulatory agreement is being renewed, particularly if an entity is required to continue supplying goods and services during that time.
64. We think an entity's rights and obligations during the time that a regulatory agreement is being renewed will depend on facts and circumstances and, consequently, it would not be appropriate to add further guidance. For example, there may be clauses in the regulatory agreement that stipulate that during the time the agreement is being

renewed, terms and conditions in the existing agreement remain. In such cases, there would be no effects on an entity's enforceable rights (obligations) to add (deduct) amounts to (from) future regulated rates during the renegotiation period. An entity would have to consider its specific facts and circumstances and assess whether the period in which a regulatory agreement is being renewed affects its rights and obligations. Consequently, we do not think the final Standard needs to include specific guidance to deal with this matter.

Staff recommendations

65. We recommend that the final Accounting Standard:
- (a) retain the proposed guidance on rights to renew or cancel a regulatory agreement in paragraphs B31–B34 of the Exposure Draft (paragraph 51), but clarify that rights to renew or cancel an agreement may be explicit or implicit (paragraph 55); and
 - (b) require an entity to consider how its current expectations of future conditions would affect its practical ability to renew (and other parties' practical ability to cancel) a regulatory agreement when determining the boundary of a regulatory agreement (paragraph 57).

Question for the IASB

- 3. Does the IASB have any comments on the analysis in paragraphs 50–64?
- 4. Does the IASB agree with the recommendations in paragraph 65?

Specifying the process for identifying and measuring the cash flows that are within the boundary

66. The Exposure Draft discusses the factors that affect the determination of the boundary of a regulatory agreement but does not specify the order in which those factors should be considered.
67. We think the intention of the Exposure Draft was for entities to first assess whether they have the practical ability to renew a regulatory agreement (with no other parties

having practical ability to cancel the agreement). Only at the point at which the entity concludes it has no practical ability to renew, would the entity assess its right (obligation) to receive (pay) compensation on termination of the agreement.

68. However, we think that if an entity has a right (obligation) to receive (pay) compensation for unrecovered regulatory assets (unfulfilled regulatory liabilities) that would cover 100 percent of any unrecovered (unfulfilled) cash flows on termination, it is unnecessary for the entity to assess its practical ability to renew the agreement (no other parties having the practical ability to cancel the agreement). Whether or not the regulatory agreement is renewed (cancelled) does not affect the cash flows that the entity will receive (pay).
69. When an entity has a right (obligation) to receive (pay) compensation for less than 100 percent of the unrecovered regulatory assets (unfulfilled regulatory liabilities), we think two options arise:

- (a) Option 1—require an entity:
- (i) first to consider its practical ability to renew (with no other parties having the practical ability to cancel) the regulatory agreement. The entity would include within the boundary of the regulatory agreement cash flows up to the point the entity no longer has the practical ability to renew the agreement.
 - (ii) second to consider the cash flows arising from its right (obligation) to receive (pay) compensation for less than 100 percent of the unrecovered regulatory assets (unfulfilled regulatory liabilities) at the point the entity no longer has the practical ability to renew as within the boundary of the agreement. The entity would measure those cash flows applying paragraph B37 of the Exposure Draft.

Option 1 is illustrated in Flow chart 1 in Appendix A.

- (b) Option 2—require an entity to consider the cash flows arising from its right (obligation) to receive (pay) compensation for less than 100 percent of the unrecovered regulatory assets (unfulfilled regulatory liabilities) within the

boundary of the regulatory agreement and measure those cash flows applying paragraph B37 of the Exposure Draft. If the entity concludes it does not have a right (obligation) to receive (pay) for compensation for unrecoverable regulatory assets (unfilled regulatory liabilities), the entity would consider whether it has practical ability to renew the regulatory agreement and include the cash flows up to the point the entity no longer has practical ability to renew within the boundary.

Option 2 is illustrated in Flow chart 2 in Appendix A.

70. We think both options would give rise to the *same cash flow stream* being included within the boundary of the regulatory agreement (that is the cash flows that would be included in the measurement of a regulatory asset or regulatory liability) but these options could lead to these *cash flows being measured differently*. Appendix B includes an example illustrating this possibility.
71. Our recommendation is that the final Accounting Standard follows the process described in Option 1 because it:
- (a) avoids the need for an entity to assess its practical ability to renew a regulatory agreement when it has a right (obligation) to receive (pay) compensation for 100 percent of unrecoverable regulatory assets (unfilled regulatory liabilities); and
 - (b) retains the proposals in the Exposure Draft for both the cash flows that should be included within the boundary and how these cash flows should be measured when the entity would receive (pay) compensation for less than 100 percent of unrecoverable regulatory assets (unfilled regulatory liabilities) on termination.

Question for the IASB

5. Does the IASB agree with the recommendation in paragraph 71?

Reassessment and changes to the boundary

72. The Exposure Draft proposes that an entity reassesses the boundary of a regulatory agreement at the end of each reporting period and updates the carrying amount of regulatory assets or regulatory liabilities accordingly.²⁰ Respondents did not raise concerns about these proposals or the rationale for the proposals (paragraph 26). We think the proposals remain appropriate.
73. We recommend that the final Accounting Standard retain the proposals in paragraphs B39–B40 of the Exposure Draft on reassessments and changes to the boundary.

Question for the IASB

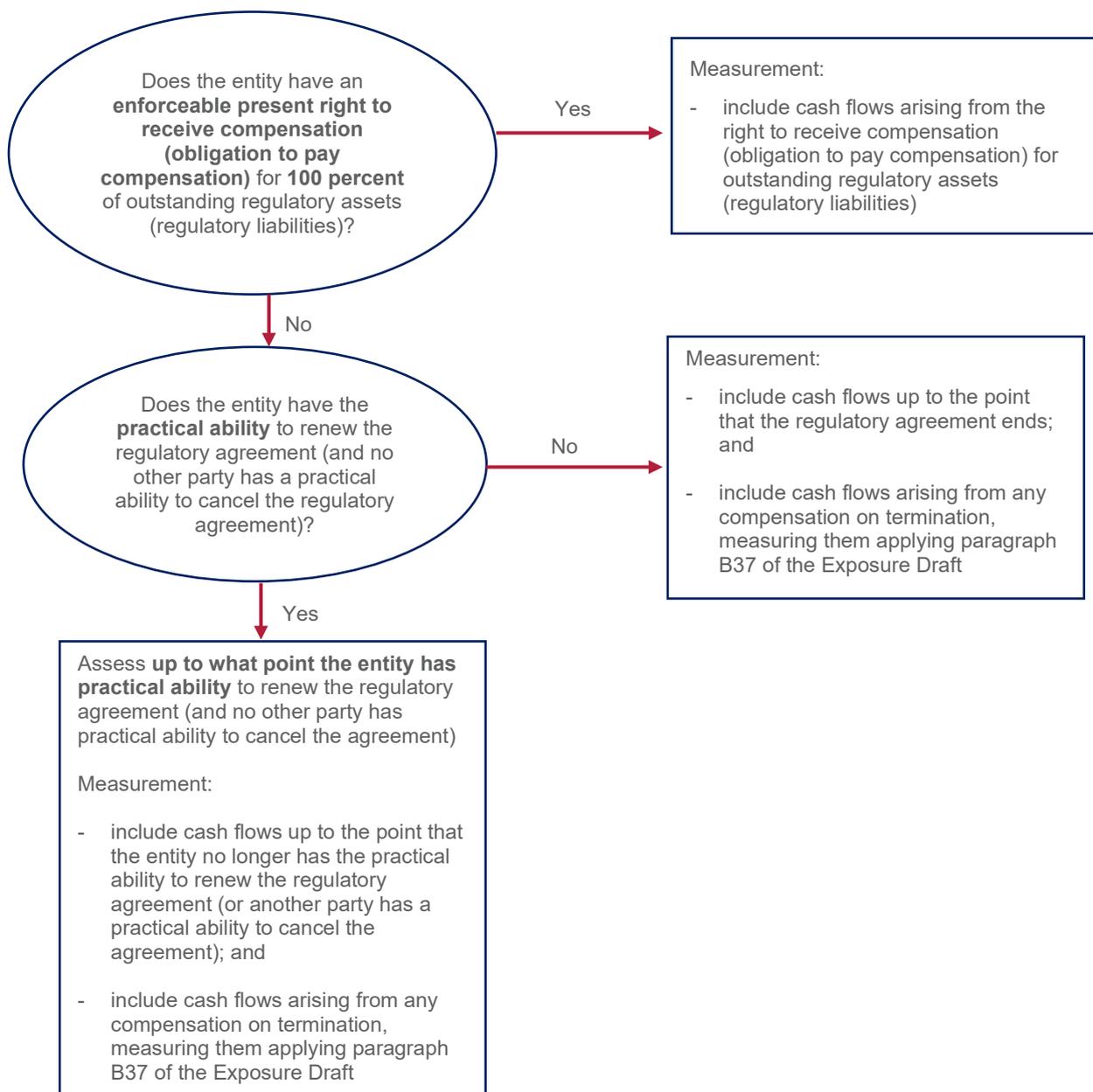
6. Does the IASB agree with the recommendation in paragraph 73?

²⁰ Paragraphs B39–B40 of the Exposure Draft.

Appendix A—Boundary determination flow chart

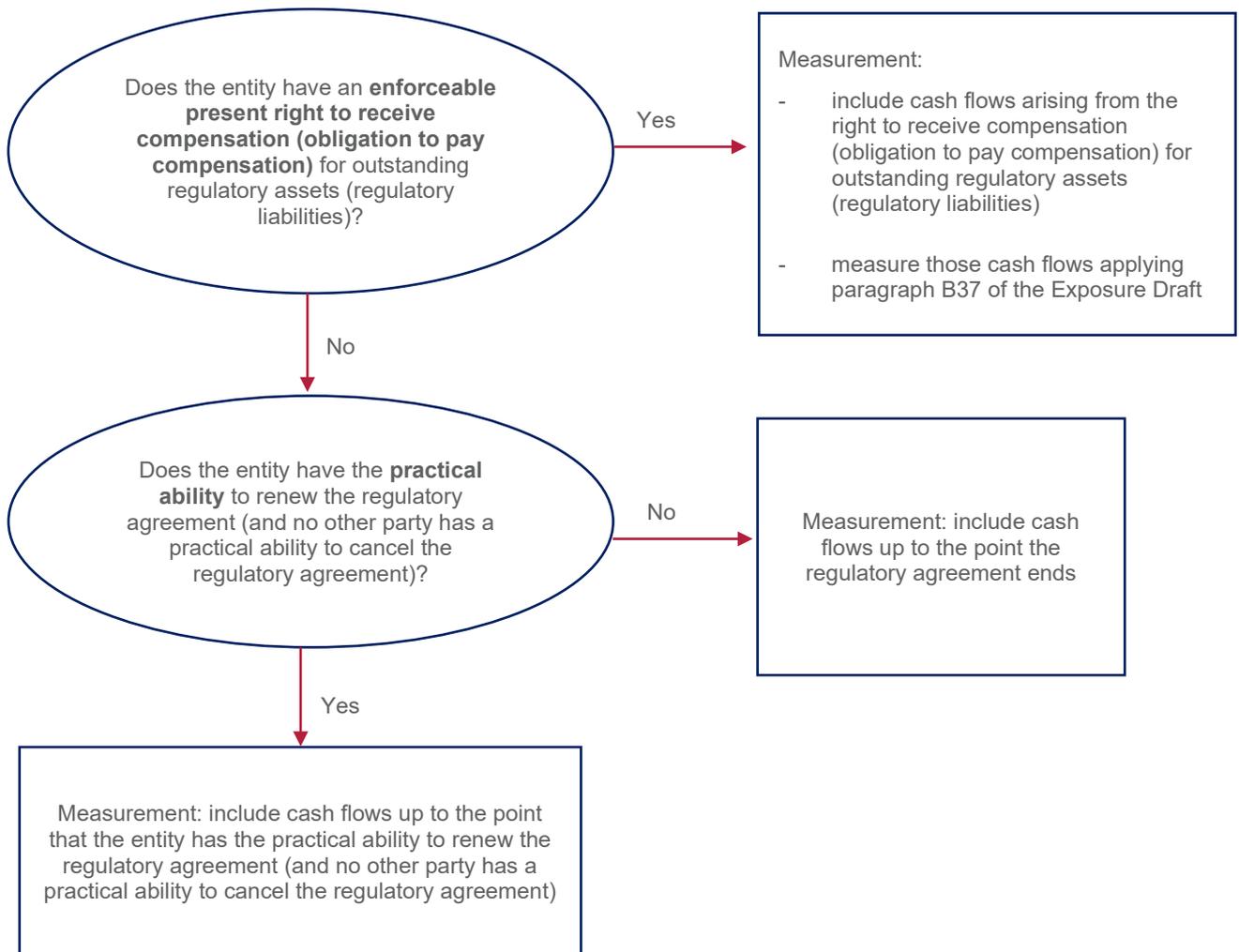
A1. Flow chart 1 sets out the recommended process by which an entity would **identify and measure the cash flows that are within the boundary** of a regulatory agreement (Option 1 in the paper).

Flow chart 1



A2. Flow chart 2 illustrates Option 2 in the paper.

Flow chart 2



Appendix B—Numerical example that illustrates Option 1 and Option 2 (paragraphs 66–71 of the paper)

- B1. Assume an entity recognises an item of expense amounting to CU75²¹ in Year 0. The regulator allows the entity to recover the expense over 75 years (that is, CU1 per year). To simplify, the example does not include time value of money considerations. The entity has a licence to operate its activities for a period of 25 years, renewable at the end of each period.
- B2. Assume:
- (a) the entity considers the terms of the agreement, current legislation and legal precedents (paragraph 45) and concludes it has an enforceable present right to compensation for 80 percent of the outstanding balance of the regulatory asset in the event the regulatory agreement terminates for reasons other than the entity's failure to perform.
 - (b) the entity assesses its practical ability to renew the agreement in Years 25 and 50 considering its current expectations of future conditions (paragraph 57). The entity concludes it would have the practical ability to renew the agreement up to Year 50.
- B3. Applying **Option 1** the entity would measure the regulatory asset in Year 0 at CU73.75 considering:
- (a) its practical ability to renew up to Year 50—that would mean that the entity would include CU50 within the boundary (that is, within the measurement of the regulatory asset); and
 - (b) its right to compensation for 80% of the outstanding balance of CU25 in Year 50—the entity concludes that balance falls within the boundary but it needs to be measured applying paragraph B37 of the Exposure Draft. The entity estimates there is a 25 percent probability of cancellation in Years 51–

²¹ Monetary amounts are denominated in 'currency units' (CU).

75. The entity uses the expected value method and concludes it should add an additional CU23.75 to the measurement of the regulatory asset for its right for compensation on the outstanding balance of the regulatory asset in Year 50.

- B4. Applying **Option 2** the entity would measure the regulatory asset in Year 0 at CU73.25, considering the entity:
- (a) estimates there is a 5 percent probability of termination in Years 1–50 and a 25 percent probability of termination in Years 51–75; and
 - (b) uses the expected value method when applying paragraph B37 of the Exposure Draft.
- B5. Table 1 illustrates the computations above.

Table 1—Compensation for 80% of outstanding balance				
<i>In CU</i>	Year 0	Years 1 - 25	Years 26 - 50	Years 51 - 75
Expense	75	25	25	25
Option 1				
Entity has practical ability to renew agreement up to year 50	50			
Entity has right to compensation for 80% outstanding balance	23.75			
Regulatory asset	73.75			
Option 2				
Scenario 1 - Regulatory asset is recovered through compensation on termination (80% outstanding amount)	<i>Probability</i>	0.05	0.05	0.25
	<i>Amounts</i>	20	20	20
Scenario 2 - Regulatory asset is recovered thorough rates charged	<i>Probability</i>	0.95	0.95	0.75
	<i>Amounts</i>	25	25	25
Regulatory asset	73.25	24.75	24.75	23.75

- B6. Had the entity selected the most likely amount method, both options would have resulted in the same measurement for the regulatory asset—that is, CU75.

Appendix C—Extracts from the Exposure Draft and IFRS 15

Extracts from the Exposure Draft

Boundary of a regulatory agreement

- B28 The boundary of a regulatory agreement determines which estimated future cash flows an entity includes in measuring a regulatory asset or regulatory liability (paragraphs 33–34). The boundary of a regulatory agreement is the latest future date at which an entity has:
- (a) an enforceable present right to recover a regulatory asset by increasing the regulated rate to be charged to customers; or
 - (b) an enforceable present obligation to fulfil a regulatory liability by decreasing the regulated rate to be charged to customers.
- B29 To illustrate the discussion in paragraph B28, assume that in 20X1 an entity incurred an input cost variance of CU100 that the entity cannot recover until 20X3. Assume also that the entity assessed at the end of 20X1 that it does not have an enforceable present right to increase regulated rates after the end of 20X2 to recover that variance. Thus, at the end of 20X1 the boundary of the regulatory agreement was the end of 20X2. Because the cash flows that could result from recovering that variance fall beyond the boundary of the regulatory agreement, the entity cannot include those cash flows in the measurement of any regulatory asset at the end of 20X1.
- B30 An entity's present right to increase the regulated rate at a future date is enforceable only if:
- (a) the regulatory agreement gives the entity the present right to supply goods or services at that future date; and
 - (b) no party apart from the entity has a right to cancel the regulatory agreement before that date without arranging compensation for the entity to recover its regulatory asset.
- B31 Sometimes an entity has an enforceable right to renew a regulatory agreement. Such a right can give the entity a present right to supply goods or services at a future date covered by that renewal if no other party has an enforceable right to prevent the renewal without arranging compensation for the entity to recover its regulatory asset.
- B32 An entity's present obligation to decrease the regulated rate at a future date is enforceable only if:
- (a) the regulatory agreement imposes upon the entity a present obligation to supply goods or services at that future date; and
 - (b) the entity has no right to cancel the regulatory agreement before that date without compensating another party (for example, an incoming supplier) that will fulfil the regulatory liability.
- B33 The boundary of a regulatory agreement can be affected by a right to renew the regulatory agreement or a right to cancel it. In assessing whether such a right affects the boundary of the regulatory agreement, an entity shall disregard a right held by any

party if there are no circumstances in which that party has the practical ability to exercise that right.

- B34 The holder of a right may not have the practical ability to exercise the right if, for example:
- (a) the economic consequences of exercising the right are significantly more adverse for the holder than the consequences of not exercising it;
 - (b) exercising a right held by an entity would lead to that entity being liquidated or ceasing to trade; or
 - (c) exercising a right held by a regulator would lead to major disruption in the provision of an essential public service.

Compensation for cancellation of a regulatory agreement

- B35 In some cases, a regulator or an entity has a right to cancel a regulatory agreement, but the regulatory agreement requires the regulator or the entity to provide or arrange compensation for regulatory assets that have not yet been recovered or for regulatory liabilities that have not yet been fulfilled. For example, the regulator, the entity or an incoming supplier of goods or services may be required to make a balancing payment.
- B36 To the extent that the amounts of receipts or payments of such compensation depend solely on the monetary amount of unrecovered regulatory assets or unfulfilled regulatory liabilities, they are cash flows within the boundary of the regulatory agreement.
- B37 If the cash flows arising from unrecovered regulatory assets or unfulfilled regulatory liabilities would differ depending on whether the regulatory agreement continues or is cancelled, the cash flows are uncertain and an entity shall apply the requirements in paragraph 39. For example, assume that the probability of cancellation is 10% and a regulatory agreement specifies that on cancellation the entity would receive compensation of CU90 for a regulatory asset with a carrying amount of CU100. Applying paragraph 39, the entity would conclude that the most likely amount is CU100 and the expected value is CU99. The entity would use whichever of these two estimates better predicts the future cash flows.
- B38 If a cancellation right has been exercised so that a right to receive cash or obligation to pay cash has arisen, that right or obligation is a financial asset or financial liability. In such a case, the entity shall derecognise the part of the regulatory asset or regulatory liability that no longer exists, and recognise and measure the financial asset or financial liability by applying other IFRS Standards, recognising any resulting difference in profit or loss.

Extracts from IFRS 15

- 35 An entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognises revenue over time, if one of the following criteria is met:
- (a) the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs (see paragraphs B3–B4);

- (b) the entity's performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced (see paragraph B5); or
 - (c) the entity's performance does not create an asset with an alternative use to the entity (see paragraph 36) **and the entity has an enforceable right to payment for performance completed to date** (see paragraph 37).
- ...
- 37 An entity shall consider the terms of the contract, **as well as any laws that apply to the contract**, when evaluating whether it has an enforceable right to payment for performance completed to date in accordance with paragraph 35(c). The right to payment for performance completed to date does not need to be for a fixed amount. However, at all times throughout the duration of the contract, the entity must be entitled to an amount that at least compensates the entity for performance completed to date if the contract is terminated by the customer or another party for reasons other than the entity's failure to perform as promised. Paragraphs B9–B13 provide guidance for assessing the existence and enforceability of a right to payment and whether an entity's right to payment would entitle the entity to be paid for its performance completed to date.
- ...
- B12 In assessing the existence and enforceability of a right to payment for performance completed to date, an entity shall consider the contractual terms **as well as any legislation or legal precedent that could supplement or override those contractual terms**. This would include an assessment of whether:
- (a) legislation, administrative practice or legal precedent confers upon the entity a right to payment for performance to date even though that right is not specified in the contract with the customer;
 - (b) relevant legal precedent indicates that similar rights to payment for performance completed to date in similar contracts have no binding legal effect; or
 - (c) an entity's customary business practices of choosing not to enforce a right to payment has resulted in the right being rendered unenforceable in that legal environment. However, notwithstanding that an entity may choose to waive its right to payment in similar contracts, an entity would continue to have a right to payment to date if, in the contract with the customer, its right to payment for performance to date remains enforceable.