January 2021

IFRS® Standards Exposure Draft ED/2021/1
Basis for Conclusions

Regulatory Assets and Regulatory Liabilities

Comments to be received by 30 July 2021

Comment deadline changed from 30 June 2021

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Basis for Conclusions on

Exposure Draft

Regulatory Assets and Regulatory Liabilities

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This Basis for Conclusions accompanies the Exposure Draft ED/2021/1 *Regulatory Assets and Regulatory Liabilities* (issued January 2021; see separate booklet). Comments need to be received by **30 July 2021** and should be submitted by email to commentletters@ifrs.org or online at https://www.ifrs.org/projects/open-for-comment/.

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ISBN for this part: 978-1-914113-03-1

ISBN for complete publication (three parts): 978-1-914113-01-7

Copies of Board publications may be ordered from the Foundation by emailing customerservices@ifrs.org or visiting our shop at https://shop.ifrs.org.

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Basis for Conclusions on Exposure Draft *Regulatory Assets and Regulatory Liabilities*

This Basis for Conclusions accompanies, but is not part of, Exposure Draft Regulatory Assets and Regulatory Liabilities. *It summarises the considerations of the International Accounting Standards Board (Board) when developing the Exposure Draft. Individual Board members gave greater weight to some factors than to others.*

Introduction

BC1 The Exposure Draft sets out proposals for the recognition, measurement, presentation and disclosure of regulatory assets and regulatory liabilities, and of regulatory income and regulatory expense. When finalised, these proposals would replace IFRS 14 *Regulatory Deferral Accounts*.

The need for the project and its history

BC2 Rate regulation can significantly affect the amount and timing of revenue, profit and cash flows resulting from an entity's rate-regulated activities.[1]

BC3 In 2005, many countries adopted IFRS Standards for the first time. In the lead up to this adoption, the Board and the IFRS Interpretations Committee received requests to clarify whether in financial statements prepared by applying IFRS Standards entities could or should recognise regulatory balances resulting from rate regulation.

BC4 The IFRS Interpretations Committee considered the requests and noted that some national accounting standards permitted or required entities to recognise such balances as assets and liabilities in some circumstances. Some of those national accounting standards were based on, or were similar to, the US standard SFAS 71 *Accounting for the Effects of Certain Types of Regulation*, published in 1982.[2] The IFRS Interpretations Committee concluded in 2005 that:

(a) the recognition criteria in SFAS 71 were not fully consistent with the recognition criteria in IFRS Standards. Consequently, the requirements in SFAS 71 were not indicative of the requirements in IFRS Standards.

(b) an entity should recognise only assets that qualified for recognition in accordance with the Board's *Framework* and with relevant IFRS Standards such as IAS 11 *Construction Contracts*, IAS 18 *Revenue*, IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*.[3, 4]

1 In this Basis for Conclusions, all references to revenue and expenses relate to revenue and expenses arising from rate-regulated activities, unless specified otherwise.

2 The guidance in SFAS 71, with subsequent amendments and related guidance, is now in Topic 980 *Regulated Operations* in the FASB *Accounting Standards Codification®*.

3 The reference is to the *Framework for the Preparation and Presentation of Financial Statements*, in effect when the IFRS Interpretations Committee discussed this matter.

4 In 2014, IFRS 15 *Revenue from Contracts with Customers* replaced IAS 11, IAS 18 and related IFRS Interpretations.

BC5 The IFRS Interpretations Committee's conclusion left unanswered questions about what rights or obligations created by rate regulation would qualify for recognition as assets or liabilities in accordance with the *Framework*. As a consequence of that conclusion, many entities stopped recognising regulatory balances as assets or liabilities in their financial statements prepared applying IFRS Standards. In 2008, the Board began a project on rate-regulated activities, acknowledging increased pressure to conclude on whether rate regulation creates any rights or obligations that could qualify for recognition as assets or liabilities.

BC6 The Board published an Exposure Draft *Rate-regulated Activities* in 2009 (2009 Exposure Draft), which proposed that entities should recognise regulatory balances arising from one type of rate regulation (commonly called cost-of-service regulation or return-on-rate-base regulation). That type of rate-regulation is similar to the type of regulation described in SFAS 71.

BC7 Many respondents to the 2009 Exposure Draft agreed with the proposals, but many other respondents disagreed with the proposals. The Board's subsequent discussions found no clear path to answering the fundamental question: do any regulatory balances meet the definitions of an asset or a liability in the *Framework*? Because of the diversity in views, and because it seemed unlikely that the fundamental question could be answered in a reasonable time, the Board suspended the project in September 2010 to focus on other priorities.

BC8 After considering feedback from its 2011 Agenda Consultation, in 2012 the Board added to its standard-setting agenda projects on:

(a) rate-regulated activities, acknowledging that the 2009 Exposure Draft and responses to it raised complex conceptual issues about identifying when rate-regulated activities may give rise to assets or liabilities.

(b) revising the *Conceptual Framework for Financial Reporting* (*Conceptual Framework*)—finalised in 2018. The Board noted that the outcome of that project would influence the outcome of the project on rate-regulated activities.

BC9 Around that time, the Board received requests from some jurisdictions to facilitate the timely adoption of IFRS Standards by rate-regulated entities in those jurisdictions by allowing those entities to continue using temporarily the accounting practices they were using then in reporting regulatory balances.

BC10 In response to those requests, in January 2014, the Board issued IFRS 14 *Regulatory Deferral Accounts*, as an interim Standard that would apply until the completion of the comprehensive project. IFRS 14 permits an entity to continue recognising regulatory deferral account balances when the entity adopts IFRS Standards for the first time, if specified conditions are met.[5] In developing IFRS 14, the Board did not attempt to decide whether those balances meet the definitions of an asset or a liability in the *Framework*.

5 'Regulatory deferral account balances' are defined in IFRS 14, which created that term. Paragraph BC57 includes this definition.

BC11 As the first stage in its more comprehensive project, in March 2013, the Board published a Request for Information *Rate Regulation* to identify the range of rate-regulatory schemes that might give rise to assets or liabilities.

BC12 The Board reviewed the responses to the Request for Information and researched the topic. In September 2014, the Board published a Discussion Paper *Reporting the Financial Effects of Rate Regulation* (Discussion Paper). That Discussion Paper described the common features of various types of rate regulation. It grouped features that seemed most likely to give rise to rights and obligations that meet the definitions of an asset and a liability in the *Framework*, and that are incremental to the assets and liabilities accounted for by applying IFRS Standards in effect at that time. The Board termed the type of rate regulation containing all those common features 'defined rate regulation'. These features are listed in paragraph BC79.

BC13 The Discussion Paper also discussed four possible accounting approaches for defined rate regulation. Paragraphs BC65–BC77 describe those approaches, respondents' views on them and the Board's reasons for not proposing any of those approaches.

BC14 Feedback from the Board's 2015 Agenda Consultation reinforced the Board's view that the Board should continue work on this project.

Development of the Exposure Draft

BC15 In developing the Exposure Draft, the Board considered the responses it received to the 2009 Exposure Draft, the Request for Information and the Discussion Paper. The Board also considered the *Conceptual Framework* and current requirements in IFRS Standards.

Consultative groups

BC16 The Board set up a Rate-regulated Activities Consultative Group which provided the Board with specialist input from a variety of perspectives, including those of users of financial statements, preparers, auditors and rate regulators.

BC17 The Board also received input from other groups, including the Accounting Standards Advisory Forum, the Capital Markets Advisory Committee, the Global Preparers Forum and the Emerging Economies Group.

World standard-setters

BC18 Participants in the 2017 World Standard-setters Conference reviewed case studies and provided input and reasoning on whether recognising regulatory assets and regulatory liabilities in those case studies would result in a more faithful representation of financial performance and whether those regulatory assets and regulatory liabilities were assets and liabilities under the *Framework*.

BC19 Participants suggested that in developing an accounting model for regulatory assets and regulatory liabilities, the Board should consider the suggestions summarised in Table BC1.

Table BC1 Suggestions by participants in the 2017 World Standard-setters Conference	
Suggestion	**Board's response**
Clarify how regulatory agreements differ from similar contracts.	The Exposure Draft defines 'regulatory agreement' and explains how regulatory assets and regulatory liabilities can exist (paragraphs 3–19 of the Exposure Draft and paragraphs BC36–BC57).
Clarify why IFRS 15 *Revenue from Contracts with Customers* does not apply.	IFRS 15 does not apply to a regulatory agreement as defined in the Exposure Draft, because such an agreement is not a contract with a customer. Furthermore, the proposals in the Exposure Draft would supplement information an entity already provides by applying IFRS 15 to contracts with its customers and would not change IFRS 15 (paragraphs BC73–BC77).
Clarify what regulatory assets and regulatory liabilities are.	Paragraphs BC36–BC47 discuss what regulatory assets and regulatory liabilities are.
Avoid creating a perception that the Board is starting with a desired outcome and then trying to justify it without conceptual reasoning.	The Board started its analysis by defining the problem it is trying to solve (paragraphs BC21–BC29). Guided by the *Conceptual Framework*, the Board has concluded that: (a) regulatory assets and regulatory liabilities meet the definitions of an asset and a liability (paragraphs BC36–BC57); and (b) accounting for regulatory assets and regulatory liabilities separately from the rest of a regulatory agreement would provide useful information (paragraphs BC58–BC62).

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Table BC1 Suggestions by participants in the 2017 World Standard-setters Conference	
Suggestion	**Board's response**
Clarify what view of financial performance drives the Board's proposals.	The discussion of the objective in the Exposure Draft refers to the need to provide information that enables users of financial statements to understand the relationship between an entity's revenue and expenses (paragraph 2 of the Exposure Draft). The proposed accounting model is based on the principle that an entity should reflect the total allowed compensation for goods or services supplied as part of its reported financial performance for the period in which those goods or services are supplied (paragraph 16 of the Exposure Draft).
Clarify whether an executory contract exists.	The Board does not view regulatory assets and regulatory liabilities as arising under a regulatory agreement that is analogous to an executory contract that is currently favourable or unfavourable (paragraph BC54).
Require separate presentation.	The Board proposes that entities should present as separate line items: regulatory assets and regulatory liabilities in the statement of financial position; and regulatory income or regulatory expense in the statement(s) of financial performance (paragraphs BC179–BC186).
Make sure the scope is appropriate.	Paragraphs BC78–BC86 explain the Board's reasons for its proposals on the scope of the proposed requirements.
Highlight the effect of changes made in revising the *Conceptual Framework* in 2018.	Analysing whether regulatory assets and regulatory liabilities met the definitions of an asset and a liability in the previous version of the *Conceptual Framework* would not help stakeholders understand the Board's proposals or its current thinking.

Overview of the proposed accounting model

BC20 This section discusses the following:

(a) what problem is the Board trying to solve? (see paragraphs BC21–BC29)

(b) features of the proposed model (see paragraphs BC30–BC35)

(c) what are regulatory assets and regulatory liabilities? (see paragraphs BC36–BC57)

(d) why account for regulatory assets and regulatory liabilities separately from other assets and liabilities? (see paragraphs BC58–BC62)

(e) how would the proposed model solve the problem? (see paragraphs BC63–BC64)

(f) other accounting approaches considered (see paragraphs BC65–BC77).

What problem is the Board trying to solve?

BC21 Users of financial statements make assessments of an entity's future cash flows. Generally, the most significant cash inflows and cash outflows are those that will arise from future revenue and future expenses. To make assessments of those cash flows, users of financial statements need some understanding of the relationship between an entity's revenue and expenses. The information an entity provides in its statement of profit or loss by applying IFRS 15 and other IFRS Standards enables users of financial statements to gain an understanding of that relationship and to make assessments of future cash flows. However, for an entity with regulatory assets or regulatory liabilities, gaining an understanding of that relationship is more difficult. This difficulty arises because when an entity has regulatory assets or regulatory liabilities, the information provided by applying IFRS 15 and other IFRS Standards is, in the Board's view, incomplete for the reasons given in paragraphs BC22–BC26.

BC22 Regulatory agreements that create regulatory assets and regulatory liabilities:

(a) specify or limit the amount of compensation to which an entity is entitled for goods or services supplied (described in the Exposure Draft as 'total allowed compensation'); and

(b) specify that part of the total allowed compensation for goods or services supplied in one period is charged to customers through the regulated rates (sometimes called prices or tariffs) for goods or services supplied in a different period (past or future).

BC23 All or most of the total allowed compensation for goods or services supplied is typically included in the regulated rates charged to customers—and hence in revenue—in the period when those goods or services are supplied. However, differences in timing can arise if a regulatory agreement includes part of the total allowed compensation for goods or services supplied in one period in determining the regulated rates for goods or services supplied in a different period (past or future).

BC24 When such differences in timing occur, an entity's statement of profit or loss for a period provides an incomplete picture of the relationship between revenue and expenses, because the amount of revenue recognised in that period by applying IFRS 15:

(a) does not include all of the total allowed compensation for the goods or services supplied in that period, because part of that total allowed compensation was already included in revenue in the past, or will be included in revenue in the future; or

(b) includes amounts that provide part of the total allowed compensation for goods or services supplied in a different period (past or future).

BC25 The following example (used in paragraphs 13–14 of the Exposure Draft) illustrates paragraphs BC23–BC24. Assume that an entity's regulated rate for goods or services supplied in 20X1 was based on estimated input costs of CU100, but by the end of that year the entity had recognised actual input costs in that year of CU120. Assume also that the regulatory agreement gives the entity the right to add the resulting under-recovery of CU20 of those input costs in determining the regulated rate for goods or services to be supplied in 20X2; and that all amounts included in determining the regulated rates for goods or services supplied in a period are included in revenue in that same period.[6]

BC26 Applying IFRS 15 and other IFRS Standards, the entity's statement of profit or loss for 20X1 includes revenue of CU100 and input costs of CU120. However, total allowed compensation for goods or services supplied in 20X1 includes compensation of CU120 for the actual input costs. Compensation for the under-recovery of input costs of CU20 in 20X1 will be charged to customers through the regulated rates for goods or services to be supplied in 20X2, and hence will be included in revenue in 20X2. That compensation of CU20 is part of the total allowed compensation for the goods or services supplied in 20X1, not for those supplied in 20X2.

BC27 When differences in timing occur as discussed in paragraphs BC23–BC26, the absence of information about them makes it difficult for users of financial statements to understand the fluctuations in the relationship between an entity's revenue and expenses from one period to another, and to understand to what extent those fluctuations were caused only by such differences in timing. Consequently, users of financial statements currently have insufficient information to understand the relationship between an entity's revenue and expenses, and so insufficient insight into the entity's prospects for future cash flows.

BC28 The Exposure Draft aims to give more complete information that enables users of financial statements to understand how such differences in timing affect the relationship between an entity's revenue and expenses. To do so, the objective of the Exposure Draft states that an entity's financial statements should provide relevant information that faithfully represents how regulatory

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

income and regulatory expense affect the entity's financial performance, and how regulatory assets and regulatory liabilities affect its financial position.

BC29 That information, together with information required by other IFRS Standards, would enable users of financial statements to understand that relationship as completely as they can when there are none of the differences in timing that would arise when part of the total allowed compensation for the goods or services supplied in a period is included in the regulated rates for goods or services supplied in a different period, and hence is reflected in revenue in a different period. In other words, users of financial statements would be able to understand that relationship as completely as they can when no regulatory assets or regulatory liabilities exist.

Features of the proposed model

BC30 To meet the objective described in paragraph BC28, the Board proposes an accounting model that would provide information about the differences in timing discussed in paragraphs BC23–BC26. That information would supplement the information that entities provide by applying IFRS 15 and other IFRS Standards. The accounting model is based on the principle that an entity should reflect the total allowed compensation for goods or services supplied as part of its reported financial performance for the period in which the entity supplies those goods or services.

BC31 The proposed model and the information provided by it have the following features:

(a) an entity would recognise a regulatory asset, and the associated regulatory income, if part of the total allowed compensation for goods or services the entity has already supplied will be included in revenue in the future.

(b) an entity would recognise a regulatory liability, and the associated regulatory expense, if the revenue the entity has already recognised includes an amount that will provide part of the total allowed compensation for goods or services that it will supply in the future.

(c) a regulatory asset or regulatory liability is an enforceable present right or enforceable present obligation to increase or decrease future regulated rates. The regulatory agreement determines that increase or decrease with the aim of producing a fixed or determinable amount of future cash flows. An entity would measure a regulatory asset or regulatory liability on a basis that reflects an estimate of those future cash flows. The entity would update those estimates at the end of each period.

(d) all the total allowed compensation for goods or services supplied in a period is revenue recognised by applying IFRS 15 in the same period or in a different period, or partly in the same period and partly in a different period. Moreover, all revenue recognised in a period by applying IFRS 15 is total allowed compensation for goods or services supplied in the same period or in a different period, or partly in the same period and partly in a different period.

(e) to compensate or charge an entity for the time lag until it recovers a regulatory asset or fulfils a regulatory liability, a regulatory agreement increases or decreases regulated rates by an additional amount, described in the Exposure Draft as regulatory interest. Over the life of the regulatory asset or regulatory liability, an entity would report regulatory interest income or regulatory interest expense as a separately disclosed component of regulatory income or regulatory expense.

(f) when an entity recovers a regulatory asset by increasing the regulated rates charged to customers, that increase is reflected in revenue (by applying IFRS 15). At the same time, the entity would:

(i) recognise regulatory expense to depict the amount included in revenue recognised in the current period that provides part of the total allowed compensation for goods or services that the entity supplied in past periods; and

(ii) decrease the carrying amount of the regulatory asset to depict the entity's recovery of part or all of that regulatory asset.

(g) similarly, when an entity fulfils a regulatory liability by decreasing the regulated rates charged to customers, that decrease is reflected in revenue (by applying IFRS 15). At the same time, the entity would:

(i) recognise regulatory income to depict the part of the total allowed compensation for the goods or services supplied in the current period that was included in revenue in past periods; and

(ii) decrease the carrying amount of the regulatory liability to depict the entity's fulfilment of part or all of that regulatory liability.

(h) regulatory assets are rights to increase future regulated rates and regulatory liabilities are obligations to decrease those rates. Because they do not affect the amount of revenue in the current period, regulatory income and regulatory expense would not be presented as part of revenue. Furthermore, because regulatory assets and regulatory liabilities will affect the amount of revenue that an entity recognises in future periods by applying IFRS 15, all regulatory income minus all regulatory expense would be presented in a separate line item immediately below revenue.[7]

BC32 In the example given in paragraph BC25 the entity would recognise:

(a) revenue of CU100, regulatory income of CU20 and input costs of CU120 in 20X1. The entity would also recognise a regulatory asset of CU20.

7 In limited circumstances, some regulatory income or regulatory expense would be presented in other comprehensive income (paragraphs BC183–BC186).

(b) revenue of CU20 and regulatory expense of CU20 in 20X2, when the entity recovers the regulatory asset by charging customers an increased regulated rate. The entity would also derecognise the regulatory asset of CU20.[8]

BC33 Unlike some existing accounting approaches for reporting regulatory balances, the proposed model does not involve the deferral of costs. Instead, the model focuses on increases in future regulated rates because of goods or services already supplied and on decreases in future regulated rates because of revenue already recognised. Moreover, the measurement of regulatory assets and regulatory liabilities is based on total allowed compensation, which typically includes not only the recovery of costs but also a profit component.

BC34 To a large extent, the model would use inputs that the Board expects an entity already needs to gather and process in determining regulated rates.

BC35 Regulatory assets and regulatory liabilities are only a subgroup of the rights and obligations created by a regulatory agreement. An entity would recognise the other rights and obligations created by the regulatory agreement only if another IFRS Standard permits or requires their recognition. Applying other IFRS Standards provides users of financial statements with useful information about the effects of those other rights and obligations, regardless of whether they are recognised as assets or liabilities. The proposals in the Exposure Draft would not affect the requirements in other IFRS Standards.

What are regulatory assets and regulatory liabilities?

BC36 This subsection considers the following questions:

(a) does a regulatory asset meet the definition of an asset in the *Conceptual Framework*?

(b) does a regulatory liability meet the definition of a liability in the *Conceptual Framework*?

(c) can an asset or liability exist if there is outcome uncertainty?

(d) what type of right or obligation is a regulatory asset or regulatory liability?

(e) why not use the definition of a 'regulatory deferral account balance' in IFRS 14?

Does a regulatory asset meet the definition of an asset in the *Conceptual Framework*?

BC37 The Exposure Draft defines a regulatory asset as an enforceable present right, created by a regulatory agreement, to add an amount in determining a regulated rate to be charged to customers in future periods because part of the total allowed compensation for goods or services already supplied will be included in revenue in the future.

8 For simplicity, this example ignores regulatory interest.

BC38 The *Conceptual Framework* defines an asset as a present economic resource controlled by an entity as a result of past events. It defines an economic resource as a right that has the potential to produce economic benefits. It also says that:

> 4.20 An entity controls an economic resource if it has the present ability to direct the use of the economic resource and obtain the economic benefits that may flow from it. Control includes the present ability to prevent other parties from directing the use of the economic resource and from obtaining the economic benefits that may flow from it. It follows that, if one party controls an economic resource, no other party controls that resource.
>
> 4.21 An entity has the present ability to direct the use of an economic resource if it has the right to deploy that economic resource in its activities, or to allow another party to deploy the economic resource in that other party's activities.
>
> ...
>
> 4.23 For an entity to control an economic resource, the future economic benefits from that resource must flow to the entity either directly or indirectly rather than to another party. This aspect of control does not imply that the entity can ensure that the resource will produce economic benefits in all circumstances. Instead, it means that if the resource produces economic benefits, the entity is the party that will obtain them either directly or indirectly.

BC39 The Board concluded that a regulatory asset meets the definition of an asset because:

(a) a regulatory asset is a right. That right entitles an entity to add an amount in determining a regulated rate to be charged to customers in future periods to provide part of the total allowed compensation for goods or services already supplied.

(b) that right has the potential to produce economic benefits. The form of those economic benefits is the addition of an amount in determining a future regulated rate. For a right to meet the definition of an asset, it does not need to be certain that the right will produce those economic benefits (paragraph 4.14 of the *Conceptual Framework* and paragraph BC48).

(c) an entity controls that right because the entity has the present ability to direct the use of the right and obtain the economic benefits that may flow from it. The entity has the present ability to:

  (i) use the right, because it has the right to deploy the regulatory asset in its activities by increasing regulated rates; and

  (ii) obtain the economic benefits that may flow from the regulatory asset, because if incremental cash inflows result from the regulatory asset, they will flow to the entity rather than to any other party.

(d) although the mechanism for recovering a regulatory asset is by increasing regulated rates for goods or services to be supplied in future periods, the regulatory asset is a present right, and exists and is controlled by the entity because of a past event: the entity supplied goods or services, but the amounts included in the regulated rates charged to customers do not yet include part of the total allowed compensation for those goods or services.

BC40 A regulatory asset is only a subgroup of the rights created by a regulatory agreement. The rights created by a regulatory agreement include:

(a) a right to increase a regulated rate for goods or services to be supplied in future periods because the entity has not yet charged customers—and hence has not yet included in revenue—the full amount of the total allowed compensation for goods or services already supplied. This right is a regulatory asset.

(b) a right to charge a regulated rate for goods or services to be supplied in future periods, designed to provide the entity with the total allowed compensation for those goods or services. This right is one of the rights that arise under the regulatory agreement, but is not a regulatory asset (because it does not relate to goods or services already supplied). An entity applying IFRS Standards does not recognise this right as an asset (except possibly in a business combination). Instead, an entity provides information about the effects of the right by recognising revenue and costs of goods or services sold when the entity supplies goods or services to customers. The proposals in the Exposure Draft would not affect the information an entity provides about this right.

BC41 An entity not subject to a regulatory agreement can typically set any price it wishes for its goods or services, constrained only by what its customers are prepared to pay and perhaps by, for example, competition law. In contrast, a rate-regulated entity does not have a right to raise its prices above the regulated rate. Some stakeholders find it counterintuitive that a rate-regulated entity can have an asset that is a right to increase a regulated rate, whereas if other entities have the right to set any price they wish, those entities do not have an asset even though their right is less constrained than the right that constitutes a regulatory asset.

BC42 For goods or services not subject to a regulatory agreement, although such a right to set any price is less constrained than the right that constitutes a regulatory asset, that less constrained right is typically available to all parties without significant cost. Paragraph 4.9 of the *Conceptual Framework* explains that rights available to all parties without significant cost—for instance, rights of access to public goods, such as public rights of way over land, or know-how in the public domain—are typically not assets for the entities that hold them. Paragraph BC4.39 of the Basis for Conclusions on the *Conceptual Framework* states:

There are various ways to explain why rights available to all other parties are typically not assets of a particular entity. One reason could be that such rights, for example, public rights of way over land, do not have a potential to produce for that entity economic benefits beyond those available to all other parties. An alternative or additional reason could be that such rights are not controlled by the entity—the entity cannot deny other parties access to any economic benefits that may flow from those rights.

Does a regulatory liability meet the definition of a liability in the *Conceptual Framework*?

BC43 The Exposure Draft defines a regulatory liability as an enforceable present obligation, created by a regulatory agreement, to deduct an amount in determining a regulated rate to be charged to customers in future periods because the revenue already recognised includes an amount that will provide part of the total allowed compensation for goods or services to be supplied in the future.

BC44 The *Conceptual Framework* defines a liability as a present obligation of the entity to transfer an economic resource as a result of past events. The *Conceptual Framework* also says that a present obligation exists as a result of past events only if:

(a) the entity has already obtained economic benefits or taken an action; and

(b) as a consequence, the entity will or may have to transfer an economic resource that it would not otherwise have had to transfer. It does not need to be certain, or even likely, that the entity will be required to transfer an economic resource (paragraph 4.37 of the *Conceptual Framework* and paragraph BC48).

BC45 The Board concluded that a regulatory liability meets the definition of a liability because:

(a) the entity has an enforceable obligation to transfer economic benefits;

(b) the form of that transfer of economic benefits is a deduction of an amount in determining a future regulated rate; and

(c) the obligation is a present obligation that exists as a result of past events because:

(i) the entity has already obtained economic benefits by charging customers amounts that are reflected in revenue already recognised; and

(ii) as a consequence, the entity will have to transfer an economic resource that it would not otherwise have had to transfer, because it will have to reduce future regulated rates.

(d) although the mechanism for fulfilling a regulatory liability is by decreasing regulated rates in future periods, the regulatory liability is a present obligation and exists because of a past event: the entity has recognised revenue and part of that revenue will provide part of the total allowed compensation for goods or services to be supplied in the future.

BC46 A regulatory liability results in a reduction in a future cash inflow, rather than in a separate cash outflow. Therefore, some stakeholders question whether a regulatory liability is an obligation to transfer an economic resource. The Board views a regulatory liability as an obligation that an entity fulfils by decreasing the regulated rates for goods or services to be supplied in future periods, leading to lower revenue and ultimately to a lower cash inflow, rather than by making a separate cash payment. In the Board's view, that form of fulfilment is as much a transfer of an economic resource as a payment of cash would be. The *Conceptual Framework* says that an economic resource (an asset) could produce economic benefits for an entity not only by providing it with cash inflows, but also by enabling it to avoid cash outflows. Although the *Conceptual Framework* makes no corresponding statement for a liability, the Board considers that the transfer of an economic resource could take the form of a reduction in cash inflows.

BC47 An entity not subject to a regulatory agreement may have an economic incentive to decrease its prices. Such an incentive does not create an enforceable present obligation and thus does not create a liability. In contrast, a regulatory liability is an enforceable present obligation.

Can an asset or liability exist if there is outcome uncertainty?

BC48 To meet the definition of an asset or a liability in the *Conceptual Framework*, a right or obligation must have the potential to produce economic benefits or require an entity to transfer an economic resource. It does not need to be certain that the economic benefits will be produced or that the transfer of economic resources will occur. For example, inventories are assets even though it is not certain that customers will buy them. Paragraphs BC126–BC127 discuss cases where the probability of an inflow or outflow of economic benefits is low.

BC49 Other aspects of uncertainty relate to:

(a) existence uncertainty and recognition (paragraphs BC124–BC125);

(b) outcome and measurement uncertainties (paragraphs BC126–BC128, BC136–BC139 and BC177); and

(c) disclosure of how risks and uncertainties affect the recovery of regulatory assets or fulfilment of regulatory liabilities (paragraph 80(d) of the Exposure Draft).

What type of right or obligation is a regulatory asset or regulatory liability?

BC50 A regulatory asset permits an entity to increase future regulated rates by a fixed or determinable amount because of goods or services already supplied. An entity recovers that asset in future periods when it adds that amount in determining the regulated rates it charges customers for goods or services supplied in those future periods.

BC51 A regulatory liability obliges an entity to deduct a fixed or determinable amount in determining future regulated rates because of an amount included in revenue already recognised. An entity fulfils that liability in future periods when it deducts that amount in determining the regulated rates it charges customers for goods or services supplied in those future periods.

BC52 A regulatory asset or regulatory liability is not a financial asset or financial liability. Although a regulatory asset or regulatory liability gives rise ultimately to receipts or payments of cash, it is not a right or obligation to receive or pay cash. A regulatory asset does not entitle an entity to require customers or any other party to pay it cash: the entity ultimately receives cash when customers pay the increased regulated rate. Similarly, a regulatory liability does not oblige an entity to pay cash to customers or any other party: the entity, in effect, ultimately pays cash by receiving less cash when customers pay the decreased regulated rate.

BC53 A regulatory asset or regulatory liability is not a right or an obligation to make a retrospective adjustment to the price for a past supply of goods or services to customers. Thus, a regulatory asset or regulatory liability is outside the scope of IFRS 15. Moreover, the existing and past customers who bought goods or services (in the case of a regulatory asset) or who were the source of amounts already included in revenue (in the case of a regulatory liability) are not necessarily the same as the existing and future customers who will pay the increased or decreased regulated rate for goods or services to be supplied in the future.

BC54 The Board considered whether regulatory assets and regulatory liabilities should be viewed as arising under a regulatory agreement that is analogous to an executory contract that is currently favourable or unfavourable. A contract is executory if neither party has fulfilled any of its obligations, or both parties have partially fulfilled their obligations to an equal extent.[9] Under such a view:

(a) a regulatory asset would be a right to supply goods or services at a favourable regulated rate. That right is a right to supply goods or services. The regulated rate is favourable because it is more than the regulated rate that would be set if the regulatory asset did not exist; and

(b) a regulatory liability would be a performance obligation to supply goods or services at an unfavourable regulated rate. That obligation is an obligation to supply goods or services. The regulated rate is unfavourable because it is less than the regulated rate that would be set if the regulatory liability did not exist.

BC55 The Board took a different view because regulatory assets and regulatory liabilities give rise to cash flows that are largely independent of the cash flows generated by the other rights and obligations created by the regulatory agreement, as discussed in paragraphs BC58–BC62. Thus, the Board views

9 Paragraphs 4.56–4.58 of the *Conceptual Framework* discuss executory contracts. Paragraphs 4.6(a)(iii) and 4.39(c) refer to rights and obligations to exchange economic resources on terms that are currently favourable or unfavourable.

regulatory assets and regulatory liabilities as cleanly separable from the other rights and obligations created by the regulatory agreement. The proposed model treats them as rights or obligations to add or deduct a fixed or determinable amount in determining regulated rates for goods or services to be supplied in the future. In the Board's view, treating them as arising under a regulatory agreement that is analogous to a partially performed executory contract would:

(a) not solve the particular problem the Board wishes to solve. That problem is that users of financial statements do not receive information about the differences in timing that arise when part of the total allowed compensation for goods or services supplied in one period is included in regulated rates—and, hence, in revenue—in a different period (paragraphs BC21–BC27);

(b) result in a less clean separation between regulatory assets or regulatory liabilities and other rights and obligations created by the regulatory agreement; and

(c) lead to more complex measurement requirements, reflecting both the revenue and expenses that will result from supplying goods or services in the future.

BC56 Differences in timing giving rise to a regulatory asset or regulatory liability have some analogies to temporary differences giving rise to a deferred tax asset or deferred tax liability. Moreover, measurements of both these categories of assets and liabilities are based on estimates of future cash flows. Nevertheless, those analogies are of only limited help in understanding the proposed model for regulatory assets or regulatory liabilities, because:

(a) a regulatory asset or regulatory liability arises only because of a limited set of past events—supply of goods or services (for a regulatory asset) or recognising revenue (for a regulatory liability); and

(b) a regulatory asset or regulatory liability is recovered or fulfilled by charging customers a regulated rate that is increased or decreased as a result of the past event that gave rise to the regulatory asset or regulatory liability.

Why not use the definition of a regulatory deferral account balance in IFRS 14?

BC57 The proposed definitions of a regulatory asset and a regulatory liability are more targeted and precise than the temporary definition in IFRS 14 of a 'regulatory deferral account balance'. That Standard defines a regulatory deferral account balance as:

> 'the balance of any expense (or income) account that would not be recognised as an asset or a liability in accordance with other Standards, but that qualifies for deferral because it is included, or is expected to be included, by the rate regulator in establishing the rate(s) that can be charged to customers'.

Why account for regulatory assets and regulatory liabilities separately?

BC58 The cash flows that arise from a regulatory asset or regulatory liability are incremental—they occur only because the entity has that asset or liability. They are also largely independent of the cash flows that result from the other rights and obligations created by the regulatory agreement. Therefore, an entity can measure regulatory assets and regulatory liabilities separately by reference to estimates of those cash flows. In the Board's view, recognising regulatory assets and regulatory liabilities separately and measuring them by reference to those cash flows would provide useful information to users of financial statements.

BC59 In reaching this conclusion, the Board considered the guidance in the *Conceptual Framework* on selecting a unit of account:

> 4.51 A unit of account is selected to provide useful information, which implies that:
>
> (a) ...
>
> (b) the information provided about the asset or liability and about any related income and expenses must faithfully represent the substance of the transaction or other event from which they have arisen. Therefore, it may be necessary to treat rights or obligations arising from different sources as a single unit of account, or to separate the rights or obligations arising from a single source (see paragraph 4.62). Equally, to provide a faithful representation of unrelated rights and obligations, it may be necessary to recognise and measure them separately.
>
> ...
>
> 4.55 Possible units of account include:
>
> (a) an individual right or individual obligation;
>
> (b) all rights, all obligations, or all rights and all obligations, arising from a single source, for example, a contract;
>
> (c) a subgroup of those rights and/or obligations—for example, a subgroup of rights over an item of property, plant and equipment for which the useful life and pattern of consumption differ from those of the other rights over that item;
>
> (d) ...

BC60 Other rights and obligations created by a regulatory agreement typically generate cash flows only in combination with other assets and liabilities, such as property, plant and equipment or recognised or unrecognised intangible assets. As a result, an entity typically does not recognise those other rights and obligations as assets and liabilities, because doing so would not provide users of financial statements with the most useful information. In assessing an entity's prospects for future cash flows from that combination of other rights and obligations created by a regulatory agreement with other assets and liabilities, users can use information in the financial statements (and perhaps also information in management commentary) about, for example, the entity's revenue, cost of goods or services sold and other expenses.

BC61 The cash flows that result from a regulatory asset or regulatory liability are incremental and do not significantly affect cash flows from the other rights and obligations created by the regulatory agreement. Therefore, accounting separately for regulatory assets and regulatory liabilities would not diminish the value of the information provided to users of financial statements about the effects of those other rights and obligations.

BC62 Future cash flows result from a regulatory asset or regulatory liability only if the entity also has an enforceable present right or an enforceable present obligation to supply goods or services in the period when the regulatory agreement permits or obliges the entity to include that increase or decrease in the regulated rates. Including that increase or decrease in the regulated rate in future periods is the mechanism for recovering the regulatory asset or fulfilling the regulatory liability. The need for that mechanism affects the boundary of the regulatory agreement (paragraphs BC142–BC158), but does not create interdependence between the cash flows arising from the regulatory asset or regulatory liability and the cash flows from the other rights or obligations created by the regulatory agreement.

How would the proposed model solve the problem?

BC63 The model would provide users of financial statements with information needed to solve the problem discussed in paragraphs BC21–BC27. Applying the model, entities would provide information in their statement(s) of financial performance and related notes about:

(a) regulatory income—arising because part of the total allowed compensation for goods or services supplied in the current period was included in revenue in past periods, or will be included in revenue in future periods.

(b) regulatory expense—arising because an amount included in revenue in the current period provides part of the total allowed compensation for goods or services that were supplied in past periods, or will be supplied in future periods.

(c) the effect of changes in the estimated future cash flows that will result from regulatory assets and regulatory liabilities.

(d) regulatory interest income on regulatory assets and regulatory interest expense on regulatory liabilities, arising as compensation or charge for the time lag until regulatory assets are recovered or regulatory liabilities are fulfilled.

BC64 Applying the model, entities would provide information in their statement of financial position and related notes about the present value of the estimate of the future cash flows that will arise from regulatory assets and regulatory liabilities.

Other accounting approaches considered

BC65 The Discussion Paper described four possible approaches to reporting the financial effects of a generic form of rate regulation, which the Discussion Paper called defined rate regulation:

(a) prohibiting the recognition of regulatory balances, with or without developing disclosure requirements.

(b) recognising the package of rights and obligations established by the regulatory agreement as an intangible asset—that is, a licence.

(c) reporting using regulatory accounting requirements.

(d) developing specific requirements to defer or accelerate the recognition of revenue or expenses or a combination of revenue and expenses.

Prohibiting recognition

BC66 The first approach would have prohibited the recognition of regulatory balances, with or without developing disclosure requirements. Some respondents to the Discussion Paper supported this approach, but for diverse reasons. Some respondents questioned whether regulatory balances meet the definitions of an asset or a liability in the *Conceptual Framework*. Paragraphs BC37–BC47 explain why the Board has concluded that regulatory assets and regulatory liabilities meet those definitions.

BC67 Many respondents supporting the recognition of some or all regulatory balances said the Board should develop disclosure requirements if it were to prohibit the recognition of such balances. These respondents said that users of financial statements need information about the effect of such balances to help them make informed investment or lending decisions.

BC68 In the Board's view, applying current requirements provides insufficient information for users of financial statements to assess the implications of differences in timing that create regulatory assets or regulatory liabilities (paragraph BC24). Users of financial statements need information about regulatory assets, regulatory liabilities, regulatory income and regulatory expense. The proposed model would require their recognition. Recognising them would provide that information in a more coherent, prominent and understandable way than relying solely on disclosure in the notes to the financial statements.

Recognition as an intangible asset

BC69 The second approach would have recognised the entire package of rights and obligations that the regulatory agreement creates as an intangible asset—for example, as a licence. Very few respondents supported this approach. Respondents opposing this approach generally identified disadvantages similar to those outlined in the Discussion Paper—for example, revaluing the regulatory licence would cause cost and complexity that would outweigh the benefit.

BC70 In the Board's view, applying IFRS 15 and other IFRS Standards already provides useful information about the effect of most of the rights and obligations created by that package. Recognising that package as an intangible asset would not provide more useful information, and would cause unnecessary costs. The model the Board proposes focuses on those rights and obligations for which applying IFRS 15 and other IFRS Standards does not provide sufficient information.

Using regulatory requirements

BC71 The third approach would have involved permitting or requiring the accounting prescribed by the regulatory agreement to be used in general purpose financial statements prepared by applying IFRS Standards. For example, if equipment were depreciated over five years in calculating regulated rates, that equipment would also be depreciated over the same period in the financial statements prepared by applying IFRS Standards, even if the equipment's useful life were different. This approach would have needed an exception so that accounting prescribed by the rate regulation could override IFRS Standards. The responses to the Discussion Paper showed almost no support for this approach because it would reduce comparability. Many respondents also opposed recognising items in financial statements prepared by applying IFRS Standards if doing so would be inconsistent with the *Conceptual Framework* and with established accounting conventions. Others said that the objective of general purpose financial statements differs from that of special purpose financial statements, such as those prepared for rate regulation.

BC72 The Board did not pursue this approach, which would have made it more difficult to make comparisons with other entities and would have provided less useful information than the approach proposed in the Exposure Draft: accounting for regulatory assets and regulatory liabilities separately, and continuing to apply existing IFRS Standards to all other assets and liabilities.

Deferring or accelerating revenue or expenses

BC73 The fourth approach would have involved developing an accounting model to defer or accelerate recognition of revenue—or a combination of revenue and expenses—to reflect the effect of rights and obligations created by defined rate regulation. Respondents supported this approach more strongly than the other approaches. Many of those respondents suggested that the Board should develop principles similar to those in IFRS 15, or perhaps treat the entire customer base as the unit of account in applying such principles.

BC74 The Board did not pursue the suggestion of treating the entire customer base as the unit of account, because:

(a) such an approach would deprive users of financial statements of useful information they already receive about the effects of transactions with customers as individuals.

(b) such an approach would make financial statements of entities subject to a regulatory agreement less comparable with those of other entities.

(c) such an approach would be difficult to reconcile with the focus in IFRS 15 on contracts, which are with individual customers, rather than with the customer base as a whole.

(d) the definitions of a regulatory asset and a regulatory liability focus on rights to add an amount, or obligations to deduct an amount, in determining regulated rates, rather than on rights to receive cash or obligations to supply goods or services. This focus makes it unnecessary to consider whether an entity can have rights to receive cash from the customer base or obligations to supply goods or services to the customer base.

BC75 The Board considers that applying IFRS Standards already results in the statement of profit or loss providing useful information that depicts:

(a) all revenue from supplying goods or services in the current period as specified in an entity's contracts with customers, reflecting the regulated rates charged to customers; and

(b) all expenses incurred in supplying goods or services in the current period and the other expenses incurred by the entity in that period.

BC76 The proposed model would supplement the information an entity already provides by applying IFRS Standards, including IFRS 15, and so enable users of financial statements to understand the total allowed compensation for goods or services supplied to customers in each period and the related rights and obligations. The income, expenses, assets and liabilities reported by applying the model are incremental to those for which an entity already accounts by applying IFRS 15 and other IFRS Standards.

BC77 The overall effect on profit or loss of applying the proposed model together with IFRS 15 would have some similarities to accounting for revenue on the basis of the total allowed compensation rather than on the basis of the transaction price determined by applying IFRS 15. Nevertheless, the model differs from that approach because it would provide information that supplements the information provided by using IFRS 15, rather than replace that information.

Scope (paragraphs 3–23)

BC78 The proposals in the Exposure Draft would apply to all of an entity's regulatory assets and all its regulatory liabilities, as defined in the Exposure Draft. The proposals would not change the accounting for any other rights and obligations created by a regulatory agreement and for other assets or liabilities. It follows from the proposed definitions that a regulatory asset or regulatory liability can exist only if:

(a) the entity is party to a regulatory agreement;[10]

10 A regulatory agreement is defined in the Exposure Draft as a set of enforceable rights and obligations that determine a regulated rate to be applied in contracts with customers.

(b) the regulatory agreement determines the regulated rate the entity charges for the goods or services it supplies to customers; and

(c) part of the total allowed compensation for goods or services supplied in one period is charged to customers through the regulated rates for goods or services supplied in a different period (past or future).

BC79 The Board considered whether it should restrict the scope of its proposals to apply only to some regulatory agreements, such as those with some of or all of the features of what the Discussion Paper called 'defined rate regulation'. The Discussion Paper described defined rate regulation as involving a regulatory pricing (rate-setting) framework or basis that:

(a) applies in situations in which customers have little or no choice but to purchase the goods or services from the rate-regulated entity because:

   (i) there is no effective competition to supply; and

   (ii) the rate-regulated goods or services are essential to customers (such as clean water or electricity).

(b) establishes parameters to maintain the availability and quality of the supply of the rate-regulated goods or services and other rate-regulated activities of the entity.

(c) establishes parameters for regulated rates to provide regulatory protections that:

   (i) support stability of prices for customers; and

   (ii) support the financial viability of the rate-regulated entity.

(d) creates rights and obligations that are enforceable on the rate-regulated entity and on the regulator.

BC80 Most respondents to the Discussion Paper agreed that the description of defined rate regulation captured the common characteristics of many rate-regulatory schemes and the rights and obligations created by the schemes. Respondents strongly supported using that description as the basis for developing an accounting model focused on incremental rights and obligations arising when the amount of revenue recognised by applying IFRS 15 differs from the amount of compensation to which the entity is entitled, as a result of the activities already performed.

BC81 It follows from the proposed definitions that two features of defined rate regulation are always present if a regulatory asset or a regulatory liability exists:

(a) there must be a regulatory agreement that establishes a basis for setting regulated rates (paragraphs BC78(b) and BC79(c)). A basis for setting regulated rates will typically also specify a minimum quality for the goods or services to be supplied for the regulated rates (part of the component specified in paragraph BC79(b)).

(b) the rights or obligations that create a regulatory asset or regulatory liability must be enforceable (paragraphs BC78(a) and BC79(d)).

BC82 The remaining features of defined rate regulation may be present in many rate-regulatory schemes, but a regulatory asset or regulatory liability can exist even if some or all of those features are not present. Those remaining features are:

(a) customers have little or no choice but to purchase the goods or services from the rate-regulated entity, because there is no effective competition to supply and the rate-regulated goods or services are essential to customers (paragraph BC79(a));

(b) the regulation establishes parameters to maintain the availability of the supply of the rate-regulated goods or services (the other part of the component specified in paragraph BC79(b)); and

(c) the parameters provide regulatory protections that support greater stability of prices for customers and support the rate-regulated entity's financial viability (paragraph BC79(c)).

BC83 The Board concluded that setting the scope of the Exposure Draft more narrowly to include only regulatory agreements that have some or all of the features of defined rate regulation listed in paragraph BC82 would not produce more useful information about the effects of regulatory assets and regulatory liabilities. Furthermore, assessing whether those features are present would be difficult and highly subjective. The Board reached these conclusions for the following reasons:

(a) a lack of effective competition for essential goods or services does not determine that a regulatory asset or regulatory liability exists, but instead increases the probability that the regulatory asset or regulatory liability will ultimately result in inflows or outflows of cash. Paragraphs BC135–BC141 discuss the measurement of future cash flows that are uncertain, including cash flows subject to demand risk.

(b) a requirement to maintain availability of supply for a specified period helps to determine where the boundary of a regulatory agreement lies (paragraphs BC142–BC158), but does not determine whether a regulatory asset or regulatory liability exists.

(c) the features of providing price stability for customers and supporting the entity's financial viability explain, in many cases, why a particular form of rate regulation exists in a particular case, but are not features that must be present for a regulatory asset or regulatory liability to exist.

BC84 In summary, the Exposure Draft applies only to an entity's regulatory assets and regulatory liabilities, and those items can exist only if all the conditions listed in paragraph BC81 are met. The Board regards the features listed in paragraph BC82 as not pertinent in determining whether those items exist, and does not propose to use any of them to restrict the scope of the proposals. Accordingly, the Exposure Draft does not use the term 'defined rate regulation'.

BC85 In addition, the Exposure Draft does not specify:

(a) the legal form of the regulatory agreement. Paragraph 8 of the Exposure Draft explains that regulatory agreements may take various forms (such as a contractual licensing agreement or a service concession arrangement), or may be imposed through statute, legislation or regulations.

(b) whether a particular type of body, such as a regulator, must exist to enforce compliance with the regulatory agreement, and what the characteristics of that body should be.

BC86 If the Board were to specify characteristics that a regulator must possess, its aim would be to create a distinction that leads to entities producing the information that would be most useful to users of financial statements. Those characteristics vary greatly: regulators and other enforcement bodies can take diverse legal forms, can be designed with various features, can have various objectives and mandates, and can be required to meet various procedural requirements. Because of that variety, the Board would have difficulty deciding which characteristics to specify. Moreover, specifying such characteristics is unnecessary because the Board proposes that the rights and obligations created by the regulatory agreement need to be enforceable. Finally, the Board has found no reason why setting the scope of the Exposure Draft more narrowly to include only regulatory agreements subject to a regulator with particular characteristics would lead to more useful information about the effects of regulatory assets and regulatory liabilities.

Total allowed compensation (paragraphs B2–B27)

BC87 The concept of total allowed compensation plays an important role in:

(a) the principle underlying the model—an entity should reflect the total allowed compensation for goods or services supplied as part of its reported financial performance for the period in which those goods or services are supplied (paragraph BC30).

(b) the definitions of a regulatory asset and a regulatory liability (paragraphs BC36–BC57). Thus, the concept of total allowed compensation underpins when an entity would recognise and derecognise regulatory assets and regulatory liabilities.

Components of total allowed compensation

BC88 Table BC2 summarises the proposals in the Exposure Draft for how an entity would determine whether components of total allowed compensation included in determining the regulated rates charged to customers in a period—and hence included in the revenue recognised in the period—relate to goods or services supplied in the same period, or to goods or services supplied in a different period—and thus whether those components affect profit or loss in the same period or a different period.

Table BC2 Components of total allowed compensation	
Component	**When the component affects profit or loss**
Amount that recovers allowable expenses minus chargeable income (see paragraph BC89)	In the period when an entity recognises the expense or income by applying IFRS Standards
Any component of target profit not listed below (see paragraph BC90)	In the period when the regulatory agreement entitles an entity to add that component in determining a regulated rate for goods or services supplied in that period
Profit margins on allowable expenses (see paragraph BC91)	In the period when an entity recognises the expense by applying IFRS Standards
All regulatory returns (see paragraphs BC92–BC95), except those on assets not yet available for use	In the period when the regulatory agreement entitles an entity to add that return in determining a regulated rate for goods or services supplied in that period
Regulatory returns on assets not yet available for use (see paragraphs BC96–BC100)	Only once the asset is available for use and then over the remaining periods in which the carrying amount of the asset is recovered through the regulated rates
Performance incentives (see paragraphs BC101–BC110)	In the period in which an entity's performance gives rise to the incentive bonus or penalty
Regulatory interest income and regulatory interest expense (see paragraphs BC111–BC113)	As the discount unwinds until recovery of the regulatory asset or fulfilment of the regulatory liability

Amounts that recover allowable expenses minus chargeable income

BC89 If allowable expenses are recognised in a period as an expense by applying IFRS Standards, that fact provides a clear link from those expenses to goods or services supplied in that period, and from those goods or services to the related component of the total allowed compensation for those goods or services. Consequently, the Board proposes in paragraph B4 of the Exposure Draft that the amount that recovers an allowable expense forms part of the total allowed compensation for goods or services supplied in the same period in which the entity recognises the allowable expense by applying IFRS Standards, regardless of when this amount is included in determining the regulated rates. That simple approach uses the judgements that an entity must already make in determining when expenses are recognised by applying IFRS Standards, and does not permit or require an entity to make separate judgements in applying the proposed model. For chargeable income, the Board proposes requirements similar to those it proposes for allowable expenses (paragraph B9 of the Exposure Draft).

Target profit

BC90 In the Board's view, if a regulatory agreement entitles an entity to include target profit in determining a regulated rate for goods or services supplied in a period, that fact generally establishes that this target profit relates to the goods or services supplied in that period. Consequently, in paragraph B10 of the Exposure Draft the Board proposes that target profit forms part of the total allowed compensation for goods or services supplied in that same period, except in some cases when the Board found a compelling reason to link that target profit to goods or services supplied in a different period (see paragraphs BC91 and BC96–BC110).

Profit margins that vary with an allowable expense

BC91 A regulatory agreement may entitle an entity to recover the amount of an allowable expense incurred plus a profit margin that varies with the amount of the expense—for example, a fixed percentage mark-up on the expense. Because these profit margins vary with the allowable expense, the Board proposes that they form part of the total allowed compensation for goods or services supplied in the same period as when the entity recognises the underlying allowable expense (paragraph B12 of the Exposure Draft).

Regulatory returns

BC92 The regulatory returns described in paragraph B13 of the Exposure Draft often constitute a significant component of target profit. Applying the proposal discussed in paragraph BC90, regulatory returns would form part of the total allowed compensation for goods or services supplied in the period in which the regulatory agreement entitles an entity to add those returns in determining a regulated rate for goods or services supplied in that period, except for returns on assets not yet available for use as discussed in paragraph BC96(b).

BC93 Regulatory returns are applied to a base specified by the regulatory agreement, such as the regulatory capital base. Such a base typically reflects historical costs or replacement costs of assets used to supply goods or services. Those regulatory returns are typically included in the regulated rates charged during the periods when those assets are being used to supply goods or services. In the Board's view, regarding those regulatory returns as part of the total allowed compensation for goods or services supplied in these same periods is consistent with the principle underlying the model (paragraph BC30).

BC94 If regulatory returns apply to a base that declines over time because assets are being used and not replaced, the amount of those regulatory returns will also decline over time. Some may question whether that declining pattern reflects the economics of the regulated activity if the entity is providing the same goods or services to the same quality in each period. However, the Board concluded that useful information would not result from smoothing the amount of those regulatory returns over the useful life of the assets included in the base to which regulatory returns apply.

BC95 Sometimes, regulatory returns apply to a base that includes a balance related to an asset for which the regulatory recovery period differs from the asset's useful life determined by applying IFRS Standards. Such cases are illustrated in Illustrative Examples 2B and 2C accompanying the Exposure Draft. In such cases, the regulatory return on the balance relating to that asset forms part of the total allowed compensation for goods or services supplied over the regulatory recovery period. The Board considers that outcome appropriate because the regulatory return on that balance has two components:

(a) the regulatory interest income on the regulatory asset (or regulatory interest expense on the regulatory liability) arising because of the decelerated (or accelerated) recovery of the cost of the asset included in the base. That regulatory interest income (or regulatory interest expense) is recognised as the discount inherent in the measurement of the regulatory asset (or regulatory liability) unwinds (paragraphs BC111–BC113).

(b) the regulatory return on the balance for that asset as determined in the base, but without adding the amount relating to any regulatory asset and without deducting the amount relating to any regulatory liability. That balance often equals the depreciated or amortised cost of the asset by applying IFRS Standards. The regulatory return on that balance forms part of the total allowed compensation for goods or services supplied over the asset's useful life, determined by applying IFRS Standards.

Regulatory returns on a balance relating to an asset not yet available for use

BC96 Regulatory agreements may provide entities with regulatory returns on a base containing a balance relating to an asset not yet available for use. Regulatory agreements commonly use one of two approaches for regulatory returns on such balances:

(a) under the first approach, those regulatory returns accumulate while the asset is not yet available for use and are included in the regulated rates charged to customers only once the asset is available for use (paragraph BC97); but

(b) under the second approach, those regulatory returns are included in the regulated rates charged to customers during periods when the asset is not yet available for use (paragraphs BC98–BC100).

BC97 If the regulatory agreement uses the first approach, the Board's proposed treatment for target profit and regulatory returns set out in paragraphs B10 and B14 of the Exposure Draft would result in those returns forming part of the total allowed compensation only for goods or services supplied once the asset is available for use. The Board considers that outcome appropriate because it is aligned with the principle underlying the model (paragraph BC30).

BC98 If the regulatory agreement uses the second approach, the Board's proposed treatment for target profit and regulatory returns (paragraphs B10 and B14 of the Exposure Draft) would result in those regulatory returns forming part of the total allowed compensation for goods or services supplied when the asset is not yet available for use. The Board considers such an outcome inappropriate because it:

(a) would contradict the model's principle in paragraph BC30—no goods or services are being supplied using that asset before it is available for use; and

(b) could result in a lack of comparability between entities, or within an entity, if some regulatory agreements use the first approach and others use the second approach.

BC99 Therefore, the Board proposes that regulatory returns on a balance relating to an asset not yet available for use form part of the total allowed compensation for goods or services supplied once the asset is available for use (paragraph B15 of the Exposure Draft). This proposal is consistent with the principle underlying the model (paragraph BC30). It would result in the same outcome (that is, those returns would form part of the total allowed compensation for goods or services supplied once the asset is available for use) regardless of whether the regulatory agreement uses the first approach or the second approach for such regulatory returns. Thus, if the regulatory agreement uses the second approach, a regulatory liability would arise for these returns during the period when the asset is not yet available for use.

BC100 The Board also proposes that regulatory returns on a balance relating to an asset not yet available for use form part of the total allowed compensation for goods or services supplied over the remaining periods in which the carrying amount of the asset is recovered through the regulated rates, once the asset is available for use. This proposal could be inconsistent with the principle underlying the model if the end of the last of those periods differs from the end of the asset's useful life determined by applying IFRS Standards. Nevertheless, in the Board's view, this proposal is appropriate on cost-benefit grounds because:

(a) it would apply consistently regardless of the approach the regulatory agreement uses.

(b) if the regulatory agreement uses the first approach, the regulatory returns would form part of the total allowed compensation for goods or services supplied in the same period in which the regulatory agreement entitles an entity to add those returns in determining a regulated rate for goods or services supplied in that period (paragraph BC97). Thus, there would be no need for an entity to allocate those regulatory returns to a different period.

(c) if the regulatory agreement uses the second approach, allocating regulatory returns accumulated before the asset is available for use would be less complex if they are allocated over the remaining periods in which the carrying amount of the asset is recovered through the regulated rates rather than over the asset's remaining useful life. Allocation over the remaining useful life could be particularly complex if assets, or components of assets, have various useful lives.

Performance incentives

BC101 Performance incentives implemented through increases or decreases in regulated rates are an increasingly common feature of rate regulation in many jurisdictions. Meeting or failing to meet criteria set out in a performance incentive scheme may entitle an entity to a bonus or make the entity liable for a penalty. In some cases, such a bonus or penalty affects the regulated rates only after the period in which the entity's performance occurs.

BC102 The Board proposes in paragraph B17 of the Exposure Draft that amounts relating to a performance incentive would form part of or would reduce the total allowed compensation for goods or services supplied in the period in which an entity's performance gives rise to the incentive bonus or penalty. For performance incentives unrelated to construction work, that proposal aligns with the principle underlying the model (paragraph BC30), which is that an entity reflects the total allowed compensation for goods or services supplied as part of its reported financial performance for the period in which those goods or services are supplied. For example, achieving customer satisfaction targets that reward an entity for the quality of goods or services supplied relates to performance provided while supplying goods or services.

BC103 The Board considered whether the proposal explained in paragraph BC102 should also apply to incentives for performing construction work, such as incentives for reaching specified milestones while constructing an asset. Treating such performance incentives as part or reduction of total allowed compensation during construction would arguably not align with the principle underlying the model, because the asset is still being constructed and thus is not yet available for use.

BC104 Nevertheless, the proposal explained in paragraph BC102 aims to reflect performance incentives as part or reduction of the total allowed compensation in the period in which an entity's performance gives rise to the incentive, even for incentives for performing construction work, because that period is when that performance occurs (or fails to occur, in the case of a penalty).

BC105 That proposal would also align the treatment of incentives for performing construction work with the treatment of all other performance incentives. In the Board's view, this alignment would:

(a) provide more useful and understandable information than applying different approaches for different types of performance incentives; and

(b) avoid unnecessary costs because an entity would not need to develop and implement different policies and processes for different types of performance incentives nor would it need to determine which incentives relate to performing construction work and which do not.

BC106 Some performance criteria test an entity's performance over a time frame that is not yet complete. In such a case, the Board proposes that an entity estimate the amount of the performance incentive using the 'most likely amount' or 'expected value' method (paragraphs BC136–BC139) and then determine the portion of that estimate which relates to the reporting period. That portion forms part of or reduces the total allowed compensation for goods or services supplied in that same reporting period.

BC107 In arriving at the proposal described in paragraph BC106, the Board rejected two alternatives:

(a) recognising a performance incentive only when the outcome is known (paragraph BC108); or

(b) recognising a performance incentive only when a specified probability threshold is met (paragraph BC109).

BC108 In the first alternative, an entity would recognise a performance incentive only when the outcome is known. That alternative reflects a view that the entity has no right to a bonus or obligation for a penalty until it has met or failed to meet all the performance criteria. However, the Board concluded that supplying goods or services gives an entity an enforceable present right to the total allowed compensation for those goods or services, even if the amount of that total allowed compensation remains uncertain until the entity meets the performance criteria (and might even turn out to be nil).

BC109 In the second alternative, an entity would recognise a performance incentive only when a specified probability threshold is met. That alternative might specify the same threshold for both a bonus and a penalty, or one threshold for a bonus and a different threshold for a penalty. One example of applying a probability threshold is the treatment of variable consideration in IFRS 15. In contrast, the proposals in the Exposure Draft do not use probability thresholds, except when it is uncertain whether a regulatory asset or regulatory liability exists (existence uncertainty). In the Board's view, uncertainty about the amount of total allowed compensation for goods or services already supplied (outcome uncertainty) does not create uncertainty about whether the entity's right to that amount of total allowed compensation exists (existence uncertainty). The Board also considers that including a probability threshold would add unnecessary and unhelpful complexity to the model and would provide less timely information to users of financial statements.

BC110 Although the Board does not propose a probability threshold, if there are only two possible outcomes and an entity uses the 'most likely amount' method, the result of using that measurement method is the same as using a probability threshold of 'more likely than not' (that is, more than 50%) for recognition.

Regulatory interest income and regulatory interest expense

BC111 Regulatory interest compensates or charges an entity for the time lag until recovery of a regulatory asset or fulfilment of a regulatory liability. The proposed measurement requirements for regulatory assets and regulatory liabilities involve discounting all estimated future cash flows, including cash flows from regulatory interest, to their present value (paragraphs BC159–BC173).

BC112 When a regulatory asset or regulatory liability first arises, an entity has a right to benefit from, or an obligation to bear, any regulatory interest that will arise on that regulatory asset or regulatory liability until its recovery or fulfilment. Accordingly, estimated cash flows that will arise from regulatory interest would be included in the estimated future cash flows used to measure the regulatory asset or regulatory liability.

BC113 As time passes, the present value of the estimated future cash flows arising from a regulatory asset or regulatory liability would change because the discount unwinds, until recovery of the regulatory asset or fulfilment of the regulatory liability. As that discount unwinds, regulatory interest income or regulatory interest expense would be recognised in profit or loss, with a corresponding change in the carrying amount of the regulatory asset or regulatory liability.

Unit of account (paragraph 24)

BC114 The *Conceptual Framework* says that a unit of account is selected to provide useful information. The Board considered several possible units of account:

(a) the entire package of rights and obligations created by the regulatory agreement, as in the intangible asset model approach outlined in the Discussion Paper. The Board rejected that unit of account for the reasons given in paragraphs BC69–BC70.

(b) the net of all rights and obligations arising from differences in timing (paragraphs BC115–BC117).

(c) each right or obligation arising from an individual difference in timing (paragraphs BC115–BC117).

BC115 The *Conceptual Framework* says that treating a group of rights and obligations as a single unit of account may provide more relevant information than treating each right and obligation as a separate unit of account if, for example, those rights and obligations:

(a) cannot or are unlikely to be the subject of separate transactions;

(b) cannot or are unlikely to expire in different patterns;

(c) have similar economic characteristics and risks and hence are likely to have similar implications for the prospects for future net cash inflows to the entity or net cash outflows from the entity; or

(d) are used together in the business activities conducted by an entity to produce cash flows and are measured by reference to estimates of their interdependent future cash flows.

BC116 The Board understands that entities typically track separately the effects of each of the individual differences in timing, so that they can identify the inputs needed to determine the regulated rates. The Board noted that:

(a) entities typically assess each individual difference in timing separately and can identify the separate effect of each difference on future regulated rates and cash flows, though possibly with some interdependency in determining the overall regulated rate; and

(b) individual differences in timing and their subsequent effects on cash flows often expire in different patterns.

BC117 Consequently, the Board concluded that using the right or obligation arising from an individual difference in timing as the unit of account is feasible at a reasonable cost and would provide more useful information about the expected timing and pattern of recovery or fulfilment of that right or obligation than treating the net of all incremental rights and obligations arising from all differences in timing as a single unit of account.

BC118 Paragraph 24 of the Exposure Draft also proposes that an entity may treat a group of rights and obligations as a single unit of account if rights, obligations, or rights and obligations arising from the same regulatory agreement have similar expiry patterns and are subject to similar risks. In such a case, because the rights and obligations are likely to have similar implications for the entity's prospects for future cash flows, treating a group of rights and obligations as a single unit of account would provide information that is as relevant as the information provided by treating each right or obligation as a separate unit of account.

BC119 The unit of account determined by applying paragraph 24 would not necessarily determine how best to predict uncertain cash flows. Paragraphs 39 and 40 of the Exposure Draft would require an entity to assess whether the most likely amount method or the expected value method would better predict uncertain cash flows arising from a single unit of account (paragraphs BC136–BC139) and whether a better prediction would result from considering units of account separately or from considering any of them together.

BC120 The outcome of an entity's decisions about whether and how to group rights, obligations or both in a single unit of account might not determine whether a better prediction of uncertain cash flows would result from considering units of account separately or from considering them together. If a single source of uncertainty affects more than one unit of account, a better prediction of uncertain cash flows may sometimes result from considering the overall effect of that single source of uncertainty on all cash flows affected by that uncertainty, regardless of whether they arise from the same unit of account. For example, credit risk or demand risk is likely to affect all cash flows resulting from recoveries or fulfilments of different units of account in the same period in a similar manner. In that case, a better prediction of uncertain cash flows may result from considering together all units of account affected by the same source of uncertainty.

BC121 Paragraph 71 of the Exposure Draft would permit an entity, for presentation purposes, to offset regulatory assets and regulatory liabilities that form separate units of account, but only if they satisfy specified conditions. To limit the costs that preparers may need to incur in assessing whether the specified conditions are met, the Board decided that offsetting regulatory assets and regulatory liabilities should be permitted when the specified conditions are met but not required.

Recognition (paragraphs 25–28)

BC122 The *Conceptual Framework* specifies that an asset or a liability is recognised only if recognition of the asset or liability and of any resulting income, expenses or changes in equity provides users of financial statements with information that is useful, that is with:

(a) relevant information about the asset and liability and about any resulting income, expenses or changes in equity; and

(b) a faithful representation of the asset or liability and of any resulting income, expenses or changes in equity.

BC123 In relation to relevant information, the *Conceptual Framework* says that recognition of a particular asset or liability and any resulting income, expenses or changes in equity may not always result in relevant information when:

(a) it is uncertain whether an asset or liability exists; or

(b) an asset or liability exists, but the outcome is uncertain and the probability of an inflow or outflow of economic benefits is low.

BC124 The Exposure Draft proposes that, if it is uncertain whether a regulatory asset or regulatory liability exists, an entity should recognise that item if it is more likely than not that it exists. Although the Exposure Draft discusses existence uncertainty, the Board understands that there is generally little uncertainty about whether regulatory assets or regulatory liabilities exist.

BC125 IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* is one Standard that applies in situations in which it is uncertain whether assets or liabilities exist. The threshold proposed by the Exposure Draft for regulatory assets and regulatory liabilities is consistent with the recognition threshold set by IAS 37 for provisions and contingent liabilities. IAS 37 sets a higher threshold for contingent assets (virtually certain) than for provisions and contingent liabilities (more likely than not). However, the Board sees no reason to set a higher recognition threshold for regulatory assets than for regulatory liabilities. Moreover, because a single regulatory agreement could give rise to both regulatory assets and regulatory liabilities, setting an asymmetric recognition threshold may result in information that could be difficult to interpret.

BC126 In relation to outcome uncertainty, the Board proposes that an entity recognise all regulatory assets and regulatory liabilities, regardless of how likely an inflow or outflow of economic benefits is. The Board concluded that even if the probability of a flow of economic benefits is low, recognition of a regulatory asset or regulatory liability would still result in relevant information. Any uncertainty about the amount or timing of those inflows or outflows would affect the measurement of the regulatory asset or regulatory liability, as discussed in paragraphs BC136–BC139.

BC127 The Board understands that if a regulatory asset or regulatory liability exists, the probability that it will give rise to an inflow or outflow of economic benefits is generally high because of the design of the regulated rate and because of regulatory oversight of an entity applying the regulatory agreement in determining the regulated rate. Thus, the Board expects that entities would recognise most regulatory assets and regulatory liabilities whose existence is certain, even if the Board were to prohibit their recognition in cases of outcome uncertainty when the probability of an inflow or outflow of economic benefits does not meet some specified minimum threshold.

BC128 In relation to faithful representation, the *Conceptual Framework* says that a significant level of measurement uncertainty may affect whether the recognition of an asset or a liability faithfully represents that asset or liability and any resulting income, expenses or changes in equity. The Board understands that the generally fairly stable and predictable cash flows arising from regulatory assets or regulatory liabilities would typically enable entities to make reasonable estimates when measuring regulatory assets or regulatory liabilities. As a result, measurement uncertainty is unlikely to be significant. The Board proposes that an entity recognise all regulatory assets and regulatory liabilities that exist, regardless of the level of measurement uncertainty.

Derecognition

BC129 When an entity recovers part or all of a regulatory asset, or fulfils part or all of a regulatory liability, by adding or deducting an amount in determining future regulated rates (paragraphs BC50–BC51), the entity would derecognise that part of the regulatory asset or regulatory liability, and recognise regulatory expense or regulatory income accordingly (paragraph BC31). Furthermore, because the Board's measurement proposals would require an entity to update its estimates of future cash flows, measurement of regulatory assets and regulatory liabilities would be nil if estimated future cash flows were nil (paragraphs BC140–BC141). The Board therefore considers that the Exposure Draft contains sufficient proposals to explain when and how regulatory assets and regulatory liabilities should be derecognised. The Exposure Draft does not contain a separate section on derecognition.

Measurement (paragraphs 29–66 and paragraphs B28–B40)

Measurement basis

BC130 The Board proposes that entities measure regulatory assets and regulatory liabilities at historical cost, modified for subsequent measurement by using updated estimates of the amount and timing of future cash flows.

BC131 To apply that proposal, entities would use a cash-flow-based measurement technique that:

(a) includes an estimate of all future cash flows resulting from a regulatory asset or regulatory liability that are within the boundary of the regulatory agreement and only those cash flows; and

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

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.

Estimating future cash flows

BC135 Regulatory assets and regulatory liabilities are rights or obligations to increase or decrease future regulated rates. The regulatory agreement determines that increase or decrease with the aim of producing a fixed or determinable amount of incremental future cash flows (paragraph BC31(c)). The model would measure regulatory assets and regulatory liabilities at each reporting date on a basis that reflects an estimate of those future cash flows. In the Board's view, this measurement would provide users of financial statements with relevant information that faithfully represents how regulatory assets and regulatory liabilities affect an entity's financial position, and how regulatory income and regulatory expense affect the entity's financial performance.

Uncertain future cash flows

BC136 Cash flows arising from regulatory assets or regulatory liabilities may be subject to some uncertainty in amount or timing. The *Conceptual Framework* says that when measuring an asset or a liability by reference to estimates of uncertain future cash flows, possible variations in their estimated amount or timing are considered in selecting a single amount from within a range of possible cash flows. The *Conceptual Framework* says that an amount within the central part of that range (a central estimate) usually provides the most relevant information and identifies three central estimates, including the most likely amount (the statistical mode) and the expected value (the probability-weighted average or statistical mean).[11]

BC137 The Board proposes that an entity estimate future cash flows using the most likely amount method or the expected value method, whichever the entity expects will better predict the cash flows. That proposal is consistent with requirements in:

(a) IFRS 15 on estimating the amount of variable consideration to be included in the calculation of the transaction price in a revenue contract; and

(b) IFRIC 23 *Uncertainty over Income Tax Treatments* on predicting the resolution of an uncertainty over a tax treatment.

BC138 To keep the model simple, the estimates of future cash flows arising from a regulatory asset would reflect all sources of uncertainty, including credit risk. After reflecting any credit risk that the entity bears, those estimated future cash flows may be lower than the amounts that the entity will ultimately charge to customers. Thus, those cash flows may also be lower than the amounts that the entity will recognise in revenue because IFRS 15 generally requires that revenue recognised is not reduced by amounts that the entity might not be able to collect from a customer.

11 The third central estimate identified in the *Conceptual Framework* is the maximum amount that is more likely than not to occur, similar to the statistical median (paragraph 6.93 of the *Conceptual Framework*).

BC139 The Board considered whether to require an entity to reduce the carrying amount of a regulatory liability to reflect the risk that the entity might not fulfil the regulatory liability (the entity's own non-performance risk). In the Board's view, such reductions would not provide useful information to users of financial statements. Consequently, paragraph 43 of the Exposure Draft proposes that estimates of future cash flows arising from a regulatory liability should not reflect the entity's own non-performance risk. The Exposure Draft also proposes that the discount rate for regulatory liabilities should not be adjusted for any reason, including for any possible effect of the entity's own non-performance risk (paragraph BC166).

Updating estimates of future cash flows

BC140 The Board proposes that entities update their estimates of future cash flows to reflect changes in the estimated timing or amount. The Board concluded that updating those estimates would provide the most relevant information to users of financial statements.

BC141 The measurement would be based on updated estimates of future cash flows, including any estimated changes caused by, for example, demand risk or credit risk. Thus, there would be no need for a separate impairment test for regulatory assets. Furthermore, the Board proposes to specify that regulatory assets are outside the scope of IAS 36 *Impairment of Assets*. Because cash flows arising from regulatory assets are largely independent of cash flows generated by any other assets, regulatory assets are not part of any cash-generating unit for the impairment test required by IAS 36 (paragraphs BC55 and BC58, and proposed amendments to paragraphs 43 and 79 of IAS 36 in Appendix D of the Exposure Draft).

The boundary of a regulatory agreement

BC142 There is a point beyond which a regulatory agreement confers no enforceable present rights, and imposes no enforceable present obligations, on an entity. The Exposure Draft calls this point the boundary of the regulatory agreement.

BC143 The definitions of a regulatory asset and a regulatory liability refer to rights and obligations that are enforceable. Thus, the right to add, or the obligation to deduct, an amount in determining the regulated rates to be charged to customers in future periods is enforceable only if those increases or decreases will occur within the boundary of the regulatory agreement.

BC144 The Exposure Draft proposes that, in assessing whether rights to cancel or rights to renew a regulatory agreement 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. Disregarding such rights is consistent with the *Conceptual Framework*, which says:

> 4.60 All terms in a contract—whether explicit or implicit—are considered unless they have no substance. Implicit terms could include, for example, obligations imposed by statute, such as statutory warranty obligations imposed on entities that enter into contracts to sell goods to customers.

> 4.61 Terms that have no substance are disregarded. A term has no substance if it has no discernible effect on the economics of the contract. Terms that have no substance could include, for example:
>
> (a) terms that bind neither party; or
>
> (b) rights, including options, that the holder will not have the practical ability to exercise in any circumstances.

BC145 Disregarding such rights is also consistent with:

(a) the requirement in IFRS 17 *Insurance Contracts* that a substantive obligation for an entity to provide services ends when the entity has the practical ability to reassess the risks of a particular policyholder (or, in some cases, a portfolio of insurance contracts) and, as a result, set a price or level of benefits that fully reflects those reassessed risks.

(b) the requirement in IFRS 10 *Consolidated Financial Statements* that an investor considers only substantive rights in assessing whether it has power over an investee: for a right to be substantive, the holder must have the practical ability to exercise that right.

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. Thus, the Board proposes that, when assessing whether the holder of a right has the practical ability to exercise the right, 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.

BC147 Some regulatory assets or regulatory liabilities—for example, some regulatory assets arising from decommissioning liabilities or pension liabilities—may be accompanied by possible future rights or obligations expected to lead to adjustments to regulated rates far in the future, so that the resulting cash flows may fall beyond the boundary of the regulatory agreement because the entity's potential right or obligation is not enforceable.

BC148 In some of these cases, such cash flows might be likely, even though they will result from possible future rights or obligations that do not yet meet the definition of a regulatory asset or regulatory liability. Some stakeholders suggest that more useful information would result from treating such cash flows as being already within the boundary of the regulatory agreement.

BC149 The Exposure Draft does not propose such a treatment. Basing the definitions of a regulatory asset and a regulatory liability, as well as the boundary of a regulatory agreement, on present enforceable rights and present enforceable obligations is fundamental to the Board's conclusion that regulatory assets and regulatory liabilities are cleanly separable from the rest of the regulatory agreement.

Compensation for cancellation of a regulatory agreement

BC150 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 the entity has not yet recovered or for regulatory liabilities the entity has not yet fulfilled. A right or obligation to receive or pay such compensation—when it arises—is a financial asset or financial liability, rather than a regulatory asset or regulatory liability.

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.

BC153 Once an entity can no longer recover a regulatory asset or fulfil a regulatory liability by increasing or decreasing future regulated rates because a cancellation right has been exercised, the right to receive or obligation to pay such compensation is a financial asset or financial liability, rather than a regulatory asset or regulatory liability. The Exposure Draft proposes that an entity derecognise the part of the regulatory asset or regulatory liability that no longer exists, and apply the applicable IFRS Standard in recognising and measuring the financial asset or financial liability, recognising any resulting difference in profit or loss.

Reassessment and changes to the boundary

BC154 The Board expects that an entity's reassessment of the boundary of a regulatory agreement at each reporting date will usually conclude that the boundary has stayed the same or moved to a later date.

BC155 A change in the boundary of a regulatory agreement could bring within the boundary additional cash flows that arise from events in previous periods. For example, assume that:

(a) in 20X1 an entity incurred an input cost variance of CU100 and would be entitled to recover that variance in 20X3, but the entity assessed at the end of 20X1 that the boundary was the end of 20X2. Thus, the entity did not recognise a regulatory asset at the end of 20X1.

(b) at the end of 20X2, the entity reassesses the boundary and concludes that the boundary is now the end of 20X3. Thus, the cash flows of CU100 resulting from the input cost variance in 20X1 are now within the boundary.

BC156 The Board considered how an entity should account for additional cash flows brought within the boundary by a change in the boundary. One possible approach would not include those cash flows in the measurement of a regulatory asset or regulatory liability. The arguments for that approach are that:

(a) the regulatory asset or regulatory liability arose from an event in a past period (20X1 in the example in paragraph BC155). The economic effect of the regulatory asset or regulatory liability cannot be captured in the results reported for that past period by recognising the regulatory asset or regulatory liability in a subsequent period (20X2 in the example).

(b) subsequent recognition may make it difficult for users of financial statements to understand the entity's financial performance in the period of recognition (20X2 in the example) because the entity would recognise regulatory income or regulatory expense arising from an event of a past period (20X1).

BC157 Nevertheless, the Board proposes an approach that would include those cash flows because:

(a) recognising a regulatory asset or regulatory liability (in 20X2 in the example) shows that the entity has an enforceable present right or enforceable present obligation to add or deduct amounts in determining future regulated rates, thus more faithfully representing its financial position.

(b) that approach provides a more understandable depiction of the entity's financial performance in the period when the regulatory asset will be recovered (20X3 in the example), or when the regulatory liability will be fulfilled. That depiction is more understandable because recognising regulatory expense in that period indicates that revenue in that period was increased by amounts related to goods or services supplied in an earlier period (20X1 in the example). Similarly, recognising regulatory income in that period indicates that revenue in that period was decreased by amounts included in revenue recognised in an earlier period.

BC158 The Board also 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 78(f) of the Exposure Draft).

Discounting the estimated future cash flows

Background

BC159 The proposed model measures regulatory assets and regulatory liabilities by estimating the future cash flows arising from the regulatory assets or regulatory liabilities and discounting those cash flows to their present value. Those cash flows include cash flows from regulatory interest, which compensate or charge an entity for the time lag until recovery of a regulatory asset or fulfilment of a regulatory liability. The discount rate used for measurement would generally be the regulatory interest rate, with limited exceptions. As time passes, the discount unwinds and so the present value of the estimated future cash flows changes. As the discount unwinds, an entity would recognise regulatory interest income on the regulatory asset and regulatory interest expense on the regulatory liability.

BC160 Some existing accounting approaches for regulatory balances focus on deferral of allowable costs. Unlike the proposed model, those approaches do not involve the inclusion of explicit estimates of all future cash flows arising from regulatory balances, including regulatory interest, and explicit discounting of those cash flows to their present value.[12] Those existing approaches lead to a measurement outcome similar to the outcome that the proposed model produces, unless either the discount rate differs from the regulatory interest rate (because the regulatory interest rate provides insufficient compensation for the time lag until recovery of a regulatory asset—paragraphs BC167–BC168), or the regulatory interest accrues in one period but is recovered or fulfilled in a different period.

BC161 It would be possible in some cases to obtain measurement outcomes similar to the model without including explicit estimates of regulatory interest and without explicit discounting. Nevertheless, in the Board's view, a consistent principle that requires explicit estimates and explicit discounting provides useful information in all cases. Paragraphs BC174–BC177 discuss the only case for which the Board proposes a departure from that principle.

BC162 Although the model requires estimates of future cash flows and discounting, implementing that requirement is often straightforward:

(a) often, the regulatory interest rate would also be the discount rate required by the model. In such cases, the simplest way to determine the present value of the future cash flows at initial recognition is to sum the future cash flows excluding the cash flows that result from regulatory interest.

(b) it would, however, be necessary to determine the discount rate and perform a more detailed discounting computation for initial measurement if the regulatory interest rate for a regulatory asset is insufficient (paragraphs 50–52 of the Exposure Draft) or if the regulatory agreement specifies a component of total allowed compensation as a future value (rather than as a present value) and

12 Some existing accounting approaches involve discounting of estimated future cash flows in some cases, but not in others.

does not identify regulatory interest as a separate component of that future value (for example, if a regulatory agreement entitles an entity to a bonus of CU100 that will be added to the regulated rates charged to customers in two years' time without providing regulatory interest for the time lag until recovery of that bonus).

(c) once the initial measurement has been determined, discounting computations would not normally be necessary subsequently unless the amount or timing of the estimated cash flows has changed since the initial measurement for reasons other than recovery or fulfilment. Discounting computations would not be necessary because the present value of the estimated future cash flows at the end of each period will also equal the sum of the estimated future cash flows excluding the cash flows from regulatory interest that has not yet accrued. An entity would only need to add the amount of regulatory interest income or regulatory interest expense that has accrued on the regulatory asset or regulatory liability since the previous measurement and has not yet been included in amounts recovered or fulfilled. For disclosure, an entity would also need to determine the amount of regulatory interest income or regulatory interest expense for the period.

(d) if regulatory interest rates are uneven, an entity would need to translate them into a single discount rate to use in determining the regulatory interest income or regulatory interest expense accrued in each period.

BC163 When discussing what discount rate should be used, the Board noted that:

(a) regulatory agreements compensate or charge entities for the time lag until recovery of a regulatory asset or fulfilment of a regulatory liability by providing or charging regulatory interest rates, which may be different for different regulatory assets or regulatory liabilities.

(b) the regulatory interest rates provided typically range from zero to a rate approximating an entity's weighted average cost of capital, and are often tied to the duration of the regulatory asset or regulatory liability.

(c) some regulatory assets or regulatory liabilities form part of a larger base on which the regulatory agreement provides a regulatory return —for example, the regulatory capital base. In such cases, the regulatory interest rate on those regulatory assets and regulatory liabilities is the return rate provided by the regulatory agreement on that larger base.

(d) the regulatory interest rates set by the regulatory agreement for any particular regulatory asset or regulatory liability may not be designed to compensate or charge an entity precisely for the time value of money and for the uncertainty in the amount or timing of the resulting future cash flows, because those rates may often be set on an aggregated basis. However, the Board expects that in most cases the regulatory interest rate would be sufficient to provide at least that amount of compensation or charge.

BC164 For a measurement based on estimated future cash flows, the Board normally specifies a discount rate that reflects the characteristics of those cash flows—their amount, timing and uncertainty. However, the Board concluded that the objective set out in paragraph 1 of the Exposure Draft could be met without requiring this level of precision and that any benefit of incremental information provided by that level of precision would be unlikely to outweigh the costs and complexity. Thus, the Board proposes that an entity use the regulatory interest rate as the discount rate, except when the regulatory interest rate for a regulatory asset is insufficient (paragraphs BC167–BC168).

BC165 The Board considered whether it should provide a practical expedient exempting entities from discounting if the effects of the time value of money and uncertainty in the amount and timing of the estimated future cash flows is not significant. The Board does not propose a practical expedient of this kind because applying such a practical expedient would still, in effect, require an entity to assess whether the time value of money and uncertainty inherent in the cash flows are significant. This could introduce unnecessary complexity that may outweigh any incremental benefit. The Board also considered whether to provide relief from discounting if the regulatory asset or regulatory liability is recovered or fulfilled within a time period specified by the Board (for example, if a regulatory asset is expected to be fully recovered within one year of its recognition in the financial statements). However, the Board rejected this alternative, considering that it would be difficult for the Board to define a 'bright line' time period within which the effects of the time and uncertainty would not be expected to be material.

BC166 The Exposure Draft proposes that estimates of future cash flows arising from a regulatory liability not reflect the entity's own non-performance risk (paragraph BC139). The Exposure Draft also proposes that an entity would always discount those cash flows at the regulatory interest rate, without adjusting them for any reason, including for any possible effect of the entity's own non-performance risk. In the Board's view, any such adjustment would not provide useful information to users of financial statements.

Assessing the sufficiency of the regulatory interest rate

BC167 On initial recognition of a regulatory asset, and in specified circumstances subsequently (paragraph BC173), the Exposure Draft proposes that an entity assess whether there is any indication that the regulatory interest rate for a regulatory asset is not sufficient to compensate the entity for the time value of money and uncertainty in the amount and timing of the estimated future cash flows arising from that regulatory asset. If such an indication exists, the Board proposes that an entity estimate the 'minimum interest rate' that would provide that compensation. Because regulated rates are typically designed to support entities' financial viability, such situations are expected to occur infrequently.

BC168 If the minimum interest rate is higher than the regulatory interest rate, the entity would use the minimum interest rate as the discount rate, thus reducing the carrying amount of the regulatory asset. In some circumstances, that reduced carrying amount would be less than the amount of the related allowable expenses. The difference in amounts arises because the regulatory agreement does not provide the entity with sufficient compensation for the time lag until recovery of the regulatory asset—in effect, disallowing part of the related expenses. When the minimum interest rate is used as the discount rate, subsequent regulatory interest income would be accrued at that rate.

BC169 To avoid introducing unnecessary cost and complexity, the Board proposes not to require an entity to assess whether the regulatory interest rate for a regulatory liability is excessive—in other words more than is needed to charge the entity for the time value of money and uncertainty. Because any such excess would not be excluded from the discount rate, the excess would be reflected by higher regulatory interest expense over time, rather than by higher regulatory expense at initial recognition of the regulatory liability. In some cases, an excessive regulatory interest rate on a regulatory liability may merely offset an excessive regulatory interest rate on a larger regulatory asset, so that the regulatory interest rate sufficiently compensates the entity for an overall net regulatory asset position. In the Board's view, an entity is unlikely to be subject to an excessive regulatory interest rate on a large overall net regulatory liability position.

BC170 For similar reasons, the Board also proposes not to require an entity to use a discount rate that is sufficient to charge the entity for the time value of money and uncertainty if the regulatory interest rate for a regulatory liability is lower than that rate. Thus, any insufficiency in the regulatory interest rate would be reflected by lower regulatory interest expense over time, rather than by lower regulatory expense at initial recognition of the regulatory liability.

Changes in discount rate

BC171 The Board proposes that an entity continue to use the discount rate determined at initial recognition, unless a change in the regulatory interest rate changes the estimated future cash flows.

BC172 The Board concluded that updating the discount rate in other cases would introduce unnecessary cost and complexity for little or no benefit to users of financial statements. The Board understands that users are interested in changes in the value of regulatory assets and regulatory liabilities caused by changes in the amounts of the estimated cash flows rather than changes in their value caused by changes in the discount rate.

BC173 The Board proposes that if a change in the regulatory interest rate were to change the estimated future cash flows, an entity use the new regulatory interest rate as the new discount rate from the date when the regulatory interest rate changes. Consequently, an entity would not recognise a gain or loss merely because of a change in the cash flows caused by a change in the regulatory interest rate. This approach can be viewed as similar to the approach used to determine the amortised cost of variable rate financial instruments. When the regulatory interest rate for a regulatory asset changes, an entity would be required to assess whether the new regulatory interest rate is sufficient (paragraphs BC167–BC168).

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.

Presentation (paragraphs 67–71)

BC178 The Board did not carry over into the Exposure Draft the presentation requirements in IFRS 14. The Board included those requirements in IFRS 14 because the Board had not yet concluded whether regulatory deferral account balances meet the definitions of an asset or a liability. Because the Board has now concluded that a regulatory asset or regulatory liability meets the definition of an asset or a liability, those presentation requirements would no longer be needed.

Presentation—statement(s) of financial performance

BC179 The Board proposes that an entity should present all regulatory income minus all regulatory expense in a separate line item immediately below revenue. Regulatory assets and regulatory liabilities are enforceable present rights to increase, or enforceable present obligations to decrease, future regulated rates. Because they do not affect the amount of revenue in the current period, regulatory income and regulatory expense would not be presented as part of revenue. Nevertheless, regulatory assets and regulatory liabilities will affect the amount of revenue that an entity will recognise in future periods by applying IFRS 15 (paragraph BC31(h)). Accordingly, all regulatory income minus all regulatory expense would be presented in a separate line item immediately below revenue.[13]

Regulatory interest income and regulatory interest expense

BC180 Regulatory interest is a stream of incremental cash flows compensating or charging the entity for the time lag until recovery of regulatory assets or fulfilment of regulatory liabilities.

13 In limited circumstances, some regulatory income or regulatory expense would be presented in other comprehensive income (paragraphs BC183–BC186).

BC181 Regulatory interest income and regulatory interest expense differ in nature from all other components of regulatory income or regulatory expense and are driven by different factors. Therefore, the Board proposes requiring an entity to disclose regulatory interest income and regulatory interest expense in the notes separately from all other components of regulatory income or regulatory expense (paragraph 78(e) of the Exposure Draft).

BC182 However, the Board is not proposing that an entity should present regulatory interest income or regulatory interest expense separately from all other components of regulatory income or regulatory expense in the statement(s) of financial performance. Amounts relating to regulatory interest will be included in determining the future regulated rates charged to customers—and hence included in revenue in future periods—when the related regulatory assets are recovered or related regulatory liabilities are fulfilled. Therefore, presenting regulatory interest income minus regulatory interest expense within the line item for all regulatory income minus all regulatory expense, immediately below revenue, would coherently and understandably show the effects on revenue of regulatory assets and regulatory liabilities and changes in them.

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*.

Disclosure (paragraphs 72–85)

BC187 In developing the proposed disclosure objectives and requirements, the Board considered:

(a) the role of disclosure objectives;

(b) the disclosure objective in IFRS 14; and

(c) the focus of the proposed disclosure objectives and requirements on financial performance.

BC188 As part of its project *Disclosure Initiative—Targeted Standards-level Review of Disclosures*, the Board expects to publish an exposure draft discussing a possible approach to developing disclosure objectives and disclosure requirements, and proposals for applying that approach to two particular IFRS Standards.[14] Some of the Board's thinking in that project has helped the Board develop the proposed disclosure objectives and requirements in the Exposure Draft.

Role of disclosure objectives

BC189 Disclosure objectives support effective communication in financial statements by helping an entity to identify useful information and to decide how to communicate that information in the most effective manner (paragraph 7.5 of the *Conceptual Framework*). The Board includes objectives in addition to the disclosure requirements to help an entity use judgement to:

(a) identify useful information that the entity should disclose in the notes; and

(b) decide whether the information the entity discloses enables users of financial statements to understand the economic phenomenon or other matters identified in a disclosure objective and to assess the implications of that phenomenon or those other matters for the entity's prospects for future cash flows.

BC190 Therefore, the Board is proposing:

(a) an overall disclosure objective, as in several other IFRS Standards developed in recent years;

(b) three specific disclosure objectives that provide a basis for an entity to decide what information it should disclose and how it should disclose that information; and

14 For more information on that project, please see https://www.ifrs.org/projects/work-plan/standards-level-review-of-disclosures

(c) disclosure requirements—requirements to disclose information needed to meet the specific disclosure objectives, if the information is material.

The disclosure objective in IFRS 14

BC191 The disclosure objective in IFRS 14 is that an entity should disclose information that enables users of financial statements to assess:

(a) the nature of, and the risks associated with, the rate regulation that establishes the price(s) that the entity can charge customers for the goods or services it provides; and

(b) the effects of that rate regulation on its financial position, financial performance and cash flows.

BC192 The Board decided that the disclosure objective in IFRS 14 is too broad to serve as the overall disclosure objective in the Exposure Draft for the following reasons:

(a) although information about the nature of, and risks associated with, rate regulation is useful to users of financial statements, users do not rely on financial statements to provide that information. IFRS Standards do not require entities to disclose such information about any other form of regulation and the Board sees no reason to require entities to provide such information for rate regulation. The *Conceptual Framework* notes that general purpose financial reports such as financial statements do not and cannot provide all of the information that existing and potential investors, lenders and other creditors need. The *Conceptual Framework* states that those users need to consider pertinent information from other sources, for example, general economic conditions and expectations, political events and political climate, and industry and company outlooks.[15]

(b) rate regulation can have pervasive effects on every aspect of an entity's financial performance, financial position and cash flows. For example, rate regulation determines whether an entity can supply the regulated goods or services at all, affects the rates an entity charges, affects the costs an entity needs to incur to supply goods or services and the profit to which the entity is entitled when supplying them, and determines the required quality of the goods or services. These aspects affect the demand for the goods or services, and thus lead to further pervasive effects. An objective of enabling users to assess such pervasive effects would go beyond what financial statements can feasibly provide and beyond what IFRS Standards require for any other form or aspect of regulation.

15 *Conceptual Framework*, paragraph 1.6.

BC193 Instead, the overall disclosure objective proposed in paragraph 72 of the Exposure Draft focuses on information about an entity's regulatory income, regulatory expense, regulatory assets and regulatory liabilities. That disclosure objective is in line with the discussion of the objective proposed in paragraphs 1–2 of the Exposure Draft.

BC194 If the Board were to set a broader disclosure objective:

(a) that objective might result in requirements to disclose further information—for example, the amount of the regulatory capital base, the return rate applied to that base, and differences between that base and corresponding amounts included in the measurement of assets recognised in the statement of financial position. Disclosing that information is not necessary to meet the proposed disclosure objectives.

(b) an entity subject to rate regulation might need to disclose information about the effects of the regulation even if no regulatory assets or regulatory liabilities existed at any time during any period reported in the financial statements. A consequence of the proposed disclosure objectives is that an entity would not be required to disclose information about the effects of rate regulation in such circumstances.

Focus on financial performance

BC195 The model proposed in the Exposure Draft is intended to provide users of financial statements with information about the effects of differences in timing that arise when part of the total allowed compensation for goods or services supplied in one period is included in determining the regulated rates for goods or services supplied—and hence included in revenue—in a different period (paragraphs BC21–BC35). The model would provide some of that information by requiring an entity to recognise regulatory assets and regulatory liabilities.

BC196 Paragraphs 72(a) and 77 of the Exposure Draft set out the first specific objective of the disclosure requirements. That objective is that the information disclosed about regulatory income and regulatory expense, together with all other information provided in the financial statements, should enable users of financial statements to understand the relationship between an entity's revenue and expenses as completely as would have been possible if the total allowed compensation for the goods or services supplied had been fully reflected in revenue in the period in which the entity supplied those goods or services. That understanding can be expected to provide users with better insights into the entity's prospects for future cash flows.

BC197 The information provided by applying the proposals in the Exposure Draft would be useful to users of financial statements not by itself, but mainly because it contributes to a better understanding of the relationship between an entity's revenue and expenses, and therefore contributes to providing insights into the entity's prospects for future cash flows over many periods. The Board expects that an entity would consider that overall context in deciding what information about regulatory income, regulatory expense, regulatory assets and regulatory liabilities is material to users of that entity's financial statements, and how to communicate it clearly and understandably.

BC198 Paragraph 78 of the Exposure Draft lists components and causes of regulatory income or regulatory expense and proposes that an entity should disclose them as a means of achieving the first specific disclosure objective. Disclosure of the components is necessary because each component is driven by a factor different from the factors that drive the other components. Each component also has a different type of effect on the relationship between revenue and expenses recognised as a result of supplying goods or services. For example, if an entity recognises an allowable expense in the current period but the regulatory agreement requires the entity to include the compensation for that expense in determining the regulated rates in a future period, the entity would recognise a regulatory asset in the current period. The regulatory income arising on initial recognition of the regulatory asset (paragraph 78(a) of the Exposure Draft) would provide information about the amount of the difference in timing whereas the regulatory interest income on that regulatory asset (paragraph 78(e) of the Exposure Draft) would provide information about compensation for the time lag until the entity recovers the regulatory asset.

BC199 The Board does not propose to require entities to disclose an analysis of regulatory income or regulatory expense by the nature of the event that gave rise to them, or by the nature of the allowable expense or the chargeable income that gave rise to them. In the Board's understanding, users of financial statements do not need that information to help them understand the relationship between revenue and expenses. Furthermore, IFRS Standards do not require an entity to disclose similar analysis of revenue if the total allowed compensation for goods or services supplied is fully reflected in revenue recognised in the period in which those goods or services were supplied.

BC200 Paragraphs 72(b) and 79 of the Exposure Draft propose a second specific disclosure objective, which is to provide information about an entity's regulatory assets and regulatory liabilities. That objective is listed second because the resulting information provides insights into a narrow set of future cash flows (only those cash flows that will arise from the regulatory assets and regulatory liabilities that exist at the end of the reporting period), whereas the information provided to meet the first specific disclosure objective contributes to providing insights into a broader set of future cash flows over many periods.

BC201 Paragraph 82 of the Exposure Draft proposes a third specific disclosure objective, which is about changes in regulatory assets and regulatory liabilities. The related information is necessary mainly to inform users of financial statements of changes not explained by other information disclosed.

BC202 The proposed specific disclosure objectives do not refer to the cash flows that occurred during the period. That is because an entity recovers regulatory assets and fulfils regulatory liabilities indirectly by increasing or decreasing regulated rates, not directly by receiving or paying cash.

Effective date (Appendix C)

BC203 The Board expects to require entities to apply the final Standard for annual reporting periods beginning on or after a date 18–24 months from the date of its publication. To a large extent, the proposed model would use inputs that preparers are already expected to gather and process in determining regulated rates. The Board expects that a period of 18–24 months would allow sufficient time for entities to make necessary updates to their systems, collect the incremental information needed to apply the proposals, and make any other necessary changes.

Transition (Appendix C)

BC204 The Board proposes retrospective application because information is more useful to users of financial statements if it is comparable for all periods presented.[16] The Board observed that retrospective application would be unlikely to burden preparers because to a large extent, the proposed model would use inputs that the Board expects preparers already need to gather and process in determining regulated rates (see analysis of the likely costs for preparers of implementing the proposals in paragraphs BC247–BC250).

BC205 The Board considered whether to propose a modified form of retrospective application from the beginning of the annual reporting period in which an entity first applies the proposed Standard (date of initial application) without restating comparative information, rather than full retrospective application from the beginning of the earliest annual reporting period presented (date of transition) with restatement of comparative information. Users of financial statements might have more difficulty understanding reported financial performance if comparative information is not restated to make it comparable. The Board concluded that the resulting costs for users of financial statements in understanding incomparable information would outweigh the savings in costs for preparers. Therefore, the Board does not propose that modified form of retrospective application.

BC206 The Board found no need for disclosures about the effect of transition to the proposed Standard beyond those required by IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Past business combinations

BC207 In this section (paragraphs BC208–BC213), the term 'regulatory balances' refers to any item that an entity recognised as if that item were an asset or liability, but that the entity would not have recognised if the proposals in the Exposure Draft had always been applied.

BC208 The Board proposes that for regulatory assets and regulatory liabilities acquired or assumed in a past business combination, an entity would apply the requirements retrospectively unless it elects to apply a simpler approach, which is discussed in paragraphs BC211–BC213. The Board proposes that if an

16 *Conceptual Framework*, paragraph 2.24.

entity elects to apply the simpler approach, the entity should apply that approach to all of its past business combinations. Both retrospective application and the simpler approach involve recognising and measuring regulatory assets and regulatory liabilities that still exist at the date of transition, derecognising all regulatory balances relating to that business combination, recognising any deferred tax effects of those adjustments, and recognising any effect on the carrying amounts of non-controlling interests and goodwill.

BC209 If an entity does not elect to use the simpler approach, the entity would be required to determine the carrying amount of goodwill at the date of transition by:

(a) breaking down the carrying amount of goodwill at the date of transition by each past business combination.

(b) reconsidering each past business combination to determine the initial carrying amount of all regulatory assets and regulatory liabilities that the entity would have recognised at the acquisition date, and the difference between that initial carrying amount and the carrying amount of regulatory assets, regulatory liabilities and regulatory balances the entity did in fact recognise at that date. That difference (net of related deferred tax) would determine the amount of the adjustment to goodwill or to the bargain purchase gain at the acquisition date (and to any non-controlling interests, if not measured at fair value).

(c) establishing how much of the adjustment to goodwill would remain at the date of transition, after considering any impairments, reversals of impairment and disposals between the acquisition date and the date of transition.

BC210 In the Board’s view, the incremental information from quantifying every adjustment that would result from a full reconsideration of every past business combination is unlikely to lead to benefits that outweigh costs. Consequently, the Board proposes that an entity could elect to use the simpler approach described in paragraph BC211.

BC211 The simpler approach would require an entity to:

(a) recognise and measure—applying the requirements proposed in the recognition and measurement sections of the Exposure Draft—all regulatory assets acquired, and all regulatory liabilities assumed, in a past business combination, which still exist at the date of transition;

(b) derecognise all regulatory balances that it recognised in that past business combination and still recognised immediately before the date of transition;

(c) recognise any deferred tax effects of the adjustments described in subparagraphs (a)–(b);

(d) adjust the carrying amount of non-controlling interests from that past business combination remaining at the date of transition for their proportionate share of the net amount of the adjustments described in subparagraphs (a)–(c), if the entity measured those interests at their proportionate share in the recognised amounts of the acquiree's identifiable net assets, rather than at fair value; and

(e) adjust the carrying amount of goodwill still remaining (at the date of transition) from that past business combination for the net amount of the adjustments described in subparagraphs (a)–(d) without further adjustment for the effects of any impairments, reversals of impairment, and disposals between the acquisition date and the date of transition. The entity would perform this calculation separately for each past business combination, so that if the adjustment reduces the carrying amount of goodwill to nil, the entity recognises any remaining amount of adjustment in retained earnings or, if appropriate, another category of equity.

BC212 An entity applying the simpler approach would not determine:

(a) the initial carrying amount of regulatory assets and regulatory liabilities at the acquisition date of past business combinations;

(b) the initial carrying amount of regulatory balances recognised at the acquisition date of past business combinations;

(c) separately for each past business combination, the net effect of the adjustments resulting from the items identified in subparagraphs (a)–(b) and then the carrying amount of goodwill the entity would have recognised at the acquisition date after those adjustments, without netting that goodwill off against a gain from a bargain purchase that arose in any other business combination; and

(d) any further adjustment needed to that adjusted carrying amount of goodwill to reflect any impairments, reversals of impairments, and disposals from the acquisition date until the date of transition.

BC213 The simpler approach to past business combinations explained in paragraph BC211 is similar to an optional exemption for past business combinations made available for first-time adopters by IFRS 1 *First-time Adoption of International Financial Reporting Standards*. However, a first-time adopter applying IFRS 1 would recognise the change resulting from recognising regulatory assets and regulatory liabilities at the date of transition to IFRSs, and from derecognising regulatory balances (other than the goodwill-related regulatory balances discussed in paragraphs BC253–BC258), by adjusting retained earnings, not by adjusting the carrying amount of goodwill (paragraph C4(b) of IFRS 1).

Likely effects of the proposals

BC214 The Board is committed to assessing, and explaining its views about, the likely benefits and costs of implementing its proposals, and the likely ongoing benefits and application costs of those proposals—these benefits and costs are collectively referred to as ‘effects’. The Board expects to gain further insight into the likely effects of its proposals from responses to the Exposure Draft and through analysis and outreach.

BC215 This section discusses:

(a) entities affected by the Board’s proposals (see paragraphs BC218–BC221);

(b) likely effects on information reported in the financial statements (see paragraphs BC222–BC229);

(c) likely effects on the quality of financial reporting (see paragraphs BC230–BC244); and

(d) likely costs of implementing the proposals (see paragraphs BC245–BC250).

BC216 The analysis of these effects is mainly qualitative rather than quantitative. Costs and benefits are likely to vary among stakeholders. Quantifying costs, and particularly benefits, is both subjective and difficult. No sufficiently well-established and reliable techniques quantify either costs or benefits in this type of analysis. The Board analysed the likely effects of the proposals rather than the actual effects, because the actual effects cannot be known prior to application. The Board considers the actual effects during post-implementation reviews.

BC217 The Board has sought to understand the potential effects of its proposals throughout the development of the Exposure Draft. The Board discussed the project and its likely effects with bodies that advise the Board, including the Rate-regulated Activities Consultative Group, the Accounting Standards Advisory Forum, the Capital Markets Advisory Committee, the Global Preparers Forum and the Emerging Economies Group. The Board also considered reports published by national standard-setters. Further input came from a discussion of case studies at the 2017 World Standard-setters Conference (paragraph BC18).

Entities affected by the Board’s proposals

BC218 The proposals would affect only entities that have regulatory assets and regulatory liabilities. Not all entities are subject to rate regulation, and not all entities subject to rate regulation have regulatory assets or regulatory liabilities. In the remaining paragraphs of this section (paragraphs BC219–BC251):

(a) all references to ‘an entity’ or ‘entities’ are to an entity or entities affected by the proposals, unless specified otherwise.

(b) the term 'regulatory balances' refers to the effects of rate regulation that an entity recognises as assets or liabilities.

BC219 Entities that currently do not recognise regulatory balances could be:

(a) entities that have not yet adopted IFRS Standards and, applying local requirements, do not recognise regulatory balances as assets or liabilities;

(b) entities that adopted IFRS Standards before IFRS 14 came into effect and concluded that not recognising regulatory balances as assets or liabilities was an appropriate application of IFRS Standards to their regulatory agreements; or

(c) entities that adopted IFRS Standards when or after IFRS 14 came into effect, but chose not to apply that Standard or were ineligible to do so, and concluded that not recognising regulatory balances as assets or liabilities was an appropriate application of IFRS Standards to their regulatory agreements.

BC220 Entities that currently recognise regulatory balances as assets or liabilities could be:

(a) entities that have not yet adopted IFRS Standards and, applying local requirements, recognise regulatory balances as assets or liabilities;

(b) entities that adopted IFRS Standards before IFRS 14 came into effect and concluded that recognising regulatory balances as assets or liabilities was an appropriate application of IFRS Standards to their regulatory agreements; or

(c) entities that apply IFRS 14.

BC221 The likely effects would be more significant for entities that currently do not recognise regulatory balances. For entities that currently recognise regulatory balances, the likely effects would vary depending on what financial reporting requirements they apply for regulatory balances.

Likely effects on information reported in the financial statements

Entities that currently do not recognise regulatory balances

BC222 On applying the proposals, entities that currently do not recognise regulatory balances would start to recognise regulatory assets and regulatory liabilities in the statement of financial position, and regulatory income or regulatory expense in the statement(s) of financial performance. Paragraph BC31 explains the consequences for information these entities would then start providing about their financial performance and financial position.

BC223 An entity recovers regulatory assets or fulfils regulatory liabilities indirectly by increasing or decreasing regulated rates charged to customers, not directly by receiving or paying cash. Consequently, the proposals would not affect the cash flows that an entity reports in the statement of cash flows. If the entity uses the indirect method for reporting cash flows from operating activities, the entity would determine their amount by deducting regulatory income from, or adding regulatory expense to, profit or loss for the period.

Entities that currently recognise regulatory balances

BC224 The current models for reporting regulatory balances largely involve the deferral of costs. In such a cost deferral model, the nominal amount of an item of expense is deferred and is subsequently recognised in profit or loss in the future periods in which the entity will recover that expense by increasing the regulated rates charged to customers. Similarly, in some instances, the nominal amount of income is accrued in advance so that it is recognised in the same period as expenses recognised in the current period, or is deferred so that it is recognised in the same period as expenses that will be recognised in a future period.

BC225 Applying the proposals, entities would recognise regulatory assets or regulatory liabilities, but not necessarily in the same circumstances in which they currently recognise regulatory balances. In addition, the measurement of regulatory assets or regulatory liabilities may sometimes be similar to measurements of regulatory balances, but is likely to differ if:

(a) the measurement of a regulatory asset or regulatory liability includes a profit component (paragraphs BC90–BC110);

(b) regulatory interest accrues in one period but is recovered or fulfilled in a different period (paragraph BC160); or

(c) the regulatory interest rate provides insufficient compensation for the time lag until recovery of a regulatory asset (paragraphs BC167–BC170).

BC226 In the statement of financial position, entities applying IFRS 14 are prohibited from classifying regulatory deferral account balances as current and non-current. On applying the proposals, if entities distinguish current assets and current liabilities from non-current assets and non-current liabilities, those entities would be required to present current regulatory assets and current regulatory liabilities separately from non-current regulatory assets and non-current regulatory liabilities, which would be consistent with the presentation of other assets and liabilities.

BC227 In the statement(s) of financial performance, entities currently present changes in regulatory balances and related expense or income (for example, expenses incurred in supplying goods or services to customers) in various locations, depending on the nature of the item and the accounting approach applied. In some instances, the change in a regulatory balance may be netted against related expense or income. On applying the proposals, entities would present all regulatory income minus all regulatory expense immediately below revenue.[17] They would also include related expense or income in amounts presented in the statement(s) of financial performance, without netting regulatory income or regulatory expense against them.

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17 In limited circumstances, some regulatory income or regulatory expense would be presented in other comprehensive income (paragraphs BC183–BC186).

BC228 IFRS 14 requires entities to draw a subtotal of all other assets and liabilities above the line items for regulatory deferral account balances, and a subtotal above the line item for the net movement for the reporting period in all regulatory deferral account balances. For reasons explained in paragraph BC178, the Board would no longer require those subtotals.

BC229 As explained in paragraph BC223, the proposals would not affect the cash flows that would be reported in the statement of cash flows of these entities.

Likely effects on the quality of financial reporting (by entities that currently do not recognise regulatory balances)

BC230 As explained in paragraph BC24, the statement(s) of financial performance of entities that currently do not recognise regulatory balances provide(s) no information about how the relationship between revenue and expenses is affected by differences in timing arising when part of the total allowed compensation for goods or services supplied in one period is included in regulated rates for goods or services supplied, and hence in revenue, in a different period. The absence of that information makes it difficult for users of financial statements to understand why the relationship between revenue and expenses fluctuates from one period to another, and whether such differences in timing are the only reason for those fluctuations. Consequently, users of financial statements would have insufficient information to understand the relationship between an entity's revenue and expenses, and so insufficient insight into the entity's prospects for future cash flows.

BC231 The Board expects that through the recognition of regulatory income or regulatory expense and disclosure of their components (paragraph BC198), the proposals would produce a clearer and more complete picture of the relationship between an entity's revenue and expenses, and thus enable users of financial statements to understand the entity's financial performance better.

BC232 Therefore, users of financial statements would have more complete information that provides a better basis for understanding the extent to which the fluctuations in the relationship between an entity's revenue and expenses are caused by the differences in timing mentioned in paragraph BC230. A better understanding of this would provide users of financial statements with better insights into the entity's prospects for future cash flows.

Likely effects on the quality of financial reporting (by entities that currently recognise regulatory balances)

BC233 Financial statements of entities that currently recognise regulatory balances already provide some information about some effects of rate regulation on the relationship between revenue and expenses. However, the proposals are expected to produce more useful financial information than a cost deferral model (paragraph BC224) for the reasons explained in paragraphs BC234–BC244.

Conceptual basis for identifying and reporting regulatory assets and regulatory liabilities

BC234 With the objective of matching expenses with revenue, a cost deferral model typically includes rules about how and when an entity should recognise in profit or loss each item of expense or income that gives rise to a regulatory balance. In contrast, the proposed model uses the concept of total allowed compensation for goods or services supplied in a period as the sole basis in identifying regulatory assets and regulatory liabilities (paragraphs BC87–BC110).

BC235 The proposed model's objective is not to match expenses with revenue, although application of the model would typically lead to an entity recognising regulatory income or regulatory expense in the same period as related effects on expenses or on revenue. The example in paragraph BC25 illustrates this: as explained in paragraph BC32, the proposals would result in the entity recognising regulatory income of CU20 in the same period (20X1) in which the entity also recognises recoverable excess input costs of CU20.

Comparability of financial information of entities affected by the proposals

BC236 The proposals would improve comparability of financial information because all entities affected by the proposals would use the same set of principles for reporting regulatory assets and regulatory liabilities.

Comparability with entities not affected by the proposals

BC237 Some models for reporting regulatory balances require or permit an entity to recognise regulatory balances as part of the carrying amount of other assets and liabilities, rather than recognising those balances as separate items. For example, an entity may be required or permitted to account for property, plant and equipment applying the regulatory requirements instead of applying the accounting standards that other entities must apply for these assets. The resulting financial information about these assets may not be comparable with financial information provided by other entities, including those not affected by the proposals.

BC238 The proposed model would not affect the requirements in other IFRS Standards, and would require an entity to present regulatory assets and regulatory liabilities separately in the financial statements. Consequently, the Board expects that financial information provided about all other assets and liabilities would be comparable with financial information produced by other entities, including those not affected by the proposals.

Focus on future cash flows

BC239 A cost deferral model produces information that may not always be useful to users of financial statements, because it may focus on past cash flows and their likely recoverability, and may not always focus on incremental future cash flows and effects of changes in those cash flows.

BC240 In contrast, the proposals focus only on the incremental future cash flows that result from regulatory assets and regulatory liabilities.

More complete information about the effects of regulatory assets and regulatory liabilities

BC241 A cost deferral model focuses mostly on allowable expenses and chargeable income, and, unlike the proposed model, may not:

(a) provide information about the differences in timing arising when a component of target profit forming part of total allowed compensation for goods or services supplied in one period is included in the regulated rates charged to customers in a different period;

(b) involve the use of explicit estimates of all future cash flows arising from regulatory balances, including regulatory interest, and explicit discounting of those cash flows to their present value; or

(c) require entities to disclose regulatory interest income or regulatory interest expense.

Coherent, prominent and understandable presentation

BC242 In some cost deferral models, the effects of deferral of income or expense are not presented separately in the statement(s) of financial performance. For example, if an item of expense incurred in the current period will be recovered in the regulated rates charged to customers in a future period and hence is deferred, the amount of expense and the deferral might not be presented separately in the statement(s) of financial performance for the current period. Instead, the expense might be capitalised directly by deferral in a regulatory balance. Consequently, the statement(s) of financial performance do not provide complete information about the income or expenses presented in this way.

BC243 Moreover, entities applying IFRS 14 are required to present a separate line item in the statement(s) of financial performance for the net movements for the reporting period in all regulatory deferral account balances.

BC244 In contrast, the proposals would also require an entity to present all regulatory income minus all regulatory expense in a single line, but immediately below revenue to emphasise the close relationship between revenue and regulatory income or regulatory expense (paragraph BC179).[18] The related expenses and income would be presented applying the applicable IFRS Standards.

18 In limited circumstances, some regulatory income or regulatory expense would be presented in other comprehensive income (paragraphs BC183–BC186).

Likely costs of implementing the proposals

Costs for users of financial statements

BC245 If financial statements do not provide information about regulatory income, regulatory expense, regulatory assets and regulatory liabilities, users of financial statements are not able to understand the relationship between revenue and expenses as completely as they can when no regulatory assets or regulatory liabilities exist. In the absence of that information, users of those financial statements incur costs because they need to refer to other sources such as management reports, investor presentations and information available from the rate regulator. Information from those other sources is typically unaudited and is also typically inconsistent across entities.

BC246 When financial statements prepared applying the proposals become available, users of financial statements are expected to have more complete information that would enable them to understand the relationship between an entity's revenue and expenses as completely as they can when no regulatory assets or regulatory liabilities exist. The Board expects that the information in those financial statements would be consistent across all entities because all entities would be using the same set of principles in reporting regulatory assets and regulatory liabilities in the financial statements. If that information is included in financial statements it would typically be audited, which is not the case for information that some entities currently provide outside financial statements. Consequently, users of financial statements would save costs of collecting and processing information. Users might have to incur some initial costs to adjust their analyses and models. However, in the long term, the Board expects that the benefits would exceed the costs because all users could develop their analyses using financial information that provides greater insight into the relationship between revenue and expenses.

Costs for entities that currently do not recognise regulatory balances

BC247 The Board does not expect the costs of applying the proposals, both on initial application and on an ongoing basis, to be significant because to a large extent, the proposed model would use inputs that the Board expects an entity already needs to gather and process in determining regulated rates. The proposed model would require an entity to gather additional inputs in some cases, including:

(a) slightly more detailed estimates of how demand risk and credit risk will affect the cash flows arising from regulatory assets and regulatory liabilities (paragraphs BC140–BC141);

(b) the minimum interest rate when the regulatory interest rate for a regulatory asset is not sufficient (paragraphs BC167–BC170);

(c) a single regulatory interest rate when the regulatory agreement provides uneven regulatory interest rates, that is, different rates for different periods (paragraph BC162(d));

(d) estimates of the outcome of performance incentives that operate over a time frame that is not yet complete (paragraph BC106); and

(e) revenue already recognised that arises from regulatory return on assets not yet available for use (paragraphs BC96–BC100).

BC248 However, as with the implementation of any new IFRS Standard, the Board expects preparers to incur some incremental costs when applying the requirements, such as:

(a) costs to change or develop systems, processes and controls to gather and archive regulatory data, make required adjustments and estimates, and provide required disclosures;

(b) costs to implement the transition requirements;

(c) incremental external audit costs;

(d) costs to educate management, finance and other personnel about the effects of the requirements; and

(e) costs to educate users of financial statements about the effects of the requirements on the financial statements.

BC249 Most of those costs are non-recurring. The ongoing costs are expected to be less than the costs that users of financial statements would continue to incur in the absence of the proposed model as explained in paragraph BC245.

Costs for entities that currently recognise regulatory balances

BC250 The Board does not expect the cost of applying the proposals, both on initial application and on an ongoing basis, to be significant because to a large extent, the proposed model would use inputs that the Board expects an entity already needs to gather and process in determining regulated rates, and in reporting regulatory balances in its financial statements. The entity would have to incur some costs to adjust the systems, processes and controls around reporting regulatory balances to apply the proposals. Applying the proposals would not unduly increase the costs for preparers because:

(a) the recognition requirements are not unduly complex; and

(b) the requirement to use the regulatory interest rate to discount future cash flows, if that rate is sufficient, would minimise the costs to preparers for determining a discount rate.

Overall assessment of likely benefits and costs

BC251 In the light of the factors discussed in paragraphs BC222–BC250, the Board's overall assessment is that the benefits of more useful information to users of financial statements would outweigh the costs to users and preparers of implementing the proposals.

Draft amendments to other IFRS Standards (Appendix D)

IFRS 1 *First-time Adoption of International Financial Reporting Standards*

BC252 This section discusses:

(a) goodwill-related regulatory balances (paragraphs BC253–BC258); and

(b) deemed cost for some assets used in operations subject to a regulatory agreement that is capable of creating regulatory assets or regulatory liabilities (paragraph BC259).

BC253 If a first-time adopter does not apply IFRS 3 retrospectively to a past business combination, it is required to exclude from its opening IFRS statement of financial position any item that was recognised applying previous GAAP, but does not qualify for recognition as an asset or a liability under IFRS Standards.

BC254 Some regulatory agreements treat goodwill as an allowable cost to be added in determining the regulated rates to be charged to customers in future periods. In some such cases, first-time adopters applying their previous GAAP treated that goodwill as a regulatory balance, recognised it as an asset and subsequently derecognised it as related amounts were included in the regulated rates charged to customers.

BC255 Such a goodwill-related regulatory balance arises from a transaction. That transaction is the business combination itself and not any supply of goods or services before the business combination. Consequently, those balances do not give rise to a regulatory asset when the business combination occurs. Therefore, entities would need to derecognise such regulatory balances on transition to the proposed model.

BC256 The Board proposes to amend paragraphs C4(c)(i) and C4(g)(i) of IFRS 1. The amendment would apply to a first-time adopter electing not to apply IFRS 3 retrospectively to a past business combination. The amendment would require the first-time adopter to derecognise such regulatory balances in the same way as intangible assets not qualifying for recognition: by increasing the carrying amount of goodwill, rather than by decreasing equity. Because IFRS Standards prohibit amortisation of goodwill, the carrying amount of goodwill would have been higher by that amount if those regulatory balances had not been recognised as assets separately from goodwill as part of the acquisition-date accounting. Paragraph C4(g)(ii) of IFRS 1 requires a first-time adopter to apply IAS 36 in testing the goodwill for impairment at the date of transition to IFRSs.

BC257 The Board proposes that if a first-time adopter included such goodwill-related regulatory balances in the measurement of goodwill at the acquisition date, it should not reclassify them from goodwill to regulatory assets at the date of transition to IFRSs, even if those balances were still outstanding. Such an outcome is consistent with the fact that the proposals in the Exposure Draft would not permit recognition of such balances as assets because they do not meet the definition of a regulatory asset (paragraph BC255). As a result, such an outcome is also consistent with how IFRS 1 treats intangible assets: a first-time adopter reclassifies them from goodwill to intangible assets only if IAS 38 requires the acquiree to recognise them.

BC258 The proposed amendments to IFRS 1 discussed in paragraphs BC256–BC257 would apply only to goodwill-related regulatory balances. They would not apply to regulatory assets and regulatory liabilities and they would not apply to other aspects of a first-time adopter's accounting for past business combinations. The Board considers the proposed amendments to IFRS 1 to be consistent with the overall approach in IFRS 1 for a first-time adopter that does not apply IFRS 3 retrospectively to a past business combination (paragraph C4 of IFRS 1).

BC259 An exemption in paragraph D8B of IFRS 1 permits first-time adopters at the date of transition to IFRSs to use as deemed cost the previous GAAP carrying amount of an item that is used, or was previously used, in operations subject to rate regulation. The Board proposes to retain this exemption, with changes to align terminology with that in the Exposure Draft, because:

(a) without the exemption, a first-time adopter would be required either to restate those items retrospectively to remove the non-qualifying amounts, or to use fair value as deemed cost. Both of those alternatives might pose significant practical challenges.

(b) for property, plant and equipment, most rate-regulated first-time adopters use a historical cost model largely consistent with IAS 16. In addition, when a first-time adopter uses the exemption, the first-time adopter is required to test the item for impairment using IAS 36 at the date of transition.

IFRS 3 *Business Combinations*

BC260 The Exposure Draft proposes that, as an exception to the recognition and measurement principles in IFRS 3, an entity should recognise and measure regulatory assets acquired and regulatory liabilities assumed in a business combination applying the recognition and measurement principles proposed in the Exposure Draft, rather than recognise and measure them at fair value. Without such an exception, an entity might:

(a) not recognise regulatory assets acquired, or regulatory liabilities assumed, in a business combination if it is uncertain whether they exist. In contrast, applying the proposals in the Exposure Draft, an entity would recognise regulatory assets or regulatory liabilities if it is more likely than not that they exist.

(b) incur significant costs in:

(i) determining the discount rate needed to measure regulatory assets and regulatory liabilities at fair value. The entity might incur significant costs because regulatory assets and regulatory liabilities are not traded in active markets and there are generally few observable inputs that could be used in determining an appropriate discount rate—one that market participants would use when pricing those assets and liabilities.

(ii) tracking separately regulatory assets acquired or regulatory liabilities assumed in a business combination at a discount rate that is not explicit in the regulatory agreement.

(iii) determining the discount rate to use subsequently if the regulatory agreement changes the applicable regulatory interest rate.

BC261 The Board concluded that the proposed exception would:

(a) provide information that is relevant to users of financial statements;

(b) save costs for preparers; and

(c) for items affecting regulated rates only when related cash is paid or received, provide a simple and understandable outcome for regulatory assets and regulatory liabilities measured using the same measurement basis as used for the related liability or related asset (paragraphs BC174–BC177).

IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*

BC262 Paragraph BC13 of the Basis for Conclusions on IFRS 5 says that the Board decided that non-current assets should be excluded from the scope of the measurement requirements in IFRS 5 only if they are already carried at fair value with changes in fair value recognised in profit or loss, or if it would be difficult to determine their fair value.

BC263 The Board proposes to exclude regulatory assets from the scope of the measurement requirements in IFRS 5. In the Board's view, it would be difficult to determine the fair value of regulatory assets because of difficulties in determining the discount rate as discussed in paragraph BC260(b). In the Board's view, the measurement requirements proposed in the Exposure Draft would provide useful information. Thus, the Board concluded that incremental benefits, if any, of providing the fair value of regulatory assets would not outweigh the costs of determining their fair value.

IAS 1 *Presentation of Financial Statements*

BC264 The Board proposes to amend paragraphs 54 and 82 of IAS 1 to require entities to present separate line items for regulatory assets and regulatory liabilities in the statement of financial position, and for regulatory income or regulatory expense in the statement(s) of financial performance (paragraphs BC178–BC186). In the Board's view, separate line items are necessary:

(a) for regulatory assets and regulatory liabilities, because their characteristics differ from those of other assets and liabilities; and

(b) for regulatory income or regulatory expense, because this would enable users of financial statements to understand how the entity's financial performance was affected by the supply of goods or services in one period and by the inclusion of part of the total allowed compensation for supplying those goods or services in the regulated rates charged to customers, and hence in revenue, in a different period.

IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*

BC265 The Board proposes to delete paragraph 54G of IAS 8 because it provides a temporary exception that would no longer be needed when applying the proposals in the Exposure Draft.

IAS 36 *Impairment of Assets*

BC266 For reasons given in paragraph BC141, the Board proposes to specify that regulatory assets are outside the scope of IAS 36.

Alternative view of Ms Mary Tokar on Exposure Draft *Regulatory Assets and Regulatory Liabilities*

AV1 Ms Tokar voted against publication of the Exposure Draft because of:

(a) the focus on understanding the relationship between an entity's revenue and expenses and the related proposals to present particular items of regulatory income and regulatory expense in other comprehensive income (OCI), and to measure some regulatory assets and regulatory liabilities by reference to the measurement under IFRS Standards of the related liabilities and related assets; and

(b) the proposed scope of the Standard.

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.

Scope

AV7 The Board proposes that an entity should recognise as an asset its enforceable present right to add an amount in determining the regulated rate to be charged to customers in a future period. The Board is proposing that this asset can and should be recognised as a separate asset and measured using a modified historical cost measurement basis. The Board noted that an asset is not recognised for the right of an entity to increase prices for activities not subject to a regulatory agreement (see paragraphs BC39–BC42).

AV8 The right to increase prices for supplying goods or services outside the scope of the proposed Standard is not recognised separately from a brand name or license, and those intangible assets are not recognised unless they were acquired. However, the Board is proposing that the existence of an enforceable regulatory agreement giving an entity a right to increase regulated rates by a fixed or determinable amount as a result of goods or services already supplied is a sufficiently differentiating feature to require recognition of an asset and that this regulatory asset satisfies the asset definition in the *Conceptual Framework for Financial Reporting*.

AV9 Ms Tokar agrees that the existence of an agreement that regulates rates for supplying specified goods or services is a necessary scope criterion, but believes that it does not sufficiently differentiate the right that warrants recognition of an asset for future rate increases. In her view, it also is necessary for performance of the entity's activity to be regulated (for example, regarding quality of service) so that competition is limited, and for the regulator to be committed to supporting the financial viability of the entity through the rate-setting process. In Ms Tokar's view, these two additional factors are necessary for recognition of an asset for the right to increase regulated rates charged for goods or services supplied in a future period, even though a right to increase prices is not recognised as an asset, either directly, or indirectly as part of a license or brand, when generated internally by an entity with activities not subject to a regulatory agreement.

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SET ISBN 978-1-914113-01-7
9 781914 113017
PART B ISBN 978-1-914113-03-1