January 2021

IFRS® Standards Exposure Draft ED/2021/1
Illustrative Examples

Regulatory Assets and Regulatory Liabilities

Comments to be received by 30 July 2021

Comment deadline changed from 30 June 2021

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Exposure Draft

Illustrative Examples on

Regulatory Assets and Regulatory Liabilities

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These Illustrative Examples accompany 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/.

ISBN for this part: 978-1-914113-04-8

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

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Illustrative Examples

These examples accompany, but are not part of, [draft] IFRS X. They illustrate aspects of [draft] IFRS X but are not intended to provide interpretative guidance.

Introduction

IE1 For simplicity, unless indicated otherwise, all examples:

(a) assume that an entity has no regulatory assets or regulatory liabilities, other than those discussed in the example;

(b) assume that the cash flows from regulatory assets or regulatory liabilities fall within the boundary of the regulatory agreement;

(c) assume that the regulatory interest rate provided by a regulatory agreement for a regulatory asset is sufficient;

(d) assume that entities apply the cost model in IAS 16 *Property, Plant and Equipment*;

(e) assume that if an example focuses on an asset not yet available for use in a particular period, the entity is nevertheless supplying goods or services to customers in that period using other assets;

(f) assume that all revenue is recognised immediately upon the supply of goods or services;

(g) denominate all monetary amounts in 'currency units' (CU), rounded to the nearest whole number; and

(h) ignore income tax.

Example 1 Input cost and quantity variances

IE2 Example 1 illustrates the requirements of the [draft] Standard for identifying, recognising and measuring regulatory assets arising from cost variances and quantity variances.

Fact pattern

IE3 Entity A supplies goods or services to customers under a regulatory agreement. Entity A began to supply the goods or services on the first day of Year 1.

IE4 The regulatory agreement entitles Entity A to recover the actual input costs incurred in supplying the goods or services to customers. The regulated rate to be charged to customers in Year 1 was set at CU2.70 per unit, based on:

(a) estimated variable input costs of CU200;

(b) estimated fixed input costs of CU70; and

(c) an estimated quantity of 100 units to be supplied in Year 1.

Table 1.1 Regulated rate per unit			
	Cost per unit	**Units**	**Total**
	In CU		In CU
Variable input costs	2.00	100	200
Fixed input costs	-	-	70
Total input costs			**270**
Estimated quantity		100	
Regulated rate per unit			**2.70**

IE5 The regulatory agreement requires variances between estimated input costs and actual input costs incurred by the entity (cost variances), and any under-recovery (or over-recovery) of these costs arising from variances between estimated and actual quantities of goods or services supplied to customers (quantity variances), to be added (or deducted) in determining the regulated rate charged to customers in the following year. The regulatory agreement provides (or charges) a regulatory interest rate of 5% on any unrecovered (or unfulfilled) balance at the start of a year.

IE6 In Year 1, the quantity of goods or services supplied was lower than estimated: Entity A supplied only 90 units to customers. Consequently, Entity A recognised revenue of CU243 during Year 1 by applying IFRS 15 *Revenue from Contracts with Customers*.

Table 1.2 Year 1 recognised revenue	
	Total
Regulated rate per unit (in CU)	2.70
Units supplied	90
Revenue in Year 1 (in CU)	**243**

IE7 During Year 1, Entity A also recognised higher than estimated variable and fixed input costs as an expense by applying IFRS Standards.

Table 1.3 Total actual input costs			
	Cost per unit	**Units**	**Total**
	In CU		In CU
Variable input costs	2.50	90	225
Fixed input costs	-	-	75
Total input costs recognised as an expense			**300**

IE8 The regulatory agreement entitles Entity A to add, in determining the regulated rates to be charged to customers for goods or services supplied in Year 2, an amount to recover the cost variances and quantity variances experienced in Year 1 (which aggregate to CU57), plus regulatory interest at 5% of this amount.

IE9 In Year 2, Entity A again incurs actual input costs of CU300, but the actual quantity supplied to customers is 100 units. No cost or quantity variances arise for Year 2 because the regulated rates for that year reflect estimated input costs of CU300 and an estimated quantity of 100 units to be supplied. The regulated rates for Year 2 also include an amount of CU60 to recover the Year 1 variances of CU57 together with related regulatory interest of CU3 (5% × CU57).

Analysis

IE10 The total allowed compensation for goods or services supplied in Year 1 and Year 2, applying paragraphs B2–B27 of the [draft] Standard, consists of:

(a) the amount that recovers allowable expenses incurred in supplying those goods or services—the actual input costs of CU300 incurred by the entity in both Year 1 and Year 2; and

(b) regulatory interest income of 5% recognised in Year 2 on the variances that Entity A is entitled to include in determining the regulated rates to be charged to customers in Year 2.

IE11 Of the total allowed compensation for the goods or services supplied in Year 1, only CU243 was included in revenue in that year. The remaining part of that total allowed compensation (CU57 out of CU300) will be included in revenue in the future (Year 2). Applying paragraph 16(c) of the [draft] Standard, Entity A recognised a regulatory asset of CU57 at the end of Year 1, to be recovered by adding that amount (together with any regulatory interest) in determining the regulated rates for goods or services to be supplied in Year 2.

IE12 If no other transactions took place in Years 1 and 2, Entity A's statements of financial performance for those years would be as shown in Table 1.4.

Table 1.4 Profit for Years 1 and 2

In CU	**Year 1**	**Year 2**
Revenue	243	360
Regulatory income (regulatory expense)	57	(57)
	300	303
Input cost expense	(300)	(300)
Profit	-	**3**

IE13 The profit in Year 2 equals the regulatory interest income recognised in that year to depict the compensation to which Entity A is entitled for the time lag until it recovers variances that arose in supplying goods or services in Year 1.

IE14 Entity A discloses a reconciliation of the carrying amount of this regulatory asset, as required by paragraph 83 of the [draft] Standard. A possible format for this reconciliation is shown in Table 1.5.

Table 1.5 Reconciliation of carrying amount of regulatory asset

In CU	**Year 1**	**Year 2**
Opening carrying amount	-	57
Amount recognised	57	-
Regulatory interest income	-	3
Recovery	-	(60)
Closing carrying amount	**57**	**-**

IE15 Entity A measures the regulatory asset by discounting estimates of all future cash flows arising from it to their present value (the future cash flows are estimated to be CU60 if those cash flows are not subject to uncertainty). Paragraph 49 of the [draft] Standard explains that because the regulatory interest rate is also the discount rate, the present value of the future cash flows (CU57) at initial recognition equals the sum of the future cash flows excluding the cash flows that will result from regulatory interest (CU57 = CU60 – CU3).

Example 2A Quantity variances affecting recovery of an item of plant

IE16 Example 2A illustrates the requirements of the [draft] Standard for identifying, recognising and measuring regulatory assets or regulatory liabilities arising from quantity variances affecting the estimated pattern of recovery of the cost of an item of property, plant or equipment.

Fact pattern

IE17 Entity B supplies goods or services to customers under a regulatory agreement. Entity B began the supply of the goods or services on the first day of Year 1.

IE18 Entity B has an item of plant it uses to supply goods or services. During Year 0, the entity completed the construction of this asset and it became available for use on the last day of that year.

IE19 The cost of the item of plant was CU1,000, both for regulatory purposes and as determined by applying IAS 16. The item of plant has a useful life of five years and the entity depreciates it using the straight-line method over this period.

IE20 The regulatory agreement entitles Entity B to:

(a) recover the cost of the item of plant through the regulated rates charged to customers evenly over its useful life of five years.

(b) add in determining the regulated rates charged to customers each year a regulatory return calculated as 8% of the unrecovered balance of the item of plant at the beginning of the year.

IE21 Estimates of the amounts that relate to the item of plant and will be included in the regulated rates to be charged to customers are shown in Table 2A.1.

Table 2A.1 Estimates of amounts to be included in the regulated rates

In CU	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**
Opening balance	1,000	800	600	400	200
Regulatory return	80	64	48	32	16
Estimates of amounts to be included in the regulated rates[(a)]	(280)	(264)	(248)	(232)	(216)
Closing balance	**800**	**600**	**400**	**200**	**-**

(a) Calculated as the sum of the recovery of the cost of the item of plant per year (CU200) plus the regulatory return the entity is entitled to add in the regulated rates to be charged to customers in that year.

IE22 If the actual quantity supplied to customers differs from the quantity the entity estimated, that quantity variance causes an under or over-recovery of the total allowed compensation. The regulatory agreement specifies that the under or over-recovery will be added or deducted in determining the regulated rates to be charged to customers in the next year.

IE23 For simplicity, this example ignores regulatory interest on the unrecovered, or unfulfilled, balances arising from any quantity variances. The example also ignores any further adjustment to the carrying amount of a regulatory asset that would be needed if the regulatory agreement provides a regulatory interest rate that does not sufficiently compensate Entity B for the time value of money and uncertainty in the amount and timing of the future cash flows arising from that regulatory asset.

IE24 The variance between Entity B's estimate of the number of units it will supply each year for Years 1–5 and the actual quantities of goods or services supplied is shown in Table 2A.2.

Table 2A.2 Quantity variances Years 1–5

In units	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**
Estimated quantity	100	110	120	90	80
Actual quantity	90	115	115	100	80
Variance	**(10)**	**5**	**(5)**	**10**	**-**

IE25 Because of these quantity variances, the actual revenue differs from previously estimated revenue for Years 1–5:

Table 2A.3 Variances between actual revenue and previously estimated revenue Years 1–5					
In CU	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**
Estimates of amounts to be included in the regulated rates before recovery of prior year variances (Table 2A.1)	280	264	248	232	216
Scheduled recovery (fulfilment) of prior year variance	-	28	(13)	10	(27)
Estimated revenue (a)	280	292	235	242	189
Estimated quantity (Table 2A.2)	100	110	120	90	80
Regulated rate per unit (b)	2.80	2.65	1.96	2.69	2.36
Actual quantity (c) (Table 2A.2)	90	115	115	100	80
Actual revenue (d = b × c)	252	305	225	269	189
Variance = (a – d)	**28**	**(13)**	**10**	**(27)**	**-**

Analysis

IE26 Applying paragraphs B2–B27 of the [draft] Standard, Entity B determines that the total allowed compensation for Years 1–5 consists of:

(a) the amount that recovers allowable expenses incurred in supplying goods or services—the depreciation expense of CU200 per year recognised for the item of plant.

(b) the regulatory return of 8% on the outstanding opening balance of the item of plant. This regulatory return forms part of the total allowed compensation for goods or services supplied in the same year in which the regulatory agreement entitles the entity to add it in determining the regulated rates.

Table 2A.4 Total allowed compensation for goods or services supplied in Years 1–5						
In CU	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Total**
Allowable expenses—depreciation expense	200	200	200	200	200	**1,000**
Regulatory return (Table 2A.1)	80	64	48	32	16	**240**
Total allowed compensation	**280**	**264**	**248**	**232**	**216**	**1,240**
Revenue (Table 2A.3)	252	305	225	269	189	**1,240**
Regulatory income (regulatory expense)	**28**	**(41)**	**23**	**(37)**	**27**	**-**

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Table 2A.4 Total allowed compensation for goods or services supplied in Years 1–5						
In CU	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Total**
Of which:						
Under-recovery: part of total allowed compensation that will be included in revenue in the future	28	-	10	-	-	**38**
Over-recovery: revenue that will provide part of total allowed compensation in the future	-	(13)	-	(27)	-	**(40)**
Scheduled recovery or fulfilment of prior year variances	-	(28)	13	(10)	27	**2**

IE27 If no other transactions took place in Years 1–5, Entity B's statements of financial performance for these years would be as shown in Table 2A.5.

Table 2A.5 Profit for Years 1–5						
In CU	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Total**
Revenue (Table 2A.3)	252	305	225	269	189	**1,240**
Regulatory income (regulatory expense) (Table 2A.4)	28	(41)	23	(37)	27	**-**
	280	264	248	232	216	**1,240**
Depreciation	(200)	(200)	(200)	(200)	(200)	**(1,000)**
Profit	**80**	**64**	**48**	**32**	**16**	**240**

IE28 In this example, the profit in each of Years 1–5 equals the regulatory return on the item of plant that the regulatory agreement entitles the entity to add in determining the regulated rates to be charged to customers when supplying goods or services during that year.

IE29 Entity B discloses reconciliations of the carrying amount of the regulatory assets and regulatory liabilities, as required by paragraph 83 of the [draft] Standard. A possible format for these reconciliations is shown in Tables 2A.6 and 2A.7.

Table 2A.6 Reconciliation of carrying amount of regulatory assets					
In CU	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**
Opening carrying amount	-	28	-	10	-
Amount recognised	28	-	10	-	-
Regulatory interest income[(a)]	-	-	-	-	-
Recovery	-	(28)	-	(10)	-
Closing carrying amount	**28**	**-**	**10**	**-**	**-**

(a) See paragraph IE23.

Table 2A.7 Reconciliation of carrying amount of regulatory liabilities					
In CU	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**
Opening carrying amount	-	-	(13)	-	(27)
Amount recognised	-	(13)	-	(27)	-
Regulatory interest expense[(a)]	-	-	-	-	-
Fulfilment	-	-	13	-	27
Closing carrying amount	**-**	**(13)**	**-**	**(27)**	**-**

(a) See paragraph IE23.

Example 2B Recovery period longer than an asset's useful life

IE30 Example 2B illustrates the requirements of the [draft] Standard for identifying, recognising and measuring a regulatory asset arising when the regulatory agreement specifies for an item of property, plant or equipment a recovery period longer than that asset's useful life.

Fact pattern

IE31 Example 2B assumes the same fact pattern as Example 2A, except:

(a) the item of plant has a useful life of four years and the entity recognises depreciation expense on a straight-line basis over this asset's useful life. However, the regulatory agreement requires the entity to add the cost of the asset to the regulatory capital base for recovery evenly through the regulated rates charged to customers over five years, as shown in Table 2A.1.

(b) actual quantities supplied to customers equal estimated quantities, and thus no quantity variances arise in Years 1–5.

Analysis

IE32 Applying paragraphs B2–B27 of the [draft] Standard, the total allowed compensation for the goods or services supplied in each of Years 1–5 consists of:

(a) the amount that recovers allowable expenses incurred in supplying the goods or services—the depreciation expense of CU250 per year recognised for the item of plant for Years 1–4.

(b) the regulatory return of 8% on the unrecovered balance of the regulatory capital base at the beginning of the year. This regulatory return forms part of the total allowed compensation for goods or services supplied in the same year in which the regulatory agreement entitles the entity to add it in determining the regulated rates.

Table 2B.1 Total allowed compensation for goods or services supplied in Years 1–5

In CU	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Total**
Allowable expenses—depreciation expense	250	250	250	250	-	**1,000**
Regulatory return (Table 2A.1)	80	64	48	32	16	**240**
Total allowed compensation	**330**	**314**	**298**	**282**	**16**	**1,240**
Revenue (Table 2A.1)	280	264	248	232	216	**1,240**
Regulatory income (regulatory expense)	**50**	**50**	**50**	**50**	**(200)**	**-**
Of which:						
Under-recovery: part of total allowed compensation that will be included in revenue in the future	50	50	50	50	-	**200**
Recovery of regulatory asset	-	-	-	-	(200)	**(200)**

IE33 The asset's recovery period is longer than its useful life, and thus part of the total allowed compensation for the goods or services supplied in Years 1–4 will be included in revenue in Year 5. Therefore, Entity B recognises a regulatory asset in Year 1. During Years 2–4 the carrying amount of the regulatory asset increases because of an increase in the amount that Entity B is entitled to add in determining the regulated rates to be charged to customers in Year 5.

IE34 Entity B measures the regulatory asset by discounting an estimate of all future cash flows arising from the regulatory asset to their present value. Paragraph 49 of the [draft] Standard explains that, because the regulatory interest rate is also the discount rate, the present value of the future cash flows equals the sum of the future cash flows excluding the future cash flows from regulatory interest. That paragraph also states that this result also holds in the case of subsequent measurement if, in addition, the regulatory interest is recovered or fulfilled in the same period in which it accrues. For example, at the end of Year 4, if the resulting cash flows are not subject to uncertainty, the present value of the future cash flows is CU200 (CU216 – CU16).

IE35 If no other transactions took place in Years 1–5, Entity B's statements of financial performance for these years would be as shown in Table 2B.2.

Table 2B.2 Profit for Years 1–5

In CU	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Total**
Revenue[(a)]	280	264	248	232	216	**1,240**
Regulatory income (regulatory expense) (Table 2B.1)	50	50	50	50	(200)	**-**
	330	**314**	**298**	**282**	**16**	**1,240**
Depreciation expense	(250)	(250)	(250)	(250)	-	**(1,000)**
Profit	**80**	**64**	**48**	**32**	**16**	**240**

(a) Revenue in Year 5 consists of amounts charged to customers for goods or services supplied using other assets (because the item of plant reached the end of its useful life in Year 4).

IE36 The profit in Years 1–5 equals the regulatory return on the regulatory capital base that the regulatory agreement entitles the entity to add in determining the regulated rates charged when supplying goods or services during these years. This regulatory return consists of two components, which are discussed in paragraphs B24–B26 of the [draft] Standard and shown in Table 2B.3.

Table 2B.3 Composition of regulatory return

In CU	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Total**
Regulatory interest income[(a)]	-	4	8	12	16	**40**
Regulatory return on the regulatory capital base, excluding regulatory asset[(b)]	80	60	40	20	-	**200**
	80	**64**	**48**	**32**	**16**	**240**

(a) The regulatory interest rate applied to the regulatory asset is the regulatory return applicable to the regulatory capital base of which the regulatory asset is part. Thus, regulatory interest income for each year is 8% of the opening carrying amount of the regulatory asset, as shown in Table 2B.4.

(b) Calculated by applying the regulatory return rate of 8% to the unrecovered balance of the regulatory capital base at the beginning of the year, excluding the balance relating to the regulatory asset (8% applied in this case to an amount equal to the outstanding carrying amount of the asset applying IFRS Standards at the beginning of the year).

IE37 Entity B discloses a reconciliation of the carrying amount of the regulatory asset, as required by paragraph 83 of the [draft] Standard. A possible format of this reconciliation is shown in Table 2B.4.

Table 2B.4 Reconciliation of carrying amount of regulatory asset

In CU	Year 1	Year 2	Year 3	Year 4	Year 5
Opening carrying amount	-	50	100	150	200
Amount recognised	50	50	50	50	-
Regulatory interest income	-	4	8	12	16
Recovery	-	(4)	(8)	(12)	(216)
Closing carrying amount	**50**	**100**	**150**	**200**	**-**

Example 2C Recovery period shorter than an asset's useful life

IE38 Example 2C illustrates the requirements of the [draft] Standard on identifying, recognising and measuring a regulatory liability arising when the regulatory agreement specifies for an item of property, plant or equipment a recovery period shorter than that asset's useful life.

Fact pattern

IE39 Example 2C assumes the same fact pattern as Example 2B, except that the item of plant has a useful life of five years and the entity recognises depreciation expense on a straight-line basis over this period. However, the regulatory agreement requires the entity to add the cost of the asset to the regulatory capital base for recovery evenly through the regulated rates charged to customers over four years. The resulting revenue in Years 1–5 is shown in Table 2C.1.

Table 2C.1 Revenue

In CU	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Recovery of regulatory capital base	250	250	250	250	-	**1,000**
Regulatory return	80	60	40	20	-	**200**
Revenue	**330**	**310**	**290**	**270**	**-**	**1,200**

Analysis

IE40 Applying paragraphs B2–B27 of the [draft] Standard, the total allowed compensation for the goods or services supplied in each of Years 1–5 consists of:

(a) the amount that recovers allowable expenses incurred in supplying the goods or services—the depreciation expense of CU200 per year recognised for the item of plant for Years 1–5.

(b) the regulatory return of 8% on the unrecovered balance of the regulatory capital base at the beginning of the year. This regulatory return forms part of the total allowed compensation for goods or services supplied in the same year in which the regulatory agreement entitles the entity to add it in determining the regulated rates.

Table 2C.2 Total allowed compensation for goods or services supplied in Years 1–5

In CU	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Total**
Allowable expenses—depreciation expense	200	200	200	200	200	**1,000**
Regulatory return (Table 2C.1)	80	60	40	20	-	**200**
Total allowed compensation	**280**	**260**	**240**	**220**	**200**	**1,200**
Revenue (Table 2C.1)	330	310	290	270	-	**1,200**
Regulatory income (regulatory expense)	**(50)**	**(50)**	**(50)**	**(50)**	**200**	**-**
Of which:						
Over-recovery: revenue that will provide part of total allowed compensation in the future	(50)	(50)	(50)	(50)	-	**(200)**
Fulfilment of regulatory liability	-	-	-	-	200	**200**

IE41 The asset's regulatory recovery period is shorter than its useful life, and thus part of the revenue for Years 1–4 will provide part of total allowed compensation for goods or services to be supplied in Year 5. Therefore, Entity B recognises a regulatory liability in Year 1. During Years 2–4, the carrying amount of the regulatory liability increases because of an increase in the amount that Entity B is obliged to deduct in determining the regulated rates to be charged to customers in Year 5.

IE42 Entity B measures the regulatory liability by discounting an estimate of all future cash flows arising from the regulatory liability to their present value. Paragraph 49 of the [draft] Standard explains that, because the regulatory interest rate is also the discount rate, the present value of the future cash flows equals the sum of the future cash flows excluding the future cash flows from regulatory interest. That paragraph also states that this result also holds in the case of subsequent measurement if, in addition, the regulatory interest is recovered or fulfilled in the same period in which it accrues. For example, at the end of Year 4, if the resulting cash flows are not subject to uncertainty, the present value of the future cash flows is CU200 (CU216 – CU16).

IE43 If no other transactions took place in Years 1–5, Entity B's statements of financial performance for these years would be as shown in Table 2C.3.

Table 2C.3 Profit for Years 1–5

In CU	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Revenue[(a)] (Table 2C.1)	330	310	290	270	-	**1,200**
Regulatory income (regulatory expense) (Table 2C.2)	(50)	(50)	(50)	(50)	200	-
	280	**260**	**240**	**220**	**200**	**1,200**
Depreciation expense	(200)	(200)	(200)	(200)	(200)	**(1,000)**
Profit	**80**	**60**	**40**	**20**	**-**	**200**

(a) Revenue in Year 5 is nil because in Year 4 the item of plant reached the end of its recovery period of four years under the regulatory agreement and, for simplicity, the example does not consider revenue the entity may have recognised in Year 5 when supplying goods or services with other assets.

IE44 The profit in Years 1–4 equals the regulatory return on the regulatory capital base that the regulatory agreement entitles the entity to add in determining the regulated rates charged when supplying goods or services during these years. This regulatory return consists of two components, which are discussed in paragraphs B24–B26 of the [draft] Standard and are shown in Table 2C.4.

Table 2C.4 Composition of regulatory return

In CU	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Regulatory interest expense[(a)]	-	(4)	(8)	(12)	(16)	**(40)**
Regulatory return on regulatory capital base before deducting regulatory liability[(b)]	80	64	48	32	16	**240**
	80	**60**	**40**	**20**	**-**	**200**

(a) The regulatory interest rate applied to the regulatory liability is the regulatory return rate applicable to the regulatory capital base of which the regulatory liability is part. Thus, regulatory interest expense for each year is 8% of the opening carrying amount of the regulatory liability, as shown in Table 2C.5.

(b) Calculated by applying the regulatory return rate of 8% to the unrecovered balance of the regulatory capital base at the beginning of the year, before deducting the regulatory liability (8% applied in this case to an amount equal to the outstanding carrying amount of the asset applying IFRS Standards at the beginning of the year).

IE45 Entity B discloses a reconciliation of the carrying amount of the regulatory liability, as required by paragraph 83 of the [draft] Standard. A possible format of this reconciliation is shown in Table 2C.5.

Table 2C.5 Reconciliation of the carrying amount of regulatory liability					
In CU	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**
Opening carrying amount	-	50	100	150	200
Amount recognised	50	50	50	50	-
Regulatory interest expense	-	4	8	12	16
Fulfilment	-	(4)	(8)	(12)	(216)
Closing carrying amount	**50**	**100**	**150**	**200**	**-**

Example 3 Regulatory returns on an asset not yet available for use

IE46 Example 3 illustrates the requirements in paragraph B15 of the [draft] Standard for identifying, recognising and measuring regulatory liabilities arising when the regulatory agreement entitles an entity to add in determining the regulated rates charged to customers a regulatory return on an asset in a period when the asset is not yet available for use. This return is therefore included in revenue during that period.

Fact pattern

IE47 Entity C supplies goods or services to customers under a regulatory agreement.

IE48 At the beginning of Year 1, Entity C completed the construction of an item of plant. The cost of the item of plant both for regulatory purposes and as determined by applying IAS 16 was CU1,000. The item is available for use on the first day of Year 2. Depreciation, determined by applying IAS 16, is recognised from that date over the asset's three-year useful life using the straight-line method.

IE49 The regulatory agreement stipulates that Entity C shall add the cost of the item of plant into the regulatory capital base at the beginning of Year 1. Therefore, the entity is entitled to recover part of the cost before the asset is available for use. The regulatory agreement also entitles Entity C to add a regulatory return in determining the regulated rates to be charged to customers when supplying goods or services each year. The regulatory return is 8% on the unrecovered balance of the regulatory capital base at the beginning of the year, and Entity C is entitled to recover the cost of the item of plant evenly over four years.

IE50 The amounts to be included in the regulated rates to be charged to customers relating to the item of plant are shown in Table 3.1.

Table 3.1 Amounts included in the regulated rates to be charged to customers relating to the item of plant

	Not yet available for use	Available for use		
In CU	**Year 1**	**Year 2**	**Year 3**	**Year 4**
Opening balance	1,000	750	500	250
Regulatory return	80	60	40	20
Amounts expected to be included in the regulated rates[(a), (b)]	(330)	(310)	(290)	(270)
Closing balance	**750**	**500**	**250**	**-**

(a) Amounts expected to be included in the regulated rates in Year 1 are amounts expected to be charged to customers for goods or services supplied using other assets.

(b) Calculated as the sum of the CU250 per year recovery of the cost of the item of plant, plus the regulatory return the entity is entitled to add in determining the regulated rates to be charged to customers in the year.

Analysis

IE51 Applying paragraphs B2–B27 of the [draft] Standard, Entity C determines that the total allowed compensation for Years 1–4 consists of:

(a) the amount that recovers allowable expenses incurred in supplying the goods or services—the depreciation expense recognised for the item of plant in Years 2–4.

(b) the regulatory return of 8%. This regulatory return forms part of the total allowed compensation for goods or services supplied in the same year in which the regulatory agreement entitles the entity to add it in determining the regulated rates, except for the return that was provided in Year 1, when the asset was not yet available for use, as discussed in (c).

(c) the regulatory return included in the regulated rates during the period when the asset is not yet available for use (Year 1). Applying paragraph B15 of the [draft] Standard, that regulatory return forms part of the total allowed compensation for goods or services supplied only once the asset is available for use and over the remaining periods in which the asset is recovered through the regulated rates (Years 2–4). Entity C is required to use a reasonable and supportable basis in allocating that regulatory return over those remaining periods and apply that basis consistently—this example assumes that a straight-line basis is appropriate in this case.

Table 3.2 Total allowed compensation for goods or services supplied in Years 1–4

In CU	Year 1	Year 2	Year 3	Year 4	Total
Allowable expenses—depreciation expense	-	333	333	334	**1,000**
Regulatory return	80	60	40	20	**200**
Requirements of paragraph B15	(80)	27	27	26	**-**
Total allowed compensation	**-**	**420**	**400**	**380**	**1,200**
Revenue	330	310	290	270	**1,200**
Regulatory income (regulatory expense)	**(330)**	**110**	**110**	**110**	**-**
Of which:					
Over-recovery: revenue that will provide part of total allowed compensation in the future	(330)	-	-	-	**(330)**
Fulfilment of regulatory liability	-	110	110	110	**330**

IE52 If no other transactions took place in Years 1–4, Entity C's statements of financial performance for these years would be as shown in Table 3.3.

Table 3.3 Profit for Years 1–4

In CU	Year 1	Year 2	Year 3	Year 4	Total
Revenue[(a)]	330	310	290	270	**1,200**
Regulatory income (regulatory expense) (Table 3.2)	(330)	110	110	110	**-**
	-	420	400	380	**1,200**
Depreciation	-	(333)	(333)	(334)	**(1,000)**
Profit	**-**	**87**	**67**	**46**	**200**

(a) Amounts included in the regulated rates in Year 1, and hence included in revenue, are amounts charged to customers for goods or services supplied using other assets.

IE53 In this example, part of the profit in Years 2–4 arises because the revenue in Year 1 included regulatory return of CU80 on the item of plant not yet available for use. As a result of applying the requirements in paragraph B15 of the [draft] Standard, that regulatory return forms part of the total allowed compensation for goods or services supplied in Years 2–4, when the cost of the item of plant is recovered through the regulated rates while it is being used to supply goods or services.

IE54 The rest of the profit in Years 2–4 equals the regulatory return on the regulatory capital base that the regulatory agreement entitles the entity to add in determining the regulated rates to be charged to customers when supplying goods or services during these years as illustrated in Table 3.1. As shown in Table 2C.4 for the fact pattern in Example 2C, that regulatory return comprises:

(a) the regulatory return on the unrecovered balance of the regulatory capital base before deducting the carrying amount of the regulatory liability (paragraph IE55); less

(b) regulatory interest expense on the regulatory liability.

IE55 In Year 1, Entity C recognises a regulatory liability because the revenue of CU330 recognised in Year 1 will provide part of the total allowed compensation for goods or services to be supplied during Years 2–4 when the item of plant is available for use. Entity C discloses a reconciliation of the carrying amount of the regulatory liability, as required by paragraph 83 of the [draft] Standard. A possible format for this reconciliation is shown in Table 3.4.

Table 3.4 Reconciliation of the carrying amount of regulatory liability

In CU	**Year 1**	**Year 2**	**Year 3**	**Year 4**
Opening carrying amount	-	330	220	110
Amount recognised	330	-	-	-
Regulatory interest expense	-	26	18	9
Fulfilment[(a)]	-	(136)	(128)	(119)
Closing carrying amount	**330**	**220**	**110**	**-**

(a) Calculated for each year as CU110 (CU330 ÷ 3) plus the regulatory interest expense for that year.

Example 4 Items affecting regulated rates only when related cash is paid or received

IE56 Example 4 illustrates the requirements in paragraphs 59–66 of the [draft] Standard dealing with items which an entity is not entitled to include in the regulated rates until it pays the related cash.

Fact pattern

IE57 Entity D supplies goods or services to customers under a regulatory agreement.

IE58 The regulatory agreement specifies that environmental clean-up costs are an allowable expense. However, Entity D is not entitled to include these costs in the regulated rates charged to customers until it pays those costs in cash.

IE59 In supplying goods or services to customers in Year 1, Entity D damaged the environment and therefore became obliged to repair this damage. Entity D estimates that the clean-up will occur in Year 5 and will cost CU1,000. For simplicity, this example assumes that all the damage occurred on the first day of Year 1 and that all the related goods or services were supplied to customers on that same date. Thus, applying IAS 37 *Provisions, Contingent Liabilities and*

Contingent Assets, Entity D recognises an environmental provision for clean-up costs on the first day of Year 1 and measures the provision by applying IAS 37.

IE60 Entity D discounts the estimated clean-up costs (using a discount rate of 2.5% determined by applying IAS 37), thus recognising a provision of CU884 at the start of Year 1. The discount of CU116 will unwind over Years 1–5, resulting in Entity D recognising a further expense in these years. This example assumes that, by applying IAS 37, there are no changes in the estimated clean-up costs or the discount rate in Years 1–5.

IE61 Entity D fulfils its obligation in Year 5 by carrying out the environmental clean-up and pays CU1,000 for the entire cost of the clean-up.

Analysis

IE62 Applying paragraphs B2–B27 of the [draft] Standard, Entity D determines that the total allowed compensation for goods or services supplied in Years 1–5 comprises:

(a) the amount that recovers allowable expenses—the environmental clean-up costs recognised as an expense in Year 1, and measured by applying IAS 37 (CU884);[1] and

(b) regulatory interest income on the outstanding balance of the regulatory asset, accruing at the same rate as the rate at which the discount unwinds on the related liability (CU116).[2]

IE63 Entity D recognises a regulatory asset in Year 1 because the total allowed compensation for goods or services supplied in Year 1 will be included in revenue only in a future period—that is, because the regulatory agreement does not entitle Entity D to add any amount in determining the regulated rates charged to customers until Entity D pays cash in fulfilling its obligation to clean up the environment.

IE64 Applying paragraph 61 of the [draft] Standard, Entity D measures its regulatory asset using the measurement basis it uses in measuring the related environmental provision by applying IAS 37. Both at initial recognition and subsequently, this example assumes that no risks are present in the regulatory asset that are not present in the provision. If any such risks were present, the entity would adjust the measurement of the regulatory asset to reflect them.

IE65 If no other transactions took place in Years 1–5, Entity D's statements of financial performance for those years would be as shown in Table 4.1.

1 If Entity D had recognised the estimated clean-up cost as part of the cost of an item of property, plant and equipment rather than as an expense, the entity would become entitled to total allowed compensation as it depreciates this asset in supplying goods or services to customers and thus as it recognises the corresponding depreciation expense (an allowable expense).

2 The rate used in the measurement of the environmental provision is the regulatory interest rate implicit in the measurement of the regulatory asset. As paragraph 64 of the [draft] Standard explains, when paragraph 61 applies to a regulatory asset, the regulatory interest rate implicit in the measurement of the regulatory asset provides sufficient compensation for the time value of money and for uncertainty in the amount and timing of the future cash flows arising from that regulatory asset until paragraph 66 applies. This is because the same rate is implicit or explicit in the measurement of the related liability.

Table 4.1 Profit for Years 1–5						
In CU	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Total**
Revenue	-	-	-	-	1,000	**1,000**
Regulatory income (regulatory expense)	906	23	23	24	(976)	-
	906	23	23	24	24	**1,000**
Environmental clean-up costs	(884)	-	-	-	-	**(884)**
Unwind of discount on the provision	(22)	(23)	(23)	(24)	(24)	**(116)**
Profit	-	-	-	-	-	**-**

IE66 The profit of nil in each of Years 1–5 depicts the facts that:

(a) the regulatory agreement entitles Entity D to recover the environmental clean-up costs arising from the obligation that it incurred in Year 1 in supplying goods or services in that year.

(b) the regulatory agreement provides no target profit relating to these costs; and

(c) the regulatory interest income exactly equals the unwind of the discount on the provision.

IE67 Entity D discloses a reconciliation of the carrying amount of the regulatory asset, as required by paragraph 83 of the [draft] Standard. A possible format of this reconciliation for Years 1–5 is shown in Table 4.2.

Table 4.2 Reconciliation of carrying amount of regulatory asset					
In CU	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**
Opening carrying amount	-	906	929	952	976
Amount recognised	884	-	-	-	-
Regulatory interest income (rounded)	22	23	23	24	24
Recovery	-	-	-	-	(1,000)
Closing carrying amount	**906**	**929**	**952**	**976**	**-**

Example 5 Uneven regulatory interest rate

IE68 Example 5 illustrates how the requirements in paragraph 54 of the [draft] Standard apply if a regulatory agreement provides regulatory interest unevenly by specifying at initial recognition of a regulatory asset or regulatory liability a series of different regulatory interest rates for successive periods over the life of that regulatory asset or regulatory liability.

Fact pattern

IE69 Entity E supplies goods or services to customers under a regulatory agreement.

IE70 At the end of Year 1, Entity E recognised allowable expenses of CU100. The regulated rate charged to customers in Year 1 did not include these expenses. The amount of CU100 forms part of the total allowed compensation for goods or services already supplied in Year 1 and will be added in determining the regulated rate to be charged to customers in future periods, and hence will be included in revenue in the future. This gives rise to a regulatory asset measured initially at CU100.

IE71 The regulatory agreement allows the entity to recover this amount through the regulated rates charged to customers evenly over Years 3 and 4, together with regulatory interest at 10% on the unrecovered regulatory balance at the beginning of Years 3 and 4. Accordingly, at the end of Year 1 Entity E estimates it will recover the regulatory asset by including CU60 in the regulated rates charged in Year 3 and CU55 in Year 4—no recovery takes place in Year 2. Table 5.1 shows the estimated changes in the unrecovered regulatory balance.

Table 5.1 Regulatory balance

In CU	**Year 1**	**Year 2**	**Year 3**	**Year 4**
Opening balance	-	100	100	50
Addition	100	-	-	-
Regulatory interest added	-	-	10	5
Recovery	-	-	(60)	(55)
Closing balance	**100**	**100**	**50**	**-**

Analysis

IE72 Applying paragraph 54 of the [draft] Standard, Entity E is required to translate the different regulatory interest rates into a single discount rate to be used throughout the life of the regulatory asset. In this example, that discount rate is the one that discounts the estimated future cash flows, expected to occur in Years 3 and 4, back to CU100 in Year 1—that rate is calculated to be 5.82%. Table 5.2 shows a reconciliation of the carrying amount of this regulatory asset, using a rate of 5.82% as the discount rate. Entity E discloses such a reconciliation, as required by paragraph 83 of the [draft] Standard.

Table 5.2 Reconciliation of carrying amount of regulatory asset

In CU	**Year 1**	**Year 2**	**Year 3**	**Year 4**
Opening carrying amount	-	100	106	52
Amount recognised	100	-	-	-
Regulatory interest income (rounded)	-	6	6	3
Recovery	-	-	(60)	(55)
Closing carrying amount	**100**	**106**	**52**	**-**

IE73 If the regulatory agreement were to subsequently change the regulatory interest rate, the new regulatory interest rate would be the single discount rate that discounts all the updated estimated future cash flows back to the carrying amount of the regulatory asset or regulatory liability immediately before the new regulatory interest rate is applied.

IE74 To illustrate, assume the same fact pattern as in paragraphs IE69–IE71, except that at the end of Year 3 a change in the benchmark rate used in determining the regulatory interest rate results in the regulatory agreement changing the regulatory interest rate applicable to the opening balance in Year 4 from 10% to 8% (see Table 5.3).

Table 5.3 Regulatory balance		
In CU	**Year 3**	**Year 4**
Opening balance	100	50
Addition	-	-
Regulatory interest added	10	4
Recovery	(60)	(54)
Closing balance	**50**	**-**

IE75 Table 5.4 shows the changes in the carrying amount of this regulatory asset, using the original rate of 5.82% as the discount rate for Year 3, and using the updated regulatory interest rate of 3.89% as the discount rate for Year 4. Entity E discloses a reconciliation of the carrying amount of the regulatory asset, as required by paragraph 83 of the [draft] Standard. A possible format of this reconciliation for Years 3–4 is shown in Table 5.4.

Table 5.4 Reconciliation of carrying amount of regulatory asset		
In CU	**Year 3**	**Year 4**
Opening carrying amount	106	52
Amount recognised	-	-
Regulatory interest income	6	2
Recovery	(60)	(54)
Closing carrying amount	**52**	**-**

Example 6A Pre-funding of an asset by customers

IE76 Example 6A illustrates how the requirements in the [draft] Standard for identifying and recognising a regulatory liability apply if a regulatory agreement allows an entity to obtain pre-funding for the construction of a new item of infrastructure by including an additional amount in the regulated rates charged to customers during construction.

Fact pattern

IE77 Entity F supplies goods or services to customers under a regulatory agreement.

IE78 Entity F needs to construct a new item of infrastructure to be able to continue supplying goods or services to customers as required by the regulatory agreement.

IE79 The regulatory agreement allows Entity F to obtain pre-funding of CU60, which would cover part of the cost of constructing that item of infrastructure. Entity F obtains this pre-funding by adding an incremental amount in determining the regulated rates it charges to customers for goods or services supplied using other infrastructure while the new item is being constructed in Year 1. Applying IFRS 15, Entity F concludes that when it supplies these goods or services, it is required to recognise revenue measured at the full amount of the regulated rates charged to customers.

IE80 The infrastructure constructed during Year 1 is available for use from the beginning of Year 2 and has a useful life of 20 years. The regulatory agreement stipulates a recovery period of 20 years from the beginning of Year 2 for the cost of the infrastructure not yet recovered by the pre-funding.

IE81 The cost of the infrastructure is CU1,000. The entity has already recovered CU60 through the pre-funding received in Year 1 and thus only CU940 was added to the entity's regulatory capital base in Year 1. The regulated rates determined by the regulatory agreement from the beginning of Year 2 include CU47 per year, intended to recover the unrecovered cost of the infrastructure (CU940) over 20 years (CU940 ÷ 20 = CU47).

Analysis

IE82 The pre-funding provides part of the total allowed compensation for goods or services to be supplied in some period. In Year 1, the asset under construction (the new infrastructure) is not yet available for use. Therefore, applying paragraph B4 of the [draft] Standard, Entity F concludes that the construction costs do not give rise to an amount of total allowed compensation for goods or services supplied during Year 1. The construction costs will begin to give rise to an amount of total allowed compensation for goods or services supplied in the future when the entity recognises depreciation expense that reflects those construction costs after the asset becomes available for use at the beginning of Year 2.

IE83 In summary the incremental amounts of pre-funding are included in revenue already recognised in Year 1. They will provide part of the total allowed compensation for goods or services to be supplied in the future. Consequently, a regulatory liability arises in Year 1.

IE84 Once the new infrastructure is available for use, Entity F will begin to fulfil the regulatory liability as it charges regulated rates for the goods or services it supplies reflecting a deduction for the amount of the pre-funding. The amount of this deduction, and thus the rate of fulfilment of the regulatory liability, is CU3 per year (CU60 pre-funding divided by the 20-year useful life).

IE85 For simplicity, this example ignores regulatory interest on the unfulfilled balance of the regulatory liability.

Example 6B Pre-funding of an asset indirectly by customers

IE86 Example 6B illustrates how the requirements in the [draft] Standard for identifying and recognising a regulatory liability apply if an entity obtains pre-funding from customers indirectly.

Fact pattern

IE87 Example 6B assumes the same fact pattern as Example 6A, except that Entity F:

(a) needs the new infrastructure to connect a new group of properties to its network to supply goods or services to future customers subsequently occupying those properties.

(b) receives pre-funding in cash during construction of the infrastructure from a property developer constructing the properties for sale to those future customers. That pre-funding does not come from existing customers and does not come directly from those future customers. Nevertheless, the pre-funding obliges Entity F to reduce the regulated rates it will charge in future periods. The pre-funding is also likely to affect the price at which the property developer will sell the properties to Entity F's future customers.

IE88 Entity F connects the group of properties to its network at the end of Year 1. The new infrastructure is available for use from the beginning of Year 2.

IE89 Entity F concludes after an analysis of the explicit and implicit terms in the contract with the property developer that, once it has connected the properties to its network, it has met the requirements in IFRS 15 for recognising the pre-funding as revenue in Year 1.

Analysis

IE90 As in Example 6A, the construction costs do not give rise to an amount of total allowed compensation for goods or services supplied before the new infrastructure becomes available for use at the beginning of Year 2.

IE91 As in Example 6A, the incremental amounts of pre-funding included in revenue recognised in Year 1 will provide part of the total allowed compensation for goods or services to be supplied in the future. Consequently, a regulatory liability arises in Year 1. For simplicity, this example also ignores regulatory interest on the unfulfilled balance of the regulatory liability.

IE92 Once the asset is available for use, Entity F will begin to fulfil the regulatory liability as it recognises revenue for supplying goods or services for which it charges regulated rates reflecting a deduction for the amount of the pre-funding. This deduction is CU3 per year, as in Example 6A.

IE93 In a variant of this fact pattern, Entity F concluded that, by applying IFRS 15, it is required to recognise a contract liability for performance obligations to be satisfied under that contract over a period of time after it has connected the properties (that is, after Year 1). In this variant, Entity F would conclude that:

(a) to the extent that it has already recognised revenue, it has a regulatory liability, for the reasons explained in paragraphs IE90–IE91; and

(b) to the extent that it has recognised a contract liability, it has therefore not recognised revenue and so has no regulatory liability.

IE94 In another variant of this fact pattern, the property developer constructed the infrastructure and transferred it upon completion to the entity without charge, instead of making a cash payment to Entity F. The economic substance of this variant is equivalent to a cash payment by the property developer towards Entity F's construction of the asset as analysed in this example. Thus, Entity F would analyse this variant in the same way as the fact pattern discussed in this example.

Example 7A Examples of circumstances that give rise to regulatory assets

	Fact pattern	Analysis
7A.1	The regulated rate charged to customers for goods or services supplied in the current period is based on estimated input costs. Actual input costs for the period exceeded this estimate. Actual input costs incurred were recognised as an expense in the current period by applying IFRS Standards. The regulatory agreement gives the entity the right to add the resulting under-recovery of input costs in determining the regulated rates to be charged to customers in future periods.	The amount that recovers the actual input costs recognised as an expense in the current period forms part of total allowed compensation for goods or services supplied in the current period. Because of the under-recovery in the current period, part of the total allowed compensation for goods or services already supplied will be included in revenue in the future. The entity recognises as a regulatory asset its right to add the amount of this part (that is, the amount of the under-recovery of input costs) in determining the regulated rates to be charged to customers in future periods.

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	Fact pattern	Analysis
7A.2	The regulated rate charged to customers for goods or services supplied in the current period is based on the revenue requirement[3] and on an estimate of the customer demand during that period. Actual demand for the current period is lower than this estimate. The regulatory agreement gives the entity the right to add the resulting under-recovery of the revenue requirement for the current period in determining the regulated rates to be charged to customers in future periods.	Part of the total allowed compensation for goods or services supplied in the current period has not yet been included in revenue. This is because the regulated rates were based on estimated demand, but actual demand was lower, resulting in an under-recovery of the revenue requirement. The entity recognises as a regulatory asset its right to add the amount of this part (that is, the amount of the under-recovery of the revenue requirement) in determining the regulated rates to be charged to customers in future periods.
7A.3	An unusual event (such as storm damage to an entity's network) occurs in the current period, causing unexpected costs. The entity recognised those costs as an expense in the current period by applying IFRS Standards. The regulatory agreement gives the entity the right to add those costs in determining the regulated rates to be charged to customers in future periods.	The amount that recovers the unexpected costs recognised as an expense in the current period is part of the total allowed compensation for goods or services supplied in the same period. Because this amount was not included in the regulated rates charged to customers in the current period, that part of the total allowed compensation for goods or services already supplied will be included in revenue in the future. The entity recognises as a regulatory asset its right to add the amount of this part (that is, the amount of the unexpected costs caused by the storm) in determining the regulated rates to be charged to customers in future periods.

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3 The revenue requirement is the total amount that an entity is entitled to include in determining regulated rates for goods or services to be supplied to customers in a specified period; it may also be called, for example, 'allowable revenue' or 'authorised revenue'. The revenue requirement for a specified period is divided by the estimated volume of goods or services to be supplied in that period. That calculation determines the regulated rate per unit that the entity needs to charge customers to recover the revenue requirement during that period.

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	Fact pattern	Analysis
7A.4	A regulatory agreement specifies that an entity has the right to recover the cost of an asset but only over a period longer than the asset's useful life determined by applying IFRS Standards.	In each period during the asset's useful life, the amount that recovers the depreciation expense recognised by applying IFRS Standards forms part of the total allowed compensation for goods or services supplied in that period. Only some of that amount is included in regulated rates, and hence in revenue, in that period. The remaining part of that amount will be included in revenue in the future. The entity recognises as a regulatory asset its right to add the remaining part of that amount in determining the regulated rates to be charged to customers for goods or services to be supplied (using other assets) in future periods after the end of the asset's useful life.
7A.5	A regulatory agreement specifies that an entity has the right to recover the cost of an asset used to supply goods or services over a period that coincides with the asset's useful life determined by applying IFRS Standards. In the current period, the entity recognised a loss on the sale of the asset. The regulatory agreement treats this loss as an allowable expense, giving the entity the right to recover it by adding an amount in determining the regulated rates to be charged to customers in future periods.	The loss recognised on the sale of the asset during the current period indicates that the amounts included in the regulated rates already charged to customers recovered too little depreciation expense on this asset used to supply goods or services in the past. The depreciation not yet recovered will be recovered by amounts that will be included in revenue in the future. The entity recognises as a regulatory asset its right to add the amount of this under-recovery (equal to the amount of the loss on the sale of the asset) in determining the regulated rates to be charged to customers in future periods.

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	Fact pattern	Analysis
7A.6	An entity recognises an expense in the current period by applying IFRS Standards. The regulatory agreement treats that expense as an addition to the regulatory capital base and gives the entity the right to recover it through the regulated rates to be charged to customers in future periods.	The amount that recovers the expense that the entity recognised in the current period is part of total allowed compensation for goods or services supplied in the current period. Because the regulatory agreement requires the entity to add this expense to the regulatory capital base, this part of total allowed compensation for goods or services already supplied will be included in revenue in the future. The entity recognises as a regulatory asset its right to add the amount of this part (that is, the amount of the expense added to the regulatory capital base) in determining the regulated rates to be charged to customers in future periods.
7A.7	A regulatory agreement entitles an entity to a performance bonus if it meets specified performance criteria. Those criteria test the entity's performance only within the current period. The entity met the specified performance criteria in the current period, entitling it to a performance bonus. The regulatory agreement gives the entity the right to add the bonus in determining the regulated rates to be charged to customers in future periods.	Applying paragraph B17 of the [draft] Standard, the entity concludes that the performance bonus forms part of total allowed compensation for goods or services supplied in the period in which the entity's performance gives rise to the bonus (the current period). Because the regulatory agreement specifies that the amount of the bonus will be added to regulated rates to be charged to customers in future periods, that amount will be included in revenue in the future. The entity recognises as a regulatory asset its right to add the amount of the bonus in determining the regulated rates to be charged to customers in future periods.

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	Fact pattern	Analysis
7A.8	A regulatory agreement entitles an entity to a performance bonus if it meets specified performance criteria. Those criteria test the entity's performance over 12 months: nine months in the current reporting period and three months in the subsequent reporting period. Thus, at the end of the current reporting period the performance testing period is not yet complete. If the entity meets the performance criteria, a bonus of CU100 will be added in determining the regulated rates to be charged to customers immediately after the end of the performance testing period. If the entity fails to meet the criteria, the bonus will be nil. The entity has concluded that, for this incomplete performance testing period: • the 'most likely amount' method will predict the amount of the cash flows that will arise from the bonus better than the 'expected value' method would; • it is most likely that the entity will meet the performance criteria and thus become entitled to the bonus; and • the portion of the bonus that relates to the current reporting period reflects the relative duration of the period (in this case 9/12 of the total).	The amount of the cash flows that will arise from the bonus is uncertain. Using the 'most likely amount' method, the entity estimates the bonus as CU100. The portion of that bonus that relates to the current reporting period is CU75 (9/12 of CU100). Accordingly, applying paragraph B19 of the [draft] Standard, the proportionate bonus of CU75 forms part of the total allowed compensation for the goods or services supplied in the current reporting period. Under the regulatory agreement, the amount of the bonus will be added to future regulated rates if the entity meets the performance criteria. Therefore, part of the total allowed compensation for goods or services supplied in the current period will be included in revenue in the future. The entity recognises as a regulatory asset its right to add the applicable portion (CU75) of the bonus in determining the regulated rates to be charged to customers in future periods. In measuring that regulatory asset, the estimated cash flow of CU75 is discounted.

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	Fact pattern	Analysis
7A.9	In the current period, an entity incurs an obligation for environmental clean-up costs and thus recognises a provision and corresponding expense by applying IAS 37. The regulatory agreement gives the entity the right to add those costs in determining the regulated rates only when it pays the related cash (see Illustrative Example 4). The amount of cash ultimately paid includes implicitly both the environmental clean-up costs (measured initially at present value) and the finance cost arising from the time lag until payment.	The amount that recovers the environmental clean-up costs recognised as an expense in the current period is part of the total allowed compensation for goods or services supplied in the current period. Because these costs will not affect regulated rates until the entity pays the related cash and the entity has not yet paid the related cash, this part of the total allowed compensation for the goods or services already supplied will be included in revenue in the future. The entity recognises as a regulatory asset its right to add the amount of this part (that is, the amount of the clean-up costs) in determining the regulated rates to be charged to customers in future periods. The entity measures this regulatory asset applying paragraph 61 of the [draft] Standard.

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	Fact pattern	Analysis
7A.10	An entity incurs a decommissioning obligation and recognises a provision by applying IAS 37. Applying IAS 16, the entity recognises the present value of the decommissioning costs as part of the cost of an asset. That asset will be available for use in supplying goods or services to customers in future periods. The regulatory agreement gives the entity the right to add the decommissioning cost in determining the regulated rates only when it pays the related cash. The amount of cash ultimately paid includes implicitly both the decommissioning cost (measured initially at present value) and the finance cost arising from the time lag until payment.	When the provision is recognised initially, the entity has not yet recognised any revenue relating to the future recovery of the decommissioning costs and the asset is not yet available for use in supplying goods or services. Hence, no regulatory asset or regulatory liability arises at that date. Subsequently, when the asset is available for use, the entity depreciates the asset and recognises depreciation expense, including a portion that results from the decommissioning cost included in the cost of the asset. The amount that recovers depreciation expense recognised in a period is part of the total allowed compensation for goods or services supplied in that period. Because the portion of the depreciation expense relating to the decommissioning cost will not affect regulated rates until the entity pays the related cash, this part of the total allowed compensation for the goods or services already supplied will be included in revenue in the future. The entity recognises as a regulatory asset its right to add the amount of this part (that is, the amount of the portion of the depreciation expense relating to the decommissioning cost already recognised) in determining the regulated rates to be charged to customers in future periods. The entity measures this regulatory asset applying paragraph 61 of the [draft] Standard. As the discount on the provision unwinds, the entity recognises the corresponding finance cost. Consequently, as a result of applying paragraph 61, the discount on the regulatory asset unwinds and thus the entity recognises regulatory interest income.

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	Fact pattern	Analysis
7A.11	An entity recognises a deferred tax liability and tax expense in the current period. The regulatory agreement gives the entity the right to add an amount in determining the regulated rates charged to customers when the income tax liability has become current and the entity has paid the related cash.	The amount that recovers the tax expense recognised in the current period forms part of total allowed compensation for goods or services supplied in the current period. Because this amount will not affect regulated rates until the entity pays the related cash and the entity has not yet paid the related cash, this part of the total allowed compensation for the goods or services already supplied will be included in revenue in the future. The entity recognises as a regulatory asset its right to add the amount of this part (that is, the amount of the tax expense recognised in the current period) in determining the regulated rates to be charged to customers in future periods. The entity measures this regulatory asset applying paragraph 61 of the [draft] Standard.

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	Fact pattern	Analysis
7A.12	An entity recognises a pension liability in the current period as a result of current service by employees. The regulatory agreement gives the entity the right to add an amount in determining the regulated rates charged to customers when the entity pays the related cash as a contribution to the plan. The entity has not yet paid the related contributions. Over the life of the plan, the total cash paid includes implicitly all amounts recognised as part of pension costs by applying IAS 19 *Employee Benefits*, including service cost, net interest on the net defined benefit liability and remeasurements.	The amount that recovers the current service cost recognised in the current period is part of total allowed compensation for goods or services supplied in the current period. Because this amount will not affect regulated rates until the entity makes the related cash contribution to the plan, and the entity has not yet made this contribution, this part of the total allowed compensation for the goods or services already supplied will be included in revenue in the future. The entity recognises as a regulatory asset its right to add this part (that is, the amount of the current service cost recognised in the current period) in determining the regulated rates to be charged to customers in future periods. The entity measures this regulatory asset applying paragraph 61 of the [draft] Standard. In subsequent periods, the measurement of the pension liability is updated to reflect: • net interest on the net defined benefit liability. The resulting effect on the measurement of the regulatory asset is regulatory interest income or regulatory interest expense and is presented in the regulatory income or regulatory expense line in profit or loss. • remeasurements of the pension liability, presented in other comprehensive income. The resulting remeasurement of the regulatory asset is also presented in other comprehensive income (see paragraph 69 of the [draft] Standard).

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	Fact pattern	Analysis
7A.13	An entity enters into a futures contract to protect itself against changes in the price of an input and to provide price stability for customers. The contract will be settled by a net payment in cash. The regulatory agreement entitles the entity to recover any loss on settlement when it has paid the cash settlement amount by increasing the regulated rate charged to customers. The entity has concluded that the futures contract is within the scope of IFRS 9 *Financial Instruments*. The entity accounts for the contract as a derivative and measures it at fair value through profit or loss. In the current year, the entity recognises a loss because of a decrease in the fair value of the contract.	Applying paragraph B3 of the [draft] Standard, the loss on remeasurement of the contract recognised in the current period is an allowable expense. The amount that recovers that allowable expense forms part of total allowed compensation for goods or services supplied in the current period. Because this amount will not affect regulated rates until the entity pays the related cash and the entity has not yet paid the related cash, this part of the total allowed compensation for the goods or services already supplied will be included in revenue in the future. The entity recognises as a regulatory asset its right to add the amount of this part (that is, the amount of the loss on remeasurement of the contract) in determining the regulated rates to be charged to customers in future periods. The entity measures this regulatory asset applying paragraph 61 of the [draft] Standard.

Example 7B Examples of circumstances that give rise to regulatory liabilities

	Fact pattern	Analysis
7B.1	The regulated rate charged to customers for goods or services supplied in the current period is based on estimated input costs. Actual input costs for the period were lower than this estimate. Actual input costs incurred were recognised as an expense in the current period by applying IFRS Standards. The regulatory agreement obliges the entity to deduct the resulting over-recovery of input costs in determining the regulated rates to be charged to customers in future periods.	Revenue recognised in the current period includes the over-recovery of actual input costs. This over-recovery will provide part of the total allowed compensation for goods or services to be supplied in the future. The entity recognises as a regulatory liability its obligation to deduct this amount (that is, the amount of the over-recovery of input costs) in determining the regulated rates to be charged to customers in future periods.
7B.2	The regulated rate charged to customers for goods or services supplied in the current period is based on the revenue requirement[4] and on an estimate of customer demand during that period. Actual demand for the current period is higher than this estimate. The regulatory agreement obliges the entity to deduct the resulting over-recovery of the revenue requirement for the current period in determining the regulated rates to be charged to customers in future periods.	Revenue recognised in the current period includes an amount that will provide part of the total allowed compensation for goods or services to be supplied in the future. This is because the regulated rates for the current period were based on estimated demand, but actual demand was higher, resulting in an over-recovery of the revenue requirement. The entity recognises as a regulatory liability its obligation to deduct this amount (that is, the amount of the over-recovery of the revenue requirement) in determining the regulated rates to be charged to customers in future periods.

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4 See footnote to paragraph 7A.2.

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	Fact pattern	Analysis
7B.3	The regulated rate charged to customers in the current period includes an amount for a contingency fund. The regulatory agreement entitles the entity to draw on the contingency fund to offset costs that the entity may incur as a result of an unusual event in the future—for example, repair costs after a storm.	Revenue recognised during the current period includes the amount added to the contingency fund in the current period. That amount will provide part of the total allowed compensation for goods or services to be supplied in the future. The entity recognises as a regulatory liability its obligation to deduct this amount (that is, the addition to the contingency fund) in determining the regulated rates to be charged to customers in future periods. The entity will fulfil this regulatory liability by deducting that amount in future periods when, by applying IFRS Standards, the entity recognises as an expense costs (such as repair costs) covered by the contingency fund.
7B.4	A regulatory agreement specifies that an entity has the right to recover the cost of an asset but over a period shorter than the asset's useful life determined by applying IFRS Standards.	In each period while the cost of the asset was being recovered through the regulated rates charged to customers, the revenue recognised included an amount that recovered depreciation expense. Because the recovery period is shorter than the asset's useful life, that amount recovered not only all of the depreciation expense recognised in that period by applying IFRS Standards, but also part of the depreciation expense that the entity will recognise in future periods. The amount that recovered future depreciation expense will provide part of the total allowed compensation for goods or services that will be supplied in the future after the asset's recovery period has finished until the end of its useful life. The entity recognises as a regulatory liability its obligation to deduct this amount (that is, the amount of future depreciation expense already recovered), in determining the regulated rates to be charged to customers in future periods.

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	Fact pattern	Analysis
7B.5	A regulatory agreement specifies that an entity is entitled to include an amount (pre-funding) to recover part of the construction cost of an asset in determining the regulated rates charged to customers in the current period. The asset was not yet available for use in the current period.	Revenue recognised in the current period includes the amount of the pre-funding, reflecting an advance recovery of depreciation expense that the entity will recognise in future periods. That amount will provide part of the total allowed compensation for goods or services to be supplied in the future when the entity recognises the depreciation expense recovered in advance. The entity recognises as a regulatory liability its obligation to deduct that amount (that is, the amount of future depreciation expense already recovered) in determining the regulated rates to be charged to customers in future periods.
7B.6	A regulatory agreement specifies that an entity is entitled to add a regulatory return on a balance relating to an asset in determining the regulated rates charged to customers in the current period. The asset was not yet available for use in the current period.[5]	Revenue recognised in the current period includes the regulatory return on a balance relating to an asset that is not yet available for use. Applying paragraph B15 of the [draft] Standard, the regulatory return on that balance forms part of total allowed compensation only for goods or services supplied in the future—once the asset is available for use. The entity recognises as a regulatory liability its obligation to deduct the amount of that regulatory return (that is, the amount of the regulatory return, already included in revenue, that arose on that balance) in determining the regulated rates to be charged to customers from the date when the asset is available for use.

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5 Paragraph 7C.3 includes a similar example but in that case the regulatory agreement entitles the entity to add the regulatory return in determining the regulated rates charged to customers only once the asset is available for use.

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	Fact pattern	Analysis
7B.7	A regulatory agreement specifies that an entity has the right to recover the cost of an asset used to supply goods or services over a period that coincides with the asset's useful life determined by applying IFRS Standards. In the current period, the entity recognised a gain on the sale of the asset. The regulatory agreement treats the gain as chargeable income, requiring the entity to deduct it in determining the regulated rates to be charged to customers in future periods.	The gain recognised on the sale of the asset during the current period indicates that revenue already recognised recovered too much depreciation expense on this asset used to supply goods or services in the past. That over-recovery will provide part of the total allowed compensation for goods or services to be supplied in the future. The entity recognises as a regulatory liability its obligation to deduct that amount (equal to the gain on the sale of the asset) in determining the regulated rates to be charged to customers in future periods.
7B.8	A regulatory agreement imposes a performance penalty on an entity if the entity does not meet specified performance criteria. Those criteria test the entity's performance only within the current period. The entity did not meet the specified performance criteria in the current period, resulting in the entity incurring a performance penalty. The regulatory agreement requires the entity to deduct the performance penalty in determining the regulated rates to be charged to customers in future periods.	Applying paragraph B17 of the [draft] Standard, the entity concludes that the performance penalty reduces the total allowed compensation for goods or services supplied in the period in which the entity's performance gives rise to the penalty (the current period). Revenue already recognised was based on a regulated rate that did not reflect the penalty, and led to an over-recovery of total allowed compensation in the current period. That over-recovery will provide part of the total allowed compensation for goods or services to be supplied in the future. The entity recognises as a regulatory liability its obligation to deduct the amount of the penalty in determining the regulated rates to be charged to customers in future periods.

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	Fact pattern	Analysis
7B.9	A regulatory agreement imposes a performance penalty on an entity if the entity does not meet specified performance criteria. Those criteria test the entity's performance over 12 months: nine months in the current reporting period and three months in the subsequent reporting period. Thus, at the end of the current reporting period the performance testing period is not yet complete. If the entity fails to meet the performance criteria, a penalty of CU100 will be deducted in determining the regulated rates to be charged to customers immediately after the end of the performance testing period. If the entity meets the criteria, the penalty will be nil. The entity has concluded that, for this incomplete performance testing period: • the 'most likely amount' method will predict the amount of the cash flows that will arise from the penalty better than the 'expected value' method would; • it is most likely that the entity will fail to meet the performance criteria and thus become liable to the penalty; and • the portion of the penalty that relates to the current reporting period reflects the relative duration of the period (in this case 9/12 of the total).	The amount of the cash flows that will arise from the penalty is uncertain. Using the 'most likely amount' method, the entity estimates the penalty as CU100. The portion of that penalty that relates to the current reporting period is CU75 (9/12 of CU100). Accordingly, applying paragraph B19 of the [draft] Standard, the proportionate penalty of CU75 reduces the total allowed compensation for the goods or services supplied in the current reporting period. Under the regulatory agreement, the amount of the penalty will be deducted from future regulated rates if the entity fails to meet the performance criteria. Revenue already recognised was based on a regulated rate that did not reflect the penalty and led to an over-recovery of total allowed compensation in the current period. That over-recovery will provide part of the total allowed compensation for goods or services to be supplied in the future. The entity recognises as a regulatory liability its obligation to deduct the applicable portion (CU75) of the penalty in determining the regulated rates to be charged to customers in future periods. In measuring that regulatory liability, the estimated cash flow of CU75 is discounted. In this case, the discount rate is the regulatory interest rate of 0%. For a regulatory liability, an entity is required to use the regulatory interest rate as the discount rate in all circumstances (paragraph 53 of the [draft] Standard).

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	Fact pattern	Analysis
7B.10	An entity recognises a deferred tax asset and tax income in the current period. The regulatory agreement does not require the entity to deduct an amount in determining the regulated rate charged to customers until the income tax asset has become current and results in a reduction in the related taxes paid by the entity.	The tax income recognised in the current period reduces the total allowed compensation for goods or services supplied in that period. Revenue already recognised was based on a regulated rate that did not reflect deferred tax, leading to an over-recovery of total allowed compensation for goods or services supplied in the current period. Because the entity will not deduct this amount in determining the regulated rate charged to customers until it pays a reduced amount of taxes, that over-recovery will provide part of the total allowed compensation for goods or services to be supplied in the future (when the entity has paid tax reduced by that amount). The entity recognises as a regulatory liability its obligation to deduct the amount of the tax income recognised in the current period in determining the regulated rates to be charged to customers in future periods. The entity measures this regulatory liability applying paragraph 61 of the [draft] Standard.

Example 7C Examples of circumstances that give rise to neither regulatory assets nor regulatory liabilities

	Fact pattern	Analysis
7C.1	An entity recognises expenses in the current period by applying IFRS Standards, but the regulatory agreement disallows them—it gives the entity no right to recover them through the regulated rates to be charged to customers in any period.	These expenses do not give rise to an amount of total allowed compensation in any period. Therefore, no regulatory asset or regulatory liability arises.
7C.2	A regulatory agreement adjusts the regulatory capital base in the current period for inflation, giving an entity the right to add an inflation adjustment in determining the regulated rates to be charged to customers in future periods.	The inflation adjustment is a form of target profit provided by the regulatory agreement. Applying the requirements of paragraph B10 of the [draft] Standard, target profit forms part of total allowed compensation for goods or services to be supplied in the periods when the regulatory agreement entitles the entity to add that amount of target profit in determining the regulated rates to be charged to customers —which in this example will be only in future periods. The right to add an amount reflecting the inflation adjustment in determining the regulated rates to be charged to customers in a future period is not a right to recover total allowed compensation for goods or services already supplied to customers. Consequently, that right does not meet the definition of a regulatory asset.[6]

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6 Two broadly equivalent approaches are typically used to compensate entities for inflation. Some regulatory agreements include inflation in a nominal return rate and apply it to a nominal base (such as the regulatory capital base). Others adjust a base such as the regulatory capital base for inflation and apply to it a real return rate excluding inflation. Neither approach results in a regulatory asset.

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	Fact pattern	Analysis
7C.3	A regulatory agreement gives an entity the right to accumulate regulatory returns on a balance related to an asset being constructed and hence not yet available for use, and to include those accumulated returns in the regulated rates to be charged to customers once the asset is available for use. The term 'allowance for funds used during construction' is sometimes used to describe this regulatory approach.	Regulatory returns on a balance related to an asset not yet available for use are a form of target profit provided by the regulatory agreement. Applying the requirements of paragraph B14 of the [draft] Standard, regulatory returns form part of total allowed compensation in the period when the regulatory agreement entitles the entity to add them in determining the regulated rates to be charged to customers—which in this example will be only when the asset is available for use. Until the asset is available for use, the total allowed compensation for goods or services supplied using the asset is nil. Therefore, no regulatory asset arises. Although the regulatory return accumulates during the construction period, it is not included in revenue during the construction period. Therefore, no regulatory liability arises during that period.

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	Fact pattern	Analysis
7C.4	A regulated entity is part of a group of entities. An unregulated entity within the group recognises an intercompany gain in its own financial statements when it sells an asset to the regulated entity. In a future period, the regulated entity will start using this asset in supplying goods or services to customers. The regulatory agreement includes in the regulatory capital base the cost of the asset to the regulated entity, without eliminating the intercompany gain, and subsequently allows the regulated entity to recover this amount through the regulated rate charged to customers.	At the date of the intercompany sale, the regulated entity has not yet supplied goods or services using the asset and has not yet recognised revenue relating to the recovery of the cost of the asset. Therefore, from the perspective of both the regulated entity and the group, no regulatory asset or regulatory liability arises at that date. For the regulated entity, this fact pattern is the same as if the entity had acquired the asset from a third party. The depreciation of the asset over its useful life will give rise to an amount of total allowed compensation equal to the asset's cost to the regulated entity, without eliminating the intercompany gain. From the group's perspective in preparing its consolidated financial statements, the regulatory agreement permits the regulated entity, in effect, to charge the intercompany gain to customers as part of target profit. Thus, from the group's perspective, the group becomes entitled over the asset's life to an amount of total allowed compensation consisting of the historical cost of the asset to the group, after eliminating the gain, plus an amount of target profit equal to the intercompany gain.

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SET ISBN 978-1-914113-01-7

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PART C ISBN 978-1-914113-04-8