IFRS

# STAFF PAPER

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**IASB® meeting**

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| **Project** | **Rate-regulated Activities** |
| Paper topic | Feedback summary—Interaction with other IFRS Standards |

CONTACT(S) Raghava Tirumala rtirumala@ifrs.org



## Objective

1. This paper analyses the feedback from comment letters and outreach events on:

   (a) the proposed guidance on interaction with other IFRS Standards in paragraphs B41–B47 of the Exposure Draft *Regulatory Assets and Regulatory Liabilities*;[1] and

   (b) proposed amendments to other IFRS Standards in Appendix D to the Exposure Draft.

   (Question 11 of the Invitation to Comment.)

2. Feedback on the following topics will be presented to the Board at a forthcoming meeting:

   (a) the interaction of the proposed presentation, disclosure and transition requirements in the Exposure Draft with other IFRS Standards such as IAS 1 *Presentation of Financial Statements* and IAS 7 *Statement of Cash Flows*; and

   (b) the proposed amendments to IAS 1 and IFRS 1 *First-time Adoption of International Financial Reporting Standards*.

[1] https://www.ifrs.org/content/dam/ifrs/project/rate-regulated-activities/published-documents/ed2021-rra.pdf

## Key messages

3. Most respondents who commented on the proposed guidance on the interaction with IAS 12 *Income Taxes* suggested the Board provide detailed guidance and examples.

4. Most respondents who commented on the proposed guidance on the interaction with IFRIC 12 *Service Concession Arrangements* said that the guidance is insufficient and suggested the Board provide detailed guidance and examples.

5. A few respondents suggested the Board provide guidance on the interaction with, and amend, a few other IFRS Standards.

## Structure of the paper

6. This paper is structured as follows:
   (a) Question 11(a)—Interaction with other IFRS Standards;
      (i) IAS 12 *Income Taxes* (paragraphs 7–10);
      (ii) IFRIC 12 *Service Concession Arrangements* (paragraphs 11–17);
      (iii) other IFRS Standards (paragraphs 18–19); and
   (b) Question 11(b)—Proposed amendments to other IFRS Standards (paragraphs 20–31).

## Question 11(a)—Interaction with other IFRS Standards

### *IAS 12* Income Taxes

*Summary of the proposed guidance*

7. Paragraphs B42–B46 of the Exposure Draft discuss:
   (a) regulatory assets or regulatory liabilities that arise when the regulated rates do not yet fully reflect current tax expense (income), or when an entity has a deferred tax liability or a deferred tax asset (paragraphs B42–B43);
   (b) deferred tax liabilities or deferred tax assets resulting from applying IAS 12 to a regulatory asset or regulatory liability (paragraph B44); and

(c) how income taxes affect the measurement of regulatory assets and regulatory liabilities (paragraphs B45–B46).

*Comment letter and outreach feedback*

8. The Board asked stakeholders to comment on the proposed guidance.

9. Most respondents who commented supported the proposed guidance but suggested the Board provide comprehensive examples to illustrate application of the proposed guidance and presentation of regulatory income or regulatory expense associated with income taxes.

10. A few respondents, mainly accounting firms and national standard-setters suggested the Board:

(a) clarify whether the recognition of a regulatory asset or regulatory liability associated with income taxes (paragraphs B42–B43 of the Exposure Draft) in turn gives rise to the recognition of a deferred tax liability or deferred tax asset (paragraph B44 of the Exposure Draft).

(b) further clarify the guidance in paragraphs B45–B46 of the Exposure Draft about how, in measuring a regulatory asset or regulatory liability, an entity should consider the income tax consequences of recovery of that regulatory asset or fulfilment of that regulatory liability.

(c) clarify whether the income tax consequences of a regulatory asset or regulatory liability should be accounted for as a separate unit of account or as an integral part of measuring that regulatory asset or regulatory liability as illustrated in paragraph B46 of the Exposure Draft.

(d) clarify how the proposed guidance should be applied to account for the income tax consequences of a regulatory asset or regulatory liability measured applying paragraph 61 of the Exposure Draft.

(e) specify that the tax base of a regulatory asset or regulatory liability should be determined applying IAS 12. Paragraph B44 of the Exposure Draft states that the tax base of a regulatory asset or regulatory liability is typically nil. These respondents said that in some jurisdictions, the tax base of a regulatory asset or regulatory liability would be equal to the carrying amount. Therefore, in those jurisdictions, the recognition of a regulatory asset or regulatory liability would not give rise to the recognition of a deferred tax liability or deferred tax asset.

(f) clarify why the initial recognition exception in paragraphs 15 and 24 of IAS 12 do not apply if the tax base of a regulatory asset or regulatory liability is nil.

(g) explain how an entity should assess recoverability of a deferred tax asset on a regulatory liability or regulatory asset.

## *IFRIC 12* Service Concession Arrangements

11. Paragraph B47 of the Exposure Draft states that:

> IFRIC 12 applies to a public-to-private service concession arrangement if the grantor controls or regulates the price at which the operator must provide services, and if other specified conditions are met. Accordingly, some arrangements within the scope of IFRIC 12 may create regulatory assets or regulatory liabilities within the scope of this [draft] Standard. An entity shall account for those regulatory assets or regulatory liabilities separately from the assets and liabilities within the scope of IFRIC 12.

### *Comment letter and outreach feedback*

12. The Board asked respondents to comment on the proposed guidance.

13. Most respondents who commented on the proposed guidance agreed that service concession arrangements can create regulatory assets and regulatory liabilities. An accounting firm suggested the Board carry out more outreach to understand how often service concession arrangements create regulatory assets and regulatory liabilities.

14. Many respondents who commented said that the proposed guidance is insufficient and suggested the Board provide detailed guidance and illustrative examples on how an entity would account for regulatory assets and regulatory liabilities in all three financial reporting models in IFRIC 12—the financial asset model, the intangible asset model, and the hybrid model. Supporting the need for detailed guidance:

(a) almost all respondents from Latin America said that service concession arrangements are common in the utility sector; and

(b) an accountancy body from Asia-Oceania said that an intangible asset recognised by applying IFRIC 12 and a regulatory asset are similar in nature.

15. In developing the guidance and the illustrative examples, some respondents suggested the Board consider the diverse features of service concession arrangements, such as arrangements in which:

(a) a government body is typically both the grantor and the sole customer;

(b) the grantor is the customer for some services and the general public are customers for other services;

(c) the grantor contractually guarantees to pay the shortfall, if any, between amounts received from users of the public service and specified or determinable amounts;

(d) the operator has a right to reset the rates charged to customers after a specified period based on costs incurred during that specified period; and

(e) the operator has a right to increase rates charged to customers at regular intervals during the concession period, but the grantor extends the concession period instead of allowing the operator to increase the rates.

16. Some respondents from Latin America provided the Board with examples of how they would change the way they report on specified rights and obligations in a service concession arrangement if the Board finalised the proposals in the Exposure Draft. At the end of the service concession period, a grantor in a service concession arrangement compensates an operator if the expenses incurred by the operator exceed the expenses estimated in setting the rates charged to customers. Similarly, the grantor receives compensation from the operator if the expenses incurred by the operator are less than the expenses estimated in setting the rates. Currently, an operator accounts for that right to compensation as a financial asset and that obligation to pay as a financial liability. If the Board finalised the proposals in the Exposure Draft, an operator would instead be required to report that right to compensation as a regulatory asset and the obligation to pay as a regulatory liability.

Those respondents also suggested the Board provide guidance on what an operator should do when a grantor extends the service concession period instead of paying compensation to the operator.

17. A European national standard-setter suggested the Board specify that:

    (a) regulatory assets and regulatory liabilities do not arise in a service concession arrangement accounted for applying the financial asset model; and

    (b) regulatory assets and regulatory liabilities arise only during the operation services phase of a service concession arrangement accounted for applying the intangible asset model.

### *Other IFRS Standards*

#### *Comment letter and outreach feedback*

18. The Board asked stakeholders if it should provide any further guidance on how the requirements proposed in the Exposure Draft would interact with any other IFRS Standards.

19. The Board received the following feedback:

    (a) an accounting firm, a European national standard-setter and a few preparers from Asia-Oceania suggested the Board clarify how an entity should apply the proposals if it measures property, plant and equipment using the revaluation model applying IAS 16 *Property, Plant and Equipment*.

    (b) a preparer from North America suggested the Board provide guidance on the interaction with IAS 19 *Employee Benefits* and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. Paragraph 59 of the Exposure Draft refers to IAS 12, IAS 19, and IAS 37 in the context of items affecting regulated rates only when related cash is paid or received. However, the Board proposed guidance only on the interaction with IAS 12. An accounting firm and a national standard-setter suggested the Board provide guidance on the interaction with IAS 37 for a regulatory asset or regulatory liability associated with decommissioning obligations.

(c) a national standard-setter from Asia-Oceania suggested the Board provide guidance on the interaction with IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*. In some regulatory agreements, an entity is compensated for any unearned compensation through government assistance.

(d) an accounting firm questioned the Board's proposal that regulatory assets and regulatory liabilities are monetary items. Paragraph 45 of the Exposure Draft states that if regulated rates are denominated in a foreign currency, an entity should treat any related regulatory assets or regulatory liabilities as monetary items when applying IAS 21 *The Effects of Changes in Foreign Exchange Rates*. That respondent said that a regulatory liability may not be a monetary item like unearned revenue because a regulatory liability may be settled not by paying cash to customers but by providing goods or services at lower rates. That respondent also suggested the Board further clarify the application of IAS 21 over the life of a regulatory asset or regulatory liability.

(e) an accounting firm suggested the Board provide guidance on how an entity should account for its regulatory assets and regulatory liabilities in the interim financial statements. Paragraph 37 of IAS 34 *Interim Financial Reporting* states that revenues that are received seasonally, cyclically, or occasionally within a financial year should not be anticipated or deferred as of an interim date if anticipation or deferral would not be appropriate at the end of an entity's financial year. Revenues of a utility are typically received seasonally or cyclically within a financial year, which suggests that a utility should recognise a regulatory asset or regulatory liability associated with, say, volume variance at an interim financial reporting date.

(f) a European preparer suggested the Board clarify the application of the expected credit loss model in IFRS 9 *Financial Instruments* to receivables if an entity has a right to recover uncollected receivables through future rates charged to customers. Currently, some entities do not recognise expected credit losses on the basis that loss arising on default of receivables is nil. Uncollected receivables are recognised in profit or loss in the period in which those amounts are included in determining the rates charged to customers.

(g) an accounting firm and a European preparer suggested the Board clarify the application of the proposals in the separate financial statements of subsidiaries in a group and in the consolidated financial statements of a parent, especially if one entity in the group is a principal supplying goods or services and another entity in the group is an agent having all contracts with customers and determines the rates charged to customers.

(h) an accounting firm suggested the Board provide illustrative examples on paragraphs 18–19 of the Exposure Draft. Those paragraphs discuss instances in which the amount of revenue recognised in a period does not include all of the total allowed compensation for the goods or services supplied in that period because IFRS 15 *Revenue from Contracts with Customers* requires an entity not to recognise part or all of the revenue until a future period.

(i) a preparer from Asia-Oceania and a preparer from North America suggested the Board provide guidance on the interaction with IFRS 16 *Leases* because some regulatory agreements may be within the scope of IFRS 16.

(j) an accounting firm suggested the Board provide guidance on the interaction with IFRS 17 *Insurance Contracts*. That respondent said that in some jurisdictions, entities are subject to a regulatory agreement that determines the premium charged for the insurance contracts issued, and that the regulatory agreement may be capable of creating regulatory assets and regulatory liabilities. See Agenda Paper 9A *Feedback Summary—Objective and Scope* for feedback from a few respondents suggesting the Board exclude insurance contracts subject to rate regulation from the scope of the Exposure Draft.

## Question 11(b)—Proposed amendments to other IFRS Standards

### *Summary of proposals in the Exposure Draft*

20. The Board proposed amending:

(a) IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to delete a paragraph that provides a temporary exception that would no longer be needed when applying the proposals in the Exposure Draft;

(b) IAS 36 *Impairment of Assets* to specify that regulatory assets are outside the scope of IAS 36 and to provide some guidance on avoiding double-counting of cash flows from regulatory assets or regulatory liabilities when testing an asset or a cash-generating unit for any impairment;

(c) IFRS 3 *Business Combinations* to require an entity to 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; and

(d) IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* to exclude regulatory assets from the scope of the measurement requirements in IFRS 5.

21. Paragraphs BC252–BC266 of the Basis for Conclusions on the Exposure Draft describe the reasoning behind the proposed amendments to other IFRS Standards.[2]

### *Comment letter and outreach feedback*

22. The Board asked stakeholders to comment on the proposed amendments.

#### *IAS 36* Impairment of Assets

23. The Board proposed amending paragraph 79 of IAS 36 to allow an entity to determine the recoverable amount of a cash-generating unit after considering regulatory assets that are not part of the cash-generating unit or regulatory liabilities that have been recognised. In such cases, the carrying amount of the cash-generating unit would be increased by the carrying amount of the regulatory assets and decreased by the carrying amount of the regulatory liabilities.

24. Most respondents who commented, mainly accounting firms and preparers, suggested the Board provide guidance and illustrative examples on applying the proposed amendments to paragraph 79 of IAS 36. A few of them said that it may not always be possible to separate cash flows of regulatory assets and regulatory liabilities from the cash flows of a cash-generating unit. A few others said that regulatory assets and

[2] https://www.ifrs.org/content/dam/ifrs/project/rate-regulated-activities/published-documents/ed2021-rra-bc.pdf

regulatory liabilities should always be included in the cash-generating unit to which they belong because they do not generate cash flows that are largely independent of those from other assets in the cash-generating unit.

25. An accounting firm said that applying the proposed amendments to paragraph 79 of IAS 36 may not lead to a meaningful comparison between the carrying amount of the cash-generating unit and its recoverable amount, especially if the regulatory assets and regulatory liabilities have a long life. The discount rate used in measuring the carrying amount of a regulatory asset or regulatory liability may be different from the discount rate used in measuring the recoverable amount of the cash-generating unit.

### *IFRS 3* Business Combinations

26. A European national standard-setter disagreed with the Board's proposal because in their view an acquiring entity may recognise a higher amount of goodwill by not recognising at fair value all regulatory assets acquired and all regulatory liabilities assumed in a business combination.

27. An accounting firm suggested the Board further investigate whether the application of the proposed amendments has any unintended consequences, especially affecting subsequent measurement and the interaction with IAS 36. Another accounting firm suggested the Board provide guidance and examples on recognising and measuring regulatory assets acquired and regulatory liabilities assumed in a business combination.

### *Other IFRS Standards*

28. A preparer in North America suggested the Board amend:

    (a) IAS 16 *Property, Plant and Equipment* to require an entity to include in the carrying amount of property, plant and equipment overhead costs that a regulator allows the entity to include in the regulatory capital base; and

    (b) IAS 23 *Borrowing Costs* to expand the definition of borrowing costs eligible for capitalisation to include regulatory returns on assets not yet available for use approved by a regulator.

29. The amendments to IAS 16 and IAS 23 would result in bringing the carrying amount of property, plant and equipment closer to the regulatory capital base.

30. A national standard-setter from Asia-Oceania suggested the Board amend IAS 32 *Financial Instruments: Presentation*, IFRS 7 *Financial Instruments: Disclosures* and IFRS 9 *Financial Instruments* to exclude regulatory assets and regulatory liabilities from the scope of those Standards.

31. A national standard-setter from Asia-Oceania suggested the Board amend IFRS 8 *Operating Segments* to require an entity to report rate-regulated activities separately from other activities. Another national standard-setter from Asia-Oceania suggested the Board require an entity to disclose the financial effects of regulatory assets and regulatory liabilities for each reportable segment.

| Question for the Board |
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| Does the Board have any questions or comments on the feedback discussed in this paper? Specifically:<br>a. Is there any feedback that is unclear?<br>b. Are there any points you think the Board did not consider in developing the Exposure Draft but should consider in the re-deliberations?<br>c. Are there any points you would like staff to research further for the re-deliberations? |