IFRS Accounting

Staff paper

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Project	**Rate-regulated Activities**
Topic	**Derecognition**
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Objective

1. This paper sets out staff analysis and recommendations on the proposals relating to derecognition of regulatory assets and regulatory liabilities in the Exposure Draft *Regulatory Assets and Regulatory Liabilities* (Exposure Draft).

Staff recommendations

2. We recommend that the final Accounting Standard:
   (a) explain that an entity typically derecognises a regulatory asset or a regulatory liability as the entity recovers part or all of the regulatory asset or fulfils part or all of the regulatory liability, by adding or deducting amounts to or from future regulated rates charged to customers;
   (b) explain that application of the recognition and measurement requirements at the end of each reporting period mean that an entity does not generally need to explicitly consider when and how regulatory assets and regulatory liabilities should be derecognised;
   (c) clarify that an entity derecognises a regulatory asset or a regulatory liability if it ceases to meet the more likely than not recognition threshold;

(d) include guidance on the derecognition of regulatory assets and regulatory liabilities due to their settlement by a regulator or another designated body (and require that an entity recognises the difference between the derecognised regulatory asset or regulatory liability and any new asset or liability in profit or loss); and

(e) specify that if a regulatory asset or a regulatory liability is added to, or deducted from, an entity's regulatory capital base and the regulatory capital base has no direct relationship with the entity's property, plant and equipment, an entity derecognises the regulatory asset or regulatory liability and recognises any associated regulatory income or regulatory expense in profit or loss.

3. We recommend that the final Accounting Standard does not include guidance on securitisation of regulatory assets.

Structure of the paper

4. This paper is structured as follows:

(a) proposals in the Exposure Draft (paragraphs 6–8);

(b) feedback received (paragraphs 9–10); and

(c) staff analysis (paragraphs 11–51).

5. This paper includes two appendices:

(a) Appendix A outlines circumstances leading to discontinuation of regulatory accounting in US generally accepted accounting principles (GAAP).

(b) Appendix B describes a common securitisation transaction of a regulatory asset and considers the application of the derecognition principles in IFRS 9 *Financial Instruments* to that transaction. It also summarises the discussion of derecognition in the *Conceptual Framework for Financial Reporting* (*Conceptual Framework*).

Proposals in the Exposure Draft

6. The proposed recognition requirements are set out in paragraphs 25–28 of the Exposure Draft:

> **25 An entity shall recognise:**
>
> **(a) all regulatory assets and all regulatory liabilities existing at the end of the reporting period; and**
>
> **(b) all regulatory income and all regulatory expense arising during the reporting period.**
>
> …
>
> 28 If it is uncertain whether a regulatory asset or a regulatory liability exists, an entity shall recognise the regulatory asset or regulatory liability if it is more likely than not that it exists.

7. The Exposure Draft does not have a section that deals explicitly with derecognition. Paragraph BC129 of the Basis for Conclusions accompanying the Exposure Draft explains why the IASB considered that a separate section on derecognition was unnecessary.

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

8. However, the Exposure Draft does address derecognition in the context of cancellation of a regulatory agreement. Paragraph B38 of the Exposure Draft and paragraph BC153 of the Basis for Conclusions accompanying the Exposure Draft are shown below.

> B38 If a cancellation right has been exercised so that a right to receive cash or obligation to pay cash has arisen, that right or obligation is a financial asset or financial liability. In such a case, the entity shall derecognise the part of the regulatory asset or regulatory liability that no longer exists, and recognise and measure the financial asset or financial liability by applying other IFRS Standards, recognising any resulting difference in profit or loss.

…

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

Feedback received

9. Some respondents, mainly accounting firms, considered that the final Standard should more explicitly address derecognition. Respondents sought clarification on:

   (a) whether regulatory assets or regulatory liabilities should be derecognised or remeasured if they no longer meet the more likely than not recognition threshold;

   (b) whether the proposed derecognition of regulatory assets and regulatory liabilities in the context of cancellation of a regulatory agreement in

paragraph B38 of the Exposure Draft would also apply to other situations that may occur during the term of the regulatory agreement—for example if (partial) settlement takes place with parties other than customers;

(c) how to deal with the overall effects of discontinuing regulatory accounting; and

(d) whether an entity applies the derecognition requirements in IFRS 9 or follows some other approach when it transfers the right to the future cash flows arising from a regulatory asset to a third party (for example, on securitisation of regulatory assets).

10. Some respondents requesting more guidance on derecognition suggested that the discussion of derecognition in paragraph BC129 of the Basis for Conclusions accompanying the Exposure Draft could be included in the final Standard (paragraph 7).

Staff analysis

11. The analysis is structured as follows:

(a) general guidance on derecognition (paragraphs 12–16);

(b) more likely than not recognition threshold is no longer met (paragraphs 17–21);

(c) derecognition of regulatory assets and regulatory liabilities (other than on cancellation or termination of a regulatory agreement) (paragraphs 22–33);

(d) discontinuing regulatory accounting (paragraphs 34–38); and

(e) securitisation (paragraphs 39–51).

General guidance on derecognition

12. Some respondents to the Exposure Draft suggested that the IASB provide general guidance on derecognition by including paragraph BC129 of the Basis for Conclusions accompanying the Exposure Draft in the final Standard (paragraph 10).

13. The first sentence of paragraph BC129 discusses the derecognition of regulatory assets and regulatory liabilities as an entity recovers part or all of a regulatory asset, or fulfils part or all of a regulatory liability, by adding or deducting an amount in determining future regulated rates. The remainder of paragraph BC129 summarises matters considered by the IASB in developing the proposals, including the IASB's view that the proposed measurement requirements mean that in most cases explicit derecognition requirements are not necessary.

14. Because recovery of regulatory assets and fulfilment of regulatory liabilities are the most common ways in which regulatory assets and regulatory liabilities are derecognised, we agree that it would be helpful for this to be explicitly stated in the final Standard, alongside the recognition requirements.

15. We recommend that the final Accounting Standard explain that:

    (a) an entity typically derecognises a regulatory asset or a regulatory liability as the entity recovers part or all of the regulatory asset or fulfils part or all of the regulatory liability, by adding or deducting amounts to or from future regulated rates charged to customers; and

    (b) application of the recognition and measurement requirements at the end of each reporting period mean that an entity does not generally need to explicitly consider when and how regulatory assets and regulatory liabilities should be derecognised.

16. Paragraphs 22–33 deal with other circumstances that give rise to derecognition of regulatory assets or regulatory liabilities.

Question for the IASB
1. Does the IASB agree with the recommendation in paragraph 15?

More likely than not recognition threshold is no longer met

17. An accounting firm suggested the IASB clarify whether ceasing to meet the more likely than not recognition threshold should trigger remeasurement or derecognition of regulatory assets and regulatory liabilities (paragraph 9(a)).

18. Paragraphs 25 and 28 of the Exposure Draft require that an entity recognise all regulatory assets and all regulatory liabilities that exist at the end of the reporting period.[1] Taken together, these paragraphs require that an entity recognise a regulatory asset or a regulatory liability only if it is more likely than not that the asset or liability exists at the end of the reporting period (that is, if it is more likely than not that an enforceable present right or an enforceable present obligation exists at the end of the reporting period).

19. We think that the proposal that an entity recognises all regulatory assets and all regulatory liabilities existing at the end of the reporting period means that regulatory assets and regulatory liabilities must continue to meet the recognition threshold each period. If changes in facts and circumstances mean that a regulatory asset or a regulatory liability ceases to meet the recognition threshold in a subsequent reporting period, this would trigger derecognition of the regulatory asset or regulatory liability.

20. We do not think that requiring an entity to assess whether the recognition threshold is met at the end of each period would impose unreasonable costs. This is because, in most cases, the facts and circumstances supporting the initial assessment of existence will not have changed and reassessment will not be required.

21. We recommend that the final Accounting Standard clarify that an entity derecognises a regulatory asset or a regulatory liability if it ceases to meet the more likely than not recognition threshold.

Question for the IASB
2. Does the IASB agree with the recommendation in paragraph 21?

[1] Paragraphs 25 and 28 of the Exposure Draft are shown in paragraph 6 of this paper.

Derecognition of regulatory assets and regulatory liabilities (other than on cancellation or termination of a regulatory agreement)

22. Paragraph 38 of the Exposure Draft discusses the derecognition of regulatory assets and regulatory liabilities on the cancellation of a regulatory agreement (paragraph 8). However, the Exposure Draft does not address other circumstances that could lead to derecognition.

Examples identified by respondents

23. Respondents commented that circumstances other than cancellation or termination of an agreement could lead to derecognition of regulatory assets and regulatory liabilities and suggested that the final Standard should include guidance on derecognition in a broader range of circumstances (paragraph 9(b)). Respondents mentioned two cases:

    (a) an accounting firm commented that in some jurisdictions regulatory agreements allow the regulator, or an entity acting on behalf of the regulator, to settle regulatory assets and regulatory liabilities directly with an entity.

    (b) a national standard-setter commented that a regulator might settle a regulatory asset by compensating the entity in some other way, such as by reducing a liability of the entity.

24. In both cases mentioned by respondents, an entity would need to derecognise the regulatory assets or regulatory liabilities because they would no longer meet the definitions of regulatory assets and regulatory liabilities in the Exposure Draft. In the first case (paragraph 23(a)), which we think may be reasonably common, an entity might be required to recognise a financial asset or a financial liability. In the second case (paragraph 23(b)), an entity would apply the relevant IFRS Accounting Standard to determine whether it would derecognise the liability (most probably a contractual obligation).

25. We recommend that the final Accounting Standard:

    (a) include guidance on the derecognition of regulatory assets and regulatory liabilities due to their settlement by a regulator or another designated body; and

(b) require that an entity recognises the difference between the derecognised regulatory asset or regulatory liability and any new asset or liability in profit or loss.

Question for the IASB
3. Does the IASB agree with the recommendations in paragraph 25?

Recovery of regulatory assets or fulfilment of regulatory liabilities through the regulatory capital base

26. We have received feedback from a European preparer about another circumstance that could lead to derecognition. A regulator might change the recovery pace (most probably leading to an extension of the recovery period) of a regulatory asset by requiring the entity to include the outstanding amount of that regulatory asset in the entity's regulatory capital base. The entity would then recover the outstanding amounts of the regulatory asset through the depreciation of the regulatory capital base. Although such changes to the regulatory capital base may not be common, feedback suggests that they do occur.

27. We think that the IASB's previous discussion of the treatment of items (allowable expenses or performance incentives) included in an entity's regulatory capital base is relevant to this issue. At its December 2022 meeting, the IASB tentatively decided that:

    (a) an entity is required to recognise a regulatory asset or a regulatory liability relating to an allowable expense or performance incentive included in its regulatory capital base when:

        (i) the entity's regulatory capital base and its property, plant and equipment have a direct relationship; and

        (ii) the entity has an enforceable present right (obligation) to add (deduct) the allowable expense or performance incentive to (from) future regulated rates.

(b) an entity is neither required nor permitted to recognise a regulatory asset or a regulatory liability relating to an allowable expense or performance incentive included in its regulatory capital base when the entity's regulatory capital base and its property, plant and equipment have no direct relationship.[2]

28. These tentative decisions reflect the fact that, in the absence of a direct relationship between an entity's regulatory capital base and its property, plant and equipment, it would be difficult and costly for the entity to track the movement of individual items of allowable expense or performance incentives included in its regulatory capital base.

29. If a regulator changes the recovery period of a regulatory asset by requiring an entity to add the regulatory asset to its regulatory capital base, consistent application of the IASB's tentative decision would mean that an entity:

    (a) continues to recognise the regulatory asset if the entity's regulatory capital base and its property, plant and equipment have a direct relationship. The entity would update the estimates of future cash flows to reflect the new circumstance and consider whether it needs to use a different discount rate; and

    (b) derecognises the regulatory asset if the entity's regulatory capital base and its property, plant and equipment have no direct relationship.

30. The derecognition of a regulatory asset in paragraph 29(b) is counterintuitive because the regulator's decision does not affect the fact that the entity has an enforceable present right that is more likely than not to exist. However, we do not think this situation is different from the situation when a regulator decides, from inception, to include an allowable expense or a bonus to an entity's regulatory capital base that has no direct relationship with its property, plant and equipment. In this case, the entity also has an enforceable present right that is more likely than not to exist.

[2] December 2022 Agenda Paper 9C.

31. A regulator could also change the period over which a regulatory liability is fulfilled by requiring that an entity *deducts* the regulatory liability from its regulatory capital base.

32. Consequently, we recommend that the final Accounting Standard specify that if a regulatory asset or a regulatory liability is added to, or deducted from, an entity's regulatory capital base and the entity's regulatory capital base has no direct relationship with the entity's property, plant and equipment, an entity derecognises the regulatory asset or regulatory liability and recognises any associated regulatory income or regulatory expense in profit or loss.

33. We plan to discuss disclosures with the IASB at a future meeting, including whether to require disclosures when an entity derecognises previously recognised regulatory assets and regulatory liabilities in situations similar to those described in paragraphs 26 and 31.

Question for the IASB
4. Does the IASB agree with the recommendation in paragraph 32?

Discontinuing regulatory accounting

34. An accounting firm noted that regulatory assets and regulatory liabilities may need to be derecognised because of changes in the boundary or the scope of a regulatory agreement and commented on the absence of any requirements on discontinuation of regulatory accounting in the Exposure Draft. The respondent said that guidance dealing with discontinuation of regulatory accounting may be helpful (paragraph 9(c)).

35. We think this comment was prompted by the fact that Topic 980 in the Accounting Standards Codification of US GAAP outlines circumstances in which an entity would

cease to meet the criteria to apply rate-regulated accounting.[3] These criteria focus on regulated rates designed to recover an entity's specific costs of providing the regulated services or products. If an entity ceases to meet these criteria it discontinues the application of rate-regulated accounting to all or a portion of its operations and derecognises most regulatory balances.

36. We have considered how an entity would apply the proposals in the Exposure Draft to the circumstances that might result in discontinuation of rate-regulated accounting (and therefore derecognition of regulatory assets or regulatory liabilities) under Topic 980. Our views are set out in Appendix A. Some circumstances might result in derecognition of regulatory assets and regulatory liabilities while others might result in an entity updating the estimates of future cash flows arising from regulatory assets and regulatory liabilities.

37. After considering the comment from this respondent we have not identified any specific guidance that should be added to the final Standard and are not recommending any additional guidance in the final Standard.

38. Some circumstances that could give rise to discontinuation of rate-regulated accounting under US GAAP, such as changes in the boundary of the regulatory agreement, including cancellation or termination, will be considered at future meetings.

Question for the IASB
5. Does the IASB have any questions or comments on the staff analysis of the comment that more guidance on discontinuation of regulatory accounting could be helpful?

[3] Within ASC 980 *Regulated Operations* there is a section on discontinuation—ASC 980-20 *Discontinuation of Rate-Regulated Accounting.*

Securitisation

39. A few accounting firms requested guidance on derecognition in relation to the securitisation of regulatory assets, with one asking if an entity would apply the derecognition guidance in IFRS 9 or follow some other approach (paragraph 9(d)). The Exposure Draft did not contain any guidance on derecognition of regulatory assets as a result of securitisation.

40. In response to these requests, we have:

    (a) sought information about the characteristics and prevalence of securitisations of regulatory assets (paragraphs 41–44);

    (b) considered sources of guidance for an entity developing an accounting policy for the derecognition of regulatory assets as part of a securitisation (paragraphs 45–47); and

    (c) considered whether there is a need to develop additional guidance (paragraphs 48–51).

Characteristics and prevalence

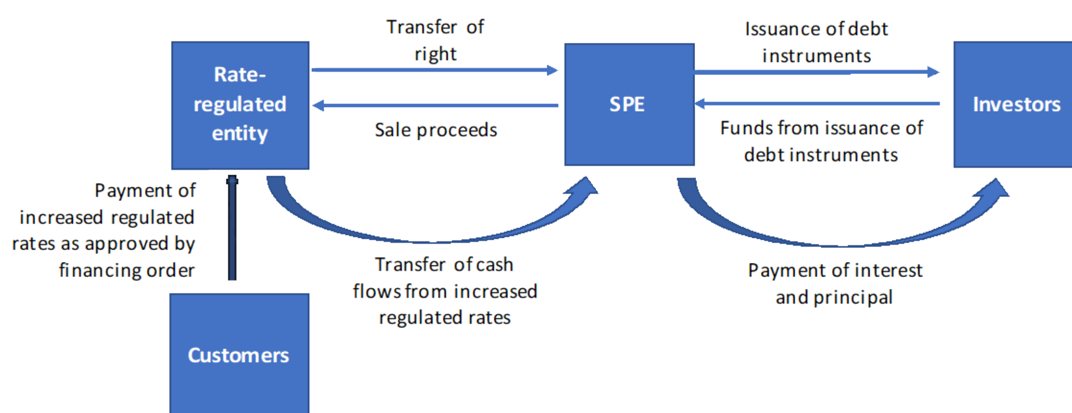
41. One jurisdiction where securitisations of regulatory assets are common is the United States. Over the last few decades utility companies in the United States have used 'ratepayer-backed securitisations' to recover storm damage costs and refinance the cost of stranded assets. Stranded assets are assets that have suffered from unanticipated or premature write-downs, devaluation or conversion to liabilities.[4] More recently securitisations have been used to fund the early retirement of coal plants and assist the transition to renewable energy.

42. Diagram 1 illustrates a simple ratepayer-backed securitisation process, as observed in the United States, in which a rate-regulated entity securitises its right to charge increased regulated rates to customers, via a special purpose entity (SPE).

[4] Llyod's of London (2017), *Stranded Assets: The Transition to a Low Carbon Economy.* Report

Appendix B describes this process in more detail. In practice securitisations may be more complex by, for example, providing funding for multiple utilities or multiple purposes, or involving the creation of multiple entities.

Diagram 1—Ratepayer-backed securitisation



43. To better understand the prevalence of securitisation of regulatory assets, the staff conducted targeted outreach with accounting firms. Feedback indicates that the securitisation of regulatory assets is not common in most jurisdictions—although this feedback probably reflects the fact that entities reporting in accordance with IFRS Accounting Standards do not currently recognise regulatory assets.[5] Securitisation of regulatory assets appears to be most common in the United States and Portugal. In the United States, where regulatory assets are recognised in accordance with US GAAP, 18 ratepayer-backed securitisations took place in 2022.[6] Although securitisations of regulatory assets are not common for IFRS reporters, feedback suggests that when they do occur, the amounts involved are material.

44. Some accounting firms suggested that securitisations could become more prevalent in the future. We agree that there are factors that could lead to securitisation becoming

[5] IFRS 14 *Regulatory Deferral Accounts* permits a first-time adopter of IFRS Standards, that is within the scope of the Standard, to continue to recognise and measure its regulatory deferral account balances in accordance with its previous GAAP. Regulatory deferral account balances may not fulfil the proposed definitions of regulatory assets and regulatory liabilities in the Exposure Draft.

[6] List of Investor-Owned Utility Securitization Ratepayer-Backed Bond (ROC/RRB/RBB) Transactions 1997–Present Link

more prevalent. As jurisdictions seek to achieve climate goals, governments are likely to encourage greater use of renewable energy sources, leading to the early retirement of gas and coal plants and the creation of stranded assets (paragraph 41). Transforming stranded assets into regulatory assets and securitising those regulatory assets is one way of financing the switch to renewable energy. It is also possible that issuing a Standard that requires the recognition of regulatory assets will increase interest in the securitisation of regulatory assets.

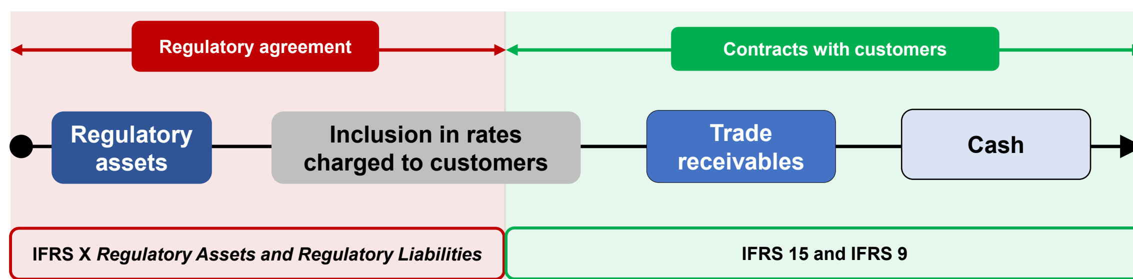
Developing an accounting policy

45. IFRS Accounting Standards do not provide guidance on all transactions or on all aspects of transactions. In the absence of specific requirements in a Standard, IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* states that management shall use its judgement in applying an accounting policy that results in information that is relevant and reliable.[7] In making that judgement, IAS 8 requires that management refer to and consider first the applicability of IFRS Standards dealing with similar and related issues, and secondly the definitions, recognition criteria and measurement concepts for elements of financial statements in the *Conceptual Framework*.[8]

46. Although regulatory assets are not financial assets, the securitisation of regulatory assets gives an entity the ability to sell the right to a stream of future cash flows, in much the same way as an entity sells or transfers the cash flows associated with financial assets. Diagram 2 illustrates the main difference between regulatory assets and financial assets. An entity recovers a regulatory asset by supplying goods or services in the future and charging an increased regulated rate to customers. In the case of financial assets, the entity holding them would only need to wait for the counterparty to pay the cash.

[7] Paragraph 10 of IAS 8.
[8] Paragraph 11 of IAS 8.

Diagram 2—Regulatory assets and financial assets (trade receivables)



47. Notwithstanding that regulatory assets are not financial assets, in the absence of guidance in the final Standard we think an entity securitising regulatory assets would refer to IFRS 9 and possibly the *Conceptual Framework* to develop an accounting policy for its securitisation transaction. Appendix B discusses the relevant parts of IFRS 9 and the *Conceptual Framework* in more detail.

Is there a need to develop guidance?

48. Guidance could reduce diversity in practice, avoid potentially inappropriate outcomes or make it easier for entities and auditors to reach agreement about the appropriate financial reporting of transactions. However, there could be practical challenges to developing guidance for inclusion in the final Standard.

49. The derecognition requirements in IFRS 9 are complex and detailed. If the IASB were to develop equivalent requirements for securitisations of regulatory assets, those requirements might need to be equally complex and detailed. Developing detailed guidance would be time consuming and could delay completion of the project. In addition, although we have obtained information about some common forms of securitisations, there could be other forms of securitisations that we have not identified and new types of transactions could evolve. For these reasons we do not propose that the IASB develops guidance at this time.

50. In the absence of guidance in the final Accounting Standard an entity could refer to the derecognition requirements in IFRS 9 which address many of the issues that an entity would need to consider in such situations. An entity could also refer to the *Conceptual Framework.*

51. We recommend that the final Accounting Standard does not include guidance on securitisation of regulatory assets.

Question for the IASB
6. Does the IASB agree with the recommendation in paragraph 51?

Appendix A—Discontinuing regulatory accounting

A1. Table 1 outlines circumstances that could result in an entity's operations failing to meet the criteria to apply Topic 980 in US GAAP and lead to discontinuation of rate-regulated accounting under Topic 980. After considering how an entity would apply the proposals in the Exposure Draft to these circumstances, we have not identified any need for further guidance in the final Standard.[9]

Table 1—Potential discontinuation of rate-regulated accounting under Topic 980
Topic 980 says that failure of an entity's operations to continue to meet the scope criteria in paragraph 980-10-15-2 can result from different causes, including the following. **Deregulation—Topic 980-20-15-2 (a)** • Deregulation. Exposure Draft • Deregulation could affect the boundary of the regulatory agreement—that is, the latest future date at which an entity has enforceable present rights and enforceable present obligations.[10] • The Exposure Draft proposes that an entity reassesses the boundary of a regulatory agreement at the end of each reporting period, considering all changes in facts and circumstances. Deregulation would be a change in circumstances that would trigger the end of a regulatory agreement. This would lead to the derecognition of regulatory assets and regulatory liabilities arising from that agreement. An entity would need to consider the terms and conditions relating to the termination of its regulatory agreement (both the terms and conditions in the original regulatory agreement and the terms and conditions in any new agreement dealing with the deregulation of the entity's activities). • Deregulation may result in the entity continuing to carry out the previously regulated activities but in an unregulated manner, or it may lead to the complete cessation of the regulated activities. If the latter, deregulation could also lead to the derecognition of other assets and liabilities in accordance with other IFRS Accounting Standards. **A change in the regulator's approach to setting rates from cost-based to another form of regulation— Topic 980-20-15-2 (b)** • A change in the regulator's approach for determining regulated rates (for example, from a cost-based regulatory scheme to another type of regulatory scheme). Exposure Draft • Unlike Topic 980, the proposals in the Exposure Draft were developed for application to a wide range of regulatory schemes, including cost and incentive-

[9] Table 1 uses terms and descriptions from Topic 980.

[10] Paragraphs 33–34 and paragraph B28–B40 of the Exposure Draft.

Table 1—Potential discontinuation of rate-regulated accounting under Topic 980
based schemes.[11] The IASB has tentatively agreed that the final Standard should not explicitly specify which regulatory schemes are within or outside its scope.[12] • An entity would need to consider the impact of any changes in the regulator's approach to determining regulated rates on its assessment of the continued existence of regulatory assets and regulatory liabilities. This assessment will also need to consider any transitional terms determined by the regulator. • An entity would also need to consider the impact of any changes in the regulator's approach to determining regulated rates when updating estimates of future cash flows arising from regulatory assets and regulatory liabilities. • Changes in the features of a regulatory scheme may give rise to new types of regulatory assets and regulatory liabilities.
Increasing competition—Topic 980-20-15-2 (c) • Increasing competition that limits the entity's ability to sell utility services or products at rates that will recover costs (as defined in Topic 980's scope criteria). The scope criteria require that regulated rates set at levels that will recover the entity's costs can be charged to, and collected from, customers. Exposure Draft • An entity would need to consider the impact of increased competition on the estimates of future cash flows arising from regulatory assets and regulatory liabilities. That is, the impact of increased competition would initially be considered as part of the measurement of regulatory assets and regulatory liabilities. • If increased competition affected the overall viability of an entity's operations, an entity would also need to consider the impact of such changes on its assessment of the boundary of the regulatory agreement.
Regulatory actions—Topic 980-20-15-2 (d)[13] • Example (d) was developed in response to specific circumstances whereby some rate-regulated entities were allowed to choose to cease being regulated. Exposure Draft • See 'Deregulation' in point (a) above.

[11] The IASB discussed features of different regulatory schemes at its meeting in May 2022 (Agenda Paper 9A).

[12] See February 2022 (Agenda Paper 9B). The IASB's tentative decision not to specify which regulatory schemes are within or outside the scope is because of the diversity of regulatory schemes. Despite being referred to as a certain type of scheme (for example, incentive-based schemes) the schemes could give rise to different sets of rights and obligations, including different types of regulatory assets and regulatory liabilities. If the features of an entity's regulatory scheme change, we do not think such changes would necessarily lead to derecognition of outstanding regulatory assets and regulatory liabilities (although this would depend on any transitional terms determined by the regulator).

[13] The exact wording of Topic 980-20-15-2 (d) is 'Regulatory actions resulting from resistance to rate increases that limit the entity's ability to sell utility services or products at rates that will recover costs if the entity is unable to obtain (or chooses not to seek) relief from prior regulatory actions through appeals to the regulator or the courts.'

Appendix B—Developing an accounting policy for securitisation

B1. This appendix considers the application of the derecognition principles in IFRS 9 to the transfer of a regulatory asset in a typical ratepayer-backed securitisation. It also summarises the discussion of derecognition in the *Conceptual Framework.*

B2. Table 2 describes a simple ratepayer-backed securitisation process.

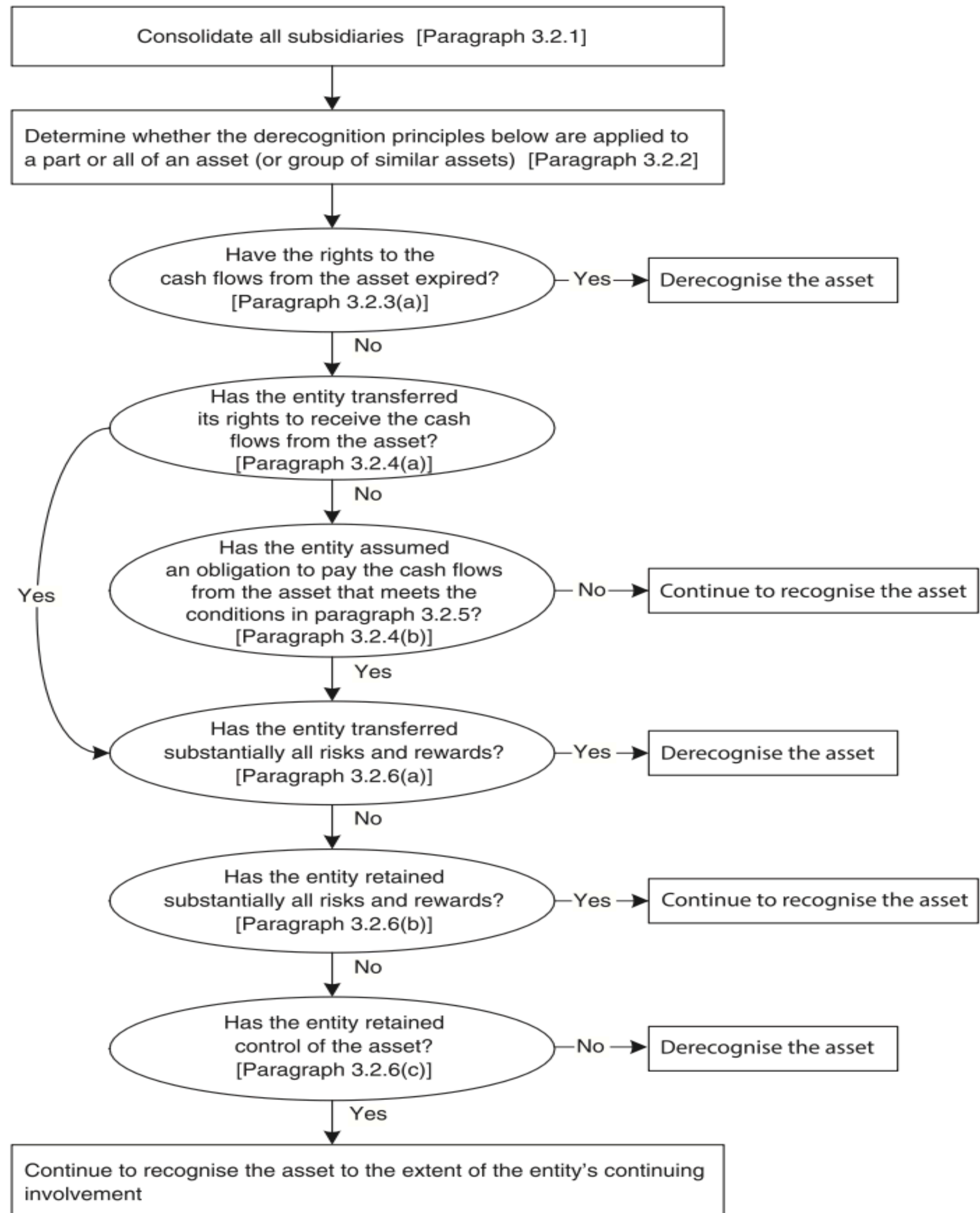
Table 2—Description of a ratepayer-backed securitisation	
Identify the need for funds	The rate-regulated entity (the entity) identifies a need for funds (for example, impairment relating to stranded assets or recovery of storm-related costs). These costs are referred to as the specified costs.
Requesting the financing order	The entity seeks approval from the relevant regulatory body to undertake a securitisation to fund specified costs. The regulatory body's power to allow this, and the matters that it must consider, are generally set out in legislation. The enabling legislation allows a regulatory body to issue irrevocable financing orders that authorise an entity to add an additional component to the regulated rates charged to customers in a territory over a specified period of time. The financing orders: (a) establish the right to receive the additional rate component as a right that can be bought, sold, and pledged; (b) authorise the entity to sell this right to a bankruptcy-remote, special purpose entity (SPE); (c) authorise the SPE to issue bonds (or other debt instruments) secured by a first priority lien on this right; and (d) require the entity to use the net proceeds from the sale of the right to fund the specified costs.
Implementing the financing order	The entity establishes an SPE and sells the right established by the financing order to the SPE. The SPE issues the bonds and uses the proceeds from the bond issue to purchase the right established by the financing order from the entity.
Ongoing	The entity charges increased regulated rates to customers and transfers these cash flows to the SPE. The SPE makes payments to bondholders. There is true-up mechanism through which the regulator periodically adjusts the additional amount to be included in the regulated rates charged to customers to ensure that cash flows generated are sufficient to repay the bonds.

B3. This appendix assumes that the right transferred to the SPE (that is, the right to the cash flows arising from increased regulated rates over a period of time) would meet the definition of a regulatory asset in the Exposure Draft. This may not always be the case. A right to recover specified costs incurred (for example, the impairment relating to stranded assets) in future regulated rates charged to customers, would fulfil the definition of a regulatory asset. However, a right to add amounts to future regulated rates for matters unrelated to the past supply of goods and services would not.

IFRS 9

B4. Section 3.2 of IFRS 9 deals with the derecognition of financial assets. The flow chart in paragraph B3.2.1 of IFRS 9 illustrates the evaluation of whether and to what extent an entity derecognises a financial asset.

Flow chart—IFRS 9 paragraph 3.2.1



B5. An entity applying the requirements in Section 3.2 of IFRS 9 first assesses whether it controls an investee (such as an SPE) in accordance with IFRS 10 *Consolidated Financial Statements* and then applies the derecognition requirements to the resulting

group.[14] If an entity controls the SPE, the transferred asset remains within the group and the question of derecognition is relevant for the entity's separate financial statements rather than the consolidated financial statements.

B6. As required by paragraph 3.2.2 of IFRS 9 an entity then identifies the cash flows to which the derecognition requirements would be applied, that is:

(a) all cash flows from a financial asset;

(b) specifically identified cash flows from a financial asset;

(c) a fully proportionate share of the cash flows from a financial asset; or

(d) a fully proportionate share of specifically identified cash flows of a financial asset.

B7. The definition of a financial asset includes contractual rights to receive cash from another entity.[15] In the case of financial assets, an entity applying the requirements in paragraph 3.2.2 of IFRS 9 is able to identify the relevant cash flows from a financial asset it has with a specific counterparty. In the case of regulatory assets, an entity has an enforceable present right to add an amount to regulated rates it will charge to customers in the future. In the case of the securitised regulatory assets, the stream of cash flows arising from this right is determined by a financing order—that is 'all cash flows arising from the securitised regulatory assets'.[16]

B8. An entity then evaluates whether, and to what extent, derecognition is appropriate. As shown by the flow chart, there are three possible outcomes: an entity derecognises the asset, an entity continues to recognise the asset, or an entity continues to recognise the asset to the extent of the entity's continuing involvement.

B9. In developing the derecognition requirements for financial assets, the IASB acknowledged that many securitisations might fail to qualify for derecognition, either

[14] Paragraph 3.2.1 of IFRS 9.

[15] Paragraph 11 of IAS 32 *Financial Instruments: Presentation*.

[16] The financing order specifies the additional amounts that are to be charged to customers, the period over which this will occur and how and when the cash flows will be transferred to the SPE.

because one or more of the three conditions to be a transfer were not met, or because the entity retains substantially all the risks and rewards of ownership. Similarly, we think in the case of securitisations of regulatory assets, the terms of the securitisation will also affect whether the conditions for a transfer have been met and whether the entity has retained substantially all the risks and rewards.

B10. The assessment of whether a transaction qualifies for the derecognition of an asset, requires judgement based on the terms and conditions of the transaction. Whenever management of an entity develops an accounting policy by analogy to an IFRS Accounting Standard, it needs to use its judgement in applying all aspects of the Standard that are applicable to the particular situation.

The Conceptual Framework

B11. According to the *Conceptual Framework*, derecognition of an asset normally occurs when an entity loses control of all or part of that asset.[17] The *Conceptual Framework* refers to the derecognition of assets and liabilities that have expired or been consumed, collected, fulfilled or transferred.[18]

B12. In developing the *Conceptual Framework* IASB noted that both a control approach and a risks-and-rewards approach to derecognition can be useful.[19] The IASB adopted an approach that involves derecognising the transferred component and continuing to recognise the retained component (if any), but which also allows for continued recognition of the transferred component in some situations. The requirements in IFRS 9 are aligned with this approach.

B13. An entity using the *Conceptual Framework* to develop an accounting policy for derecognition of securitised regulatory assets would need to consider what asset it has transferred and whether it has retained any exposure to the transferred asset. If an entity transfers an entire asset and retains no exposure to that asset, both the control

[17] Paragraph 5.26 of the *Conceptual Framework*.

[18] Paragraph 5.28 of the *Conceptual Framework*.

[19] Paragraph BC5.24 of the Basis for Conclusions accompanying the *Conceptual Framework*.

approach and the risks-and-rewards approach would support derecognition of the asset. If an entity has retained exposure to the transferred asset (for example, the entity is exposed to under recovery of amounts from customers), it would have to assess whether that exposure represents 'exposure to significant positive or negative variations in the amount of economic benefits that may be produced by the asset.'[20]

[20] Paragraph 5.29 of the *Conceptual Framework.*