RÉPUBLIQUE FRANÇAISE

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AUTORITÉ DES NORMES COMPTABLES

Paris, 23 July 2021

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PDC n° 39

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Exposure Draft ED/2021/1 *Regulatory Assets and Regulatory Liabilities*

Dear Andreas,

I am writing to you on behalf of the Autorité des Normes Comptables (ANC) to express our views on the above-mentioned Exposure Draft (ED).

The recognition of regulatory assets and regulatory liabilities in an entity's financial statements has been subject to long-standing discussions since the IFRS Interpretations Committee first considered this matter in 2004. Accordingly, we welcome the publication of the ED which, in our view, includes a robust set of proposed requirements that is likely to provide more useful information about an entity's financial performance. We also welcome the fact that the IASB (Board) developed those proposed requirements in manner consistent with the principles set out in the 2018 *Conceptual Framework for Financial Reporting*, thus ensuring an entity would recognise assets and liabilities with a firm conceptual basis.

We are overall supportive of the Board's proposals. In particular, we are supportive of the model underpinning those proposals.

That being said, we are cautiously supportive of the proposed scope to which this model would apply (Question 1). This is mainly because we have not received extensive feedback from our stakeholders to fully analyse the relevance or effects of the late adjustments that the Board made on the scope's definition during the development of the ED and that may have increased the number of entities potentially affected by the Board's proposals.

As explained in our detailed answer, we think the shift of focus from 'defined rate regulations' as defined in the 2014 Board's Discussion Paper *Reporting the Financial Effects of Rate Regulation* to regulatory agreements as defined in this ED, together with the lack of explicit reference to a regulatory adjustment mechanism, may have resulted in significant changes to the project's scope. In our view, applying the Board's proposals, the existence of an enforceable principle specifying that an entity is permitted to recover part of the total allowed compensation to which it is entitled for a specific period in a different period may now be sufficient to recognise regulatory assets and regulatory liabilities (see paragraphs 14–19 of this letter). In addition, an entity may now recognise such assets and liabilities for activities that are subject to more than an insignificant demand risk (see paragraphs 7–13). These are significant changes compared to the defined rate regulations that the Board initially considered. We do not challenge the technical merits of those changes which are largely aligned with how the Board has developed recent IFRS Standards. However, we are unsure as to whether the whole of the affected stakeholders have

properly monitored and analysed those changes which arose at a quite late stage in development of the ED. Having said that, in our view, the proposed scope may end up overlapping with the scope of defined rate regulations—the fact that we have not been made aware of entities that would fall within the scope of ED whilst not being subject to rate regulation tentatively confirms our view.

Additionally, before finalising the proposed scope, we think the Board should clarify or develop further application guidance in relation to:

- the role of a regulator in the Board's proposals—we think there is still uncertainty as to whether a regulator shall exist for an entity to recognise regulatory assets and regulatory liabilities (see paragraphs 21–23);

- assessing enforceable rights and obligations—assessing enforceability in the context of regulated activities may be challenging (see paragraphs 26–31); and

- the interaction between the scope and recognition requirements—differing views exist as to whether the 'more likely than not' threshold in paragraph 28 of the ED that applies to the recognition of regulatory assets and regulatory liabilities also affects the way an entity assesses the existence of enforceable rights and obligations (see paragraphs 77–79).

Notwithstanding our support to the ED, we have reservations on some of the Board's proposals. In particular, we:

- disagree with the Board's proposed requirement in paragraph B15 of the ED in relation to regulatory returns on assets that are not yet available for use (Question 3(a)(ii) in paragraphs 53–64). In our view, the proposed requirement to defer the inclusion of such returns in profit or loss until the asset is available for use is predicated upon debatable technical arguments and is expected to result in significant implementation costs. We recommend the Board revisit this proposal and assess its consistency with the other requirements on how an entity determines the total allowed compensation for a specific reporting period. If the Board were to retain this proposal, we recommend specific transition requirements be developed (see paragraphs 152).

- have mixed views about the requirements on discounting (Question 6 in paragraphs 90–110). We agree that the discounting of future cash flow is consistent with the use of a cash-flow-based measurement technique. However, we are unclear as to the purpose the ED specifies for discounting. We recommend the Board better articulate this purpose in any final IFRS Standards. Furthermore, we disagree with the Board's proposals in paragraphs 50–53 of the ED with regard to determining and using a minimum interest rate for a regulatory asset if there are indications that the regulatory interest rate may be insufficient to provide the compensation as described in paragraph 50 of the ED. We think an entity shall use the regulatory interest rate in all circumstances. We are also unclear as to the reasons that led the Board to require the assessment of the discount rate's sufficiency for regulatory assets but not for regulatory liabilities—thus, we disagree with the resulting proposed asymmetry. Consistent with our view on discounting, we also disagree with requiring entities to translate uneven regulatory interest rates into a single discount rate as specified in paragraph 54 of the ED.

- have reservations about the proposed approach for the disclosures (Question 9 in paragraphs 133–149) and recommend the Board reconsider that approach. We do not disagree with the proposed disclosures objectives *per se* but think :
  - those disclosure objectives put too much emphasis on the proposed model's intricacies and by doing so, tend to lose sight of what, we think, would provide more useful information to users—ie how the regulatory agreements to which an entity is a party work and how those agreements affect the entity's financial performance.
  - the disclosure requirements that supplement the disclosure objective and the specific disclosure objectives may ultimately result in unnecessarily detailed information being provided.
  - some of those disclosures objectives are rather unclear.

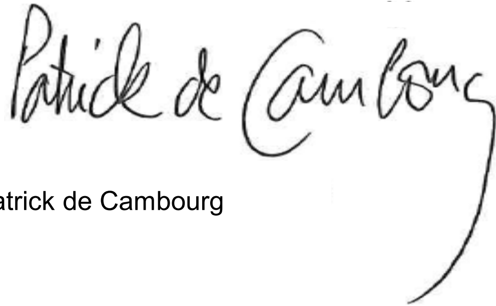
We also identified in our answer to Question 13 (see paragraphs 174–190) some matters that should warrant further consideration from the Board.

We expect the benefits of Board's proposals to exceed their costs for stakeholders. Having said that, the Board should not understate the implementation costs of its proposals. In our jurisdiction, entities do not recognise regulatory balances. Consequently, the implementation of the Board's proposals is going to be a significant accounting change. It will result in entities implementing new processes (most notably to operationalise the cash-flow-based measurement technique proposed in the ED) or revamp their closing processes (in particular for the preparation of interim financial reports)—the Board's expectation in paragraph BC247 of the ED appears somewhat simplistic in this respect. We think that setting an effective date of any final IFRS Standard 24 months

from the date of its publication (with early adoption permitted) would give sufficient time to entities to ensure an adequate level of preparedness. We draw the Board's attention to the fact that the benefits and costs may be very finely balanced for entities which operate activities in the US and currently apply ASC 980 *Regulated Operations*.

Should you need any further information, please do not hesitate to contact me.

Yours sincerely,



Patrick de Cambourg

Question 1—Objective and scope

Paragraph 1 of the Exposure Draft sets out the proposed objective: an entity should provide relevant information that faithfully represents how regulatory income and regulatory expense affect the entity's financial performance, and how regulatory assets and regulatory liabilities affect its financial position.

Paragraph 3 of the Exposure Draft proposes that an entity apply the [draft] Standard to all its regulatory assets and all its regulatory liabilities. Regulatory assets and regulatory liabilities are created by a regulatory agreement that determines the regulated rate in such a way that part of the total allowed compensation for goods or services supplied in one period is charged to customers through the regulated rates for goods or services supplied in a different period (past or future). The [draft] Standard would not apply to any other rights or obligations created by the regulatory agreement—an entity would continue to apply other IFRS Standards in accounting for the effects of those other rights or obligations.

Paragraphs BC78–BC86 of the Basis for Conclusions describe the reasoning behind the Board's proposals. They also explain why the Exposure Draft does not restrict the scope of the proposed requirements to apply only to regulatory agreements with a particular legal form or only to those enforced by a regulator with particular attributes.

Question 1(a)—Do you agree with the objective of the Exposure Draft? Why or why not?

1. Rate regulations may have significant effects on the amount and timing of an entity's revenue, profits and cash flows. The fact that existing IFRS Standards provide incomplete information about an entity's regulated assets and regulated liabilities reduces users' understanding of an entity's financial performance, position and cash flows. Accordingly, many entities operating businesses subject to rate regulations welcome the Board's proposals to develop requirements along the lines of the objective set out in paragraph 1 of the ED. They think such an objective would result in an improvement to financial reporting and would fill a gap in IFRS Standards.
2. Consequently, we agree with the objective of the ED.
3. We also agree with the model underpinning the Board's proposal ie a model that supplements—instead of adjusting or overriding—the information that an entity already provides by applying IFRS Standards, including IFRS 15 *Revenue from Contracts with Customers*.

Question 1(b)—Do you agree with the proposed scope of the Exposure Draft? Why or why not? If not, what scope do you suggest and why?

4. We agree with the proposed scope of this project. However, we think important the Board provides further clarifications in relation to:
    a. whether the existence of a regulator is required to assess whether regulatory assets and obligations exist[1] (see paragraphs 21–23 below);
    b. how an entity assesses whether rights and obligations are enforceable (see paragraphs 26–31 below); and
    c. regulatory assets and regulatory liabilities only reflect future adjustments to an entity's revenue as defined in IFRS 15 (see paragraphs 32–34).
5. We observe that this ED sets out proposals that may capture a broader scope of activities than initially considered when the Board started to work on this project. We do not see this 'scope-creeping' as being problematic from a conceptual perspective. However, we fear that a number of stakeholders, having in mind the scope that the Board contemplated some years ago, might be unaware of the latest developments in this respect and might have not thoroughly assessed how the Board's proposals in the ED would affect them—in particular whether the Board's proposals would provide useful information about their operations and whether the expected benefits of the Board's proposals would exceed the expected costs for those entities. Accordingly, we are cautiously supportive of the proposed scope.

[1] Throughout this document, we use the terminology 'third party' instead of 'regulator' to qualify the party that has entered into the regulatory agreement with the entity. This is because we are unsure of whether the existence of a regulator is required to apply the proposals in this ED.

6. We explain in paragraphs 7–19 below why we think the scope of the Board's proposals is wider than expected by a number of stakeholders.

- **From defined rate regulations to regulatory agreements**

7. As a preliminary note, we observe that the Discussion Paper *Reporting the Financial Effects of Rate Regulation* (DP) that the Board published in 2014 focussed on 'defined rate regulation' ie a generic type of rate regulation that stakeholders had suggested as being relevant for any standard-setting project. Most respondents agreed that the description of the defined rate regulations as set out in this DP was an adequate basis for developing an accounting model reflecting the incremental rights and obligations to which they give rise.
8. As explained in paragraphs BC79–BC83 of the ED, the Board decided to develop proposals applying to rate regulations that have *some* features of defined rate regulations as described in the DP—ie the existence of a regulatory agreement establishing a basis for setting regulated rates and the existence of enforceable rights and obligations. The shift of focus from 'defined rate regulations' applying to specific activities to 'regulatory agreements' giving rise to regulatory assets and regulatory liabilities has potentially increased the scope of entities affected by the Board's proposals.
9. We do not disagree with the approach retained by the Board in this respect. Consistent with our comment letter dated 7 January 2015, we think that the features described in paragraph BC82 should not be set as scoping criteria. We note in particular that the terms '*customers have little or no choice*' and '*no effective competition to supply*' used for the feature described in paragraph BC82(a) of the ED could be very difficult to assess in practice and could thus result in inconsistent application of the proposed requirements if they were set as scoping criteria. Additionally, we think that incorporating the features in paragraph BC82 could result in developing sector-specific requirements. Such a standard-setting approach would be inconsistent with how the Board developed recent IFRS Standards—the focus of standard-setting is on rights and obligations created by contracts or agreements, the focus is not on the features of the parties entering those contracts and agreements.
10. However, from a conceptual perspective, we note that the feature described in paragraph BC82(a) of the ED could have had some merits by restricting the scope of this project to assets or liabilities that are subject to little measurement uncertainty. This is because the fact that customers have no choice but to buy the entity's goods or services effectively reduces the demand risk to which the entity is exposed—ie the quantity of goods or services the entity delivers to the customer base is unlikely to vary significantly over time. The restriction of customer choice makes demand relatively inelastic and thus contributes to a high level of predictability of the timing and probability of future cash flows, a level of predictability that users may wish.
11. As currently drafted, the ED paves the way for recognising regulatory assets and regulatory liabilities reflective of any type of variable contingent consideration (to be paid or to pay), irrespective of its level of uncertainty. We have been made aware of the example of some airport activities to which the Board's proposals would apply and that are subject to significant demand risk. Some regulatory agreements—whose features vary across airports and/or jurisdictions—specify rights and obligations as described in the ED. Entities operating such activities are entitled to recover part of their costs (including costs related to security checks) through the invoicing of airport taxes to airline companies––those taxes being subsequently recharged by airline companies to passengers. Airport activities are subject to contingencies that may result in airports being shut down either on a temporary or on a long-term basis. Those contingencies affect the passenger traffic and thus, the entities' ability to recover their costs. Such contingencies include natural hazards (typhoons, volcano eruptions, etc.), terror attacks or public health crises. The Covid-19 pandemic epitomises the severity of changes in demand that can affect airport activities. It resulted in a decrease of 70% in the passenger numbers after travel restrictions came into force all around the world. With new waves of infection taking hold, airport passenger numbers have remained very low since the beginning of 2021 and visibility for the on the mid-term is limited. Owing to the long-lasting effect of the pandemic, those entities would have had to derecognise in June 2020 the regulatory assets and regulatory liabilities they would have had to recognise in 2019, had the Board's proposals in the ED been applied.
12. We also note paragraph AV9 of the Alternative View on the ED that, in our view, flags an essential point in assessing the relevance of the proposed scope. Accordingly, we encourage the Board to seek users' feedback about whether they feel comfortable with the proposed scope.
13. Having said that, we also expect the scope of the ED to ultimately overlap with the scope of defined rate regulations as outlined in paragraph BC79 of the ED—ie we expect entities operating activities subject to a low demand risk to be primarily targeted by the proposed scope. This is because:
    a. the measurement requirements (including those on the boundaries of a regulatory

agreement) as proposed in the ED provide a sufficient basis to mitigate concerns that some users might have with regard to the recognition of assets and liabilities with more than little measurement uncertainty.

b. it is unlikely that enforceable rights and obligations would exist if the demand risk were to be too high. Contracts are usually structured in a manner that they specify rights and obligations applying in rather normal or plausible conditions. An entity would be unlikely to enter a contract that would permit it to recover its operating costs (together with a return) if there were significant uncertainty in the recovery mechanism of such costs.

- **The lack of reference to a regulatory adjustment mechanism**

14. Furthermore, we think that the Board has also widened the scope of this project over time through the changes it made to the definition of a regulatory agreement.
15. Paragraph 4.6 of the DP referred to a regulated rate subject to a 'regulatory adjustment mechanism' (RAM)[2]. In our view, the existence of a RAM implied that the rate the entity is permitted to charge to the customers is subject to a formal computation process (such as a predefined formula).
16. In contrast, the Board's proposals in the ED are less specific with regard to how the agreement determines the rate the entity charges to the customers. Paragraph 7 of the ED specifies that a regulatory agreement should determine 'a regulated rate' to be applied to contracts with customers. Appendix A to the ED defines a regulated rate as '*a price for goods or services, determined by a regulatory agreement, that an entity charges its customers in the period when it supplies those goods and services*'. In this perspective, a regulated rate seems to be equivalent to the price that applies to contracts in the scope of IFRS 15, irrespective of how that rate is agreed between the entity and the third party.
17. Considering the requirements in paragraphs 6–9 of the ED applying to a regulatory agreement, the existence of an enforceable principle specifying that the entity is permitted to recover part of the total allowed compensation (TAC) to which it is entitled for a specific period through the regulated rates of goods or services supplied in a different period, is, in our view, sufficient for a regulatory asset or a regulatory liability to exist—the existence of such an asset or a liability being confirmed having applied the requirements in paragraphs 25–28 of the ED. Overall, we think there has been a shift of focus from a 'rate adjustment *mechanism*' to what we would call a 'rate adjustment *principle*', the latter being, in our view, less restrictive than the former to recognise regulatory assets and liabilities[3].
18. Here again, we do not disagree with the Board's approach for defining a regulatory agreement. The focus on the existence of rights and obligations that are enforceable underpins most of latest IFRS Standards and this is not something new for our stakeholders.
19. Having said that, the scope ends up capturing a wide array of regulatory agreements the characteristics of which (i) may vary greatly and (ii) will have to be assessed against a broad scope of national legal frameworks, with differing levels of maturity. This may increase the costs of the proposed amendments.

Question 1(c)—Do you agree that the proposals in the Exposure Draft are clear enough to enable an entity to determine whether a regulatory agreement gives rise to regulatory assets and regulatory liabilities? If not, what additional requirements do you recommend and why?

20. We think there is still uncertainty about whether the proposed requirement give rise to regulatory assets and liabilities in some circumstances. This is primarily because (i) the role of regulator in the Board's proposals (see paragraphs 21–23), (ii) the definition of a regulated rate (see paragraphs 24–25) and (ii) the notion of 'enforceable rights and obligations' (see paragraphs 26–31) are unclear. In addition, we think the Board should clearly specify that regulatory assets and regulatory liabilities exist if they give rise to future adjustments to revenue from contracts with customers as defined in IFRS 15 (see paragraphs 32–34).

[2] Paragraph 4.6 of the DP states: '*for defined rate regulation, the mechanism used to calculate the regulated rate(s) includes a regulatory adjustment mechanism to reverse specified differences between the amount of the revenue requirement accrued to date and the amounts billed to customers. This regulatory adjustment mechanism seeks to ensure that the rate-regulated entity earns no more and no less than the amount of the revenue requirement and any related profit or return to which itis entitled. The regulatory adjustment to the rate also seeks to reflect the time value of money when increases or decreases in the rate are deferred*'.

[3] We note that the Board removed the reference to the RAM in June 2019 ie quite at a late stage of the standard-setting process.

- **Regulator's role in the Board's proposals**

21. We note that the proposed requirements in the ED do not specify that a regulator shall exist for a present right or a present obligation to meet the definition of a regulatory asset or a regulatory liability as set out in paragraphs 5–6 of the ED—in other words, a regulator's existence is no criterion to assess whether rights or obligations meet those definitions. We note that paragraph BC85(b) of the ED[4] would support that view. We also note that the description of a regulatory agreement as set out in paragraphs 7–9 neither refers to the existence of a regulator. This description rather implies that any set of enforceable rights and obligations may give rise to regulatory assets or regulatory liabilities, irrespective of (i) the legal form of any such set and (i) the characteristics of the parties that entered into the agreement.
22. Having said that, we note that the wording used in the ED might support an alternative view in this respect. The ED refers to the existence of a regulatory agreement—the adjective 'regulatory' may be understood as referring to the existence a body responsible for checking whether a business is working legally and according to rules or laws. Paragraph 27 of the ED also refers to circumstances in which a regulator exists. We also note that paragraph BC86 states that '…*the Board has found no reason why setting the scope of the ED more narrowly to include only regulatory agreements subject to a regulator <u>with particular characteristics</u> would lead to more useful information*…' (emphasis added). Should this be understood as the Board willing to (i) exclude any regulator from the analysis or (ii) include a regulator in the analysis but with no characteristics specified?
23. For the avoidance of doubt, we recommend the Board:
    a. clarify, through an explicit statement, whether the existence of a regulator is required for assessing whether a right or an obligation meets the definition of a regulatory asset or regulatory liability. We think this clarification would be essential to support consistent application of any final requirements. Our outreach with French stakeholders indicates that some of them are still unable to assess whether the rights and obligations related to the contracts they operate would be subject to the proposed requirements because of the lack of clarity about the existence of a regulator.
    b. define the term 'regulatory'. This would help distinguish regulatory agreements from other agreements.

- **Definition of a regulated rate**

24. Furthermore, we note that the definition of regulatory assets and liabilities requires the existence of a regulatory agreement. This agreement determines a regulated rate to be applied in contracts with customers. As explained in paragraphs 16–17 above, we think that the Board's proposals rely on a very generic definition of a regulated rate. We read the Board's proposals as requiring an entity to recognise regulatory assets and regulatory liabilities when an enforceable right (or obligation) to add (or to deduct) an amount in future regulated rates exists, this right potentially being a simple enforceable principle for the entity to recover the total allowed compensation—such as the right to recover the expenses incurred—through its subsequent performance. However, we acknowledge some could argue otherwise.
25. Here again, for the avoidance of doubt, we recommend the Board clarify the definition of a regulated rate.

- **Enforceable rights and obligations**

26. We also note that the notion of 'enforceability' is still creating some confusion in practice. The existence of a set of 'enforceable rights and obligations' is embedded in the definition of regulatory agreement and thus, supports the definition of regulatory assets and liabilities. The assessment of a regulatory agreement's boundary also depends on the existence of enforceable rights and obligations. Accordingly, some essential aspects of the Board's proposals rely on the notion of enforceability.
27. Similar to paragraph 10 of IFRS 15, paragraph 9 of the ED states that enforceability is 'a matter of law'. The ED does not, however, include any additional guidance or illustrative example in this respect. The Illustrative Examples do not either provide any additional insights into this aspect.

[4] Paragraph BC85(b) of the ED states: '*In addition, the Exposure Draft does not specify:.. whether a particular type of body, such as a regulator, must exist to enforce compliance with the regulatory agreement, and what the characteristics of that body should be'*.

28. We acknowledge that the concept of enforceability is not new in the context of applying IFRS Standards.

29. Assessing enforceability may be straightforward in 'mature' legal environments—ie when the regulatory agreement specifies detailed provisions—or when rights and obligations derive from a single contract or agreement.

30. However such an assessment may be more challenging in the context of regulated activities, in particular when:

    a. the set of rights and obligations derives from a bundle of contracts or agreements. For example, a regulator may grant an entity with (i) the present right to operate an activity in the context of a long-term supply agreement and (ii) a right for compensation for the goods or services supplied. However, the regulated rate is agreed between the parties for shorter periods (price periods)—ie the long-term supply agreement encompasses several successive price periods the terms of which are agreed over time. In those circumstances, what is the regulatory agreement that creates *enforceable* rights and obligations? The long-term supply agreement only? That agreement together with the existing/future arrangements specifying the regulated rates for each price periods? Such questions have implications on how an entity determines the existence and measurement of regulatory assets and liabilities.

    b. (i) the law or regulation simply specifies that the entity has the right to recover eligible expenses incurred together with an unspecified regulatory return and (ii) the eligible expenses and the rate are subject to a negotiation process with the third party at specific points in time. In those circumstances, the entity is typically permitted to recover expenses to a 'reasonable extent' and is responsible for both determining the allowable expenses and demonstrating their reasonableness. A 'rate case' occurs with the third party to agree on the compensation the entity will ultimately recover. In those circumstances, some of our stakeholders question whether enforceable rights and obligations exist because the third party has discretion in assessing the eligibility of some allowable expenses and defining the regulatory returns. Conversely, some other stakeholders think enforceable rights and obligations do exist but think the entity is required to assess whether regulatory assets and regulatory liabilities are recognised applying paragraphs 25–28 of the ED—in particular assessing the indicators described in paragraph 27 of the ED.

31. Accordingly, we suggest the Board:

    a. develop additional application guidance in relation to assessing whether rights and obligations are enforceable;

    b. consider adding a definition of 'enforceable rights and obligation' in Appendix A to any final Standard; and

    c. clarify the interaction between 'enforceability' and the recognition requirements in paragraphs 25–28 of the ED.

- **The link with IFRS 15—regulated rate to be applied in contracts with customers**

32. The reference to contracts with customers as defined in IFRS 15 permeates the Board's proposals. We understand that regulatory assets and regulatory liabilities exist if they result in adjustments to the amounts an entity will charge to customers applying the requirements in IFRS 15.

33. We think helpful if the Board could explicitly state this point—for example by developing further the proposed definition of regulatory assets and regulatory liabilities in paragraph 6 of the ED in this respect. This would ensure that adjustments to revenue recognised applying other IFRS Standards (such as interest revenue as specified in IFRS 9 *Financial Instruments*) are not within the scope of the Board's proposals.

34. Alternatively, the Board could set specific scope exclusions. Any such exclusions could apply to regulated rates to be applied to contracts in the scope of IFRS 9 or IFRS 17 *Insurance Contracts*.

Question 1(d)—Do you agree that the requirements proposed in the Exposure Draft should apply to all regulatory agreements and not only to those that have a particular legal form or those enforced by a regulator with particular attributes? Why or why not? If not, how and why should the Board specify what form a regulatory agreement should have, and how and why should it define a regulator?

35. A regulatory asset (liability) permits (obliges) an entity to increase (deduct) future regulated rates by a fixed or determinable amount because of goods or services already supplied (because of an amount

included in revenue already recognised). From an economic perspective, the right to increase the rate (or the obligation to decrease it) reflects contracts of a specific nature. That right may exist absent any regulator. We do not see why the existence (or non-existence) of a regulator would change the economics of those contracts and accordingly, why it would justify differing accounting requirements.

36. Consequently, we think that the proposed requirements should apply to any regulatory agreement as described in paragraph 7 of the ED, irrespective of whether a regulator is the party to the agreement or supervises whether the parties to the agreement fulfil their obligations. From a pure standard-setting perspective, we acknowledge and agree with the Board's explanations in paragraph BC86 of the ED.

37. However, as explained in paragraphs 21–23 above, we think the Board should explicitly states whether a regulator shall exist for an entity to recognise regulatory assets and regulatory liabilities.

38. In addition, should the Board confirm that regulatory assets and regulatory liabilities exist regardless of a regulator's existence, we recommend the Board clearly specify that rights and obligations arising from 'self-regulation' do not give rise to such assets and liabilities. We understand that some stakeholders think the existence of a regulator would enable to clearly scope-out those circumstances. Whereas we think that rights and obligations an entity has towards itself are unable to give rise to such assets and liabilities, we recommend the Board make clear statements in this respect for the avoidance of doubt.

39. As a final note, we observe that IFRS 14 *Regulatory Deferral Accounts* includes a definition of a 'rate regulator'. We also note the Board has neither discussed the existence of that definition in the Basis for Conclusions on the ED nor explained why it had decided to not retain this definition. If, as we think, an entity recognises regulatory assets and regulatory liabilities absent any regulator, we consider that including any such discussion would be useless. However, if the Board were to require the existence of a regulator, the Board should assess how this definition has been applied in the jurisdictions that decided to adopt IFRS 14 and explain why it decided not to retain that definition in its proposals.

Question 1(e)—Have you identified any situations in which the proposed requirements would affect activities that you do not view as subject to rate regulation? If so, please describe the situations, state whether you have any concerns about those effects and explain what your concerns are.

40. As explained in paragraph 5 above, we are unsure of whether all affected entities have thoroughly assessed the Board's proposals. However, on the basis of feedback received, we have not been aware of any situations in which the proposed requirements would affect activities that are not subject to rate regulation.

Question 2—Regulatory assets and regulatory liabilities

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

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

Paragraphs BC36–BC62 of the Basis for Conclusions discuss what regulatory assets and regulatory liabilities are and why the Board proposes that an entity account for them separately.

Question 2(a)—Do to you agree with the proposed definitions? Why or why not? If not, what changes do you suggest and why?

41. We agree with the proposed definitions as set out in the ED.

42. However, we reiterate our recommendation with regard to the need to have further clarifications in relation to the notion of 'enforceable rights and obligations'.

Question 2(b)—The proposed definitions refer to total allowed compensation for goods or services. Total allowed compensation would include the recovery of allowable expenses and a profit component (paragraphs BC87–BC113 of the Basis for Conclusions). This concept differs from the concepts underlying some current accounting approaches for the effects of rate regulation, which focus on cost deferral and may not involve a profit component (paragraphs BC224 and BC233–BC244 of the Basis for Conclusions). Do you agree with the focus on total allowed compensation, including both the recovery of allowable expenses and a profit component? Why or why not?

43. We agree with the focus on TAC, including both the recovery of allowable expenses and a profit component.
44. However, some of our stakeholders who operate in the US say the Board could have retained an alternative approach, ie a cost deferral approach. This approach underpins ASC 980 *Regulated Operations*. They say a cost deferral approach already provides useful information by allowing the recognition of relevant regulatory assets and regulatory liabilities in the US. They also outline this approach would be much easier to implement than the Board's proposed approach and consequently, would create less operational challenges. Those stakeholders observe that the Basis for Conclusions on the ED does not explain why the Board decided not to retain a cost deferral approach. Accordingly, we recommend the Board provide further explanation about its decision not to proceed with a cost deferral approach.

Question 2(c)—Do you agree that regulatory assets and regulatory liabilities meet the definitions of assets and liabilities within* the Conceptual Framework for Financial Reporting *(paragraphs BC37–BC47)? Why or why not?

45. We agree with the Board's analysis as set out in paragraphs BC37–BC47 of the ED that explains why, in its view, regulatory assets and regulatory liabilities meet the definitions of assets and liabilities within the *Conceptual Framework*.
46. That being said, we think the analysis as to whether regulatory liabilities meet the definition of liabilities in the *Conceptual Framework* could be further developed. As specified in paragraph 4.27(a) of the *Conceptual Framework*, a liability exists if, among other things, the entity has an obligation. Paragraph 4.29 of the *Conceptual Framework* explains that '*an obligation is a duty or responsibility that an entity has no practical ability to avoid*…'. We think the assessment of the '*no practical ability to avoid*' criterion should warrant further explanations having considered the principles in paragraph 4.32 of the *Conceptual Framework* —this is because the obligation for the entity to deduct an amount in determining a regulated rate to be charged to customers in future periods is conditional on the entity rendering goods or services to customers during those future periods. In this case, we note that the requirements for the boundary of a regulatory agreement are helpful, in particular those in paragraphs B28(b) and B32 of the ED[5], because they ensure that the entity has no practical ability to avoid its obligation.
47. We note the discussion in paragraph BC46 about whether a regulatory liability is an obligation to transfer an economic resource—this is because a regulatory liability results in a reduction in a future cash inflow, rather than in a separate cash outflow. We observe that the Board concluded that the transfer of an economic resource could take the form of a reduction in cash inflows even though the *Conceptual Framework* makes no such statement. We think this point is not sufficiently critical to conclude that a regulatory liability does not meet the definition of a liability and accordingly, agree with the Board's conclusion. However, we recommend the Board carries forward its analysis in this respect in the Basis for Conclusions of any final IFRS Standard.

Question 2 (d)—Do you agree that an entity should account for regulatory assets and regulatory liabilities separately from the rest of the regulatory agreement (paragraphs BC58–BC62)? Why or why not?

48. A regulatory agreement creates a bundle of rights and obligations. IFRS Standards may already apply to some of those rights and obligations and may require the recognition of related assets or liabilities. For example, the regulatory agreement may create rights and obligations to which IFRS 15,

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[5] Paragraph 28 of the ED explains that '…*the boundary of a regulatory agreement is the latest future date at which an entity has: (a) an enforceable present right to recover a regulatory asset by increasing the regulated rate to be charged to customers; or (b) an <u>enforceable present obligation</u> to fulfil a regulatory liability by decreasing the regulated rate to be charged to customers*' (emphasis added). Paragraph B32 of the ED goes on and explains that '*an entity's present obligation to decrease the regulated rate at a future date is enforceable only if: (a) the regulatory agreement imposes upon the entity a present obligation to supply goods or services at that future date; and (b) the entity has no right to cancel the regulatory agreement before that date without compensating another party (for example, an incoming supplier) that will fulfil the regulatory liability'*.

IAS 38 *Intangible Assets* or IFRIC 12 *Service Concession Arrangements* apply. Those IFRS Standards set requirements that provide users of financial statements useful information.

49. The ED includes proposed requirements in relation to rights and obligations that existing IFRS Standards do not capture. Those requirements would supplement the information an entity already provides by applying IFRS Standards. We also note that the cash flows that would result from a regulatory asset or a regulatory liability are incremental in nature and may not significantly affect or overlap with cash flows from the other rights and obligations created by the regulatory agreement

50. Accordingly, we agree with the Board's conclusion that regulatory assets and regulatory liabilities should be accounted for separately from other rest of the regulatory agreement.

Question 2(e)—Have you identified any situations in which the proposed definitions would result in regulatory assets or regulatory liabilities being recognised when their recognition would provide information that is not useful to users of financial statements?

51. We have not identified any such situations.

Question 3—Total allowed compensation

Paragraphs B3–B27 of the Exposure Draft set out how an entity would determine whether components of total allowed compensation included in determining the regulated rates charged to customers in a period, and hence included in the revenue recognised in the period, relate to goods or services supplied in the same period, or to goods or services supplied in a different period. Paragraphs BC87–BC113 of the Basis for Conclusions explain the reasoning behind the Board's proposals.

Question 3(a)—Do you agree with the proposed guidance on how an entity would determine total allowed compensation for goods or services supplied in a period if a regulatory agreement provides:

(i) regulatory returns calculated by applying a return rate to a base, such as a regulatory capital base (paragraphs B13–B14 and BC92–BC95)?

52. We agree with the proposed requirements in relation to how an entity would include regulatory returns in the determination of TAC.

(ii) regulatory returns on a balance relating to assets not yet available for use (paragraphs B15 and BC96–BC100)?

53. We disagree with the Board's proposals in this respect. We are cognisant of the Board's rationales set out in paragraphs BC96–B99 of the ED but think those rationales are not sufficiently compelling to support the proposed timing of recognition in profit or loss for such regulatory returns.

54. We first understand that the Board's proposal aims to achieve comparability between entities operating either of the two types of regulatory agreements described in paragraph BC96 of the ED. We do not understand why comparability is here essential considering the fact that the above-mentioned regulatory agreements have dissimilar features. As explained in paragraph 2.27 of the *Conceptual Framework*, '…*like things must look alike and different things must look different… comparability is not enhanced by making unlike things look alike*…'. The Board's proposal, as currently justified, may aim to make unlike agreements look alike. We recommend the Board provide a clear explanation about its intention in this respect if it were to proceed with the proposed requirement.

55. We also understand that the Board considered that including such returns in the TAC for goods or services supplied when the asset is not available for use would be inappropriate because no goods or services are being supplied using that asset before it is available for use. We appreciate that rationale but think that the Board is overly restrictive in how it views the 'goods or services supplied' to the customer base. This view tends to replicate in the ED some aspects of the conceptual approach in IFRS 15, in particular by:

    a. distinguishing the goods or services supplied to (i) the customers existing when the asset is being constructed—in which case the customers receive the goods or services from other assets that are available for use—and (ii) the customers that will receive the goods or services from that asset once it is available for use; and

    b. considering that the construction of the asset is not distinct from furniture of 'goods of services' to the customers that will exist once the asset is available for use.

56. In our view, the purpose of this project is to consider the customers as a whole ie as a customer base. IFRS 15 and other IFRS Standards capture the rights and obligations with individual customers. In contrast, the supplementary approach proposed in the ED accounts for some rights and obligations with the customer base. Having considered a single customer base, we think that the construction of assets (such as items of property, plant and equipment) and managing a portfolio of assets in progress are part of an entity's obligations specified in the regulatory agreement. In other words, the construction is a service rendered to the customer base.

57. Similarly, in a more holistic approach, it can be argued that in many agreements, the entity produces goods or renders services that are essential to customers and thus, delivers public services—ie the entity acts on the government's behalf. Accordingly, it can be argued that the government or the community is the entity's client and that a service is rendered by the entity when it constructs an asset. This service warrants a compensation that has no reason to be deferred until the asset is made available for its intended use.

58. Additionally, we think that the Board's proposal in paragraph B15 applying to the regulatory returns on assets that are not available for use outlines a possible contradiction in the manner of how entities would determine TAC.

59. In paragraphs BC98–BC99 of the ED, the Board explains that its proposal in paragraph B15 is consistent with the model's principle specified in paragraph BC30—in other words, paragraph B15 is no exception to the overarching principle of the ED. However, we seek clarification on how this reconciles with the requirements in paragraph B4 of the ED when applied in specific circumstances. Paragraph B4 of the ED specifies that '…*an entity shall treat that allowable expense as relating to the supply of goods or services in the period when the entity recognises the expense applying IFRS Standards*…'.

60. To illustrate what we view as a contradiction, let's consider two examples:

    a. in the first example, the entity incurs expenses in relation to evaluating the technical feasibility (technical studies) of constructing an asset that will be used to deliver goods to the customers. The regulatory agreement allows the entity to recover such expenses by adding their amount in determining the regulated rate charged to customers for goods supplied using other assets. Applying existing IFRS Standards, the entity does not capitalise such expenses and recognises them in profit or loss when incurred. We understand that applying paragraph B4 of the ED, the entity would conclude that those expenses form part of the TAC of the reporting period during which they are incurred and would give rise to a regulatory asset accordingly. However, applying the conceptual approach underpinning the requirement in paragraph B15, the technical studies would not be considered as being a good or service supplied to the customers and could not be included in the TAC of the reporting period during which they are incurred.

    b. the second example is similar to the first one except that the construction of the asset has started. The entity incurs administration and other general overhead expenses that are recovered by adding their amount in determining the regulated rate charged to customers for goods supplied using other assets. Applying paragraph 19(d) of IAS 16 *Property Plant and Equipment*, the entity excludes such expenses from the cost of the item of PPE and recognises them in profit or loss. Here again, applying paragraph B4, the entity would conclude that those expenses form part of the TAC of the reporting period during which they are incurred. In contrast, the thinking underlying the requirement in paragraph B15 would lead to a different conclusion.

61. Unless the Board is willing to require entities to assess, when applying paragraph B4 of the ED, whether any items of expenses relate to the supply of goods and services with the meaning implied by paragraph B15—ie the construction of an asset is no good or service supplied, a view we strongly disagree with—we think that the requirements in paragraph B15 introduce an exception whose justification, as set out in the Basis for Conclusions, is unconvincing. We think the approach as currently specified in paragraph B4 (and as we understand it) should prevail—ie an allowable expense forms part of the TAC of a period when the entity recognises that expense applying IFRS Standards regardless of whether goods or services are supplied to the customers with the meaning implied by paragraph B15.

62. We appreciate the merits of the additional arguments put forward by those who support the Board's proposal. In particular:

    a. we agree that the proposed accounting for regulatory returns on assets that are not yet available for use could been seen as similar to a pre-funding of the assets by customers as illustrated in Example 6 of the Illustrative Examples on the ED. However, this is only a possible view. In practice:

        i. the allocation of regulatory returns on assets not yet available for use does not mean the entity receives a prefunding. Those returns are part of a comprehensive compensation agreed between the entity and the third party and are just a means of phasing that compensation over time. For example, if the third party had not granted those returns, it might have granted a higher return on some other items that are recoverable applying the regulatory agreement. This outlines the interrelations that exist within a regulatory agreement and implies that the unit of account should be defined at a higher level than the asset itself—paragraphs 176–185 include our comments on the unit of account specified by the ED.

        ii. those returns can alternatively be seen as compensating the entity for the carrying costs incurred during the construction phase. This could justify, in our view, regulatory returns forming part of the TAC for goods and services supplied during the construction phase.

        iii. the entity may be entitled to regulatory returns that are not conditional on the entity ultimately commissioning the asset. In those circumstances, if the construction of the asset were to not be finalised, the entity would have no obligation to decrease future regulated rates to 'refund' the returns previously received. Accordingly, we question whether the recognition of regulatory liability, as defined in the ED, would be appropriate.

    b. we understand some users' concerns that an entity's net income could be understated once the asset is available for use if the regulatory returns were to be recognised as part of the TAC during the asset's construction—this is because the regulatory returns would not match the depreciation expense from that date onwards. However, we note that in most cases such regulatory returns are not material, thus resulting in limited loss of useful information in profit or loss. Additionally, consistent with the Board's view set out in paragraph BC235 of the ED, we note that the proposed model's objective is not to match expenses with revenue, although application of the model would typically lead to an entity recognising regulatory income or regulatory expense in the same period as related effects on expenses or on revenue.

63. As a final note, we observe that entities usually manage large portfolios of assets under construction. The proposed requirement would force entities to track amounts charged to customers at the level of each asset under construction and adjust its TAC accordingly. Thus, we think this requirement would be burdensome to apply and question whether its benefits would exceed its costs.

64. For the reasons set out above, we recommend the Board not proceed with the requirement in paragraph B15 of the ED. If the Board were to decide otherwise, we suggest the Board clarify the interaction between this paragraph and paragraph B4 of the ED (see paragraphs 58–61 above).

(iii) performance incentives (paragraphs B16–B20 and BC101–BC110)?

65. We agree with the proposed accounting for performance incentives, in particular with the principle specified in paragraph B17 of the ED whereby amounts relating to a performance incentive form part of, or reduce, the TAC for goods or services supplied in the period in which the entity's performance gives rise to the incentive.

66. We also agree with the Board's proposal in paragraph B18 that would result in an entity treating incentives for performing construction work as part or reduction of the TAC during construction.

67. We note the Board's observation in paragraph BC103 of the ED whereby the requirement in paragraph B18 would not 'arguably' align with the principle underlying the model and that is specified in paragraph BC30 of the ED. In our view, it neither aligns with the proposed requirement in paragraph B15 of the ED applying to the regulatory returns on a balance relating to assets not yet available for use. We think that the arguments similar to those outlined in paragraphs BC104–BC105 of the ED could also apply to regulatory returns on a balance relating to assets not yet available for use and accordingly, do not understand the misalignment between the proposed accounting for such returns and the proposed accounting for performance incentives. This, in our view, supports revisiting the proposed requirement in paragraph B15 of the ED (see paragraphs 53–64).

Question 3(b)—Do you agree with how the proposed guidance in paragraphs B3–B27 would treat all components of total allowed compensation not listed in question 3(a)? Why or why not? If not, what approach do you recommend and why?

68. We agree with the proposed application guidance.

Question 3(c)—Should the Board provide any further guidance on how to apply the concept of total allowed compensation? If so, what guidance is needed and why?

69. We think the Board should develop specific application guidance to address the circumstances in which items affect regulated rates when the related expenses are allowable as specified in the regulatory agreement rather than as applying relevant IFRS Standards. For example, the expenses related to some pension benefits become allowable at a timing that differs from the timing specified in IAS 19 *Employee Benefits*—in our jurisdiction, for example, the regulatory agreements happen to require the use of the corridor approach that existed before IAS 19 was revised in 2011. Those differences in the timing of recognition of expenses between the regulatory agreement and IFRS Standards should, in our view, give rise to regulatory assets or regulatory liabilities.

Question 4—Recognition

Paragraphs 25–28 of the Exposure Draft propose that:

- *an entity recognise all its regulatory assets and regulatory liabilities; and*

- *if it is uncertain whether a regulatory asset or regulatory liability exists, an entity should recognise that regulatory asset or regulatory liability if it is more likely than not that it exists. It could be certain that a regulatory asset or regulatory liability exists even if it is uncertain whether that asset or liability will ultimately generate any inflows or outflows of cash. Uncertainty of outcome would be addressed in measurement (Question 5).*

Paragraphs BC122–BC129 of the Basis for Conclusions describe the reasoning behind the Board's proposals.

Question 4(a)—Do you agree that an entity should recognise all its regulatory assets and regulatory liabilities? Why or why not?

70. We agree with the recognition principle set out in paragraph 25 of the ED. In particular, from a conceptual thought process, we think helpful to not conflate the recognition and measurement principles. If a regulatory asset or a regulatory liability exists—subject to the condition discussed in Question 4(b) below—that asset or liability shall be recognised. The assessment of how likely an inflow or outflow of economic benefit is shall be reflected in the measurement of that asset or liability. Accordingly, we agree with the Board's observations in paragraph BC126 of the ED.

71. However we would encourage the Board to nuance its statement in paragraph BC127 of the ED whereby that '…*if a regulatory asset or regulatory liability exists, the probability that it will give rise to an inflow or outflow of economic benefits is generally high because of the design of the regulated rate and because of the regulatory oversight*…'. We do not disagree with this statement but think it is incomplete. The demand risk is an important driver of the outcome uncertainty. As explained in paragraphs 7–13 of this letter, we think that the Board has potentially extended the scope of this project to encompass arrangements that are not limited to defined rate regulations as defined in the 2014 DP. We agree it may be rare for that demand risk to be so severe that there would be only a low probability that no flows at all would occur. However, that risk is much higher than in the circumstances in which customers have little or no choice but to buy the entity's goods and services.

Question 4(b)––Do you agree that a 'more likely than not' recognition threshold should apply when it is uncertain whether a regulatory asset or regulatory liability exists? Why or why not? If not, what recognition threshold do you suggest and why?

- **The recognition threshold retained**

72. We agree with the condition specified in paragraph 28 of the ED that constraints the principle set out in paragraph 25 of the ED. In particular, we agree with the Board's observations in paragraph BC125 of the ED and see no compelling reason to specify an asymmetrical threshold for regulatory assets

and regulatory liabilities—thus, we agree with the proposal to specify the same threshold to assets and liabilities.

73. Having said that, we do not necessarily agree with the Board's observation in paragraph BC124 of the ED whereby '…*the Board understands that there is generally little uncertainty about whether regulatory assets or regulatory liabilities exist*'.

74. Some regulatory agreements are clear enough to identify the items that form part of the TAC and their timing of recovery—this is in particular true when the regulatory agreement specifies a RAM or detailed formula for determining the regulated rate. In those circumstances, there is little uncertainty about the existence of a regulatory asset or a regulatory liability. There may even be no uncertainty when the third party's oversight procedures (such as the review and formal approval of the rate calculation) are completed before an entity's financial statements are authorised for issue.

75. However, the Board's understanding may not hold true in other circumstances, for example when:

    a. the regulatory agreement only specifies a right to recover some expenses without providing a detailed computation for the regulated rate;

    b. the regulatory agreement is sufficiently detailed to specify most of the transactions or events that it is intended to cover but is silent on 'unexpected costs or events' (such as the costs incurred in the context of the Covid-19 crisis). In those circumstances, an entity needs to interpret the terms and conditions of the regulatory agreement to assess whether the costs are within its scope. An entity will have to wait for the end of the negotiation or approval process with the third party to know whether the related costs are recoverable.

76. We think that entities will come across the circumstances described in paragraph 75 above more frequently than the Board had thought. Those circumstances will require the use of judgement, considering the indicators listed in paragraph 27 of the ED.

- **The interaction between the scope and recognition requirements**

77. Some of our stakeholders think there is some confusion as to how to understand the scope and recognition requirements. They think that paragraph 28 of the ED could, and even should, be read as applying the 'more likely than not threshold' to assess whether a right or an obligation is enforceable and thus, whether the ED's scope applies—this is because (i) paragraph 28 of the ED refers to the existence of a regulatory asset or a regulatory liability and (ii) paragraph 6 of the ED also refers to the existence of such assets and liabilities[6]. Those stakeholders think a right or an obligation is unlikely to be enforceable if it is only more likely than not that it exists. In their view, a right or an obligation is enforceable if it is highly probable that it exists. Accordingly, those stakeholders would suggest the Board retain a higher threshold for recognising regulatory assets and liabilities[7].

78. The scope and recognition requirements are not, in our view, intertwined. We think, consistent with paragraph 7 of the ED, that an entity shall first assess whether an agreement creates enforceable rights and obligations and thus, whether it is a regulatory agreement. In our view, there should be little, if any, doubt about the enforceability of those rights and obligations to conclude on their enforceability. As a second step, the entity assesses whether it is more likely than not that the individual timing differences arising from that agreement exist. This assessment may be particularly needed when the circumstances described in paragraph 75 above arise.

79. That being said, to avoid implementation difficulties and diversity in practice, we recommend the Board clarify the interaction between the scope and recognition principles. Illustrative examples could also accompany such a clarification.

[6] Paragraph 6 of the ED states '*By definition a regulatory asset or regulatory liability can exist only if:..*' (emphasis added).

[7] Those stakeholders also observe that Topic 980 in US GAAP retains a 'probable' threshold—'probable' being read as equivalent to 'highly probable' in the IFRS literature.

Question 5—Measurement

Paragraph 29 of the Exposure Draft specifies the measurement basis. Paragraphs 29–45 of the Exposure Draft propose that an entity measure regulatory assets and regulatory liabilities at historical cost, modified by using updated estimates of future cash flows.

An entity would implement that measurement basis by applying a cash-flow-based measurement technique. That technique would involve estimating future cash flows—including future cash flows arising from regulatory interest—and updating those estimates at the end of each reporting period to reflect conditions existing at that date. The future cash flows would be discounted (in most cases at the regulatory interest rate —see Question 6). Paragraphs BC130–BC158 of the Basis for Conclusions describe the reasoning behind the Board's proposals.

Question 5 (a)—Do you agree with the proposed measurement basis? Why or why not? If not, what basis do you suggest and why?

80. As a preliminary note, we think that the Board's explanations in relation to the measurement basis it retained for regulatory assets and liabilities could have been further developed. Assessing whether the measurement basis is a '*current value measurement basis, modified to use a historical discount rate*' or a '*historical cost, modified for subsequent measurement by using updated estimates of the amount and timing of future cash flows*' is worth of interest but is not the first matter to consider.

81. Any discussion about the measurement basis should, in our view, consider as a starting point the nature of such assets and liabilities. Paragraphs BC50 and BC51 of the ED explain that a regulatory asset is a right to increase future regulated rates whereas a regulatory liability is an obligation to deduct a fixed or determinable amount in determining future regulated rates. As explained in paragraph BC52 of the ED, such assets and liabilities are no financial assets or financial liabilities—the entity has neither any right to receive cash from, nor any obligation to pay cash to customers because any such rights or obligations arise when the entity performs applying IFRS 15. They do not directly generate cash-flows either in conjunction with other assets or on a stand-alone basis—for example the entity cannot dispose of such items and receive (pay) cash as consideration. Accordingly, retaining a measurement basis using estimates of future cash flows—as the two measurement bases mentioned in paragraph 80 above do—for such assets and liabilities does not, in our view, flow so naturally. Accordingly, retaining a 'cash-flow based measurement technique'—see Question 5(b)—does not seem so intuitive either.

82. Having said that, we observe that regulatory assets and regulatory liabilities are part of the same transaction cycle—for example, regulatory assets are ultimately derecognised and replaced by a contract asset as defined in IFRS 15 or a trade receivable. As implicitly explained in paragraph B134 of the ED, regulatory assets and regulatory liabilities share some similarities with contracts assets and contract liabilities. Because contracts assets and contract liabilities reflects the transaction price that the entity will ultimately recognise as revenue—and as cash flows—applying IFRS 15, we see merits in retaining a measurement basis for regulatory assets and liabilities that ultimately aligns with the transaction price. Only the measurement basis specified in paragraph 29 of the ED would achieve such alignment and accordingly, would result in information that is useful. Consequently, we agree with the Board's proposal.

83. With regard to the terminology used, we are not entirely convinced by the description of that measurement basis as '*historical cost, modified for subsequent measurement by using updated estimates of the amount and timing of future cash flows*'. We think the measurement basis fits better with the definition of 'current value' as set out in paragraph 6.10[8] of the *Conceptual Framework* than with the definition of 'historical cost' in paragraph 6.4[9] of the *Conceptual Framework*. In particular, should the proposed measurement basis be primarily historical cost, the entity would only reflect changes in value that relate to impairment. In contrast, the proposed model results in recognising all changes in values and does not view some decrease in value as impairment.

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[8] Paragraph 6.10 of the *Conceptual Framework* states: '*Current value measures provide monetary information about assets, liabilities and related income and expenses, using information updated to reflect conditions at the measurement date. Because of the updating, current values of assets and liabilities reflect changes, since the previous measurement date, in estimates of cash flows and other factors reflected in those current values (see paragraphs 6.14–6.15 and 6.20). Unlike historical cost, the current value of an asset or liability is not derived, even in part, from the price of the transaction or other event that gave rise to the asset or liability*'.

[9] Paragraph 6.4 of the *Conceptual Framework* states: '*Historical cost measures provide monetary information about assets, liabilities and related income and expenses, using information derived, at least in part, from the price of the transaction or other event that gave rise to them. Unlike current value, historical cost does not reflect changes in values, except to the extent that those changes relate to impairment of an asset or a liability becoming onerous (see paragraphs 6.7(c) and 6.8(b))*'.

84. That being said, we think the debate about the terminology retained for the measurement basis may not have significant implications and thus, consider this as rather anecdotal from a practical perspective. In our view, the facts that the measurement basis (i) focusses on changes in estimates of cash-flows and (ii) retains a 'locked' discount rate (unless the regulatory agreement changes the regulatory interest rate) are the essential features of the measurement basis. New information becomes available over time (for example because negotiations with the third party clarifies that an expense is, or is not, recoverable) and that information should be reflected in the measurement of regulatory assets and regulatory liabilities at each reporting date—that is why we would not support a genuine 'historical cost' measurement basis.

85. If we agree with the conceptual merits of the measurement basis retained and the usefulness of the information derived therefrom, we would like to outline that it will create practical challenges. In particular, it will require the implementation of estimation processes that will be predicated upon new forecast processes. The Board should not understate the implementation costs that the measurement basis retained will entail for entities which have not recognised any regulatory assets or liabilities so far.

86. Some of our stakeholders operating regulated activities in the US outline the operational complexities resulting from this measurement basis. Their US subsidiaries hold thousands of individual assets and individual liabilities. Those stakeholders outline the recurring regulatory time lags that exist in the US between the date when (i) the allowable expenses are incurred and (ii) these expenses are reflected in the rates. Consequently, significant uncertainties in the amount and timing of the future cash flows arising from the regulatory assets and regulatory liabilities exist at their initial recognition. Such regulatory lags would also require the computation of effective regulatory interest rates applying paragraph 54 of the ED. To avoid recurring operational complexities, these stakeholders support a cost deferral approach or recommend the Board develop some practical expedients.

Question 5(b)—Do you agree with the proposed cash-flow-based measurement technique? Why or why not? If not, what technique do you suggest and why?

87. We agree with the proposed cash-flow-based measurement technique. This technique is consistent with the measurement basis retained for regulatory assets and regulatory liabilities.

If cash flows arising from a regulatory asset or regulatory liability are uncertain, the Exposure Draft proposes that an entity estimate those cash flows applying whichever of two methods—the 'most likely amount' method or 'expected value' method—better predicts the cash flows. The entity should apply the chosen method consistently from initial recognition to recovery or fulfilment. Paragraphs BC136–BC139 of the Basis for Conclusions describe the reasoning behind the Board's proposal.

Question 5(c)—Do you agree with this proposal? Why or why not? If not, what approach do you suggest and why?

88. We agree with the Board's proposals in this respect, in particular for the reason set out in paragraph BC137 of the ED.

89. We also agree with the proposed requirements about credit risk (paragraphs 37–38 of the ED) and the entity's own non-performance risk (paragraph 43 of the ED). With regard to the inclusion of credit risk in the cash flows that an entity estimates, we acknowledge the limitation set out in paragraph BC138 of the ED—ie that the cash flows retained for regulatory assets may be lower than the amounts that the entity will recognise in revenue because IFRS 15 generally requires that revenue is not reduced by amounts that the entity might not be able to collect from a customer afterwards. In other words, regulated income reflects the net of future revenue less any amounts that may not be collected from customers whereas amounts recognised as revenue applying IFRS 15 exclude the effect of any loss allowance on contract assets or trade receivables applying IFRS 9 *Financial Instruments*. We think this rather a presentation matter the effect of which is not expected to be material.

Question 6—Discount rate

Paragraphs 46–49 of the Exposure Draft propose that an entity discount the estimated future cash flows used in measuring regulatory assets and regulatory liabilities. Except in specified circumstances, the discount rate would be the regulatory interest rate that the regulatory agreement provides. Paragraphs BC159–BC166 of the Basis for Conclusions describe the reasoning behind the Board's proposals.

Question 6(a)—Do you agree with these proposals? Why or why not? If not, what approach do you suggest and why?

90. We agree with the Board's proposal to require the discounting of estimated future cash flows. Given the approach retained for measuring regulatory assets and liabilities—ie using a cash-flow based measurement technique—we see no compelling rationale for reaching a different conclusion.
91. Furthermore, we welcome the Board's proposal to require, as a principle, entities to use the regulatory interest rate—see however in question 6(b) our reservations on the proposed departure from that principle.
92. We also agree with the Board's proposal in paragraph 55(b) of the ED whereby after the regulatory asset or regulatory liability's initial recognition, an entity continues to use the discount rate determined at initial recognition, except in the circumstances described in paragraph 58 of the ED. We specifically agree with the Board's observations in paragraph BC172 in this respect. Moreover, we observe this is consistent with the requirement in paragraph 64 of IFRS 15 that specifies that an entity does not update the discount rate for changes in interest rates or other circumstances for a contract with a customer that includes a significant financing component.

Paragraphs 50–53 of the Exposure Draft set out proposed requirements for an entity to estimate the minimum interest rate and to use this rate to discount the estimated future cash flows if the regulatory interest rate provided for a regulatory asset is insufficient to compensate the entity. The Board is proposing no similar requirement for regulatory liabilities. For a regulatory liability, an entity would use the regulatory interest rate as the discount rate in all circumstances. Paragraphs BC167–BC170 of the Basis for Conclusions describe the reasoning behind the Board's proposals.

Question 6(b)—Do you agree with these proposed requirements for cases when the regulatory interest rate provided for a regulatory asset is insufficient? Why or why not?

- **Assessing sufficiency of the regulatory interest applied to regulatory assets**

93. We disagree with the Board's proposals in paragraphs 50–53 of the ED. We think an entity shall use the regulatory interest rate as the discounting rate in all circumstances:
    a. this is the rate that is contractually agreed with the third party and the basis on which regulatory returns will be earned.
    b. the determination of this rate is often subject to public scrutiny (for example, the parameters that the regulator used to set the rate are often made public)—this gives some comfort that the regulatory interest rate has been agreed on a 'fair basis'.
    c. an entity would be required to assess whether there are indications that the regulatory interest rate for a regulatory asset may be insufficient in the light of the requirements in paragraph 50 of the ED, both at the commencement of the regulatory agreement and whenever the regulatory rate is subsequently changed.
    d. determining a minimum interest rate might require the use of significant judgement and thus, may result in significant measurement uncertainty.
    e. we are unsure a minimum interest rate would provide useful information to users—we think they prefer profit emerging consistent with the regulatory return rather than with a rate subject to measurement uncertainty. We think the disclosure of the regulatory interest rate is sufficient for users to understand how returns are determined and to make their own judgement about whether that rate is sufficient.
    f. retaining a minimum interest rate for applying the proposed requirements might have unintended consequences on the relations and negotiations between the entity and the third party.

94. We welcome the fact that if the regulatory interest rate were to include any additional return above the amount required to compensate the entity for time value of money and the risks inherent in the cash flows, that additional return would not be recognised as a 'Day 1 gain' for a regulatory asset. This is because :

    a. it would require entities to split the regulatory rate into several components to identify the 'additional return' component. This would be burdensome to implement.

    b. we are unsure of whether such a gain would result in useful information.

95. However, in circumstances in which the regulatory interest rate were to be inadequate to compensate the entity for time value of money and the risks inherent in the cash flows, the entity would recognise a 'Day 1 loss' reflecting a imposed partial disallowance[10] . We note an entity would not recognise the 'Day 1 gain' in the opposite circumstances and thus question why the Board requires such an asymmetrical approach. Is the Board viewing this situation as being similar to an onerous contract?

96. This asymmetrical approach may result in quite questionable outcomes. We have been made aware of circumstances in which a regulatory agreement specifies two regulatory interest rates for regulatory assets: long-term items attract a rate above the entity's WACC, let's say an 8 per cent rate, whereas short-term items (such as input costs variances) attract a nil interest rate. The regulatory agreement is overall profitable for the entity. However, applying the Board's proposal, an entity would:

    a. use the regulatory interest rate for discounting the cash flows relating to long term items and accordingly, would recognise no Day 1 gain;

    b. determine the minimum interest rate along the lines described in paragraph 50 of the ED and then use that rate to discount the cash flows relating to short term items; accordingly, the entity would recognise a Day 1 loss; and

    c. globally recognise a Day 1 loss that may result in information that does not faithfully reflect the economics of the agreement—the agreement being overall profitable for the entity.

97. Having considered the analysis in paragraphs 93–96, we think the expected costs of the Board's proposals may exceed their benefits. Accordingly, we recommend the Board not proceed with the requirements in paragraphs 50–53 of the ED.

- **Lack of clarity about the rationales for not assessing whether the regulatory interest for regulatory liabilities is sufficient**

98. Paragraph 53 of the ED specifies that for a regulatory liability, an entity shall use the regulatory interest rate as the discount rate in all circumstances.

99. Consistent with our view set out above, we are not opposed to this requirement. However, we think the explanations in paragraphs BC169–BC170 supporting this requirement are rather unclear and think helpful if the Board were to provide further insights into this aspect.

100. Additionally, in paragraph BC169, the Board explains that '*to avoid introducing unnecessary cost and complexity, the Board proposes not to require an entity to assess whether the regulatory interest rate for a regulatory liability is excessive*'. In our view, determining a minimum interest rate along the lines specified in paragraph 50 is also complex and costly.

101. We acknowledge the explanation in paragraph BC170 of the ED but draw the Board's attention to the inconsistency that its approach would entail. Let's assume that a regulatory agreement specifies an interest rate that is not sufficient to compensate the entity for the time value of money and uncertainty of the cash flows. Let's also assume that for this regulatory agreement, an entity recognises (i) a regulatory asset for a performance bonus meeting the description in Illustrative Example 7A.7 on the ED and (ii) a regulatory liability for performance penalty meeting the description in Illustrative Example 7B.8 on the ED. Applying the proposed requirements, the entity would discount (i) the regulatory asset applying a minimum interest rate—and thus would recognise a 'Day 1 loss'—and (ii) the regulatory liability using the regulatory interest rate—thereby recognising no 'Day 1 gain'. We question whether such an asymmetry provides useful information and think this corroborates our view that an entity shall use the regulatory interest rate in all circumstances.

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[10] For ease of reference, we use the terminology 'Day 1 loss' to describe the circumstances in which the entity recognises a regulatory asset whose amount is lower than the amount that will be subsequently charged to customers applying IFRS 15. This 'Day 1 loss' reflects the fact the entity has undergone a partial disallowance—the entity recognises a regulatory asset at its present value using the minimum interest rate that is higher than the regulatory interest rate. The 'loss' is the difference between, for example, the amount of (i) the allowable expense that is recognised in profit or loss applying IFRS Standards and (i) the regulatory income that arises from the recognition of the related regulatory asset.

- **The concept of minimum interest rate sheds light on the purpose of discounting but the ED does not clearly specify this purpose**

102. In our view, the purpose of discounting in this ED lacks clarity. Paragraphs 46–49 do not specify such objective. It seems, though, that the concept of minimum interest rate helps understand this objective.

103. We infer from paragraphs 50–51 of the ED that the objective of discounting is to reflect the effect of both (i) the time value of money and (ii) the uncertainty (or risk) in the amount and timing of future cash flows (or a risk premium for bearing uncertainty in the cash flows). In other words, applying the proposed requirements, an entity shall use a discount rate that compensates the entity *at minimum* for those two features. If the regulatory interest rate compensates the entity a least for the time value of money and the uncertainty (or risk) in the amount and timing of future cash flows, the entity retains that rate. Otherwise, the entity determines and retains the minimum interest rate—which will be higher than the regulatory interest rate.

104. If the Board were to retain its proposals in any final IFRS Standards, we recommend:

    a. the 'discounting estimated future cash flows' section be redrafted to provide clarity about the features that the discount rate must have instead of directly referring to the regulatory interest rate. For example the ED could specify that the an entity discounts the estimates of future cash flows to reflect at minimum the time value of money and the risks related the amount and timing of those cash flows. The ED would then specify that the entity would retain the regulatory interest rate if this rate meets the features of the above-mentioned discount rate.

    b. the definition of 'regulatory interest rate' in Appendix A be amended accordingly. The existing definition only refers to 'time lag' thus implying such rate should compensate the entity only for the time value of money.

105. In addition, should the Board decide to retain the requirements in paragraphs 50–53 of the ED, we recommend the Board redraft them more clearly. We have been made aware that those requirements should be read as specifying a rebuttable presumption whereby an entity uses the regulatory interest rate unless there is evidence that the regulatory interest rate does not meet the objective described in paragraph 103 above. We think mentioning explicitly the existence of such a rebuttable presumption would be helpful because it would make clear that an entity would be required to assess the sufficiency of the regulatory interest only in very specific circumstances and thus, would provide some relief in the implementation of the proposed requirements.

Question 6 (c)—Have you identified any other situations in which it would be appropriate to use a discount rate that is not the regulatory interest rate? If so, please describe the situations, state what discount rate you recommend and explain why it would be a more appropriate discount rate than the regulatory interest rate.

106. We have not identified any such situations.

Paragraph 54 of the Exposure Draft addresses cases when a regulatory agreement provides regulatory interest unevenly by applying a series of different regulatory interest rates in successive periods. It proposes that an entity should translate those rates into a single discount rate for use throughout the life of the regulatory asset or regulatory liability.

Question 6 (d)—Do you agree with the proposal? Why or why not? If not, what do you recommend and why?

107. Consistent with our view expressed above, we disagree with the Board's proposed requirement in paragraph 54 of the ED.

108. We think the circumstances in which entities would have to apply the requirement in paragraph 54 may be more widespread than the Board expected. This is because there are often time lags between the date when (i) allowable expenses are incurred and (ii) such are reflected in the regulated rates charged to customers.

109. For example, assume that an entity incurs an allowable expense at the end of Year N. Further to negotiations, the third party permits the entity to recover this piece of expense from Year N+2 to Year N+6 through the regulated rates charged to customers over that period. The entity is entitled to a 7 per cent regulatory return over that period. This implies that the entity will receive no regulatory return over Year N+1 (ie a nil interest rate). Assuming that the entity recognises a regulatory asset for that piece of expense at the end of Year N, applying paragraph 54 of the ED, the entity would have to retain a discount rate that translates the different regulatory interest rates—ie the nil and

the 7 per cent rates—into a single regulatory interest rate (ie a 5.1 per cent rate) and use that rate throughout the life of the regulatory asset——ie from Year N+1 to Year N+6.

110. Some of our stakeholders operating regulated activities in the US say the Board's proposal would be challenging to apply in this jurisdiction and would create significant operational complexities. They observe that regulations in the US create recurring regulatory time lags as described in paragraph 108. These situations would necessitate the recurring computation of effective regulatory rates applying paragraph 54 of the ED to measure a high volume of individual regulatory assets and regulatory liabilities.

Question 7—Items affecting regulated rates only when related cash is paid or received

In some cases, a regulatory agreement includes an item of expense or income in determining the regulated rates in the period only when an entity pays or receives the related cash, or soon after that, instead of when the entity recognises that item as expense or income in its financial statements. Paragraphs 59–66 of the Exposure Draft propose that in such cases, an entity would measure any resulting regulatory asset or regulatory liability using the measurement basis that the entity would use in measuring the related liability or related asset by applying IFRS Standards. An entity would adjust that measurement to reflect any uncertainty that is present in the regulatory asset or regulatory liability but not present in the related liability or related asset. Paragraphs BC174–BC177 of the Basis for Conclusions describe the reasoning behind the Board's proposals.

Question 7(a)—Do you agree with the measurement proposals when items of expense or income affect regulated rates only when related cash is paid or received? Why or why not? If not, what approach do you suggest for such items and why?

111. We welcome and agree with the Board's proposed requirement in paragraph 61 of the ED. We think it will ease the implementation of the measurement requirements in the ED while being consistent with the approach that the Board had retained when developing some requirements in other IFRS Standards—such as the requirements for indemnification assets and for reimbursement in IFRS 3 *Business Combinations*.

112. Notwithstanding our support to the Board's proposal, we seek clarifications about some aspects of the scope of the proposed requirement. In particular, we understand this requirement would:

    a. apply when, as specified in paragraph 59 of the ED, '…*the regulatory agreement treats an item of expense or income as allowable or chargeable in determining the regulated rates only once an entity pays or receives the related cash, or <u>soon after that</u>*…' (emphasis added). We understand the requirement may not apply when, for example, the entity pays an employee benefit at the end of Year Y but the employee benefit's amount is chargeable to the customers from Years Y+1 to Y+3. In contrast, we understand the requirement would apply if the employee benefit amount were to be charged to customers no later than at the beginning of Year Y+1. In other words, the 'soon after' may intend to target 'cut off situations' rather than situations in which the amount is recovered over a long period of time. We ask the Board whether our understanding is correct. If so, we encourage the Board to consider whether it would be appropriate to extend the scope of the requirement in paragraph 61 of the ED to circumstances in which the allowable expenses is recovered over time after the cash outflow occurs.

    b. typically apply to some employee benefits in the scope of IAS 19 *Employee Benefits*. It would apply for example when the entity pays a benefit to an employee and the agreement specifies that the amount paid becomes allowable and rechargeable to the customer at the same time. However, we are unsure of whether the requirement would apply if the entity were to make prepayments to a fund in advance of the employee receiving the benefits. In this case, the cash outflow and the timing at which the expense becomes allowable and rechargeable to the customer would not be aligned. We think that, in those circumstances, the focus should be when the fund pays the benefit to the employee rather than when the entity makes prepayments to the fund.

    c. not apply to the circumstances in which the regulatory agreement would specify that an expense becomes allowable after it is recognised as an expense applying IFRS Standards––for example because there are timing differences as described in paragraph 69 of this letter. Here again, we ask the Board whether our understanding is correct because we have been aware of differing views in this respect.

When these measurement proposals apply and result in regulatory income or regulatory expense arising from remeasuring the related liability or related asset through other comprehensive income, paragraph 69 of the Exposure Draft proposes that an entity would also present the resulting regulatory income or regulatory expense in other comprehensive income. Paragraphs BC183–BC186 of the Basis for Conclusions describe the reasoning behind the Board's proposal.

Question 7(b)—Do you agree with the proposal to present regulatory income or regulatory expense in other comprehensive income in this case? Why or why not? If not, what approach do you suggest and why?

113. We support the principle whereby an entity shall present in other comprehensive income (OCI) all regulatory income or regulatory expense related to items of expense or income presented in OCI. We think this principle results in the statement of profit or loss providing more useful information about an entity's performance. We note that the Board tentatively supported the same principle as reflected in the June 2019 IASB Update. This principle is also consistent with the approach that the Board retained in paragraph 22 of IFRS 14 *Regulatory Deferral Accounts*.

114. We note that this principle is reflected, to some extent, in the requirement in paragraph 69 of the ED. However, applying this requirement, an entity would present in OCI the items of income or expense that meet both conditions:

    a. they arise from 'remeasurement' of regulatory assets and liabilities; and

    b. they are subject to the measurement requirement in paragraph 61 of the ED.

115. Paragraphs BC183–BC185 are unclear about the rationales that led the Board to restrict the requirement only to some regulatory assets and liabilities and thus, depart from its June 2019 tentative decision. We encourage the Board to provide further clarifications in this respect.

116. In our view, the rationale in paragraph BC185 applies to any regulatory income or regulatory expense, regardless of whether it is subject to the measurement requirement in paragraph 61 of the ED.

117. Consequently, we disagree with the requirement in paragraph 69 of the ED as currently drafted and recommend it be applied to any regulatory income or regulatory expense relating to items of expense or income presented in OCI.

Question 8—Presentation in the statement(s) of financial performance

Paragraph 67 of the Exposure Draft proposes that an entity present all regulatory income minus all regulatory expense as a separate line item immediately below revenue. Paragraph 68 proposes that regulatory income includes regulatory interest income and regulatory expense includes regulatory interest expense. Paragraphs BC178–BC182 of the Basis for Conclusions describe the reasoning behind the Board's proposals.

Question 8 (a)—Do you agree that an entity should present all regulatory income minus all regulatory expense as a separate line item immediately below revenue (except in the case described in Question 7(b))? Why or why not? If not, what approach do you suggest and why?

118. We agree with the Board's proposal to present all regulatory income minus all regulatory expense as a net in the statement of profit or loss. We think that retaining a gross presentation may clutter the statement of profit or loss for very limited, if any, information benefit.

119. However, our stakeholders have mixed views with regard to how to present that net amount in the statement of profit or loss—ie whether an entity shall present the net amount as a separate line item immediately below revenue.

120. To assess whether regulatory income[11] should be presented together with, or separately from, revenue recognised applying IFRS 15, we think helpful to flag the main difference existing between (i) regulatory income / regulatory asset and (ii) revenue / contract asset or receivable.

121. Applying IFRS 15, the recognition of revenue results in an entity having either (i) an unconditional right to consideration because only the passage of time is required before payment of that consideration—in which case an entity recognises a receivable—or (ii) no such unconditional right to consideration because the entity needs to satisfy other performance obligations in the same contract—in which case an entity has a contract asset. In both cases, the entity is not exposed to any demand risk or customer churn because it has a present contract with an existing customer and if conditional, the right to consideration depends on the entity's own actions.

[11] For ease of reference, this section only discusses the case of regulatory income.

122. The ED deals with circumstances in which the entity recognises a regulatory asset when it has a right to recover part of the TAC by increasing the rates that will apply to future contracts with customers. In those circumstances, the right to consideration depends both on (i) the entity's own actions and (ii) the existence of a number of future customers that is sufficient to enable the entity to recover the TAC. In other words, the entity is exposed to demand risk.

123. Our stakeholders operating activities in which there is very little demand risk consider that regulatory income is very similar—not to say identical—to revenue because their customer base is stable and there is very little uncertainty about whether a sufficient number of customers will exist in the future to recover the TAC related to previous periods. In their view, regulatory income is not 'riskier' than revenue. In addition, they note that the ED proposes a model that is supplementing the requirements in IFRS 15 because this Standard, alone, gives incomplete information about an entity's financial performance—IFRS 15 only reflects the amounts charged to date to the customers for a specific performance obligation. The ED brings the 'missing link' or the 'true-up amount' that faithfully portrays the compensation to which the entity is entitled for that same performance obligation and thus, faithfully reflects the entity's financial performance.

124. As explained in paragraphs 7–13 of this letter, we think the scope of this ED theoretically encompasses regulatory assets that are subject to any level of demand risk, something we view as a significant change from the scope that the Board contemplated in the 2014 DP. This results in some of our stakeholders operating activities subject to a demand risk that is not negligible being required to apply the Board's proposals.

125. In contrast to the views expressed in paragraph 123 above, those stakeholders think that regulatory income is a genuine contingent consideration the variability of which is different from revenue recognised applying IFRS 15. They agree that such income will ultimately flow through to revenue but note this is *future* revenue from *future* contracts with *future* customers. They also observe that, applying the proposed cash-flow-based measurement technique, the income and expenses arising from the recognition of regulatory assets and regulatory liabilities are subject to more measurement uncertainty than revenue recognised and measured applying IFRS 15[12]. Additionally, they note that designing a model that 'supplements' the requirements in IFRS 15 does not mean that it should 'override' the amounts presented in accordance with that IFRS Standard. Those stakeholders think that conflating revenue and regulatory income would not faithfully reflect their financial performance.

126. If the Board were to retain unchanged the proposed scope, and given the views reflected above, we think the Board should permit entities to either present all regulatory income minus all regulatory expense:

    a. as a separate line item immediately below revenue, or

    b. in the same line item as revenue and disclose separately in the notes the amount of (i) revenue and (ii) regulatory income minus all regulatory expense.

Question 8 (b)—Do you agree with the proposed inclusion of regulatory interest income and regulatory interest expense within the line item immediately below revenue? Why or why not? If not, what approach do you suggest and why?

127. As explained in paragraph BC182 of the ED, amounts relating to regulatory interest will be included in determining the future regulated rates charged to customers and hence included in revenue for future periods.

128. In addition, we note that an entity that is not subject to a regulated rate usually determines the price of the goods or services supplied to earn a profit. In doing so, the pricing of goods or services usually reflects the entity's cost of funding. Applying IFRS 15, such an entity recognises as revenue the selling price of goods and services in its entirety—it does not reclassify part of that price as financial income (or as a reduction of its financial expenses).

129. Consequently, we do not see any compelling reason for an entity in the scope of this ED to present separately amounts relating to regulatory interest from regulatory income before they form part of revenue.

130. Some might say that the Board's proposal is not consistent with the existing presentation requirements in IFRS 15. This is because paragraph 65 of IFRS 15 requires an entity to present the effects of a financing component separately from revenue from contracts with customers. Those

[12] Those stakeholders note in particular the requirements in paragraphs 56–58 of IFRS 15 for constraining estimates of variable consideration. Applying paragraph 56 of IFRS 15, an entity includes in a contract's transaction price variable consideration only to the extent that it is highly probable than a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved.

stakeholders could thus argue, by analogy with IFRS 15, that regulatory interest income and regulatory interest expense should be presented separately.

131. This analogy might have some merits but we think it is inapplicable in the context of this ED. We note that the requirement in paragraph 60 of IFRS 15 that applies when an entity identifies a significant financing component in a contract with a customer results in an entity adjusting the promised amount of consideration for the effects of the time value of money. In contrast, applying the proposed measurement requirements in the ED, an entity would use a discount rate that compensates the entity for *at least* the time value of money *and* for uncertainty in the amount and timing of future cash flows arising from a regulatory asset. We expect an entity to use the regulatory interest rate in many circumstances (unless the requirement in paragraph 50 of the ED applies). That rate may also compensate the entity for other factors such as encouraging the entity to invest, protecting its financial viability or fulfilling the broader objectives of the regulatory agreement.

132. The use of differing discount rates illustrates that the purposes of discounting in (i) IFRS 15 and (ii) this ED are dissimilar. In IFRS 15, the purpose is to distinguish a (i) financing arrangement and (ii) the delivery of goods or services. In our view, in this ED, the regulatory interest rate granted to the entity is a compensation for a mixture of transactions, not solely for a financing transaction[13]. Accordingly, we do not see any sufficient basis for distinguishing a financing transaction and think that a presentation of regulatory income (expense), together with regulatory income (expense), provides more useful information.

Question 9—Disclosure

Paragraph 72 of the Exposure Draft describes the proposed overall objective of the disclosure requirements. That objective focuses on information about an entity's regulatory income, regulatory expense, regulatory assets and regulatory liabilities, for reasons explained in paragraphs BC187–BC202 of the Basis for Conclusions. The Board does not propose a broader objective of providing users of financial statements with information about the nature of the regulatory agreement, the risks associated with it and its effects on the entity's financial performance, financial position or cash flows.

133. As a preliminary note, we welcome the introduction of an overall disclosure objective that describes the overall information needs of users and that is supplemented by specific disclosure objectives. We think this way of setting out disclosure requirements provide useful context that helps entities identify the information to disclose. However, we have significant reservations about several aspects of the proposed disclosures.

Question 9(a)—Do you agree that the overall disclosure objective should focus on information about an entity's regulatory income, regulatory expense, regulatory assets and regulatory liabilities? Why or why not? If not, what focus do you suggest and why?

134. We disagree with the focus retained by the overall disclosure objective. We think this objective focusses too much on the 'accounting mechanics' proposed by the ED and may result in entities disclosing excessively granular information. We do not disagree with the principle of providing information about regulatory income, regulatory expense, regulatory assets and regulatory liabilities but that information is not, itself, sufficient to enlighten users about an entity's existing and future financial performance.

135. We acknowledge that paragraphs 74–76 of the ED specify principles that an entity shall apply to determine the level of detail and aggregation (disaggregation) necessary to satisfy the overall disclosure objective and the specific disclosure objectives. Those principles may help ensure an entity provides the appropriate level of information. However, in our view, the disclosure requirements that supplement the disclosure objective and the specific disclosure objectives may ultimately result in unnecessarily detailed information being provided.

136. In our experience, users need information about how (i) the regulatory agreements work and (ii) those agreements have affected, and are expected to affect, an entity's primary financial statements. In other words, we think providing background and 'high-level' financial information would be more helpful to users than an extensive description of the proposed accounting model's intricacies or detailed reconciliations between the balances of regulatory assets and liabilities at the opening of the reporting period and the balances of such items at the end of the same reporting period. Without that focus, we think users may lose sight of information that is, in our view, really useful.

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[13] A financing transaction may exist because of the time lag between when the entity incurs an item of expense and when it recovers that item onto customers.

137. Accordingly, we would rather be supportive of a disclosure objective similar to the one in IFRS 14 and described in paragraph BC191 of the ED.

Question 9(b)—Do you have any other comments on the proposed overall disclosure objective?

138. The proposed overall disclosure objective duplicates the objective of the proposed IFRS Standard as set out in paragraph 2 of the ED. We agree there should be consistency between that objective and the proposed overall disclosure objective. However, we think there is very limited interest in having a 'copy-paste' of the overall objective in the disclosure section. This, in our view, confirms that the proposed overall disclosure objective is all too of an accounting nature and does not put the focus on the essential information users need—such as how the regulation has affected and is expected to affect an entity's financial performance.

139. Additionally, we do not really see any substantial difference between the wording '*…that understanding will provide insights into the entity's prospects for future cash flows…*' underpinning paragraph 72(a) of the ED and the wording '*…that understanding will provide insights into how regulatory assets and regulatory liabilities will affect the amount, timing and uncertainty of the entity's future cash flows…*' underpinning paragraph 72(b) of the ED. We read paragraph BC200 as trying to provide an explanation for the difference that the Board was willing to make ('*…providing insights into a broader set of future cash flows over many periods…*') without this paragraph being effective in enlightening the reader about the Board's intention.

140. We also note that (i) paragraph BC196 of the ED specifies that '*…paragraphs 72(a) and 77 of the ED set out the first specific of the disclosure requirements…*' and (ii) paragraph BC200 of the ED specifies that '*…paragraphs 72(b) and 77 of the ED propose a second specific disclosure objective…'.* In other words, the overall disclosure objective seems intertwined with the specific disclosure objectives. In our view, this adds confusion about how to understand the proposed disclosure objectives and conveys the feeling the Board is repeating exactly the same things with solely different words.

141. We recommend the Board set out a more explicit overall disclosure objective. We also suggest an Illustrative Example be developed to help stakeholders better understand that objective, together with the specific disclosure objectives.

Paragraphs 77–83 of the Exposure Draft set out the Board's proposals for specific disclosure objectives and disclosure requirements.

Question 9(c)—Do you have any comments on these proposals? Should any other disclosures be required? If so, how would requiring those other disclosures help an entity better meet the proposed disclosure objectives?

- **Specific disclosure objective set out in paragraph 77 of the ED and related disclosure requirements in paragraph 78 of the ED**

142. We support this specific disclosure objective. However, we disagree with the disclosure requirements set out in paragraph 78 of the ED. We think those requirements would result in providing too granular information. Furthermore, we question whether such a list of items of information would provide users with useful information and thus, question the information benefits that would result therefrom. We think helpful if the Board could explain which analysis, assessment or evaluation that list would enable users to make and confirm whether all those items of information are really 'must have' for users—rather 'nice to have'.

143. We think a better way forward would be to require entities to (i) provide some items of information—for example by aggregating some of the items of information in paragraph 78 of the ED—or (ii) a mixture of 'high-level' qualitative and quantitative information that help users understand how a regulatory agreement has affected an entity's performance.

- **Specific disclosure objective set out in paragraph 79 of the ED and related disclosure requirements in paragraphs 80–81 of the ED**

144. We agree with the specific disclosure objective set out in paragraph 79 of the ED.

145. We agree in principle with the requirement in paragraph 80(a) of the ED to provide quantitative information using time bands. Nonetheless, we have reservations about the level granularity that the Board may contemplate and that is reflected in paragraph 81(b). We would rather support providing high-level information about when the regulatory assets and regulatory liabilities are recovered or reversed.

146. We think that time band information along the lines described in paragraph 81(b) will be feasible but will require the use of judgement in some circumstances. The time bands suggested in paragraph 81(b) of the ED would be easily operable if regulatory assets and regulatory liabilities were financial instruments resulting in cash inflows or outflows occurring at predetermined dates. Regulatory assets and regulatory liabilities are no such instruments. Applying the Board's proposals, they may result from a RAM—in which case the timing of cash inflows or outflows can be well forecast—but they may also arise from a 'simple' enforceable right to recover some allowable expenses, the detailed recovery schedule of which needs to be discussed with a third party over lengthy negotiations—in which case, presenting time bands will require the use of judgement. Finally, some of our stakeholders observed that the example of time bands in paragraph 81(b) would need significant adjustments in some circumstances because some regulatory assets (regulatory liabilities) may be recovered (fulfilled) over more than 50 years.

- **Specific disclosure objective set out in paragraph 82 of the ED and related disclosure requirement in paragraph 83 of the ED**

147. We are unclear as to the purpose of this disclosure objective, in particular as to the '*changes in regulatory assets and regulatory income that were not a consequence of regulatory income or regulatory expense*' to which the Board refers. The Basis for Conclusions on the ED does not provide any insight in this respect. Has the Board intended to target changes such as regulatory assets or regulatory liabilities acquired or assumed in a business combination or changes arising from the application of the requirements in IAS 21 *The Effects of Changes in Foreign Exchange Rates*? We think helpful to have an example of such changes.

148. Additionally, we note that applying the Board's proposals in paragraph 78 of the ED would practically result in entities already providing the reconciliation required in paragraph 83 of the ED. Thus, we do not see any significant merit in specifying a separate disclosure objective for the changes referred to in paragraph 147 above—those changes would better fit in the implicit reconciliation required in paragraph 78 of the ED.

Question 9(d)—Are the proposed overall and specific disclosure objectives and disclosure requirements worded in a way that would make it possible for preparers, auditors, regulators and enforcement bodies to assess whether information disclosed is sufficient to meet those objectives?

149. We have not been aware of difficulties that would prevent stakeholders from assessing whether information disclosed is sufficient to meet the disclosure objectives

Question 10—Effective date and transition

Appendix C to the Exposure Draft describes the proposed transition requirements. Paragraphs BC203–BC213 of the Basis for Conclusions describe the reasoning behind the Board's proposals.

Question 10(a)—Do you agree with these proposals?

150. We agree with the Board's proposal to require entities to apply any final IFRS Standard retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* ('full retrospective approach'). This will result in entities providing comparable information across all periods presented.

151. Notwithstanding our support, we recommend the Board develop specific transition requirements for regulatory returns on assets not yet available for use (see paragraph 152) and seek clarifications on the relief given for past business combinations (see paragraphs 153–156).

152. As explained in paragraphs 53–64, we disagree with the proposed requirement in paragraph B15 of the ED whereby the regulatory returns included in the regulated rates during the period when an asset is not available for use form part of the TAC for goods and services supplied only once that asset is available for use. However should the Board decide to proceed with this proposal, we recommend the Board not require retrospective application—the Board could specify that an entity shall apply this requirement prospectively, or could require retrospective application only to assets that are made available for use on or after or after the beginning of the earliest period presented. Entity would find it difficult and costly to apply paragraph B15 retrospectively to assets made available for use many years ago. We note that the Amendments to IAS 16 *Property, Plant and Equipment: Proceeds before Intended Use* published in May 2020 included a similar relief for similar circumstances[14].

[14] Paragraph 80D of IAS 16 introduced further to the above-mentioned amendments states: '…*An entity shall apply those*

153. Furthermore, we note that the Board developed in paragraph C4 of the ED specific transition requirements applying to past business combinations. We understand those requirements specify the accounting for business combinations (i) involving the acquisition of entities with regulatory assets or regulatory liabilities within the scope of the ED and (ii) whose acquisition date is before the date of transition. Those requirements propose a 'simpler approach' than the application of the full retrospective approach.

154. We welcome the proposal of providing entities with some practical relief in this respect but question whether any such relief is in reality needed. The Board's proposal seems to be predicated upon the assumption that whenever an entity applies new IFRS Standards or amendments retrospectively in accordance with IAS 8, the entity 'restates' past business combinations and thus, makes adjustment to the amount of goodwill (badwill) recognised for those business combinations. This does not tally with a number of our stakeholders' experience. We note in this respect that paragraph 50 of IFRS 3 specifies that '*after the measurement period [of a business combination] ends, the acquirer shall revise the accounting for a business combination <u>only</u> to correct an error in accordance with IAS 8'* (emphasis added). Consequently, the Board's proposal casts significant doubt on how the requirements in IAS 8 on the full retrospective approach interplay with the requirements in IFRS 3.

155. If the Board were to proceed with the relief provided in paragraph C4 of the ED, this would indicate the Board reads the existing IFRS Standards as requiring the restatement of past business combination whenever a change in accounting policy occurs. Such a reading may have widespread implications on the existing practice. Accordingly, we recommend the Board clarifies how it reached the conclusion that past business combinations are restated when an entity applies the full retrospective approach.

156. Assuming that the application of the full retrospective approach would require entities to restate past business combinations, we would then support the proposed provisions in paragraph C4 of the ED.

Question 10(b)—Do you have any comments you wish the Board to consider when it sets the effective date for the Standard?

157. Notwithstanding our support for a full retrospective approach, we note that applying that approach will necessitate significant implementation efforts. In our jurisdiction, entities have not recognised regulatory balances so far. Accordingly, the new requirements would result in significant changes that would need to be reflected in all periods presented. Entities need sufficient time to prepare for the new requirements; this includes:

    a. collecting the data—even though part of those data is already available for year-end reporting periods. The data collection will be particularly time-consuming for the first interim financial reports because there is no information available to date for interim reporting periods (see paragraph 168 in this respect).

    b. developing estimations processes to apply the measurement requirements;

    c. developing or modifying IT systems;

    d. preparing for the disclosure requirements—if finalised as proposed;

    e. getting acquainted with the model, training staff and educating users.

158. Some of our stakeholders have also operations in the US to which the requirements in Topic 980 already apply. Those stakeholders say the proposed IFRS requirements—the measurement requirement in particular—will be burdensome to apply to those operations. Those stakeholders also need sufficient time to implement the Board's proposals.

159. Accordingly, we recommend the Board require entities to apply any new final IFRS Standards for annual reporting periods beginning on or after 24 months from the date of publication. This time lag would accommodate the needs of entities operating numerous or very significant regulatory agreements. We note that the Board's proposals would also cater for the needs of entities willing to apply any new IFRS Standard at the earliest possible time and/or being in a better state of preparedness because earlier application would be permitted.

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amendments retrospectively, but only to items of property, plant and equipment that are brought to the location and condition necessary for them to be capable of operating in the manner intended by management on or after the beginning of the earliest period presented in the financial statements in which the entity first applies the amendments…'

Question 11—Other IFRS Standards

Paragraphs B41–B47 of the Exposure Draft propose guidance on how the proposed requirements would interact with the requirements of other IFRS Standards. Appendix D to the Exposure Draft proposes amendments to other IFRS Standards. Paragraphs BC252–BC266 of the Basis for Conclusions describe the reasoning behind the Board's proposals.

Question 11 (a)—Do you have any comments on these proposals? Should the Board provide any further guidance on how the requirements proposed in the Exposure Draft would interact with any other IFRS Standards? If yes, what is needed and why?

160. We think that the application guidance developed in paragraphs B41–B46 of the ED on the interaction between the proposed requirements and IAS 12 *Income Taxes* is helpful.

161. In contrast, we think the statement in paragraph B47 has no added value. Writing that '…*some arrangements within the scope of IFRIC 12 may create regulatory assets or liabilities*…' is simply stating the obvious and is unlikely to help assuage the concerns of some stakeholders about the interaction between the proposed requirements and IFRIC 12. We note that the Board's public deliberations in this respect have been rather 'sketchy' and thus encourage the Board to ensure the above-mentioned interaction works well in practice. We also encourage the Board to develop an illustrative example in this respect.

Question 11 (b)—Do you have any comments on the proposed amendments to other IFRS Standards?

- **Consequential amendment to IFRS 3—the IFRS 3 recognition and measurement exception**

162. We support the exception to the recognition and measurement principle in IFRS 3 for the reasons described in paragraphs BC260–BC261 of the ED.

163. We think essential to avoid any inconsistency between the measurement basis retained for regulatory assets and regulatory liabilities at the acquisition date and their subsequent measurement basis. Measuring regulatory assets and regulatory liabilities at their fair value at the acquisition date would result in estimating cash flows that may be similar to the cash flows that an entity would estimate applying the proposed measurement requirements. However, applying the existing requirements in IFRS 3 and IFRS 13 *Fair Value Measurement*, the entity would determine a discount rate assessed from a market participant's perspective. That rate is likely to differ from the regulatory interest rate—or the minimum interest rate. Without any exception to IFRS 3, if an entity were to subsequently update (i) its estimates of future cash flows and, at the same time, (ii) the discount rate because of a resetting of the regulatory interest rate, an entity would recognise a gain or loss with little, if any, informational value[15][16]. We think this would not result in useful information.

164. We note that similar gains or losses may arise because of differing recognition principles in IFRS 3 and in the proposed requirements. Here again, we think the resulting 'Day 2' gains or losses would not provide useful information.

165. Additionally, we think that retaining a fair value measurement for regulatory assets and regulatory liabilities at the acquisition date and possibly afterwards—so as to avoid the above-mentioned gains or losses as some might wish to suggest—would:

    a. not provide relevant information in many circumstances. A regulatory agreement generally specifies rights and obligations that do not exist on competitive market. Accordingly, determining a discount rate assessed from a market participant's perspective would make little sense, if any.

    b. create practical difficulties. In many circumstances, the entity does not have any competitor and would find it difficult to gather observable inputs against which to benchmark the regulatory interest rate.

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[15] Any such gain or loss would arise if the regulatory interest rate (or the minimum interest rate) were to differ from the discount rate used to determine the fair value of regulatory assets and liabilities at the acquisition date.

[16] We note that the Board's proposals in this respect are consistent with the principles set out in paragraphs 6.48 and 6.78 of the *Conceptual Framework*. In particular, paragraph 6.78 explains that '…*using the same measurement basis for initial recognition and subsequent measurement avoids recognising income or expenses at the time of the first subsequent measurement solely because of a change in measurement basis*'.

- **Consequential amendments to other IFRS Standards**

166. We also support the proposed consequential amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards*, IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, IAS 8 and IAS 36 *Impairment of Assets*.

Question 12—Likely effects of the proposals

Paragraphs BC214–BC251 of the Basis for Conclusions set out the Board's analysis of the likely effects of implementing the Board's proposals.

Question 12 (a)—Paragraphs BC222–BC244 provide the Board's analysis of the likely effects of implementing the proposals on information reported in the financial statements and on the quality of financial reporting. Do you agree with this analysis? Why or why not? If not, with which aspects of the analysis do you disagree and why?

167. Entities operating in our jurisdiction currently do not recognise regulatory balances. We agree with the description of the likely effects for those entities.

Question 12 (b)—Paragraphs BC245–BC250 provide the Board's analysis of the likely costs of implementing the proposals. Do you agree with this analysis? Why or why not? If not, with which aspects of the analysis do you disagree and why?

168. We think that the Board's statement in paragraph BC247 whereby '*the Board does not expect the costs of applying the proposals, both on initial application and on an ongoing basis, to be significant because to a large extent, the proposed model would use inputs that the Board expects an entity already needs to gather and process in determining regulated rates*' should be more nuanced. Implementing the Board's proposals will require much time and many efforts. The proposals' implementation is expected to be particularly challenging for entities preparing financial reports applying IAS 34 *Interim Financial Reporting*. The inputs the Board referred to are often available on an annual basis. In contrast, such inputs are seldom available on a quarterly or half-year basis. This is mainly because regulatory agreements are negotiated between the entity and the third party on the basis of annual data and thus, in those circumstances, no information has ever been required on a period shorter than 12 months. Accordingly, those entities will have to gather or estimate inputs for each interim period and thus, will have to implement specific closing processes. For most of our affected stakeholders, the benefits of the Board's proposals are expected to exceed their costs but those costs are not insignificant.

169. We have few stakeholders which operate activities in the US and thus, apply ASC 980. Those stakeholders view the Board's proposals as no improvement to financial reporting in comparison to the requirements in US GAAP. Entities in the US incur allowable expenses and have the right to recover them in future rates. However, those entities neither immediately know the regulatory returns that will be applied to the allowable expenses nor the timing of recovery of both the expenses and the related returns. Those details are agreed after 'rate cases' with the third party occur. Accordingly, pending the completion of the rate case, entities defer on their local statement of financial position the items of expenses for which they have a right to compensation. Those stakeholders think a cost-deferral accounting model would correctly reflect the way the regulations work in the US.

170. Those stakeholders also think that measuring regulatory assets and regulatory liabilities using a cash-flow based technique would bring significant and recurring operational complexities such as (i) the follow-up of thousands of long term individual regulatory assets and regulatory liabilities, (ii) the computation of effective regulatory interest rates, (iii) frequent remeasurements of the regulatory assets and regulatory liabilities whenever the regulator grants the tariff adjustment (such remeasurements are frequent because the regulator frequently changes the regulatory rate applied to long-term regulatory assets and regulatory liabilities), (iv) the misalignment with regulator accounting (which will require the use of two sets of accounts and two sets of forecasts), (v) the recognition of additional deferred taxes, etc.

171. In this context, these stakeholders consider that the proposed cash-flow-based technique will be burdensome to apply and think that the costs of the Board's proposal may exceed its benefits.

172. Few of our stakeholders have also reported to us that the costs of applying the Board's proposals may exceed their benefits. They think the implementation of the proposals will result in information that, in their view, is not useful. Those stakeholders operate businesses that are subject to significant demand risk and are thus uncomfortable with the recognition of regulatory assets (regulatory

liabilities). They think essential to include as scope criterion the fact that customers have little or no choice but to purchase the goods or services from the rate-regulated entity, because there is no effective competition to supply and the rate-regulated goods or services are essential to customers. The existence of a negative price elasticity could be evidence that this criterion is met. Alternatively, if the Board were to retain unchanged the scope, those stakeholders suggest the recognition threshold for regulatory assets and liabilities be raised—for example regulatory assets and liabilities being recognised if it is probable they exist, with the meaning of 'probable' as set out in US GAAP.

Question 12(c)—Do you have any other comments on how the Board should assess whether the likely benefits of implementing the proposals outweigh the likely costs of implementing them or on any other factors the Board should consider in analysing the likely effects?

173. We do not have any comment in this respect.

Question 13—Other comments

Do you have any other comments on the proposals in the Exposure Draft or on the Illustrative Examples accompanying the Exposure Draft?

- **Agreements that are not in the scope of this ED**

174. A regulatory asset or a regulatory liability exists if, among other things, part of the TAC for goods and services supplied in one period is charged to customers through the regulated rates for goods or services supplied in a different period. In our view, this criterion is essential to distinguish regulatory agreements that give rise to regulatory assets or regulatory liabilities from those that do not—such as general price regulations in which the regulatory agreements do not create a direct cause-effect relationship between the supply of goods or services, the total allowed compensation for supplying those goods or services and the rate charged to customers.

175. We think it would be helpful to stakeholders if the Board could better clarify in the Basis for conclusions on any final IFRS Standards why general price regulations are not in the scope of this ED.

- **The proposed unit of account**

176. The ED does not seek the views of respondents in relation to the requirement set out in paragraph 24 of the ED that specifies the unit of account. We have mixed views in relation to this requirement.

177. The drafting of this requirement is rather generic. It specifies as overarching principle that an entity would account for the right and obligation arising from each difference in timing as a separate unit of account. An entity would be permitted to treat a group of rights and obligation as a single unit of accounts if such rights and obligations (i) have similar expiry patterns and (ii) are subject to similar risks.

178. We acknowledge that the Board's proposed requirement logically flows from the principles set out in the *Conceptual Framework*.

179. However, it does not flow from the existing practice. We observe that the statement in paragraph BC116 of ED whereby *'entities typically track separately the effects of the individual differences in timing*' does not tally with our stakeholders' practical experience. We also disagree with the Board's statement in paragraph BC116(a) whereby '*entities typically assess each individual difference in timing separately and can identify the separate effect of each difference on future regulated rates and cash flows, though possibly with some interdependency in determining the overall regulated rate'*. Those two statements may hold true for some regulatory agreements but they do not apply in all circumstances.

180. We acknowledge that the proposals in the ED are based on the concept of TAC. As explained in paragraph B2 of the ED, the TAC includes items of differing nature. However, the cash flows of such items may be strongly interrelated, in particular when the right to add an amount (an obligation to deduct an amount) in determining a regulated rate is not determined by reference to a precise mechanism or formula and is derived by an enforceable principle. We think that such an interrelation would support identifying a unit of account at a higher level than required by the Board's proposals.

181. We also observe that the Board would *require* an entity to reassess the unit of account determined applying paragraph 24 of the ED when it determines the measurement of regulatory assets and regulatory liabilities. Paragraph 40 of the ED states that '*in assessing which of the methods described in paragraph 39 better predicts the uncertain cash flows, an entity shall also assess whether a better*

prediction will result from considering each regulatory asset and each regulatory liability separately, or from considering any of them together with other regulatory assets or regulatory liabilities'. The fact that an entity may end up changing the unit of account for measurement purpose indicates that the approach retained in paragraph 24 may not be relevant.

182. Accordingly, we have strong reservations about the principle to identify the right or obligation arising from an individual difference in timing as the unit of account. We also think that the cost of applying this requirement might exceed its expected benefits.

183. We acknowledge that an entity would be permitted to treat a group of rights and obligation as a single unit of account if two conditions are met—ie the rights and obligations (i) have similar expiry patterns and (ii) are subject to similar risks. However, we are unclear as to the meaning of 'similar risks'. Does this mean the rights and obligations should be subject to similar regulatory returns? To similar level of existence certainty applying paragraph 28 of the ED? We are also unclear about the meaning of 'similar expiry patterns'. We think the Board should clarify its proposal in this respect.

184. Having assessed the expected effects of the Board's permission, we are unsure it would provide significant relief to entities in preparing information that is useful at a reasonable cost. This is because assessing and meeting both conditions for that permission to apply could be challenging in practice.

185. Thus, we recommend the Board reconsider its approach for the unit of account. An alternative approach the Board might wish to consider could be to specify as principle that the net of all differences in timing arising from a regulatory agreement is the unit of account. Because such an approach could result in an entity aggregating differences with very differing expiry patterns, an entity could be required to disaggregate that unit of account in units of accounts having similar expiry patterns.

- **Lack of initial recognition requirement**

186. We draw the Board's attention to the fact that the ED does not specify any requirement in relation to the initial recognition of regulatory assets and regulatory liabilities. Determining when an entity first recognises a regulatory asset or a regulatory liability affects, for example, how an entity computes the exchange differences on regulatory assets and regulatory liabilities when it reports the balances of such items in its functional currency applying IAS 21 *The Effects of Changes in Foreign Exchange Rates*.

- **Foreign currency amounts**

187. Paragraph 45 of the ED specifies that regulatory assets or regulatory liabilities are monetary items when applying IAS 21. We seek clarifications about how the Board came to that conclusion, having considered the definition for monetary items in paragraph 16 of IAS 21 and recommend the explanations be provided in the Basis for Conclusions on any final IFRS Standards.

- **Presentation requirements applying to the statement of financial position**

188. We do not oppose the requirement in paragraph 70(b) to present separately current and non-current regulatory assets (regulatory liabilities) because this is consistent with the requirements in other IFRS Standards. However, this classification may require the use of significant judgement. We note that the reasons that led the Board not to require an entity to present regulatory deferral balances applying IFRS 14 are to some extent valid in the context of this ED[17].

189. We also have two observations about the requirements in paragraphs 71 of the ED:

    a. the interaction between paragraph 71 of the ED—in particular paragraph 71(b)—with paragraph 24 is unclear, in particular because those paragraphs use different terminologies.

    b. this paragraph includes a permission to offset assets and liabilities whereas other

[17] Paragraph BC47 of IFRS 14 outlines those reasons: '*Regulatory deferral account balances arise from specific individual costs (income) that the rate regulator requires or permits to be deferred to future periods. The rates charged for goods or services in the current period may be intended to recover a combination of past costs, current costs and, in some cases, anticipated future costs. Although the rate regulator may specify the period over which the recovery of the regulatory deferral account balances is intended, judgement may be needed to identify the costs that the revenue billed in a period recovers. This means that detailed scheduling of the timing of recovery or reversal of each regulatory deferral account debit or credit balance may be needed for the purpose of identifying which amounts should be classed as current or for determining which amounts would be recovered or reversed in the same period for the purposes of offsetting. Consequently, the IASB has decided that regulatory deferral account balances should not be presented as current or non-current and that debit and credit balances should not be offset in the statement of financial position...*'

IFRS Standards such IAS 32 *Financial Instruments: Presentation* and IAS 12 *Income Taxes* include mandatory requirements. We do not disagree with this permission but think it would be helpful if the Board could provide more context about this in the Basis for Conclusions on any final IFRS Standards—the Basis for Conclusions on the ED does not include any observations about the requirements in paragraphs 70–71 of the ED.

- **Transition Resource Group (TRG)**

190. Entities operating in our jurisdiction neither apply IFRS 14 nor recognise regulatory balances in their IFRS financial statements. Accordingly, the proposed requirements, if finalised, would represent an important change to the existing practice and would, therefore, require significant implementation effort. In view of the magnitude of the change and to ensure a seamless transition, we recommend the Board support the implementation of the new IFRS Standard through the creation of a TRG or use its Consultative Group for Rate Regulation to deal with transition issues. This has proved helpful for the implementation of IFRS 15 and IFRS 17 *Insurance Contracts*.