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STAFF PAPER

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Project	**Rate-regulated Activities**		
Paper topic	Presentation and disclosure		
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Purpose of this paper

1. The purpose of this paper is to provide further analysis of the following issues:
   (a) presentation of amounts of regulatory income or regulatory expense related to items of income or expense presented in other comprehensive income (OCI) (paragraphs 3-19); and
   (b) disclosure of regulatory interest or regulatory return (paragraphs 20-30).

Staff's recommendations

2. Staff make the following recommendations:
   (a) an entity should present:
      (i) in other comprehensive income (OCI) all regulatory income/ (regulatory expense) related to items of expense or income presented in OCI, and present them immediately above or immediately below the related expense or income; and
      (ii) in profit or loss all other regulatory income/ (regulatory expense), immediately below the line item(s) for revenue.
   (b) an entity should disclose any regulatory interest or regulatory return accrued on regulatory assets or regulatory liabilities as a separate caption in:

(i) the breakdown of regulatory income/ (or regulatory expense) for the period; or

(ii) the reconciliation of the carrying amounts of regulatory assets and of regulatory liabilities from the beginning to the end of the period.

Presentation in the statement(s) of financial performance

3. As noted in Agenda paper 9A *Principles of the model: a summary*, regulatory assets and regulatory liabilities arise when an entity supplies goods or services in one period but some amounts relating to those goods or services are charged to customers through the rate. Those amounts are added or deducted in determining future rate(s) and, consequently, are recognised and presented as revenue in a different period than the period in which the related goods or services are supplied.

4. The model currently proposes that the net movement between opening and closing balances of regulatory assets and regulatory liabilities should be presented as a regulatory income/ (regulatory expense) line item immediately below the revenue line items presented by applying IAS 1.[1]

5. However, some regulatory income/ (regulatory expense) arises when related expense or income is presented in OCI. This would occur, for example, when an entity presents an incurred expense in OCI and has a right to include that expense in determining the rate(s) to be charged in a future period. Examples of such items include remeasurements of defined benefit pension obligations (or assets) and remeasurements of derivatives used for hedging.

6. There could be two approaches to presenting such regulatory income/ (regulatory expense) in the statement(s) of financial performance:

   (a) Approach 1—present it in OCI so that the regulatory income/ (regulatory expense) and the related income or expense are both presented outside profit or loss; or

[1] See Agenda paper 9G *Summary of tentative decisions made to date*.

(b) Approach 2—tentatively decided by the Board in November 2018—present it in profit or loss immediately below revenue, like all other regulatory income/ (regulatory expense).

7. Both approaches are illustrated using a common fact pattern in the following example:

Fact pattern:

The regulatory agreement specifies that:

(a) pension costs are an allowable expense;

(b) Entity A is not allowed to include these costs in the rates charged to customers until after it makes the related cash disbursements; and

(c) such costs – with a 0% margin – are included in the rates charged to customers in the first year after cash disbursement.

Entity A maintains a defined benefit plan for its employees, which is accounted for in accordance with IAS 19 *Employee Benefits*.

During the years X0–X2, Entity A recognises:

(a) in profit or loss

(i) service cost (eg CU98 in X1); and

(ii) net interest on the net defined benefit liability (eg CU9 in X1).

(b) in other comprehensive income

(i) remeasurements of the net defined benefit liability (eg CU53 loss in X1).

The employees' service terms end in X2. Entity A pays CU340 for employees' benefits in X2, fulfilling its defined benefit obligation.

Application of the model:

- The regulatory compensation for services already supplied over the lives of the plan members includes the cost of pension payments that are ultimately determined to be allowable.
- The regulatory compensation in years X0–X2 for services already supplied (eg CU160 in X1) *exceeds* the amount already charged to customers (nil).
- As a result, Entity A recognises a regulatory asset reflecting its present right to add the amount of the pension costs in determining the rates to be charged to customers in year X3.

Approach 1—present in OCI the regulatory income/ (expense) related to the pension expense or income presented in OCI

In CU	X0	X1	X2	X3	Total
Revenue	-	-	-	340	340
Regulatory income / (expense)[1]	90	107	128	(340)	(15)
Defined benefit plan:					
Service costs	(90)	(98)	(108)	-	(296)
Net interest on the net defined benefit liability	-	(9)	(20)	-	(29)
Profit / (loss)	-	-	-	-	-
Remeasurements of the net defined benefit liability	-	(53)	38	-	(15)
Remeasurement of related regulatory asset	-	53	(38)	-	15
Other comprehensive income	-	-	-	-	-
Total comprehensive income	-	-	-	-	-
Regulatory asset	90	250	340	-	-
Defined benefit obligation	90	250	-	-	-

Approach 2—present all regulatory income/ (regulatory expense) in profit or loss, immediately below revenue

In CU	X0	X1	X2	X3	Total
Revenue	-	-	-	340	340
Regulatory income / (expense)[1]	90	160	90	(340)	-
Defined benefit plan:					
Service costs	(90)	(98)	(108)	-	(296)
Net interest on the net defined benefit liability	-	(9)	(20)	-	(29)
Profit / (loss)	-	53	(38)	-	15
Remeasurements of the net defined benefit liability	-	(53)	38	-	(15)
Other comprehensive income	-	(53)	38	-	(15)
Total comprehensive income	-	-	-	-	-
Regulatory asset	90	250	340	-	-
Defined benefit obligation	90	250	-	-	-

Approach 1—present in OCI

8. Many users of financial statements use the statement of profit or loss as the primary source of information about an entity's financial performance, giving far less prominence to items presented OCI. However, in developing some IFRS Standards, the Board has decided that in exceptional circumstances some items of income or expense are to be included in OCI when doing so results in the statement of profit or

loss providing more relevant information, or providing a more faithful representation of an entity's financial performance.[2]

9. When regulatory income/ (regulatory expense) arises from expense or income presented in OCI, not using OCI for the regulatory income/ (regulatory expense) would mean that the sub-total for profit or loss includes the regulatory income/ (regulatory expense) but does not include the related expense or income. Consequently, proponents of Approach 1 suggest that, in such circumstances, presenting the related regulatory income/ (regulatory expense) in OCI would result in the statement of profit or loss providing more relevant information or a more faithful representation of the entity's financial performance.

Approach 2—present immediately below revenue

10. The balances of regulatory assets and regulatory liabilities reflect the amounts to be added or deducted in determining future rate(s) that will be charged to customers in exchange for future supplies of goods or services. Those amounts will ultimately flow through to revenue recognised using IFRS 15.

11. As described in Agenda Paper 9A, the purpose of the model being developed is to **supplement** the information provided by IFRS 15.[3] Consequently, the Board tentatively decided that all regulatory income/ (regulatory expense) should be presented in a line item immediately below the revenue line items presented by applying IAS 1 (paragraph 2). This tentative decision is consistent with the principle of providing information about future rate(s) that supplements information provided about revenue recognised by applying IFRS 15.

12. Proponents of Approach 2 highlight that the net amount of regulatory income/ (regulatory expense) reported immediately below revenue includes amounts related to expenses or income reported in different parts of the statement of profit or loss, including the taxation line item. Consequently, there is no compelling reason to treat differently regulatory income/ (regulatory expense) that results from expense or income presented in OCI.

[2] See paragraph 7.16-7.17 of the *Conceptual Framework for Financial Reporting*.
[3] See paragraph 22 Agenda Paper 9A.

13. In addition, proponents of Approach 2 point out that, in some cases, the expense to be presented through OCI in the current period may be included in determining the rate(s) charged to customers in the same period. In such cases, the same amount is included in the total allowed compensation presented within the IFRS 15 revenue line item in profit or loss, even though the expense is presented in OCI. Approach 2 results in a similar split between profit or loss and OCI if the amount involved will be included in future rate(s).

Staff's analysis

14. The two approaches focus on different principles for presentation:

    (a) **Principle 1**: when an entity has a right to recover an expense, or has an obligation to pass through income, in determining the future rate(s) to charge customers, and that expense or income is presented in OCI, the income resulting from the right to recover that expense, or the expense resulting from the obligation to pass through that income, should also be presented in OCI.

    (b) **Principle 2**: all regulatory income/ (regulatory expense) should be presented immediately below revenue.

15. Approach 1 prioritises Principle 1 above Principle 2; Approach 2 prioritises Principle 2 above Principle 1. Staff consider both principles are valid and both approaches have merit.

16. Approach 2 would be less complex for preparers to apply because it does not require any analysis or calculation in order to disaggregate amounts of regulatory income/ (regulatory expense) relating to OCI items and other amounts.

17. However, we consider that Approach 1 gives users of financial statements clearer and more understandable information, without imposing costs on preparers that exceed the benefits. Indeed, a requirement to disaggregate in a similar way to Approach 2 was introduced into IFRS 14 *Regulatory Deferral Accounts* in response to comments made by respondents, including preparers, to the Exposure Draft for that Standard published in April 2013. At that time, the Board was persuaded by those respondents who stated

that the proposal to recognise all net movements in regulatory deferral account balances in a single line item in profit or loss could be confusing or misleading when a material portion of the movement related to items that are presented in other comprehensive income.[4]

18. Consequently, we recommend that an entity should present:

    (a) in other comprehensive income (OCI) all regulatory income/ (regulatory expense) related to items of expense or income presented in OCI, and present it immediately above or immediately below the related expense or income; and

    (b) in profit or loss all other regulatory income/ (regulatory expense), immediately below the line item(s) for revenue.

19. As a result of this approach, if the expense or income presented in OCI in accordance with other IFRS Standards is subsequently reclassified to profit or loss, the related regulatory income/ (regulatory expense) would also be reclassified.

Question for the Board

Presentation
1. Does the Board agree with the staff recommendation in paragraph 18 that an entity should present: (a) in other comprehensive income (OCI) all regulatory income/ (regulatory expense) related to items of expense or income presented in OCI, and present it immediately above or immediately below the related expense or income; and (b) in profit or loss all other regulatory income/ (regulatory expense), immediately below the line item(s) for revenue.

[4] See paragraph BC59(c) of the Basis for Conclusions on IFRS 14 *Regulatory Deferral Accounts*.

Disclosure

20. In November 2018, the Board made a number of tentative decisions with respect to the disclosure requirements of the model. These are summarised within Agenda Paper 9G. As noted in paragraph 60 of Agenda paper 9A, we have not identified a need for the Board to change its tentative decisions made to date about disclosure requirements. We have, though, identified that as a result of the refinement of the description of the model, some minor editorial amendments may be needed in drafting the proposals for public consultation; for example, the disclosure objectives contain the phrase ‘regulatory timing differences’, which we have now moved away from to be more specific that the model focuses on effects of the incremental rights and obligations arising from those timing differences.

21. In addition, the further development of the model, in particular the proposals for measurement, have raised some questions about the level of granularity of the proposed disclosures for regulatory interest or regulatory return. Consequently, we provide further analysis and a recommendation for additional disclosure as follows.

Disclosure of regulatory interest or regulatory return

22. In November 2018, the Board tentatively decided to require the following disclosures:

    (a) a breakdown of the regulatory income/ (regulatory expense) line item in profit or loss and that this breakdown should include a number of specified components (eg originations of regulatory assets / liabilities, recovery of regulatory assets / fulfilment of regulatory liabilities); and

    (b) a reconciliation of the opening and closing carrying amount of regulatory assets and liabilities, but the Board did not specify a list of required components to include in this reconciliation.

23. The interest or return earned by an entity on items in the regulatory capital base (RCB) forms part of the total allowed compensation the entity becomes entitled to for goods or services supplied during the period. However, when a timing difference gives rise to a regulatory asset (or liability), the interest or return given on the regulatory asset is of a different nature than the other components of the total allowed

compensation (eg costs incurred, margins, bonuses/penalties, etc.) included in the initial measurement of that regulatory asset. The interest or return given on a regulatory asset provides compensation for the delayed recovery of the total allowed compensation *after* the supply of goods or services. Consequently, the interest or return on the regulatory asset accrues with the passage of time and is recognised over time, rather than being recognised immediately as a result of the supply of goods or services during the period.

24. If the interest or return is accrued and included in the rate(s) charged to customers in the same pattern and in the same period, then no further timing difference arises. If, however, the interest or return accrues in an earlier period than the period in which it is included in the rate(s) charged to customers, it may be unclear whether the interest accrued should be disclosed as an origination of a separate regulatory asset or regulatory liability, or merely as an addition to the existing regulatory asset or regulatory liability to which it relates.

25. The existing tentative decision does not specifically require the separate disclosure of the interest or return component and therefore, in the absence of explicit guidance diversity in practice could arise.

26. Because the interest or return accrues with the passage of time on the outstanding balance of the regulatory asset or regulatory liability, it does not represent the 'origination' of a new timing difference (ie a separate regulatory asset or regulatory liability). The origination of a regulatory asset or regulatory liability arises when the total allowed compensation for goods or services supplied exceeds, or is lower than, the amount already charged to customers through the rate(s). Consequently, the interest or return accrued on the regulatory asset or regulatory liability has a different nature than the other components of total allowed compensation and, therefore, disclosing it separately provides additional relevant information to users of financial statements.

27. Thus, the staff are asking the Board to prescribe that any interest or return accrued on regulatory assets or regulatory liabilities be disclosed as a separate caption in the breakdown of regulatory income/ (regulatory expense) or in the reconciliation of opening/ closing balances, and not be combined with the originations caption or the recovery or fulfilment captions.

28. For the avoidance of doubt, we are not proposing to change the Board's tentative decision that the regulatory interest is part of the regulatory income / (regulatory expense) line item and is not, therefore, presented as part of financing activities.

29. The two potential levels of granularity considered by staff are illustrated below:

Example 4

Assume the same fact pattern as Example 2 in Agenda Paper 9D (ie interest accrues at 6.43% on an initial regulatory asset balance of CU100).

Option 1

If interest accrued is not disclosed separately, the reconciliation of the regulatory asset from the beginning of the period until the end would look as follows:

Year	X0	X1	X2	X3	X4
Opening balance	-	100.00	106.43	69.95	34.45
Origination of reg. asset	100.00	6.43	-	-	-
Recovery of reg. asset	-	-	(36.49)	(35.50)	(34.45)
Closing balance	**100.00**	**106.43**	**69.95**	**34.45**	**(0.00)**

As noted above, the disclosure of the CU6.43 interest accrued in X1 as an origination could result in confusion. Furthermore, the 'recovery of regulatory asset' figures for years X2-X4 are condensed and include the regulatory interest accrued for those years at the implicit rate—this has less information value, as the figure does not depict the actual recovery for the period (ie the amount included in the rate(s) charged to customers).

Option 2

If interest accrued is presented separately, the reconciliation of the regulatory asset from the beginning of the period until the end would look as follows:

Year	X0	X1	X2	X3	X4
Opening balance	-	100.00	106.43	69.95	34.45
Origination of reg. asset	100.00	-	-	-	-
Regulatory interest	-	6.43	6.85	4.50	2.22
Recovery of reg. asset	-	-	(43.33)	(40.00)	(36.67)
Closing baalnce	**100.00**	**106.43**	**69.95**	**34.45**	**(0.00)**

In this format, regulatory interest accrued is disclosed as a separate caption, and thus is not comingled with the origination and recovery captions; that is:

(a) origination depicts only differences between the amounts billed to customers during a period for goods or services supplied and the total allowed compensation for those goods or services (but not total allowed compensation earned as a result of the passage of time); and

(b)	recovery depicts solely amounts included in the rate(s) for the period (ie cash inflows) to recover the balance of the regulatory asset together with interest that has arisen in the period.

30. We have considered the cost to preparers of requiring this separate disclosure. We expect the benefit to users of financial statements of the additional information to outweigh the costs to preparers because entities commonly disclose interest amounts separately from the amounts on which the interest accrues for other types of assets and liabilities.

Question for the Board

Disclosure of regulatory interest or regulatory return
2. Does the Board agree with the staff's recommendation to require an entity to disclose any regulatory interest or regulatory return accrued on regulatory assets or regulatory liabilities as a separate caption in: (a) the breakdown of regulatory income / (regulatory expense) for the period; or (b) the reconciliation of the carrying amount of regulatory assets and of regulatory liabilities from the beginning to the end of the period.