

STAFF PAPER

September 2020

IASB[®] meeting

Project	Rate-regulated Activities		
Paper topic	Sweep issues		
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Purpose of this paper

1. This paper discusses the following sweep issues that have arisen in drafting an exposure draft on regulatory assets and regulatory liabilities:
 - (a) definitions of a regulatory asset and a regulatory liability (paragraphs 4–26);
 - (b) regulatory returns on assets not yet available for use (paragraphs 27–29);
 - (c) effective date (paragraphs 30–31); and
 - (d) comment period (paragraphs 32–36).
2. The exposure draft is expected to be published in Q4 2020.

Summary of staff recommendations

3. The staff recommend:
 - (a) defining:
 - (i) 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

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services already supplied will be included in revenue in the future;

- (ii) 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;
- (b) that the regulatory return on a balance relating to an asset not yet available for use forms part of the total allowed compensation for goods or services supplied once the asset is available for use and over the remaining periods in which an entity recovers the carrying amount of the asset through the regulated rates. The entity should use a reasonable and consistent basis in determining how to allocate the return on that balance over those remaining periods;
- (c) that entities should apply the final Standard for annual reporting periods beginning on or after a date 18–24 months from the date of its publication; and
- (d) to extend the comment period of Exposure Draft *Regulatory Assets and Regulatory Liabilities* from 120 days to 180 days.

Definitions of a regulatory asset and a regulatory liability

- 4. At its June 2019 meeting, the Board tentatively decided to define:
 - (a) a regulatory asset as a present right to add an amount to the rate(s) to be charged to customers in future periods because the total allowed compensation for the goods or services already supplied exceeds the amount already charged to customers; and

- (b) a regulatory liability as a present obligation to deduct an amount from the rate(s) to be charged to customers in future periods because the total allowed compensation for the goods or services already supplied is lower than the amount already charged to customers.
5. In the pre-ballot draft of the Exposure Draft, the staff considered a few minor edits to the definitions in paragraph 4 for further clarity. The following definitions were included in the pre-ballot draft of the Exposure Draft:
- (a) a regulatory asset is ~~a~~ an enforceable present right, created by a regulatory agreement, to add an amount ~~to the rate(s) in determining a regulated rate~~ to be charged to customers in future periods because the total allowed compensation for ~~the~~ goods or services already supplied exceeds the amount already charged to customers.
 - (b) a regulatory liability is ~~a~~ an enforceable present obligation, created by a regulatory agreement, to deduct an amount ~~from the rate(s) in determining a regulated rate~~ to be charged to customers in future periods because the total allowed compensation for ~~the~~ goods or services already supplied is lower than the amount already charged to customers.
6. When drafting the Exposure Draft using the definitions in paragraph 5, the staff encountered problems in explaining:
- (a) the effects of using the phrase ‘amounts already charged to customers’; and
 - (b) how a regulatory liability arises.

Difficulty in explaining the effects of using ‘amounts already charged to customers’

7. When drafting the Exposure Draft, the staff was aware that the phrase ‘amounts already charged to customers’ in the definitions of regulatory asset and regulatory liability in paragraph 5 could create some confusion by appearing to result in double counting. An entity might conclude that it needs to recognise:

- (a) both a regulatory asset and (by applying IFRS 15) a contract asset of equal amounts if the entity supplied goods or services (satisfied the performance obligation) but has not yet invoiced the customers; and
 - (b) both a regulatory liability and (by applying IFRS 15) a contract liability of equal amounts if the entity invoiced an amount to its customers but has not yet satisfied the performance obligation.
8. For example, assume that Entity A:
- (a) is entitled to total allowed compensation of CU1,000 for the goods or services supplied to customers in 20X1;
 - (b) invoiced customers CU1,015 during 20X1, of which CU25 relates to goods or services to be supplied (performance obligations to be satisfied) in 20X2;
 - (c) is yet to invoice customers CU10 for goods or services supplied (performance obligations satisfied) in 20X1; and
 - (d) recognised revenue of CU1,000 for 20X1 applying IFRS 15.
9. Entity A recognises a contract liability of CU25 and a contract asset/receivable of CU10 at the end of 20X1 by applying IFRS 15. Applying the definitions in paragraph 5, Entity A might have compared the total allowed compensation of CU1,000 for goods or services supplied in 20X1 with the amount of CU1,015 invoiced to customers and concluded that it has a regulatory liability of CU15, when in fact, Entity A should have observed that the total allowed compensation of CU1,000 for goods or services supplied in 20X1 has been fully reflected in revenue and concluded that it has no regulatory asset or regulatory liability at the end of 20X1.
10. In paragraph 11 of the pre-ballot draft, the staff attempted to clarify that the double counting discussed above was not intended. That paragraph stated:
- If an entity satisfies its performance obligations to customers earlier or later than when it charges customers at the regulated rate and the resulting asset or liability is a contract asset or contract liability (IFRS 15), that asset or liability is not a regulatory asset or regulatory liability.

11. At the time of the pre-ballot, the staff were aware that it might not be entirely satisfactory to use paragraph 11 of the pre-ballot draft to eliminate concerns about double counting, instead of resolving this question more directly in the definitions themselves. The feedback we received from Board members and external reviewers confirmed the staff's concerns. As a result, the updated draft of the definitions refers to revenue recognised rather than to amounts charged to customers.
12. When assessing the effect of this change, it is important to remember that the pre-ballot draft did in fact rely on comparing total allowed compensation with revenue. But it did this indirectly and in two stages. The first stage was to refer in the formal definitions to amounts charged to customers. The second stage was to use paragraph 11 of the pre-ballot draft to, in effect, over-ride that aspect of the definitions and substitute a reference to revenue. Thus, this aspect of the redrafting merely moves the reference to revenue from paragraph 11 of the pre-ballot draft up into the definitions themselves and makes that paragraph redundant. In the staff's view, this change makes the definitions, and the rest of the draft Exposure Draft, clearer and more understandable. It does not change the outcomes.
13. The staff think that referring to 'revenue already recognised' would work because of how the concepts of regulated rates, total allowed compensation and revenue are interrelated, as explained in paragraphs 14–17.
14. A regulated rate is 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 or services.
15. Total allowed compensation for goods or services supplied is the full amount of compensation for those goods or services that a regulatory agreement entitles an entity to charge customers through the regulated rates in either the period when the entity supplies those goods or services, or a different period.
16. The amount of revenue an entity recognises in a period applying IFRS 15 depends on regulated rates for goods or services the entity supplies in the period. That amount of revenue typically equals the total allowed compensation for the goods or services

supplied in the period if the regulatory agreement includes all of that total allowed compensation in determining the regulated rates for goods or services supplied in that same period.

17. The amount of revenue the entity recognises in a period differs from the total allowed compensation for the goods or services the entity supplies in that period if differences in timing arise because the regulatory agreement includes part of that total allowed compensation in determining the regulated rates for goods or services supplied in a different period (past or future). Those differences in timing are captured by the accounting for regulatory assets and regulatory liabilities.

Difficulty in explaining how a regulatory liability arises

18. To apply the definitions in paragraph 5, an entity would compare the following two amounts:
 - (a) the total allowed compensation for goods or services already supplied; and
 - (b) the amounts already charged to customers.
19. A regulatory liability is an obligation to reduce future regulated rates for goods or services to be supplied **in the future**. Therefore, it is confusing to word the definition by reference to total allowed compensation for goods or services **already** supplied. Indeed, if the goods or services have not yet been supplied, the total allowed compensation for those goods or services must always be nil.
20. To remove that confusion, the staff’s proposed definition focuses on the facts that:
 - (a) an amount has already been included in regulated rates charged to customer—and hence in revenue already recognised; and
 - (b) that amount will provide part of the total allowed compensation for goods or services to be supplied in the future.
21. Amending the definition of a regulatory liability in this way permits a close parallel with the definition of a regulatory asset. Both definitions focus firstly on the past

event and secondly on the future consequence of that event, as illustrated in the following table.

	Right or obligation	Past event	Future consequence
Regulatory asset	right to add an amount in determining a future regulated rate	goods or services have already been supplied	part of the total allowed compensation for the goods or services already supplied will be included in revenue in the future
Regulatory liability	obligation to deduct an amount in determining a future regulated rate	revenue has already been recognised	that revenue will provide part of the total allowed compensation for goods or services to be supplied in the future

Other change to the definitions

22. The definitions in the pre-ballot focused on computing and comparing the amounts of total allowed compensation for goods or services and the amounts already charged to customers. In reviewing feedback on the pre-ballot draft, the staff became aware that setting up the definitions in this way as an arithmetical calculation causes considerable and unnecessary complexity in the drafting.
23. The staff realised that these complexities could be avoided by removing the references to this arithmetical calculation. Thus, the revised draft of the definitions focuses on:
 - (a) an amount of total allowed compensation that will not be included in revenue until the future (regulatory asset).

(b) an amount included in revenue already recognised that will provide part of the total allowed compensation for the future (regulatory liability).

24. This change would not change any outcomes and it would not require entities to perform any more work or any less work.

Staff conclusion on definitions

25. The staff have tested the revised definitions extensively against the library of examples they have considered during the project and have confirmed that the revision does not change the outcomes of applying the definitions. In the staff’s view, the revised definitions are clearer, cleaner and easier to understand. Also, they would not require entities to perform any more work or any less work.

26. On the basis of the discussion in paragraphs 4–25, the staff recommend that the Board define:

(a) 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; and

(b) 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.

Question 1

Does the Board agree with the staff recommendation in paragraph 26?

Regulatory returns on assets not yet available for use

27. In March 2020, the Board tentatively decided that regulatory returns on an asset not yet available for use (ie a construction work-in-progress base) included in the regulated rates charged to customers during the construction period forms part of the total allowed compensation for goods or services to be supplied once that asset becomes available for use.¹
28. However when drafting the Exposure Draft, the staff observed that there is likely to be a follow-on question—will that regulatory return form part of the total allowed compensation for the goods or services supplied over the useful life of that asset or over a different period. Agenda Paper 9A analyses that question and explains the basis for the staff’s recommendation.
29. On the basis of that analysis, the staff recommend that:
- (a) the return on a balance relating to an asset not yet available for use forms part of the total allowed compensation for goods or services supplied once the asset is available for use and over the remaining periods in which the entity recovers the carrying amount of the asset through the regulated rates; and
 - (b) the entity should use a reasonable and consistent basis in determining how to allocate the return on that balance over the period specified in subparagraph (a).

¹ The *IASB Update* for the March 2020 Board meeting stated ‘regulatory returns on a construction work-in-progress base included in the regulated rates charged to customers during the construction period form part of total allowed compensation only during the period when the asset is in operation and is being used to supply good or services’. After the draft Exposure Draft, the staff has refined drafting and aligned it more to IAS 16 *Property, Plant and Equipment*. Hence the expression ‘asset not yet available for use’.

Question 2

Does the Board agree with the staff recommendation in paragraph 29?

Effective date

- 30. Paragraph 6.35 of the *Due Process Handbook* requires the mandatory effective date to be set so that jurisdictions have sufficient time to incorporate the new requirements into their legal systems and those applying the Standards have sufficient time to prepare for the new requirements.
- 31. To a large extent, the proposed model would use information that preparers are already expected to gather and process in determining regulated rates. The staff expects that a period of 18–24 months would allow sufficient time for entities to make necessary updates to their systems, collect the incremental information needed to apply the proposals, and make any other changes necessary. Consequently, the staff recommend an implementation period of 18–24 months, which is largely aligned with decisions made by the Board for other Standards.

Question 3

Does the Board agree with the staff recommendation that entities should apply the final Standard for annual reporting periods beginning on or after a date 18–24 months from the date of its publication?

Comment period

- 32. At its July 2019 meeting, the Board tentatively decided to set a comment period of 120 days for the Exposure Draft.
- 33. At the supplementary meeting in April 2020, the staff informed the Board that, closer to the publication of the Exposure Draft, the staff would assess whether issues arising

from covid-19 continue to affect our stakeholders, and whether the comment period should be extended to 180 days.

34. At the April 2020 meeting, the Board was informed that the expected publication date for the Exposure Draft was October 2020. However, because additional time has been needed to address comments on the draft Exposure Draft to improve clarity, the expected publication date of the Exposure Draft is now December 2020.
35. The new timeline would make a 120-day comment period overlap with the December holiday season and the annual financial reporting season for companies with a calendar year-end. The staff expect that a longer comment period would provide stakeholders with more time to provide the Board with high-quality feedback, and give stakeholders more time to manage the effects and constraints, if any, of covid-19 on financial reporting priorities and annual financial reporting timelines.
36. Therefore, the staff recommend that the Board extend the comment period from 120 days to 180 days. Assuming publication in December 2020, a 180-day comment period would end in June 2021.

Question 4

Does the Board agree with the staff recommendation to extend the comment period of the Exposure Draft *Regulatory Assets and Regulatory Liabilities* from 120 days to 180 days?