Staff paper

Agenda reference: 9A

IASB® meeting

Date	**December 2023**
Project	**Rate-regulated Activities**
Topic	**Unit of account and offsetting**
Contacts	Davina Tam (davina.tam@ifrs.org) Mariela Isern (misern@ifrs.org)

Objective

1. This paper sets out staff analysis and recommendations on the proposals on the unit of account and on offsetting of regulatory assets and regulatory liabilities for presentation purposes in the Exposure Draft *Regulatory Assets and Regulatory Liabilities* (Exposure Draft).

Staff recommendation

2. We recommend that the final Accounting Standard:

   (a) clarify that the unit of account is the right or obligation arising from a difference in timing or from a group of differences in timing when the differences in timing included in that group are created by the same regulatory agreement, have similar expiry patterns and are subject to similar risks; and

   (b) exclude the proposal on permitting an entity to offset regulatory assets and regulatory liabilities for presentation purposes in paragraph 71 of the Exposure Draft.

Structure of the paper

3. This paper is structured as follows:

   (a) proposals in the Exposure Draft (paragraphs 4–11);

   (b) feedback (paragraphs 12–14);

   (c) staff analysis (paragraphs 15–33):

      (i) proposal on the unit of account (paragraphs 16–22); and

      (ii) interaction with other proposed requirements (paragraphs 23–33).

Proposals in the Exposure Draft

4. Paragraph 24 of the Exposure Draft states:

> An entity shall account for the right or obligation arising from each individual difference in timing described in paragraph 12(a) as a separate unit of account. However, if rights, obligations, or rights and obligations arising from the same regulatory agreement have similar expiry patterns and are subject to similar risks, they may be treated as arising from the same individual difference in timing.

5. Paragraphs BC114–BC118 of the Basis for Conclusions accompanying the Exposure Draft explain the IASB considered several possible units of account:

   (a) the entire package of rights and obligations created by the regulatory agreement;[1]

   (b) the net of all rights and obligations arising from differences in timing; and

   (c) each right or obligation arising from an individual difference in timing.

6. The IASB concluded that using *the right or obligation* arising from *an individual difference in timing* as the unit of account:

[1] The IASB rejected this unit of account for the reasons given in paragraphs BC69–BC70 of the Basis for Conclusions accompanying the Exposure Draft.

(a) was feasible at a reasonable cost; and

(b) would provide more useful information about the expected timing and pattern of recovery or fulfilment of that right or obligation than treating the net of all incremental rights and obligations arising from all differences in timing as a single unit of account.[2]

7. The IASB also concluded that if rights, obligations, or rights and obligations arising from the same regulatory agreement have similar expiry patterns and are subject to similar risks, grouping these rights and obligations would provide information that is as relevant as the information provided by treating each right or obligation as a separate unit of account. This is because these rights and obligations are likely to have similar implications for an entity's prospects for future cash flows.[3]

8. The IASB noted that the unit of account determined by applying paragraph 24 of the Exposure Draft would not necessarily determine how best to predict uncertain cash flows by applying either the most likely amount method or the expected value method, as proposed by paragraph 39 of the Exposure Draft.[4] Consequently, the IASB developed paragraph 40 of the Exposure Draft (emphasis added):

> In assessing which of the methods described in paragraph 39 better predict 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.

9. Paragraphs BC119–BC120 of the Basis for Conclusions accompanying the Exposure Draft explain that when, for example, a source of uncertainty affects more than one unit of account in the same period in a similar manner, a better prediction of uncertain cash flows may result from considering together all units of account that are affected by the same source of uncertainty.

[2] Paragraph BC117 of the Basis for Conclusions accompanying the Exposure Draft.
[3] Paragraph BC118 of the Basis for Conclusions accompanying the Exposure Draft.
[4] Paragraph BC119 of the Basis for Conclusions accompanying the Exposure Draft.

10. The proposal on the unit of account has also interactions with paragraph 71 of the Exposure Draft, which deals with offsetting of regulatory assets and regulatory liabilities for presentation purposes. Paragraph 71 of the Exposure Draft states:

> An entity is permitted to offset regulatory assets and regulatory liabilities that form separate units of account only if the entity:
>
> (a) has a legally enforceable right to offset those regulatory assets and regulatory liabilities by including them in the same regulated rate; and
>
> (b) expects to include the amounts resulting from the recovery or fulfilment of those regulatory assets and regulatory liabilities in the same regulated rate for goods or services supplied in the same future period.

11. The IASB proposed to permit, but not require, offsetting of regulatory assets and regulatory liabilities for presentation purposes to limit the costs that preparers may need to incur in assessing whether the specified conditions in paragraph 71(a) and (b) are met.[5]

Feedback

12. A few respondents, mainly preparers and national standard-setters:

    (a) asked how paragraph 24 of the Exposure Draft would be applied to some regulatory accounts that include items that are subject to different risks, however are netted and recovered over the same period in accordance with specific regulatory mechanisms.

    (b) asked the IASB to provide more guidance to help entities apply the proposal on the unit of account. Some of these respondents questioned the interaction between:

        (i) the unit of account proposal (that the unit of account is the right or obligation arising from each individual difference in timing); and

[5] Paragraph BC121 of the Basis for Conclusions accompanying the Exposure Draft.

(ii) the proposal in paragraph 40 of the Exposure Draft to consider whether a better prediction of the cash flows would result from considering units of account separately or from considering any of them together.

According to these respondents, the fact that an entity may consider a group of regulatory assets or regulatory liabilities as the unit of account for measurement purposes appears to contradict the requirement to account for the right or obligation arising from each individual difference in timing as a separate unit of account.

(c) expressed concerns about the interaction between the proposed unit of account and other proposals in the Exposure Draft—mainly regulatory returns on an asset not yet available for use and the accounting for regulatory assets and regulatory liabilities arising from differences between the regulatory recovery period and the assets' useful lives. These respondents said the IASB's proposal may be onerous to apply in practice because an entity may need more granular information than that currently used in setting regulated rates.

13. With regards to the offsetting proposal in paragraph 71 of the Exposure Draft, a national standard-setter said it is unclear how the proposed conditions for offsetting regulatory assets and regulatory liabilities would interact with the proposal on the unit of account in paragraph 24 of the Exposure Draft.

14. In addition, a few other respondents who commented on the offsetting proposal suggested the IASB:

(a) *permit* offsetting based on only the first proposed condition (that is, an entity has a legally enforceable right to offset regulatory assets and regulatory liabilities by including them in the same regulated rate); or

(b) *permit* offsetting based on conditions similar to those specified in IAS 12 *Income Taxes* or IAS 32 *Financial Instruments: Presentation*.

Staff analysis

15. This section is structured as follows:

    (a) proposal on the unit of account (paragraphs 16–22); and

    (b) interaction with other proposed requirements (paragraphs 23–33).

Proposal on the unit of account

16. As mentioned in paragraph 12(a), a few respondents said that some regulatory agreements determine adjustments to the regulated rate on a more aggregated basis than the unit of account proposed by the Exposure Draft (an *individual difference in timing*).

17. For example, a preparer in Europe described a regulatory account that includes differences in timing relating to differences between expected and actual amounts for items of varying nature such as expenditures, revenues and non-controllable costs (for example, differences between expected and actual pension contributions paid). This regulatory account is calculated at the end of a given financial year. Once the regulator approves the balance of the regulatory account for a given financial year, the individual items included in that balance are no longer tracked separately. That balance would then be recovered or fulfilled in future regulated rates in accordance with the terms specified in the regulatory agreement. In this case, the question raised by the respondent is whether the entire regulatory account balance could be considered as the unit of account for accounting purposes.

18. When developing the Exposure Draft the IASB understood that:[6]

> […] entities typically **track separately the effects of each of the individual differences in timing**, so that they can identify the inputs needed to determine the regulated rates. The Board noted that:
>
> (a) entities typically assess each individual difference in timing **separately and can identify the separate effect of each**

[6] Paragraph BC116 of the Basis for Conclusions accompanying the Exposure Draft.

difference on future regulated rates and cash flows, though possibly with some interdependency in determining the overall regulated rate; and

(b) individual differences in timing and their subsequent effects on cash flows often expire in different patterns.

19. The feedback from respondents however means that entities would only track differences in timing using the same level of aggregation the regulator has used for determining an adjustment to the future regulated rates. Requiring entities to consider differences in timing at a more granular level than that used by the regulator would give rise to costs (for example, cost of tracking individual differences in timing) that may outweigh any benefits.

20. However, as mentioned in paragraph 7, the Exposure Draft also proposes that an entity may treat a group of rights, obligations or rights and obligations as arising from an individual difference in timing if those rights, obligations, or rights and obligations arise from the same regulatory agreement, have *similar* expiry patterns and are subject to *similar* risks.

21. When a regulatory agreement groups differences in timing and considers them to be a single adjustment to the future regulated rate (paragraph 17), those differences in timing would have the *same* expiry pattern and be subject to the *same* risks. This would be an example of a right or obligation arising from a group of differences in timing. We think paragraph 24 of the Exposure Draft would capture this example, but that paragraph could be redrafted for greater clarity and the final Standard could include such an example.

22. Consequently, we recommend that the final Accounting Standard clarify the unit of account is the right or obligation arising from a difference in timing or from a group of differences in timing when the differences in timing included in that group are created by the same regulatory agreement, have similar expiry patterns and are subject to similar risks.

Question for the IASB
1. Does the IASB agree with the staff recommendation in paragraph 22?

Interaction with other proposed requirements

23. As mentioned in paragraph 12(b), a few respondents asked the IASB to clarify how paragraph 24 of the Exposure Draft interacts with paragraph 40 of the Exposure Draft—that is the requirement for an entity to assess whether a better prediction of uncertain cash flows would 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. These respondents thought these paragraphs in the Exposure Draft were contradictory.

24. Paragraph 40 of the Exposure Draft would allow an entity to consider regulatory assets and regulatory liabilities together if that resulted in a better prediction of the cash flows. Paragraph BC120 of the Basis for Conclusions accompanying the Exposure Draft provides the rationale underlying this proposal:

> The outcome of an entity's decisions about whether and how to group rights, obligations or both in a single unit of account might not determine whether a better prediction of uncertain cash flows would result from considering units of account separately or from considering them together. If a single source of uncertainty affects more than one unit of account, a better prediction of uncertain cash flows may sometimes result from considering the overall effect of that single source of uncertainty on all cash flows affected by that uncertainty, regardless of whether they arise from the same unit of account. For example, credit risk or demand risk is likely to affect all cash flows resulting from recoveries or fulfilments of different units of account in the same period in a similar manner. In that case, a better prediction of uncertain cash flows may result from considering together all units of account affected by the same source of uncertainty.

25. We think the rationale in paragraph BC120 would allow an entity to measure an uncertainty affecting the cash flows of regulatory assets or regulatory liabilities considering the cash flows of those regulatory assets and regulatory liabilities as a

group if that uncertainty affects those cash flows in a similar manner and in the same period. This is because if a single source of uncertainty affects more than one unit of account, a better prediction of uncertain cash flows may result from considering the overall effect of that single source of uncertainty on all cash flows affected by that uncertainty.

26. We used the rationale in paragraph 25 when discussing credit risk in September 2023.[7] At that meeting the IASB tentatively decided that if an entity bears credit risk the entity:[8]

    (a) estimates uncollectible amounts considering the *net cash flows* that will arise from the recovery of regulatory assets and the fulfilment of regulatory liabilities; and

    (b) allocates the estimate of uncollectible amounts to regulatory assets only.

27. As discussed in September 2023, an entity would have to consider the net of all cash flows arising from regulatory assets and regulatory liabilities to estimate the uncollectible amounts because that source of uncertainty—credit risk—affects the amounts included in regulated rates charged to customers. Those amounts consist of the net cash flows that arise from the recovery of regulatory assets and the fulfilment of regulatory liabilities. If the entity only considered cash flows arising from regulatory assets, the entity would be overstating the effects of credit risk in their measurement.

28. We think the drafting of paragraph 40 in the Exposure Draft can be improved to align it to paragraph BC120 in the Basis for Conclusions accompanying the Exposure Draft and to the tentative decision made by the IASB in September 2023.

29. The Exposure Draft also proposed to permit an entity to offset regulatory assets and regulatory liabilities for presentation purposes only if the entity:

[7] Agenda Paper 9A discussed at the September 2023 IASB meeting.
[8] IASB Update for September 2023 can be accessed here.

(a) has a legally enforceable right to offset those regulatory assets and regulatory liabilities by including them in the same regulated rate; and

(b) expects to include the amounts resulting from the recovery or fulfilment of those regulatory assets and regulatory liabilities in the same regulated rate for goods or services supplied in the same future period.

30. As mentioned in paragraph 13, a respondent questioned how the offsetting requirement in paragraph 71 of the Exposure Draft would interact with the proposal on the unit of account. The proposal on the unit of account considers *similar* expiry patterns and the proposal on offsetting considers *same* timing of recovery or fulfilment (**emphasis added**):

> 24 […] However, if rights, obligations, or rights and obligations arising from the same regulatory agreement have **similar expiry patterns** and are subject to similar risks, they may be treated as arising from the same individual difference in timing.
>
> 71 An entity is permitted to offset regulatory assets and regulatory liabilities that form separate units of account only if the entity:
>
> (a) has a legally enforceable right to offset those regulatory assets and regulatory liabilities by including them in the same regulated rate; and
>
> (b) expects to include the amounts resulting from **the recovery or fulfilment** of those regulatory assets and regulatory **liabilities in the same regulated rate** for goods or services supplied **in the same future period.**

31. We note that a regulator may decide that some differences in timing should be netted and treated as a single adjustment when determining the regulated rate for a future period (paragraph 17). We think that the proposed offsetting requirement for presentation purposes may be redundant in the context of a regulatory agreement because a regulator would have already decided about ‘offsetting’—that is, whether differences in timing should be recovered or fulfilled together by being considered as a single adjustment—when determining the future regulated rates. Therefore, we do

not think there would be many cases for which entities would be applying the proposed offsetting requirements for presentation purposes.

32. Furthermore, paragraph 32 of IAS 1 *Presentation of Financial Statements* prohibits offsetting of assets and liabilities or income and expenses, unless required or permitted by an IFRS Standard.[9] Consequently, even if paragraph 71 (which includes the conditions for offsetting) is removed, entities would be prohibited from inappropriately offsetting regulatory assets and regulatory liabilities. Therefore, we recommend that the final Accounting Standard exclude paragraph 71 from the Exposure Draft.

33. A few respondents also queried the interaction between the proposed unit of account and other proposals in the Exposure Draft—mainly regulatory returns on an asset not yet available for use and the accounting for regulatory assets and regulatory liabilities arising from differences between the regulatory recovery period and the assets' useful lives (paragraph 12(c)). Respondents raising these concerns were respondents subject to incentive-based schemes. We think that the IASB's tentative decisions on these matters have addressed the concerns on the unit of account raised by these respondents.[10]

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

[9] Paragraph 32 of IAS 1 will be carried forward into the prospective [draft] IFRS 18 *Presentation and Disclosure in Financial Statements*.

[10] Agenda Papers 9B and 9C discussed by the IASB at its meeting in July 2022 and Agenda Paper 9B discussed in October 2022.