Staff paper

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IASB® Meeting

Date	**February 2024**
Project	**Rate-regulated Activities**
Topic	**New disclosures**
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Objective

1. This paper sets out the staff analysis and recommendations on new disclosure requirements arising from the IASB's redeliberations on the Exposure Draft *Regulatory Assets and Regulatory Liabilities* (Exposure Draft).

2. Agenda Paper 9C sets out the staff analysis and recommendations on the disclosure requirements proposed in the Exposure Draft.

3. Agenda Paper 9E includes illustrative drafting of the disclosure requirements suggested in this paper and Agenda Paper 9C.

Staff recommendations

4. The staff recommend that the final Accounting Standard:

   (a) include a specific disclosure objective specifying that an entity should disclose information that enables users of financial statements to understand the relationship between the entity's regulatory capital base and its property, plant and equipment. That understanding would provide insights into the nature of the regulatory scheme, the effect of that scheme on the entity's financial position and financial performance and allow users to make comparisons between entities subject to different types of regulatory schemes.

(b) to achieve the specific disclosure objective in (a), require an entity to disclose:

  (i) whether there is a direct (no direct) relationship between its regulatory capital base and its property, plant and equipment; and

  (ii) the main reasons why it has concluded that its regulatory capital base has a direct (no direct) relationship with its property, plant and equipment.

(c) not require an entity to disclose the amount of its regulatory capital base.

(d) require an entity to disclose the nature of unrecognised regulatory assets and unrecognised regulatory liabilities, the reasons why there is uncertainty about their existence and, when practicable, an estimate of the amount unrecognised.

(e) require an entity whose regulatory capital base has no direct relationship with its property, plant and equipment to disclose information:

  (i) that allows users to understand differences between the recovery period of the regulatory capital base and the assets' useful lives, including a description of the main factors considered in determining the regulatory recovery period that are not considered in the determination of the assets' useful lives; and

  (ii) about whether the recovery period of the regulatory capital base has changed during the period and, if so, the main reasons for that change.

(f) require an entity whose regulatory capital base has no direct relationship with its property, plant and equipment to disclose information about the nature of any unrecognised regulatory assets or unrecognised regulatory liabilities that arise when the regulator requires the entity to add (deduct) allowable expenses or performance incentives to (from) its regulatory capital base.

(g) require an entity to disclose the regulatory approach (nominal approach or real approach) used by the regulator to compensate it for inflation.

(h) not require an entity to disclose assumptions used in estimating uncertain future cash flows used in the measurement of regulatory assets or regulatory liabilities related to long-term performance incentives beyond those disclosures required by IAS 1 *Presentation of Financial Statements*.[1]

(i) require an entity whose regulatory capital base has a direct relationship with its property, plant and equipment and capitalises its borrowing costs to disclose qualitative information about:

   (i) whether it receives regulatory returns on an asset not yet available for use;

   (ii) whether those regulatory returns comprise both a debt and an equity return or only a debt return and whether those regulatory returns are included in regulated rates charged during the construction period or operational period of the asset; and

   (iii) the effect of those regulatory returns on changes in the related regulatory assets or regulatory liabilities.

Structure of the paper

5. This paper is structured as follows:

   (a) direct (no direct) relationship concept (paragraphs 6–20);

   (b) unrecognised regulatory assets and unrecognised regulatory liabilities (paragraphs 21–43);

   (c) long-term performance incentives (paragraphs 44–50); and

   (d) regulatory returns on an asset not yet available for use (paragraphs 51–56).

[1] Paragraphs 125–131 of IAS 1.

Direct (no direct) relationship concept

Background

6. When redeliberating the Exposure Draft proposals, the IASB tentatively decided to base some accounting requirements on whether there is a direct (no direct) relationship between an entity's regulatory capital base and its property, plant and equipment (the direct (no direct) relationship concept).

7. The IASB's tentative decisions that are based on the direct (no direct) relationship concept relate to:

   (a) differences between the regulatory recovery period and the assets' useful lives (paragraph 8); [2]

   (b) allowable expenses or performance incentives that a regulator includes in an entity's regulatory capital base (paragraph 9); [3] and

   (c) regulatory returns on an asset not yet available for use when an entity capitalises borrowing costs incurred to construct that asset (paragraphs 51–52).[4]

8. In relation to differences between the regulatory recovery period and an asset's useful life, the IASB tentatively decided to:

   (a) retain the proposals for an entity to recognise regulatory assets or regulatory liabilities arising from differences between the regulatory recovery period and an asset's useful life if the entity has concluded that its regulatory capital base and its property, plant and equipment have a direct relationship;

   (b) not retain the proposals for an entity to recognise regulatory assets or regulatory liabilities arising from differences between the regulatory recovery period and an asset's useful life if the entity has concluded that there is no

[2] Agenda Paper 9B discussed at the October 2022 IASB meeting.
[3] Agenda Paper 9C discussed at the December 2022 IASB meeting.
[4] Agenda Paper 9A discussed at the November 2022 IASB meeting.

direct relationship between its regulatory capital base and its property, plant and equipment. Instead, the entity would be required to provide disclosures to enable users of financial statements to understand the reasons for its conclusion.

9. In relation to allowable expenses and performance incentives, the IASB tentatively decided that:

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

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

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

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

Summary of feedback

10. The direct (no direct) relationship concept was introduced during redeliberations. Consequently, there were no disclosures about this concept proposed in the Exposure Draft.

11. However, the staff discussed with members of the Consultative Group for Rate Regulation (Consultative Group) what information should be required to be disclosed about the relationship between an entity's regulatory capital base and its property, plant and equipment.

12. Most members who commented suggested that an entity should be required to disclose:

    (a) whether its regulatory capital base and its property, plant and equipment have a direct (no direct) relationship.

    (b) information about the differences between an entity's regulatory capital base and its property, plant and equipment, if the entity concludes there is no direct relationship. However, members cautioned against requiring an entity to provide too much detail stating that, when there is no direct relationship, it would be difficult to provide detailed quantitative information about the differences.

13. Members, including a member who is a user of financial statements, said that this information would help users understand the nature of the rate regulation and how it affects the recognition of regulatory assets and regulatory liabilities.

14. The same user also said it would be helpful if an entity disclosed the reasons why there are differences between the recovery period of the regulatory capital base and the assets' useful lives.

15. Some Consultative Group members suggested that the final Standard should require an entity to disclose the amount of the regulatory capital base.

Staff analysis

16. We agree with the members of the Consultative Group that an entity should be required to disclose:

    (a) whether its regulatory capital base and its property, plant and equipment have a direct (no direct) relationship; and

    (b) the main reasons why it has concluded that its regulatory capital base has a direct (no direct) relationship with its property, plant and equipment.

17. This information would help users:

    (a) understand the different regulatory schemes to which entities are subject and the effect that those schemes have on the recognition of regulatory assets, regulatory liabilities, regulatory income and regulatory expense; and

    (b) compare the financial position and financial performance of entities that are subject to different types of regulatory schemes.

18. The *Guidance for developing and drafting disclosure requirements in IFRS Accounting Standards* requires that the IASB, when drafting disclosure requirements, link items of information that an entity is required to disclose with a specific disclosure objective.

19. We therefore recommend that the final Accounting Standard:

    (a) include a specific disclosure objective specifying that an entity should disclose information that enables users of financial statements to understand the relationship between the entity's regulatory capital base and its property, plant and equipment. That understanding would provide insights into the nature of the regulatory scheme, the effect of that scheme on the entity's financial position and financial performance and allow users to make comparisons between entities subject to different types of regulatory schemes.

    (b) to achieve the specific disclosure objective in (a), require an entity to disclose:

        (i) whether there is a direct (no direct) relationship between its regulatory capital base and its property, plant and equipment; and

        (ii) the main reasons why it has concluded that its regulatory capital base has a direct (no direct) relationship with its property, plant and equipment.

20. The proposed overall disclosure objective specifies that an entity should disclose information about regulatory income, regulatory expense, regulatory assets and regulatory liabilities (paragraph 72 of the Exposure Draft). We think a requirement for an entity to disclose its regulatory capital base is not necessary to meet the proposed

overall disclose objective. Also, we do not think this disclosure is needed to meet the objective of financial statements in paragraph 3.2 of the *Conceptual Framework for Financial Reporting* (*Conceptual Framework*) because an entity's regulatory capital base is not included in the financial statements. Consequently, we recommend the final Accounting Standard not require an entity to disclose the amount of its regulatory capital base.

Question for the IASB
1. Does the IASB agree with the staff recommendations in paragraphs 19 and 20?

Unrecognised regulatory assets and unrecognised regulatory liabilities

Background

21. The Exposure Draft proposed the recognition of all regulatory assets and regulatory liabilities existing at the end of the reporting period. If it is uncertain whether a regulatory asset or regulatory liability exists, the Exposure Draft proposed recognition if it is more likely than not that the regulatory asset or regulatory liability exists. Regulatory assets and regulatory liabilities that do not overcome that recognition threshold would remain unrecognised.

22. The IASB's tentative decisions during redeliberations mean that in some additional situations items that meet the definitions of regulatory assets and regulatory liabilities will not be recognised in the financial statements. These unrecognised regulatory assets and unrecognised regulatory liabilities may arise when:

    (a) there are differences between the recovery period of the regulatory capital base and the assets' useful lives and the entity's regulatory capital base has no direct relationship with its property, plant and equipment (paragraph 8);

(b) regulators require entities to add (deduct) allowable expenses or performance incentives to (from) their regulatory capital base and an entity's regulatory capital base has no direct relationship with its property, plant and equipment;[5] and

(c) regulators adjust the regulatory capital base for inflation—this applies to all entities regardless of the relationship between an entity's regulatory capital base with its property, plant and equipment.[6]

23. The IASB tentatively decided to prohibit the recognition of regulatory assets and regulatory liabilities in these situations because:

(a) assessing whether an entity has an enforceable present right or enforceable present obligation to add (deduct) these items in future regulated rates may be difficult in some cases;

(b) items in paragraph 22(a)—it would be impracticable or difficult and costly to identify the relationship between the regulatory capital base and an entity's property, plant and equipment at an asset level for a variety of reasons. For example, both the componentisation of the items included in the regulatory capital base and their level of aggregation differ from those of an entity's fixed asset register, the regulatory capital base may include forecasted amounts or it may be adjusted by inflation.

(c) items in paragraphs 22(b)–22(c)—it would be difficult and costly for entities to track the movement of these regulatory assets and regulatory liabilities. In addition, difficulties in tracking these regulatory assets and regulatory liabilities mean that there will be significant measurement uncertainty associated with these items. This measurement uncertainty reduces the usefulness of the information provided by recognition to users of financial statements.

[5] Agenda Paper 9C discussed at the December 2022 IASB meeting.
[6] Agenda Paper 9A discussed at the December 2022 IASB meeting.

Summary of feedback

24. Some respondents to the Exposure Draft provided feedback about disclosure of regulatory assets and regulatory liabilities that are unrecognised because they do not meet the threshold for recognition (paragraph 21):

    (a) a national standard-setter in Europe said that the overall disclosure objective should focus on both recognised and unrecognised regulatory assets and regulatory liabilities.

    (b) a national standard-setter from Asia-Oceania suggested the IASB clarify whether an entity should apply the disclosure requirements in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* for contingent assets and contingent liabilities to regulatory assets and regulatory liabilities that do not meet the recognition threshold and hence are not recognised.

25. The staff discussed with Consultative Group members, whether an entity should be required to disclose information about unrecognised regulatory assets and unrecognised regulatory liabilities, focussing on regulatory assets and regulatory liabilities that are unrecognised for the reasons described in paragraph 23.

26. Members expressed mixed views about the potential disclosure of information about unrecognised regulatory assets and unrecognised regulatory liabilities. One member, a user, said disclosure of some information about unrecognised regulatory assets and unrecognised regulatory liabilities would be useful in their analysis, for example disclosure of information about allowable expenses and performance incentives that are included in an entity's regulatory capital base and qualitative information about how these items will be recovered. One member questioned whether an entity would be able to disclose information about items that are not recognised because they are difficult to track in many cases. This member also expressed concern about the overall effect of such additional disclosures on the financial statements, given how much information the proposed disclosure requirements would already require.

27. No members supported requiring an entity to disclose information about unrecognised regulatory assets arising from an inflation adjustment to the regulatory capital base. Members expressed concerns about the difficulty of quantifying these regulatory assets and the potential for the costs of providing such information to exceed the benefits to users.

Staff analysis

28. Paragraph 5.11 of the *Conceptual Framework* states that even if an item meeting the definition of an asset or liability is not recognised, an entity may need to provide information about that item in the notes.

29. The staff analysis is structured as follows:

    (a) unrecognised regulatory assets and unrecognised regulatory liabilities because of existence uncertainty (paragraphs 30–31);

    (b) unrecognised regulatory assets and unrecognised regulatory liabilities arising from differences between the regulatory recovery period and the asset's useful life (paragraphs 32–35);

    (c) unrecognised regulatory assets and unrecognised regulatory liabilities arising from allowable expenses and performance incentives included in an entity's regulatory capital base (paragraphs 36–39); and

    (d) unrecognised regulatory assets arising from inflation adjustment to the regulatory capital base (paragraphs 40–43).

Unrecognised regulatory assets and unrecognised regulatory liabilities because of existence uncertainty

30. We think existence uncertainty may arise when, for example, regulatory agreements are insufficiently detailed about the recoverability of specific costs. In some cases, the amounts involved could be significant. Hence, we think information about unrecognised regulatory assets and unrecognised regulatory liabilities and the reasons

why the entity has concluded their existence was uncertain could affect a user's analysis. In addition, such disclosures would help an entity to fulfil the specific disclosure objective proposed in paragraph 79 of the Exposure Draft that focuses on regulatory assets and regulatory liabilities at the end of the period.

31. Consequently, we recommend that the final Accounting Standard require an entity to disclose the nature of unrecognised regulatory assets and unrecognised regulatory liabilities, the reasons why there is uncertainty about their existence and, when practicable, an estimate of the amount unrecognised.[7]

Differences between regulatory recovery period and assets' useful lives

32. We think disclosures about unrecognised regulatory assets and unrecognised regulatory liabilities arising from differences between regulatory recovery periods and assets' useful lives might provide useful information. This information would enable users to:

(a) compare an entity whose regulatory capital base has a direct relationship with its property, plant and equipment with an entity whose regulatory capital base has no direct relationship with its property, plant and equipment; and

(b) assess whether the entity is recovering its regulatory capital base significantly faster or slower compared to the depreciation pace of its assets. This may have implications on the future cash flows and it can also highlight the existence of some risks—for example, an accelerated recovery profile of the regulatory capital base compared to the assets' depreciation pace could indicate the regulator is trying to avoid liquidity issues for the entity or the risk of assets becoming stranded.

33. However, it would be very difficult to provide detailed quantitative information about these unrecognised regulatory assets and unrecognised regulatory liabilities for the

[7] These disclosures are largely consistent with the disclosures for contingent liabilities in paragraph 86 of IAS 37.

same reasons that we concluded that an entity should not recognise them (paragraphs 23(a)–23(b)).

34. Having said that, we think an entity could provide some information that would help users assess whether differences between the regulatory recovery pace and the accounting depreciation pace would have led to the recognition of significant regulatory assets and regulatory liabilities.

35. Consequently, we recommend the final Accounting Standard require an entity whose regulatory capital base has no direct relationship with its property, plant and equipment to disclose information:

(a) that allows users to understand differences between the recovery period of the regulatory capital base and the assets' useful lives, including a description of the main factors considered in determining the regulatory recovery period that are not considered in the determination of the assets' useful lives; and

(b) about whether the recovery period of the regulatory capital base has changed during the period and, if so, the main reasons for that change.

Allowable expenses and performance incentives included in an entity's regulatory capital base

36. Unrecognised regulatory assets and unrecognised regulatory liabilities may arise when regulators require entities to add (deduct) allowable expenses or performance incentives to (from) their regulatory capital base and an entity's regulatory capital base has no direct relationship with its property, plant and equipment.

37. We think disclosures about these unrecognised regulatory assets and unrecognised regulatory liabilities might help users to better understand and compare entities that have a direct relationship with those that have no direct relationship. Such disclosures would help an entity to fulfil the new specific disclosure objective proposed in paragraph 19(a) that focuses on the relationship between the entity's regulatory capital base and its property, plant and equipment.

38. However, it would be very difficult to provide quantitative information about these items, for the same reasons the IASB decided an entity should not recognise these items as regulatory assets or regulatory liabilities (paragraphs 23(a) and 23(c)).

39. Having said that, we think qualitative disclosures about these items would help users compare entities that have a direct relationship between their regulatory capital base and their property, plant and equipment with those that have no direct relationship. Consequently, we recommend the final Accounting Standard require an entity whose regulatory capital base has no direct relationship with its property, plant and equipment to disclose information about the nature of any unrecognised regulatory assets or unrecognised regulatory liabilities that arise when the regulator requires the entity to add (deduct) allowable expenses or performance incentives to (from) its regulatory capital base.

Inflation adjustment to the regulatory capital base

40. As noted in paragraph 22(c), an unrecognised regulatory asset may arise when regulators adjust an entity's regulatory capital base for inflation.

41. However, it would be very difficult to provide quantitative information about these items, for the same reasons the IASB decided an entity should not recognise these items as regulatory assets (paragraphs 23(a) and 23(c)).

42. Our discussions with users suggest that they are interested in understanding the regulatory approach (nominal approach or real approach)[8] used by the regulator to compensate an entity for inflation on the regulatory capital base. This information would help users to better understand the entity's risks and cash flows. However, our discussion with the Consultative Group suggests that users are unclear how they would use quantitative information about unrecognised regulatory assets arising from inflation adjustments.

[8] Agenda Paper 9A discussed at the December 2022 IASB meeting described the two regulatory approaches (nominal approach and real approach).

43. Consequently, we recommend the final Accounting Standard require an entity to disclose the regulatory approach (nominal approach or real approach) used by the regulator to compensate it for inflation.

Question for the IASB

2. Does the IASB agree with the staff recommendations that the final Accounting Standard:

   a. require an entity to disclose the nature of unrecognised regulatory assets and unrecognised regulatory liabilities, the reasons why there is uncertainty about their existence and, when practicable, an estimate of the amount unrecognised?

   b. require an entity whose regulatory capital base has no direct relationship with its property, plant and equipment to disclose information:

      i. that allows users to understand differences between the recovery period of the regulatory capital base and the assets' useful lives, including a description of the main factors considered in determining the regulatory recovery period that are not considered in the determination of the assets' useful lives?

      ii. about whether the recovery period of the regulatory capital base has changed during the period and, if so, the main reasons for that change?

   c. require an entity whose regulatory capital base has no direct relationship with its property, plant and equipment to disclose information about the nature of any unrecognised regulatory assets or unrecognised regulatory liabilities that arise when the regulator requires the entity to add (deduct) allowable expenses or performance incentives to (from) its regulatory capital base?

   d. require an entity to disclose the regulatory approach (nominal approach or real approach) used by the regulator to compensate it for inflation?

Long-term performance incentives

Background

44. The Exposure Draft proposes that, for long-term performance incentives, an entity should estimate the amount of the performance incentive using the 'most likely amount' method or the 'expected value' method and then determine the portion of that

estimate that relates to the reporting period. That portion forms part of or reduces the total allowed compensation for goods or services supplied in the reporting period. An entity should use a reasonable and supportable basis in determining that portion and apply that basis consistently (paragraph B19 of the Exposure Draft).

45. Some respondents (mostly national standard-setters and preparers in Europe and Asia-Oceania and a few accounting firms) were concerned about the significant outcome and measurement uncertainties that arise from some long-term performance incentives.

46. At its April 2023 meeting, the IASB tentatively decided to retain the proposals on long-term performance incentives. At that meeting, IASB members asked the staff to consider whether the final Standard should require any specific disclosure requirements for long-term performance incentives.[9]

Summary of feedback

47. We discussed with members of the Consultative Group whether the final Standard should include any specific disclosures about long-term performance incentives that are subject to significant outcome or measurement uncertainty.

48. One member of the Consultative Group said the final Standard should not require an entity to disclose additional information about long-term performance incentives that are subject to outcome or measurement uncertainty because the requirements in IAS 1 relating to sources of estimation uncertainty should be enough. Another member suggested disclosing information about any conditions that may affect the recoverability of a regulatory asset associated with a long-term performance incentive.

[9] Agenda Paper 9A discussed at the April 2023 IASB meeting.

Staff analysis

49. Paragraphs 125–131 of IAS 1 require an entity to disclose information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. Consequently, if an entity makes assumptions when estimating the amount of the performance incentive that have a significant risk of resulting in a material adjustment to the carrying amounts of the related regulatory assets or regulatory liabilities, IAS 1 would require the entity to disclose information about those assumptions. The requirements in paragraphs 125–131 of IAS 1 will be added to IAS *8 Accounting Policies, Changes in Accounting Estimates and Errors* when the prospective [draft] IFRS 18 *Presentation and Disclosure in Financial Statements* replaces IAS 1.

50. Consequently, we recommend that the final Accounting Standard not require an entity to disclose assumptions used in estimating uncertain future cash flows used in the measurement of regulatory assets or regulatory liabilities related to long-term performance incentives beyond those disclosures required by IAS 1.

Question for the IASB
3. Does the IASB agree with the staff recommendation in paragraph 50?

Regulatory returns on an asset not yet available for use

Background

51. At its July 2022 meeting, the IASB tentatively decided that when an entity has an enforceable present right to regulatory returns on an asset not yet available for use,

those returns would form part of the total allowed compensation for goods or services supplied during the construction period of that asset.[10]

52. At its November 2022 meeting, the IASB refined that tentative decision for entities whose regulatory capital base has a direct relationship with its property, plant and equipment. The IASB tentatively decided that when an entity capitalises its borrowing costs:

    (a) if the regulatory agreement provides the entity with both a debt and an equity return on an asset not yet available for use—to require the entity to reflect only those returns in excess of the entity's capitalised borrowing costs in the statement of financial performance during the construction period; and

    (b) if the regulatory agreement provides the entity with only a debt return on such an asset—to prohibit the entity from reflecting the return in the statement of financial performance during the construction period.[11]

53. At that meeting the IASB discussed that additional disclosures may be necessary to help users of financial statements analyse the information about the regulatory returns on an asset not yet available for use of entities that have a direct relationship between their regulatory capital base and their property, plant and equipment. For example, users may find useful, information that links the total amount of regulatory returns on an asset not yet available for use during the reporting period with both the entity's capitalised borrowing costs and the movement on related regulatory assets or regulatory liabilities for the same period.

[10] IASB Update July 2022.

[11] Agenda Paper 9A discussed at the November 2022 IASB meeting.

Staff analysis

54. To illustrate the information that could be disclosed, consider the following example:

    (a) an entity invests CU1,000 in the construction of an asset during year 1. During that period, the entity is entitled to regulatory returns on that asset of CU80, comprising both a return on equity and a return on debt. Those regulatory returns will be included in regulated rates charged once the asset is in operation.[12]

    (b) the entity incurs borrowing costs of CU35 in constructing the asset during year 1.

    (c) applying the IASB's tentative decisions, the entity would account for a regulatory asset and regulatory income amounting to CU45 in year 1.

55. As mentioned in paragraph 53, users may find useful information that links the total amount of regulatory returns on the asset not yet available for use (CU80 in the example above) with both the capitalised borrowing costs (CU35) and the regulatory asset recognised during the period (CU45).

56. Consequently, we recommend the final Accounting Standard require an entity whose regulatory capital base has a direct relationship with its property, plant and equipment and capitalises its borrowing costs to disclose qualitative information about:

    (a) whether it receives regulatory returns on an asset not yet available for use;

    (b) whether those regulatory returns comprise both a debt and an equity return or only a debt return and whether those regulatory returns are included in regulated rates charged during the construction period or operational period of the asset; and

[12] Amounts are denominated in currency units (CU).

(c) the effect of those regulatory returns on changes in the related regulatory assets or regulatory liabilities.

Question for the IASB
4. Does the IASB agree with the staff recommendation in paragraph 56?