



IFRS® Foundation

# Exposure Draft *Regulatory Assets and Regulatory Liabilities*

24 February 2021

# With you today...

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# Before we start...

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<https://www.ifrs.org/projects/work-plan/rate-regulated-activities/#published-documents>



Supporting material issued with Exposure Draft can be found here—

<https://www.ifrs.org/projects/work-plan/rate-regulated-activities/#supporting-material>

# Agenda

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Problem definition

Proposed solution

Board's proposals

Likely effects of proposals

Next steps

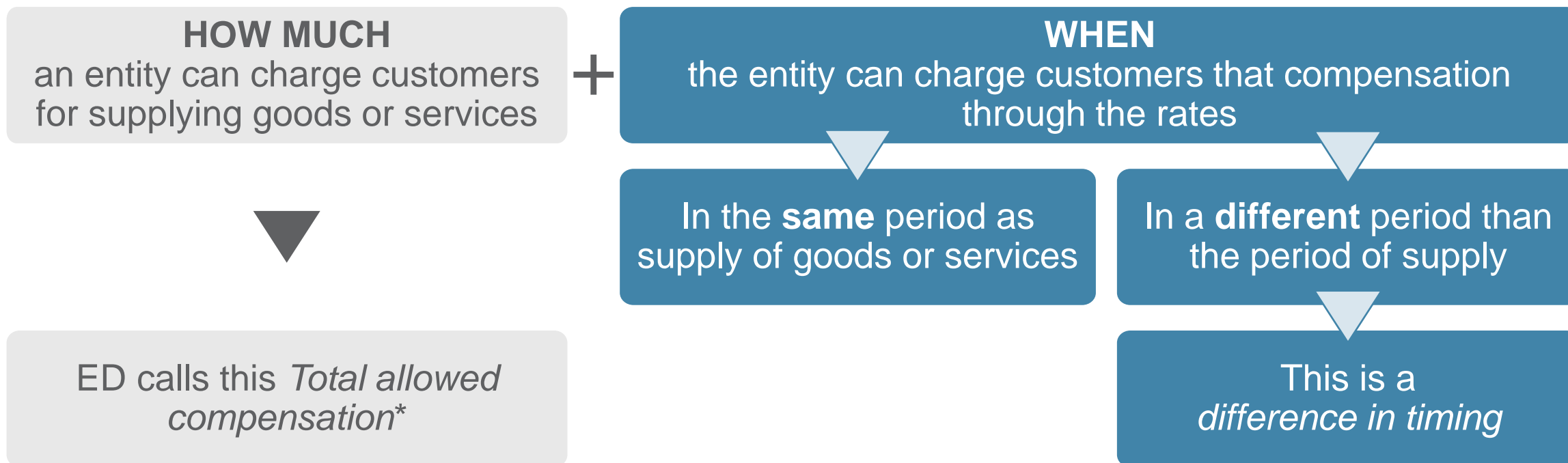
Questions

A grayscale world map is the background for the slide. Overlaid on the map are several thick, light gray curved lines that sweep across the continents. Additionally, there are several dotted lines that form a grid-like pattern across the map, intersecting the curved lines.

# Problem definition

# What is the problem? (1/3)

A regulatory agreement establishes



\* See Appendix for the full definition of *total allowed compensation* for goods or services supplied

# What is the problem? (2/3)

## Illustration

- Entity A charges a regulated rate, for goods supplied in Year 1, set based on estimated input costs of CU100\*
- Actual input costs for Year 1 were CU120
- Estimated and actual input costs for Year 2 were CU100
- Entity A has a right given by regulatory agreement to add under-recovery of CU20 of input costs of Year 1 in regulated rate for Year 2

Total allowed compensation for goods or services supplied in the two years would include:

|                            | Year 1<br>CU | Year 2<br>CU |
|----------------------------|--------------|--------------|
| Total allowed compensation | 120          | 100          |

Applying IFRS Standards, Entity A's Statement of profit or loss would include:

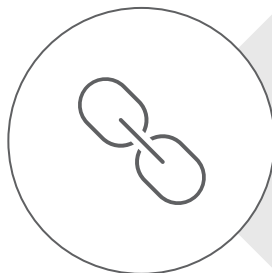
|                      | Year 1<br>CU | Year 2<br>CU |
|----------------------|--------------|--------------|
| Revenue              | 100          | 120          |
| Input costs          | (120)        | (100)        |
| <b>Profit (loss)</b> | <b>(20)</b>  | <b>20</b>    |

\* Monetary amounts are denominated in 'currency units' (CU).

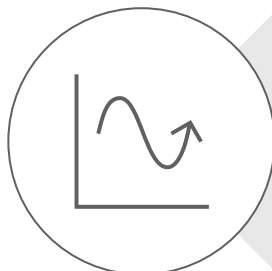
# What is the problem? (3/3)

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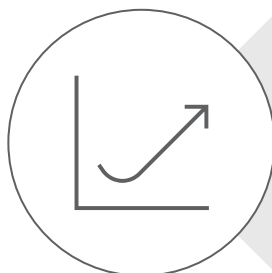
Without information about *differences in timing* users of financial statements have *insufficient basis*—



To understand revenue-expenses relationship



To fully analyse a time series of profits



To make projections of future cash flows



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# Proposed solution

# How does the Board propose to solve the problem? (1/2)

When the regulatory agreement requires an entity to charge compensation in a different period (a difference in timing), a regulatory asset or regulatory liability arises

Regulatory asset is a right to add amount in future rates because of goods or services already supplied\*

Regulatory liability is an obligation to deduct amount in future rates because of compensation already charged\*

An entity would report:

- regulatory assets and regulatory liabilities in statement of financial position
- regulatory income and regulatory expense in statement of financial performance



Reflect *total allowed compensation for goods or services supplied as part of reported financial performance for the period in which those goods or services are supplied*

\* See Appendix for a summary of the proposed model and full definitions of *regulatory asset* and *regulatory liability*

# How does the Board propose to solve the problem? (2/2)

## Illustration

(Amounts in CU)

| <i>Statement of profit or loss</i>                | Year 1    | Year 2      |
|---------------------------------------------------|-----------|-------------|
| Revenue                                           | 100       | 120         |
| <b>Regulatory income minus regulatory expense</b> | <b>20</b> | <b>(20)</b> |
| Input costs                                       | (120)     | (100)       |
| <b>Profit (loss)</b>                              | <b>-</b>  | <b>-</b>    |

- **Regulatory income CU20 in Year 1** to reflect compensation for goods supplied in Year 1
- **Regulatory expense CU20 in Year 2** to reflect compensation in rates of Year 2 for goods of Year 1

| <i>Statement of financial position</i> | Year 1    | Year 2   |
|----------------------------------------|-----------|----------|
| <b>Assets</b>                          |           |          |
| ...                                    |           |          |
| Regulatory asset                       | <b>20</b> | <b>-</b> |

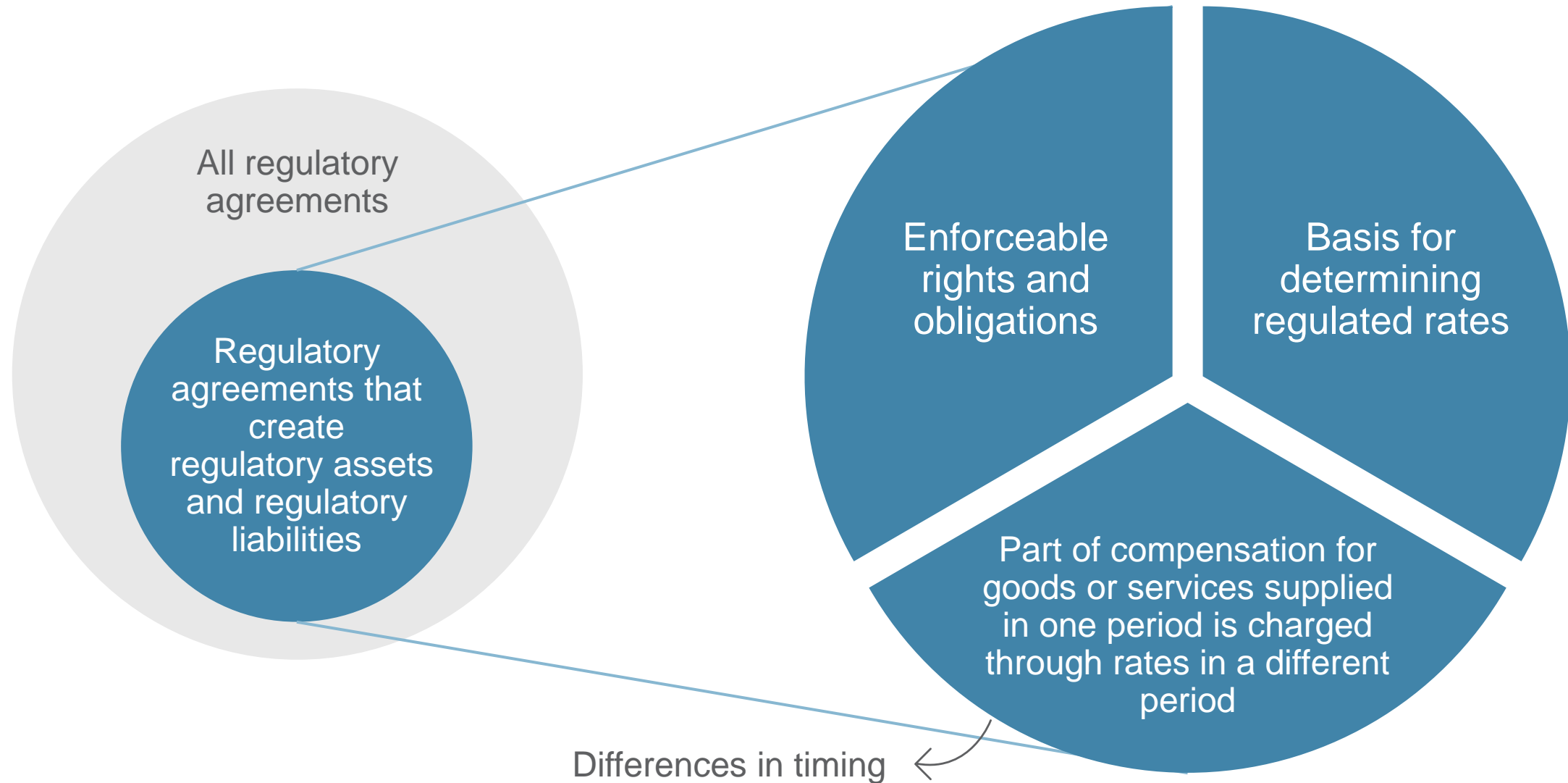
- **Regulatory asset of CU20 in Year 1** to reflect right to increase regulated rates in Year 2
- **No regulatory asset in Year 2** because rates increased to recover under-recovered CU20 of Year 1



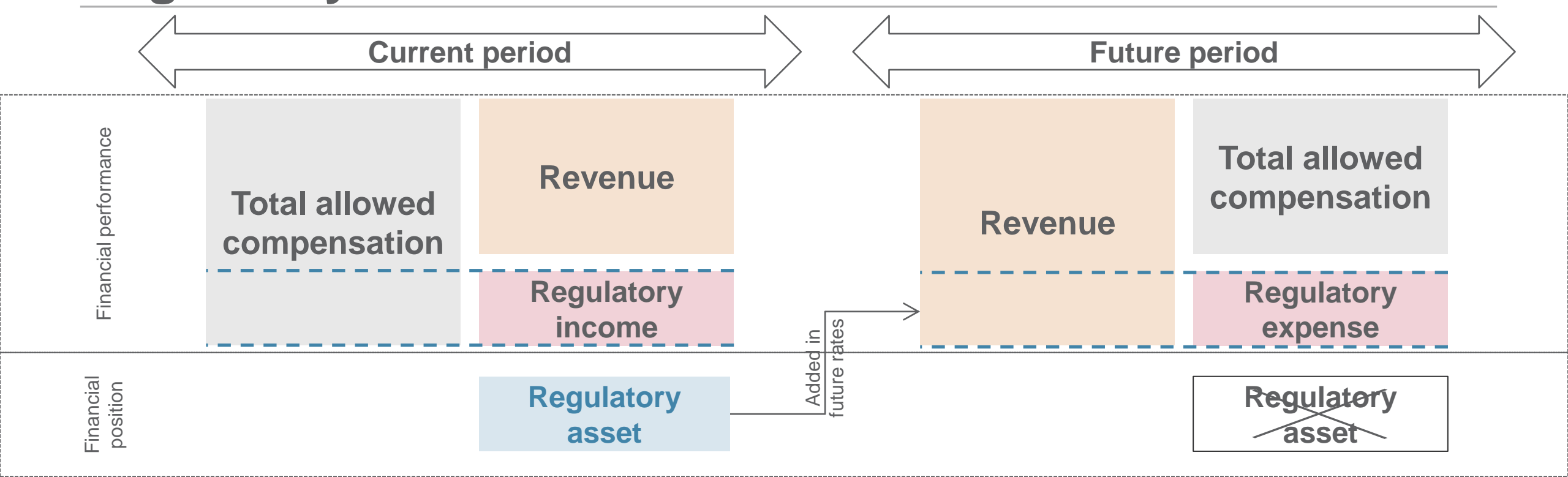
# Board's proposals

Scope

# Regulatory agreements that create...



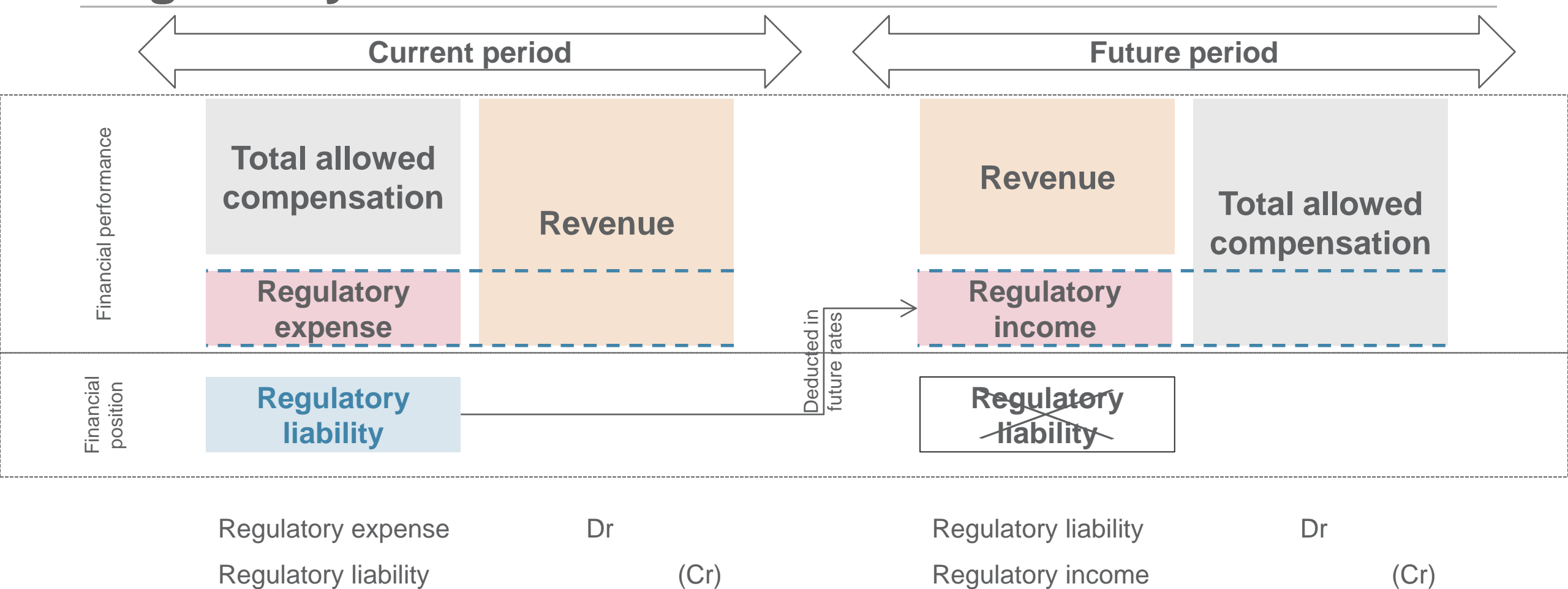
# Regulatory assets



Regulatory asset                      Dr  
 Regulatory income                      (Cr)

Regulatory expense                      Dr  
 Regulatory asset                      (Cr)

# Regulatory liabilities



A grayscale world map is the background for the slide. Overlaid on the map are several thick, light gray curved lines that sweep across the continents. Additionally, there are dotted lines forming a grid-like pattern across the map, suggesting latitude and longitude.

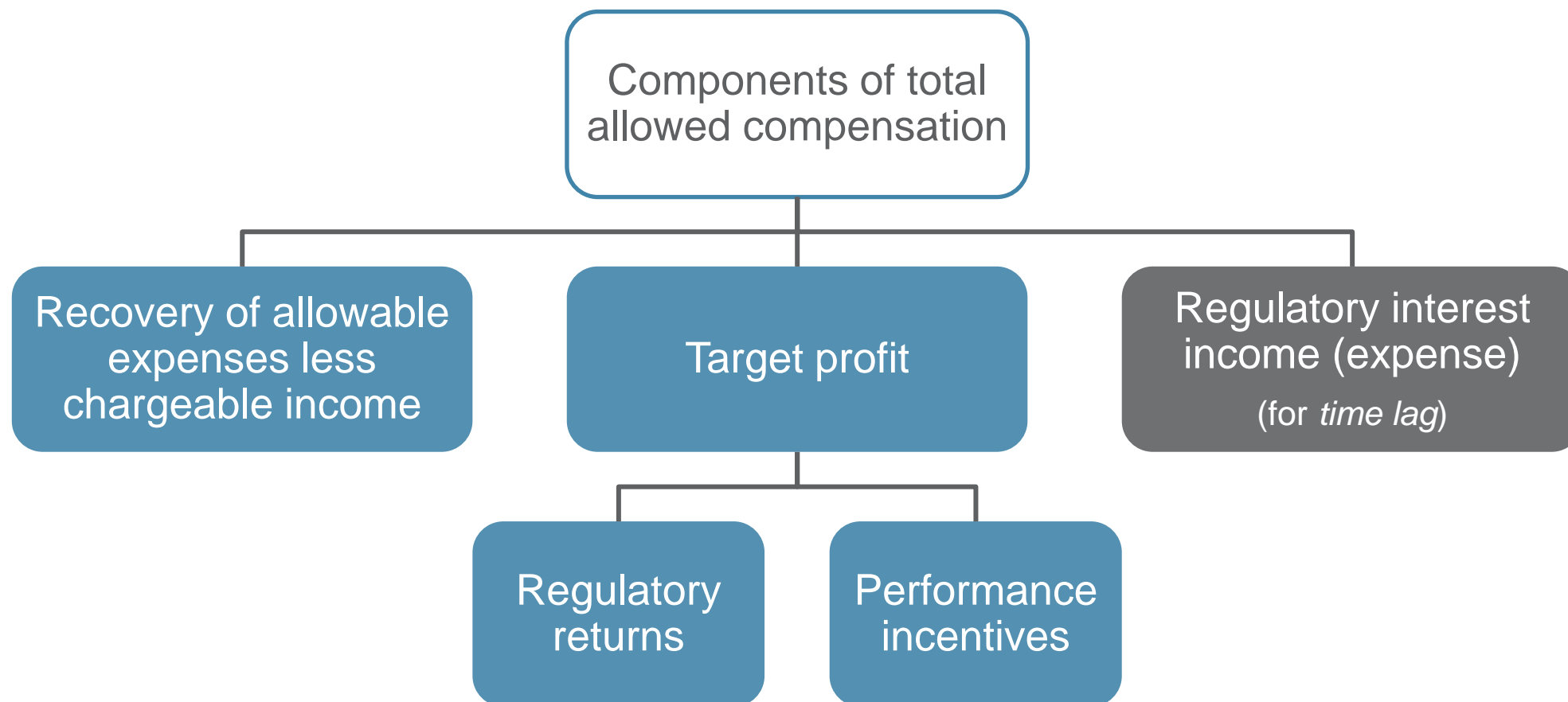
# Board's proposals

Total allowed compensation  
for goods or services



# Components of total allowed compensation (1/2)

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# Components of total allowed compensation (2/2)

When components of total allowed compensation affect profit

| Recovery of allowable expenses less chargeable income         | Target profit                                 |                                                               | Regulatory interest income (expense) (for time lag)                                            |
|---------------------------------------------------------------|-----------------------------------------------|---------------------------------------------------------------|------------------------------------------------------------------------------------------------|
|                                                               | Regulatory returns*                           | Performance incentives                                        |                                                                                                |
| When expense or income are recognised applying IFRS Standards | When returns added in setting regulated rates | When performance gives rise to the incentive bonus or penalty | As discount unwinds until recovery of regulatory asset (or fulfilment of regulatory liability) |

\* Regulatory returns on an asset not available for use affect profit:

- only once the asset is available for use
- over the remaining periods in which the asset is recovered through the regulated rates



# Board's proposals

## Measurement

# Cash-flow-based measurement

## Cash-flow-based measurement technique

Initial  
recognition

### Include all future cash flows

If they are uncertain, estimate using 'most likely amount' method or 'expected value' method

The cash flows include those from regulatory interest

### Discount estimated future cash flows

Using the *regulatory interest rate*

- unless this rate for a regulatory asset is insufficient

Subsequent  
measurement

### Update estimates of future cash flows

- to reflect recovery of regulatory asset or fulfilment of regulatory liability
- for changes in estimates

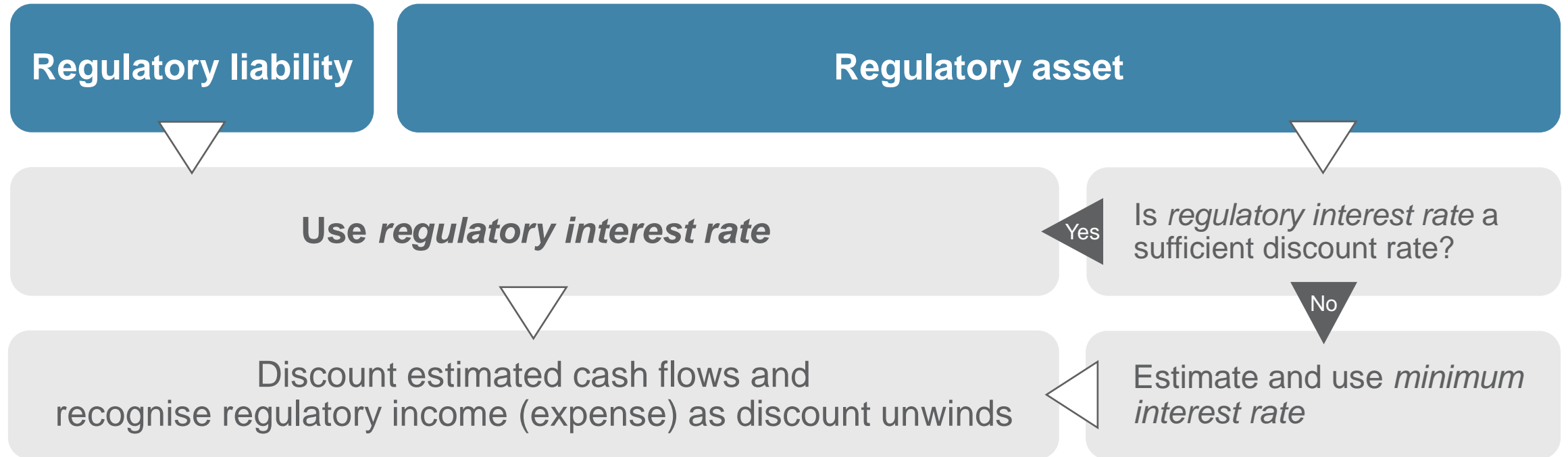
### Continue to use discount rate

as determined at initial recognition

- unless regulatory agreement changes the regulatory interest rate

# Discount rate

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# Board's proposals

## Presentation and Disclosure

# Presentation

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## In statement of financial position

- Separate line items for regulatory assets and regulatory liabilities
- Classified as current and non-current

## In statement of financial performance

- Regulatory income minus regulatory expense immediately below revenue line item
  - net movement between opening and closing balances of regulatory assets and regulatory liabilities
  - in one situation, some regulatory income or regulatory expense presented in other comprehensive income

# Presentation—Statement of profit or loss

## Illustration

(Amounts in CU)

| Statement of profit or loss                | Year 1 | Year 2 |
|--------------------------------------------|--------|--------|
| Revenue                                    | 100    | 120    |
| Regulatory income minus regulatory expense | 20     | (20)   |
| Input costs                                | (120)  | (100)  |
| <b>Profit (loss)</b>                       | -      | -      |

1

Mostly includes compensation for goods or services supplied in the year, but:

- may not include part of that compensation that is charged in other years (past or future)
- can also include compensation for goods or services supplied in other years (past or future)

2

- Compensation included in revenue of other years (past or future) for goods or services supplied in the year; less
- Compensation included in revenue for the year for goods or services supplied in other years (past or future)



# Disclosure (1/3)

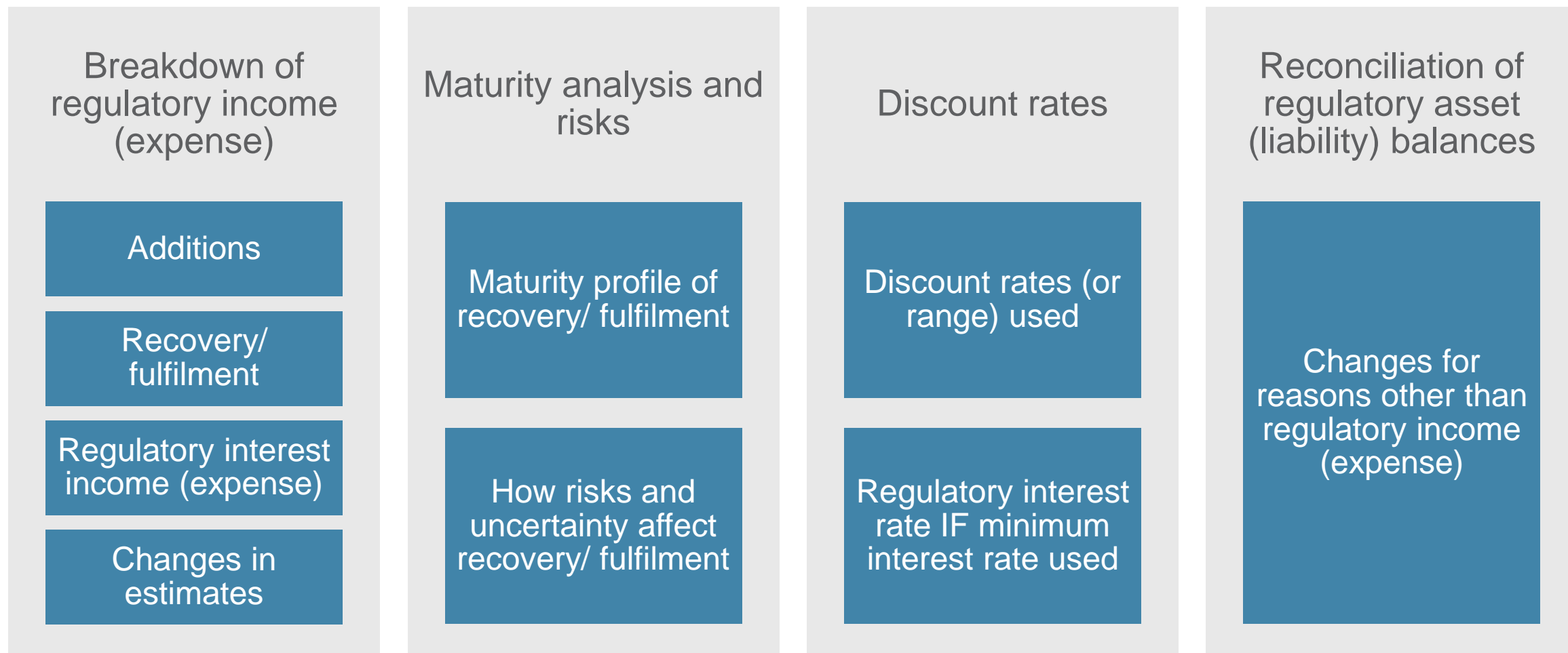
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## Proposed objective

- Focus on financial performance
- Information provided by applying ED together with all other information provided in financial statements would enable users of financial statements
  - *to understand the relationship between an entity's revenue and expenses as completely as they can when no regulatory assets or regulatory liabilities exist*
- That understanding would provide users with better insights into the entity's prospects for future cash flows

# Disclosure (2/3)

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# Disclosure (3/3)

| Note X Regulatory income minus regulatory expense                                                          | Year 1<br>CU | Year 2<br>CU |                                      |
|------------------------------------------------------------------------------------------------------------|--------------|--------------|--------------------------------------|
| Amounts for goods or services supplied in current year:                                                    |              |              |                                      |
| —to be included in revenue in future years                                                                 | 20           | XX           | Addition to regulatory assets        |
| —already included in revenue in prior years                                                                | XX           | XX           | Fulfilment of regulatory liabilities |
| Amounts included in revenue in current year:                                                               |              |              |                                      |
| —for future goods or services                                                                              | (XX)         | (XX)         | Addition to regulatory liabilities   |
| —for goods or services in prior years                                                                      | (XX)         | (20)         | Recovery of regulatory assets        |
| Regulatory interest income on regulatory assets less regulatory interest expense on regulatory liabilities | XX           | XX           |                                      |
| Changes in estimates                                                                                       | XX           | XX           |                                      |
| <b>Regulatory income minus regulatory expense</b>                                                          | <b>20</b>    | <b>(20)</b>  |                                      |



# Board's proposals

Transition

# Transition

|                                                   | Comparative | Date of initial application<br>1 Jan 20X2 |
|---------------------------------------------------|-------------|-------------------------------------------|
|                                                   | 20X1        | 20X2                                      |
| <i>Statement of profit or loss</i>                | CU          | CU                                        |
| Revenue                                           | XX          | XX                                        |
| <b>Regulatory income minus regulatory expense</b> | <b>XX</b>   | <b>XX</b>                                 |
| Expenses                                          | (XX)        | (XX)                                      |
| <b>Profit (loss)</b>                              | <b>XX</b>   | <b>XX</b>                                 |

← Full retrospective application →

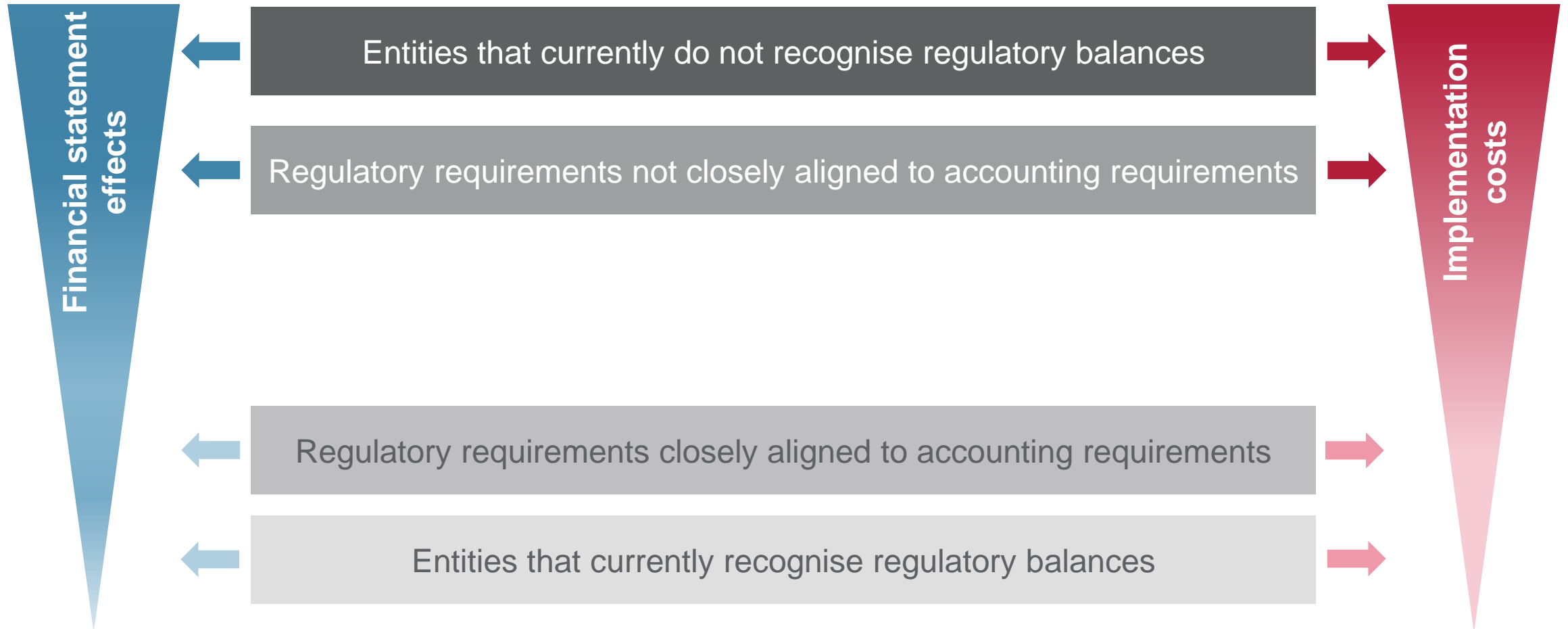
- Full restatement of comparatives
- Affects time series data that is based on financial statements
- Data comparable across time periods and entities

A grayscale world map is the background, showing continents and a grid of dotted lines. Overlaid on the left side are several thick, curved, light-gray lines that sweep across the map from the bottom left towards the top right.

# Likely effects of proposals

# Likely effects of the proposals

The proposals would affect some entities more than others



# Likely effects on quality of financial reporting and benefits for users

Better information for users—coherent, prominent and understandable presentation and disclosure of information about regulatory assets and regulatory liabilities

## Understandability

Better insights into the relationship between an entity's revenue and expenses by providing information about differences in timing

## Usefulness

Information focused on the incremental future cash flows that result from regulatory assets and regulatory liabilities

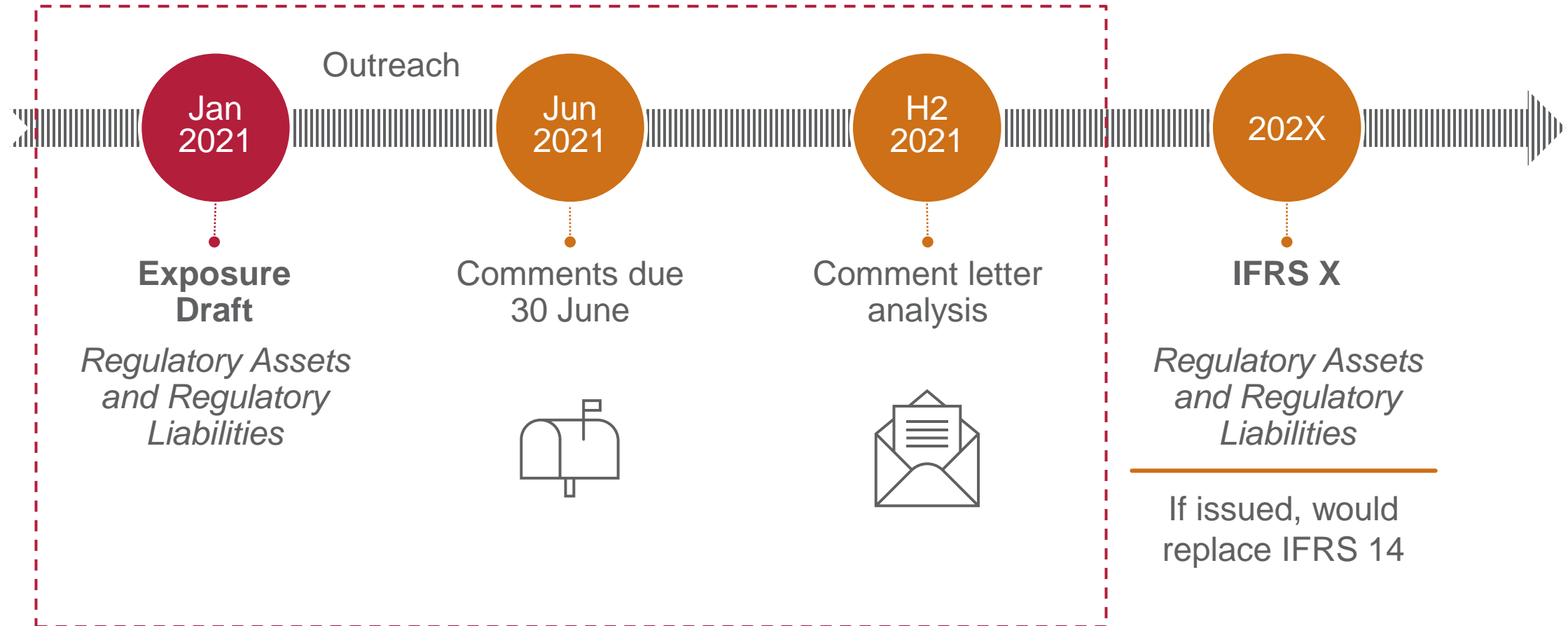
## Comparability

Improved comparability across entities using a single set of principles for reporting all regulatory assets and regulatory liabilities

The availability of better information about regulatory assets and regulatory liabilities in the financial statements would decrease investors' costs of gathering information from other sources.



# Next steps



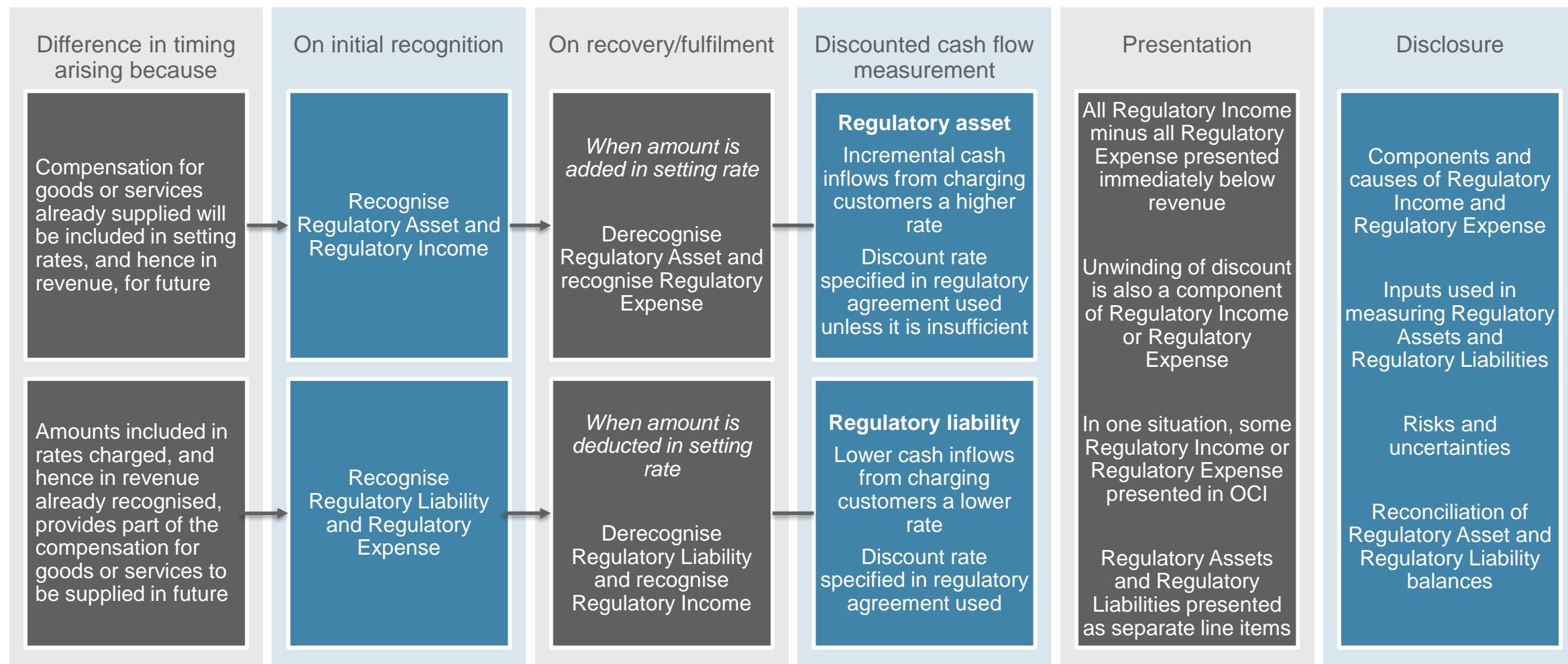
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Questions?

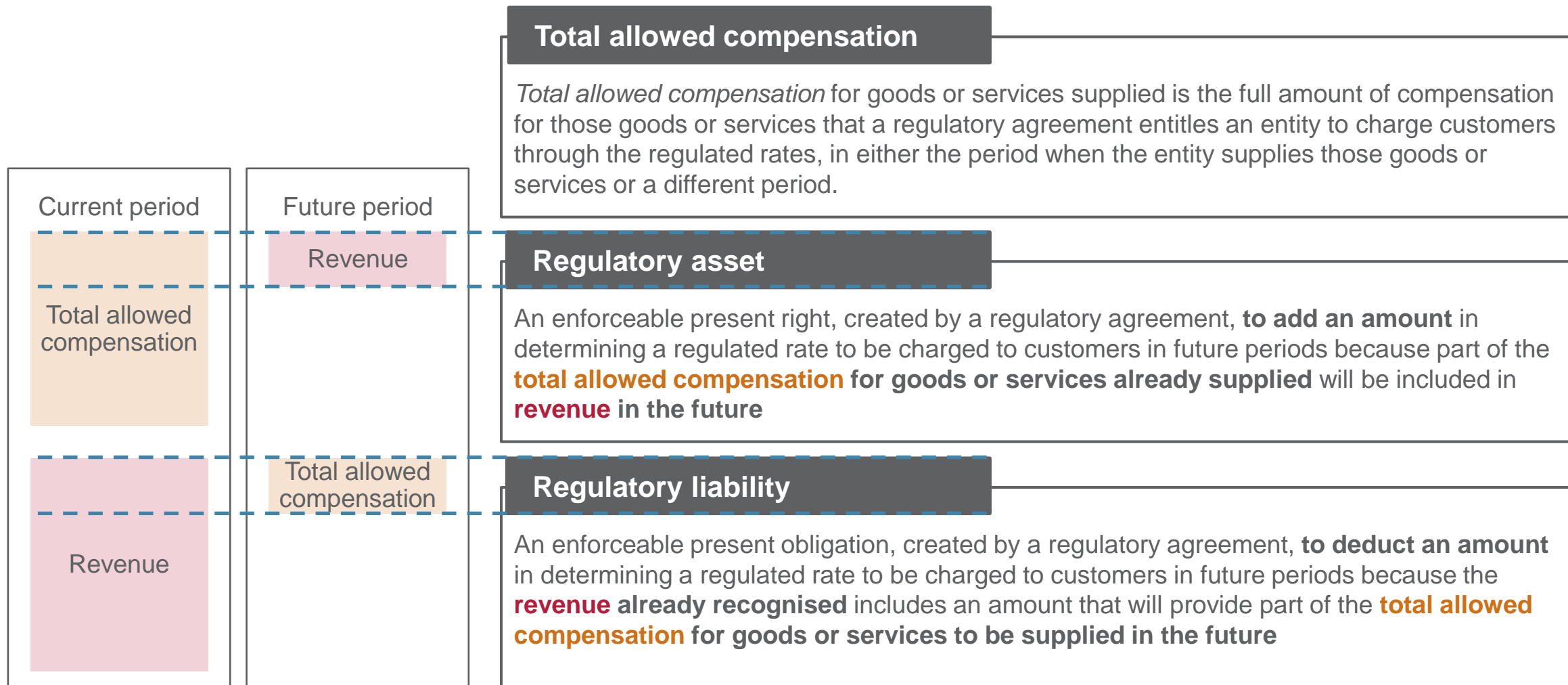
A grayscale world map is the background for the top half of the slide. Overlaid on the map are several thick, light gray curved lines that sweep across the continents. A network of thin, dotted lines is also visible, connecting various points across the map. The overall aesthetic is clean and professional.

# Appendix

# Summary of the model



# Definitions of key terms



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