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30 July 2021

Andreas Barckow
Chair
International Accounting Standards Board
Columbus Building
7 Westferry Circus
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Dear Dr Barckow

Exposure Draft 2021/1 – Regulatory Assets and Regulatory Liabilities

Deloitte Touche Tohmatsu Limited is pleased to respond to the International Accounting Standards Board's (the Board) exposure draft *Regulatory Assets and Regulatory Liabilities* (the ED).

We welcome the issuance of the proposal. We support the project to develop requirements for regulatory assets and liabilities. Many entities with rate-regulated activities today resort to reporting extensive alternative performance measures to capture the effects of the rate regulation and the rights and obligations those regulations create. We acknowledge that this is a particularly challenging project with the need to cater to a wide range of types of regulations.

We generally agree with the proposals. However, we have concerns about the proposed accounting for timing differences between the recognition of the regulatory base and the application of IFRS Standards. This relates particularly to assets under construction and differences between the regulatory recovery period and the period over which an asset is depreciated under IFRS Standards. To be able to comply with the proposed requirements in such cases, entities will need to identify and track each individual asset in its regulatory capital base. This is inconsistent with the way in which most regulators and preparers currently think about the regulatory capital base and we therefore expect that entities will continue to report alternative performance measures to adjust for this aspect of the model. Furthermore, the proposals, when applied to such cases are likely to require considerable cost and effort to implement and audit. We believe this aspect of the proposed model would benefit from additional field testing with preparers.

In our view, were the Board to remove the proposed requirement to recognise regulatory assets and liabilities when there are timing differences between the regulatory base and the IFRS Standards-compliant base, the remaining proposals would fundamentally improve the financial reporting by regulated entities. Furthermore, several other areas of the current proposals, highlighted in our detailed responses included in the Appendix, will become simpler and more cost-effective to implement.

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If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0) 20 7007 0884.

Yours sincerely

Veronica Poole
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Appendix 1

Question 1—Objective and scope

Paragraph 1 of the Exposure Draft sets out the proposed objective: an entity should provide relevant information that faithfully represents how regulatory income and regulatory expense affect the entity's financial performance, and how regulatory assets and regulatory liabilities affect its financial position.

Paragraph 3 of the Exposure Draft proposes that an entity apply the [draft] Standard to all its regulatory assets and all its regulatory liabilities. Regulatory assets and regulatory liabilities are created by a regulatory agreement that determines the regulated rate in such a way that part of the total allowed compensation for goods or services supplied in one period is charged to customers through the regulated rates for goods or services supplied in a different period (past or future). The [draft] Standard would not apply to any other rights or obligations created by the regulatory agreement—an entity would continue to apply other IFRS Standards in accounting for the effects of those other rights or obligations.

Paragraphs BC78–BC86 of the Basis for Conclusions describe the reasoning behind the Board's proposals. They also explain why the Exposure Draft does not restrict the scope of the proposed requirements to apply only to regulatory agreements with a particular legal form or only to those enforced by a regulator with particular attributes.

a) Do you agree with the objective of the Exposure Draft? Why or why not?

b) Do you agree with the proposed scope of the Exposure Draft? Why or why not? If not, what scope do you suggest and why?

c) Do you agree that the proposals in the Exposure Draft are clear enough to enable an entity to determine whether a regulatory agreement gives rise to regulatory assets and regulatory liabilities? If not, what additional requirements do you recommend and why?

d) Do you agree that the requirements proposed in the Exposure Draft should apply to all regulatory agreements and not only to those that have a particular legal form or those enforced by a regulator with particular attributes? Why or why not? If not, how and why should the Board specify what form a regulatory agreement should have, and how and why should it define a regulator?

e) Have you identified any situations in which the proposed requirements would affect activities that you do not view as subject to rate regulation? If so, please describe the situations, state whether you have any concerns about those effects and explain what your concerns are.

f) Do you agree that an entity should not recognise any assets or liabilities created by a regulatory agreement other than regulatory assets and regulatory liabilities and other assets and liabilities, if any, that are already required or permitted to be recognised by IFRS Standards?

Scope

The scope of the proposed Standard, by not specifying whether a regulator must exist or what type of body might constitute a regulator, has the potential to capture a wide range of activities. It appears that that entities that were previously outside the scope of IFRS 14 *Regulatory Deferral Accounts* could be within the scope of the proposed Standard. For example, we are aware of a coalition of retirement villages that operates under a *pricing protocol* established by the local government authorities. That protocol could give rise to differences in timing described in paragraphs 13-17 of the proposal. It is not clear whether this type of activity was intended to be included or not.

We acknowledge the explanations provided in paragraph BC86 of why the Board decided not to define the characteristics that a regulator must possess. Nevertheless, we are concerned that not defining a rate regulator would introduce subjectivity in determining whether an entity is within the scope of the proposal. Accordingly, we suggest that a definition of a rate regulator, similar to that in IFRS 14, could be added to the proposed Standard to provide greater clarity:

> An authorised body that is empowered by statute or regulation to establish the rate or a range of rates that bind an entity. The rate regulator may be a third-party body or a related party of the entity, including the entity's own governing board, if that body is required by statute or regulation to set rates both in the interest of the customers and to ensure the overall financial viability of the entity.

A definition that includes a specific reference to `statute or regulation' seems more consistent with the original objective of the project and would ensure that *self-regulated* entities are scoped out of the proposed Standard.

It may also be unclear whether gaming activities could be considered in scope of the proposed Standard because the returns to participants are regulated (for example, through a requirement that gaming machines return a specified percentage of the amounts bet, over time). We acknowledge that generally the regulation applicable to gaming activities does not determine the price to be charged (i.e. the "price for goods or services" referred to in the definition of regulated rate) and as such may be excluded from the scope of the proposed Standard. Nevertheless, we are concerned that the resulting scope of the proposed Standard may be broader than intended. We recommend a narrower scope that is consistent with the original objective of the project and focuses on the *purpose/objective* of the regulation rather than the mere fact that the rate is regulated. In addition, some additional examples of the types of activities and industries that are intended to be within the scope, and those that are not, would be helpful.

It is also unclear whether some regulatory agreements that require an entity to adjust the pricing of *related services* rather than the services to the base customers fall within scope. For example, a regulation might reduce or increase the price of connection services in an electricity supply market as a consequence of the pricing of electricity supply services being rate-regulated. In effect, the regulatory asset or liability related to the supply of electricity is passed on to (or recovered from) the customers who receive connection services rather than those who receive the supply services.

We are also aware of regimes in which a *government guarantees* recovery of regulatory deferral accounts such that, in some circumstances, regulatory assets can be recovered from the Government, for cash, rather than through the future supplies of goods or services. Consistent with our response to

the Discussion Paper, we recommend an analysis of when, if ever, a 'secondary' method of recovery affects the recognition of an asset or liability or their classification (for example, by introducing a financial asset or liability that would not otherwise exist).

Cap and floor schemes

Cap and floor schemes generally constrain the returns an entity can make over a specified period. In some such schemes, price deviations below the floor, or above the cap, are recovered from, or repaid to, either the customer base in the next cycle ore other parties within the regulatory framework (for example, through refunds, fines or other adjustments to the regulatory base). The ED does not refer specifically to cap and floor schemes. We would expect cap and floor schemes would generally not be within the scope of the proposed Standard if the regulation allows the entity to operate at their discretion, provided they operate within the bounds of the cap and floor. It would be useful to clarify if our understanding is correct.

Similarly, some incentive/performance-based regulation frameworks (as opposed to cost-recovery frameworks) are based on an assessment of historical returns earned by entities (after the end of the associated reporting period). If the specified return is not met, then the base rate is reopened to recover the specified return, by adjusting the future rates. Clarification of whether these types of schemes are intended to be within the scope of the proposed Standard would be helpful.

Boundary of a Regulatory Agreement

We are concerned that the proposals regarding the boundary of a regulatory agreement may be overly restrictive. In particular, we are concerned that the proposals may not accommodate many of the regulatory schemes observed in practice today that do not feature an enforceable right to renew.

We observed in our response to the DP that some regulations cover a specified period even though the assets are expected to last for longer periods. The expectation is, generally, that the rate regulation will be revised, and the regulatory balances carried into the new regulation period. For example, in some jurisdictions a regulator may approve rates to be used for the next three years after which the utility will have an opportunity to seek an adjustment to rates through a process known as a rate case or price determination.

We are aware of many schemes that do not feature an explicit term but rather are *open-ended* arrangements that are expected to be extended indefinitely. Such schemes, often referred to as 'evergreen arrangements', operate under an over-arching perpetual licence agreement containing specific pricing periods with a roll-over feature, i.e. any under- or over-payment at the end of one pricing period rolls forward into the next period. We are also aware of schemes that have defined terms which are considerably shorter than the lives of the associated property, plant and equipment used to provide regulated services. In both cases, there is a strong expectation that the arrangement will be extended for at least the remaining life of the infrastructure even though there is *no enforceable renewal right*. Furthermore, if the licence were to be cancelled, it is likely that a balancing payment (as contemplated in paragraph B35 of the ED) would be received despite the fact that this may not be reflected in the currently enforceable regulatory agreement.

It is unclear whether the Board meant to accommodate these rolling arrangements. We are concerned that the ED may be read as either disallowing them (e.g. for the schemes with no term) or restricting

their term in a way that would not result in accounting that reflects the nature of the underlying arrangements, such as restricting enforceability to a pricing term even though both parties have an expectation that these interim agreements are, essentially, part of a broader agreement. Specifically, in relation to 'evergreen arrangements', the proposal does not seem to envisage scenarios in which a roll-over feature is present despite this being a common feature of regulatory agreements in the utilities industry across many jurisdictions.

Due to the prevalence of both types of scheme outlined above, we suggest that the Board may wish to consider other approaches to determining an appropriate boundary for regulatory agreements. For example, an approach that links the boundary of the regulatory agreement to the remaining useful life of regulated property, plant and equipment may be appropriate in circumstances in which there is a reasonable expectation of a balancing payment if the licence were not to be renewed. We believe that such an approach that links regulatory assets and liabilities and the assets that predominantly constitute the regulatory capital/asset base may provide more relevant financial information reflecting the underlying business objectives.

We also note that some regulatory agreements result in adjustments to regulated rates far into the future that may fall beyond the period covered by the current approved rates. In our experience, this is very common particularly for cost-of-service based regulations as utility entities periodically seek to increase rates to keep pace with increasing costs and recover expenditure that the regulator only acknowledges when cash is paid, but the entities are prohibited from discontinuing services to customers in case approval of the rate case is delayed beyond the end date of the period covered by the earlier approved rates. Based on our understanding of the ED, entities that cannot discontinue service regardless of whether there is an agreement in place would not be able to recognise a regulatory asset during the period of renegotiation. The Board may wish to consider whether this is indeed the intended outcome.

Finally, we suggest that the Board consider clarifying that the boundary of the regulatory agreement is not limited to the period covered by "approved" rates. This may be useful because some may read the definition of a regulatory agreement in paragraph 7 of the ED (specifically the reference to 'a set of enforceable rights and obligations') as limiting the agreement to the period for which future rates have been set rather than to the underlying term of the agreement.

Disclosure

We note that the ED does not include any requirement to disclose information about the features of the rate regulation, or judgements about factors such as the transition between two pricing periods. Although IAS 1, and the proposed new presentation Standard, requires information about the judgements the entity makes, we think the proposed Standard should include explicit disclosure requirements for these aspects as well. It will be important to ensure that the requirements lead to disclosures tailored to the specific circumstances of the entity.

Question 2—Regulatory assets and regulatory liabilities

The Exposure Draft defines 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.

The Exposure Draft defines 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.

Paragraphs BC36–BC62 of the Basis for Conclusions discuss what regulatory assets and regulatory liabilities are and why the Board proposes that an entity account for them separately.

a) Do you agree with the proposed definitions? Why or why not? If not, what changes do you suggest and why?

b) The proposed definitions refer to total allowed compensation for goods or services. Total allowed compensation would include the recovery of allowable expenses and a profit component (paragraphs BC87–BC113 of the Basis for Conclusions). This concept differs from the concepts underlying some current accounting approaches for the effects of rate regulation, which focus on cost deferral and may not involve a profit component (paragraphs BC224 and BC233–BC244 of the Basis for Conclusions). Do you agree with the focus on total allowed compensation, including both the recovery of allowable expenses and a profit component? Why or why not?

c) Do you agree that regulatory assets and regulatory liabilities meet the definitions of assets and liabilities within the Conceptual Framework for Financial Reporting (paragraphs BC37–BC47)? Why or why not?

d) Do you agree that an entity should account for regulatory assets and regulatory liabilities separately from the rest of the regulatory agreement (paragraphs BC58–BC62)? Why or why not?

e) Have you identified any situations in which the proposed definitions would result in regulatory assets or regulatory liabilities being recognised when their recognition would provide information that is not useful to users of financial statements?

We agree with the definitions of a regulatory asset and regulatory liability as set out in the ED. However, consistent with our comments above on the proposed scope, we suggest it would be useful to clarify whether the definitions cover situations in which the regulatory asset or liability will be recovered from a customer for *related services* (see example above) that is within the same broad network but who is not a direct customer.

Question 3—Total allowed compensation

Paragraphs B3–B27 of the Exposure Draft set out how an entity would determine whether components of total allowed compensation included in determining the regulated rates charged to customers in a period, and hence included in the revenue recognised in the period, relate to goods or services supplied in the same period, or to goods or services supplied in a different period. Paragraphs BC87–BC113 of the Basis for Conclusions explain the reasoning behind the Board's proposals.

a) Do you agree with the proposed guidance on how an entity would determine total allowed compensation for goods or services supplied in a period if a regulatory agreement provides: (i) regulatory returns calculated by applying a return rate to a base, such as a regulatory capital base (paragraphs B13–B14 and BC92–BC95)? (ii) regulatory returns on a balance relating to assets not yet available for use (paragraphs B15 and BC96–BC100)? (iii) performance incentives (paragraphs B16–B20 and BC101–BC110)?

b) Do you agree with how the proposed guidance in paragraphs B3–B27 would treat all components of total allowed compensation not listed in question 3(a)? Why or why not? If not, what approach do you recommend and why?

c) Should the Board provide any further guidance on how to apply the concept of total allowed compensation? If so, what guidance is needed and why?

Please see our response to Question 4.

Question 4—Recognition

a) Paragraphs 25–28 of the Exposure Draft propose that: an entity recognise all its regulatory assets and regulatory liabilities; and if it is uncertain whether a regulatory asset or regulatory liability exists, an entity should recognise that regulatory asset or regulatory liability if it is more likely than not that it exists. It could be certain that a regulatory asset or regulatory liability exists even if it is uncertain whether that asset or liability will ultimately generate any inflows or outflows of cash. Uncertainty of outcome would be addressed in measurement (Question 5).

b) Paragraphs BC122–BC129 of the Basis for Conclusions describe the reasoning behind the Board's proposals.

c) Do you agree that an entity should recognise all its regulatory assets and regulatory liabilities? Why or why not?

d) Do you agree that a 'more likely than not' recognition threshold should apply when it is uncertain whether a regulatory asset or regulatory liability exists? Why or why not? If not, what recognition threshold do you suggest and why?

As a general comment, we found it difficult to understand how the principles on recognition of regulatory assets and liabilities are meant to apply without relying on the illustrative examples. The fact that proposed Standard departs from the usual structure of IFRS Standards —initial recognition and measurement, subsequent measurement and derecognition —may contribute to this. We encourage the Board to restructure the proposal to follow this approach. Whatever approach is retained, we

think it is important that the main principles provide clear guidance on the timing of the initial recognition and subsequent measurement of regulatory assets and liabilities.

Identification, recognition and timing of regulatory income and expense

The current drafting seems to imply that the Standard determines total allowed compensation. We think it would be more appropriate to acknowledge that it is the regulatory agreement that determines total allowed compensation, and the financial reporting requirements determine when that compensation is recognised. The timing of the cash flows will reflect both the timing of the regulatory recoveries and the timing of the receipts from the customers.

For the purposes of this comment letter, we have classified regulatory assets and liabilities into two groups—those that reflect the terms of the regulatory agreement (cost, quantity and performance factors) and those that reflect differences between the timing of the recognition of the regulatory asset base and the IFRS Standards-compliant asset base. As we explain, we support the recognition of regulatory income and expenses from the first set of factors, but not the second.

Cost, quantity and performance factors

Cost and quantity factors

Many rate regulations set the rates to be charged to customers on the basis of estimated costs and estimated quantities (of units being sold). Example 2A illustrates the consequences of an entity over- or under- charging its customers, because of cost or quantity variances. We support the recognition of regulatory assets or liabilities in such circumstances because the regulation gives the entity the right to charge the amounts on the basis of the estimated quantities and costs and also requires the entity to reduce, or gives it the right to increase, its charges if the actual amounts charged differ from those estimated.

Performance factors

Many regulatory schemes give an entity the right to increase future charges if it achieves performance targets or requires the entity to reduce charges if it fails to meet the targets. There are many different types of incentives, some related to service level performance and others to factors such as controlling costs. We think that an entity should recognise a regulatory asset or liability as it meets, or fails to meet, those performance factors. Whilst the application guidance in Appendix B of the ED reflects this conclusion, we think it should be set out as one of the principles in the main body of the Standard.

We think it would be helpful to provide guidance on how to recognise regulatory assets and liabilities related to performance factors. As an example, some performance incentives set a target over a five-year period and provide for nil “compensation” if the target is achieved, with a penalty being charged if the entity falls short, by having future revenue reduced, or a reward being granted if the target is exceeded, by being able to charge additional amounts in the future. Our interpretation of the proposal is that in such a case the entity must estimate the expected or most likely amount at the end of year five and recognise a fifth of that estimate in year one as part of the total allowed compensation. The entity then re-estimates at the end of year two, adjusting so that two-fifths of the revised amount is recognised by the end of year two and so on.

In some jurisdictions the performance incentives are assessed or measured over terms spanning several financial reporting periods. This may lead to practical difficulties in measuring reliably the regulatory asset or liability. The Board may wish to consider introducing a constraint for performance-related regulatory income or expenses similar to the constraint in IFRS 15 *Revenue from Contracts with Customers*. Such an approach could be accompanied by specific disclosure requirements for the 'unrecognised' components, that could become part of future rate adjustments (some examples are discussed in IE 7C).

Differences between the timing of the regulatory base and the IFRS Standards-compliant base

The proposal would require entities to recognise regulatory assets or liabilities as a result of timing differences between IFRS Standards and regulatory requirements. These timing differences are not rights or obligations created by the regulation but rather result from factors such as an asset being recovered for regulatory purposes over a shorter or longer period than the depreciable period determined applying IAS 16 *Property, Plant and Equipment*, or because an entity is able to recover costs associated with constructing an asset before it comes into use. We have concerns about the requirement to recognise regulatory assets or liabilities, which appear to be consistent with some of concerns expressed in the Alternative View of Ms Tokar.

Assets not yet available for use

Illustrative Example 3 describes a case in which the revenues set by the regulator include returns on an asset not yet available for use. In other words, the regulated entity is entitled to recover costs it has incurred before the related asset is available for use. The example simplifies the situation such that the entity appears to report income even though its asset is not generating benefits. We understand that the example is presented in this way to isolate the consequences of the model being proposed. However, in reality, the entity is able to generate revenue even though the assets of focus are not contributing to that revenue because it has other assets. When a regulator includes unproductive assets in its regulatory base, it is because it considers a portfolio of assets and not individual assets. In contrast, the proposal would require an entity to track individual assets and their contributions to the regulatory base. We note that US GAAP has a concept of group depreciation for regulatory assets, with depreciation based on a group of assets.

We consider the regulatory returns on an asset not yet available for use, regardless of whether or not the customers are being charged for goods or services supplied using other assets and irrespective of when they are charged for the asset not yet available for use, to be a reimbursement of funding costs incurred during construction. As such, we suggest that it would be more appropriate for the amounts to be included as part of the total allowed compensation for the construction period. In contrast to rights and obligations related to quantity, cost and performance factors that arise by virtue of a regulatory agreement, these differences in the timing of the regulatory base and the IFRS Standards-compliant base are a function of the IFRS Standards.

Not reflecting these returns in profit or loss during the construction period would be inconsistent with the funding economics of the regulatory agreement and could potentially result in entities creating new non-GAAP measures to illustrate the reimbursement over the construction period.

We are also concerned about the potentially significant costs the proposal would impose on some entities to track the information necessary. Furthermore, even if entities do track individual regulatory

assets, our understanding is that the focus is on the annual regulatory cycle. Even these entities would need to undertake significant amounts of work to be able to identify the timing differences for their interim financial statements.

The proposals could cause an entity that applies IFRS Standards to its consolidated financial statements that has subsidiaries that apply US GAAP to maintain three sets of asset records related to its regulatory activities—US GAAP asset group accounting, IFRS Standards individual asset accounting and a separate regulatory set to meet the requirements of this proposal. All of the costs incurred to collect this new regulatory asset information are incurred solely to be able to adjust the amount of regulatory income or expense in a given period, and the related regulatory assets and liabilities.

If our understanding is correct, the proposal would lead to construction-related performance incentives being recognised as income when those incentives are achieved whereas regulatory returns that the regulator allows the entity on that expenditure would have to be deferred until the asset begins to be depreciated in accordance with IAS 16. These two concepts appear inconsistent.

Depreciable period

Illustrative Examples 2B and 2C reflect circumstances when the proposals consider that the difference between when a regulation specifies that an asset can be recovered and when the asset is depreciated for IFRS Standards purposes results in a timing difference to be recognised as a regulatory asset or liability.

This is another example of IFRS Standards requirements, rather than a regulatory agreement, creating regulatory assets and liabilities. It is also another area of the proposals that would require an entity to track the differences between the regulatory and IFRS Standards-compliant amounts for individual assets.

Cash paid or received

In our response to the DP, we stated that regulatory assets or liabilities might be recovered, or repaid, relatively quickly or spread over a longer period, and that their recognition should reflect the regulatory contract. We continue to hold that view.

Our understanding of the proposal is that an entity would follow the appropriate IFRS Standard for recognising the asset or liability and set up a contra account, to reverse the accrual, that would convert to a regulatory asset or liability at the amount expected to be recovered over time. We suggest that this requirement be deleted from the proposal as we believe that the regulatory assets and liabilities should not be recognised for timing difference between IFRS Standards requirements and the regulatory agreement, but instead should only be recognised with respect to an entity's right to increase, or the obligation to decrease, future rates.

Alternative Performance Measures

In our experience, in presenting alternative performance measures, regulated entities adjust for cost, quantity and performance factors. We are not aware of any entities that adjust for differences between the timing of the regulatory base and the IFRS Standards-compliant base.

More likely than not

Paragraph 28 of the ED includes a 'more likely than not' criteria for the recognition of regulatory assets and liabilities. Paragraph 5.15 of the Conceptual Framework states that "[a]n asset or liability can exist even if the probability of an inflow or outflow of economic benefits is low (see paragraphs 4.15 and 4.38)." The Framework reflects uncertainty in measurement rather than in recognition.

Our understanding is that the departure from the Framework is deliberate and designed to make it easier to apply the requirements. We can see how this could be helpful for the components of a regulatory agreement where there is uncertainty about whether a specific cost is allowable (i.e. recoverable) under that agreement. If the outcome is binary, a more likely than not criteria would result in the recognition of either the whole claim or none. We agree that the proposed approach would help achieve more consistent application of the requirements in such cases.

However, there are other components of a regulatory agreement for which it will be clear that the agreement gives the regulated entity the right to recover, or responsibility to return, in a future period amounts related to activities that have taken place in the current period, i.e. existence is certain. Nonetheless, there could be some uncertainty about how to measure that regulatory asset or liability. Reflecting that uncertainty in the measurement, such as using an expected value, could be more appropriate. This could be the case with many performance factors built into regulatory agreements.

It would be helpful if the Board provided an explanation for reaching a conclusion that seems to be inconsistent with the Framework and explained the potential consequences. Although this specific departure seems well-motivated, it assumes that all components of a regulatory agreement have similar characteristics. Our concern is that setting a more likely than not recognition criteria that applies to all components of a regulatory agreement would prevent an entity from measuring a regulatory asset or liability at an expected value when that measurement basis would be most appropriate.

An alternative approach would be to apply the criteria in the Framework but add specific measurement guidance for different types of regulatory components. For example. if a regulatory agreement gives the entity the right to recover specified costs, the proposed Standard could state that the agreement establishes that the entity has an asset. When there is uncertainty about whether a specific cost is recoverable, the entity measures the asset on the basis of the most likely outcome—i.e. for a binary amount that would be nil or the full amount depending on whether it is more likely than not the entity will be able to recover that cost. That approach would reflect the principles in the Framework and provide focused guidance on measurement that would be helpful to preparers and auditors. It is also consistent with the proposal without creating a conflict with the Conceptual Framework.

Interaction with IFRS 15

We have some concerns about how the proposal interacts with the requirements of IFRS 15. Paragraph 18(b) of the ED refers to a scenario in which the variable consideration constraint in IFRS 15.56 is applied. The consequences described in that paragraph assume that the variability would arise from the terms of the regulatory agreement. We assume that any variability in revenue that arises for other reasons would be outside the scope of the proposals given the definition of total allowed compensation in paragraph 11.

For example, the IFRS 15 revenue might be constrained because the seller could be required to refund some of the amounts received because of volume discounts. In such a case the seller would recognise a refund liability reflecting the amounts not recognised as revenue.

We think it is possible that some regulations will specify that the regulated entity is responsible for the consequences related to the constraining factor. The amount by which revenue is constrained does not give the entity a right of recovery in future periods. In such cases the regulator will typically have reflected the expected constraints in the rates it has set. If the final amounts are smaller or larger than expected, the regulator might factor that into rates it sets in the future, but the entity does not have a right to recover, or return, them through future charges.

Other regulations provide that the entity is entitled to recover constrained amounts in future periods by adding the cost to the amounts they charge customers in future periods.

Paragraph 19 could imply that constrained income in a given period never affects the total allowed compensation—i.e. the regulations assume that the invoiced amounts reflect how much of the total allowed compensation the entity has received or will receive. We think the recognition of a regulatory asset or liability should follow the rights and obligations set out in the regulation. Accordingly, if under the regulation, an IFRS 15 refund liability creates a corresponding regulatory asset, this should be recognised as regulatory income. Conversely, if the regulation assumes that the invoiced amounts, rather than the constrained amounts, are part of the total allowed compensation it would not be appropriate to recognise regulatory income.

We suggest that some guidance be added to the Standard on this issue, perhaps in the form of an Illustrative Example.

Question 5—Measurement

Paragraph 29 of the Exposure Draft specifies the measurement basis. Paragraphs 29–45 of the Exposure Draft propose that an entity measure regulatory assets and regulatory liabilities at historical cost, modified by using updated estimates of future cash flows. An entity would implement that measurement basis by applying a cash-flow-based measurement technique. That technique would involve estimating future cash flows— including future cash flows arising from regulatory interest—and updating those estimates at the end of each reporting period to reflect conditions existing at that date. The future cash flows would be discounted (in most cases at the regulatory interest rate —see Question 6). Paragraphs BC130–BC158 of the Basis for Conclusions describe the reasoning behind the Board's proposals.

a) Do you agree with the proposed measurement basis? Why or why not? If not, what basis do you suggest and why?

b) Do you agree with the proposed cash-flow-based measurement technique? Why or why not? If not, what technique do you suggest and why?

If cash flows arising from a regulatory asset or regulatory liability are uncertain, the Exposure Draft proposes that an entity estimate those cash flows applying whichever of two methods—the 'most likely amount' method or 'expected value' method—better predicts the cash flows. The entity should apply the chosen method consistently from initial recognition to recovery or fulfilment. Paragraphs BC136–BC139 of the Basis for Conclusions describe the reasoning behind the Board's proposal.

c) Do you agree with this proposal? Why or why not? If not, what approach do you suggest and why?

We generally support the measurement approach subject to the comments both below and in response to Question 6.

Consideration of existence risk in initial and subsequent measurement

We understand from discussions with the staff that existence risk is not intended to be incorporated into the measurement of regulatory assets or liabilities, i.e. a regulatory asset or liability is recognised if it satisfies the "more likely than not" threshold in paragraph 28 of the proposal and any uncertainty around existence is ignored for measurement purposes.

As previously noted, that proposal is inconsistent with the Conceptual Framework. If our understanding of the Board's intent is correct, and that it intends to override the Framework, we suggest clarifying this in the proposed Standard. Otherwise, we are concerned that the application of paragraph 39 may create diversity in practice. Specifically, some may believe that the proposals require existence risk to be factored into the measurement of regulatory assets and liabilities by using an "expected value" technique that reflects that possibility that the asset or liability will not be allowed by the regulator.

We also believe that clarification may be warranted to address situations when a regulatory asset or liability no longer meets the "more likely than not" threshold in paragraph 28 of the proposal, and whether this would constitute a remeasurement event or a derecognition event. We believe this would constitute a derecognition event however BC129 suggests that derecognition guidance is unnecessary given the remeasurement requirements of the model. As currently drafted, some may

conclude that, once recognised, actions by the regulator that reduce the recovery probability so the "more likely than" not threshold is no longer met would be reflected in measurement. In contrast, we understand that the intent is that a regulatory asset or liability must at all times remain "more likely than not" of recovery through rates in order for continued recognition to be appropriate. We believe this should be clarified to avoid confusion.

We also suggest that the proposal clarify the guidance in scenarios when the more likely than not threshold is 'barely' met, or missed, and the entity uses the most likely amount. The resolution of the uncertainty could potentially lead to material changes in estimates. Although IAS 1 has general guidance disclosures related to estimation uncertainty, when a Standard requires the use of "more likely than not criteria" the Board might want to consider disclosure requirements that are specific to the context of that uncertainty.

Question 6—Discount rate

Paragraphs 46–49 of the Exposure Draft propose that an entity discount the estimated future cash flows used in measuring regulatory assets and regulatory liabilities. Except in specified circumstances, the discount rate would be the regulatory interest rate that the regulatory agreement provides. Paragraphs BC159–BC166 of the Basis for Conclusions describe the reasoning behind the Board's proposals.

a) Do you agree with these proposals? Why or why not? If not, what approach do you suggest and why?

Paragraphs 50–53 of the Exposure Draft set out proposed requirements for an entity to estimate the minimum interest rate and to use this rate to discount the estimated future cash flows if the regulatory interest rate provided for a regulatory asset is insufficient to compensate the entity. The Board is proposing no similar requirement for regulatory liabilities. For a regulatory liability, an entity would use the regulatory interest rate as the discount rate in all circumstances. Paragraphs BC167–BC170 of the Basis for Conclusions describe the reasoning behind the Board's proposals.

b) Do you agree with these proposed requirements for cases when the regulatory interest rate provided for a regulatory asset is insufficient? Why or why not?

c) Have you identified any other situations in which it would be appropriate to use a discount rate that is not the regulatory interest rate? If so, please describe the situations, state what discount rate you recommend and explain why it would be a more appropriate discount rate than the regulatory interest rate.

Paragraph 54 of the Exposure Draft addresses cases when a regulatory agreement provides regulatory interest unevenly by applying a series of different regulatory interest rates in successive periods. It proposes that an entity should translate those rates into a single discount rate for use throughout the life of the regulatory asset or regulatory liability.

d) Do you agree with the proposal? Why or why not? If not, what do you recommend and why?

We do not agree with the proposal and believe the regulatory interest rate(s) should be used in measuring regulatory assets and liabilities in all cases. Introducing a requirement to assess whether the rate is "sufficient" or blending rates into a single rate introduces complexity that increases the

compliance costs, and interpretative differences, with no obvious benefits. This is consistent with our view that the regulatory accounting should reflect the terms of the regulatory agreement.

If the requirements on sufficiency of the regulatory interest rate in paragraphs 50–52 is retained, it should be extended to regulatory liabilities to ensure consistent treatment for both assets and liabilities. We also think that more guidance on determining a "sufficient" rate is needed as well as a discussion of how the discount rate relates to a discount rate in an impairment assessment.

We also note that IFRS 15 includes a practical expedient that allows an entity to be relieved from recognising a separate financing component. Similar, optional, relief could be considered for the proposal.

Question 7—Items affecting regulated rates only when related cash is paid or received

In some cases, a regulatory agreement includes an item of expense or income in determining the regulated rates in the period only when an entity pays or receives the related cash, or soon after that, instead of when the entity recognises that item as expense or income in its financial statements. Paragraphs 59–66 of the Exposure Draft propose that in such cases, an entity would measure any resulting regulatory asset or regulatory liability using the measurement basis that the entity would use in measuring the related liability or related asset by applying IFRS Standards. An entity would adjust that measurement to reflect any uncertainty that is present in the regulatory asset or regulatory liability but not present in the related liability or related asset. Paragraphs BC174–BC177 of the Basis for Conclusions describe the reasoning behind the Board's proposals.

a) Do you agree with the measurement proposals when items of expense or income affect regulated rates only when related cash is paid or received? Why or why not? If not, what approach do you suggest for such items and why?

When these measurement proposals apply and result in regulatory income or regulatory expense arising from remeasuring the related liability or related asset through other comprehensive income, paragraph 69 of the Exposure Draft proposes that an entity would also present the resulting regulatory income or regulatory expense in other comprehensive income. Paragraphs BC183–BC186 of the Basis for Conclusions describe the reasoning behind the Board's proposal.

b) Do you agree with the proposal to present regulatory income or regulatory expense in other comprehensive income in this case? Why or why not? If not, what approach do you suggest and why?

Please see our response to Question 4 for part (a) of this question.

We suggest paragraph 69 clarifies that if the related liability or asset is remeasured through profit or loss then the remeasurement of the regulatory asset or liability should also be presented in profit or loss.

Question 8—Presentation in the statement(s) of financial performance

Paragraph 67 of the Exposure Draft proposes that an entity present all regulatory income minus all regulatory expense as a separate line item immediately below revenue. Paragraph 68 proposes that regulatory income includes regulatory interest income and regulatory expense includes regulatory interest expense. Paragraphs BC178–BC182 of the Basis for Conclusions describe the reasoning behind the Board's proposals.

a) Do you agree that an entity should present all regulatory income minus all regulatory expense as a separate line item immediately below revenue (except in the case described in Question 7(b))? Why or why not? If not, what approach do you suggest and why?

b) Do you agree with the proposed inclusion of regulatory interest income and regulatory interest expense within the line item immediately below revenue? Why or why not? If not, what approach do you suggest and why?

The interaction of the disclosure requirements in the ED with IFRS 15 and the (proposed) IAS 1 replacement is not clear. IFRS 15 defines revenue as "income arising in the course of an entity's ordinary activities". The proposed Standard requires the presentation of regulatory income minus regulatory expense as a net amount immediately below "revenue". We suggest that these terms be defined (and the net amount that is required to be disclosed) be defined or at least described. It is not clear whether the proposal considers regulatory income and expenses to be a component of revenue or an element of a different nature.

The total allowed compensation and revenue from contracts with customers should be the same, over time. The Board could consider whether an entity should be required to disclose total revenue from its regulated customer base, separating revenue that meets the definition of revenue from contracts with customers and the net regulatory income less regulatory expense.

Question 9—Disclosure

Paragraph 72 of the Exposure Draft describes the proposed overall objective of the disclosure requirements. That objective focuses on information about an entity's regulatory income, regulatory expense, regulatory assets and regulatory liabilities, for reasons explained in paragraphs BC187–BC202 of the Basis for Conclusions. The Board does not propose a broader objective of providing users of financial statements with information about the nature of the regulatory agreement, the risks associated with it and its effects on the entity's financial performance, financial position or cash flows.

a) Do you agree that the overall disclosure objective should focus on information about an entity's regulatory income, regulatory expense, regulatory assets and regulatory liabilities? Why or why not? If not, what focus do you suggest and why?

b) Do you have any other comments on the proposed overall disclosure objective?

Paragraphs 77–83 of the Exposure Draft set out the Board's proposals for specific disclosure objectives and disclosure requirements.

c) Do you have any comments on these proposals? Should any other disclosures be required? If so, how would requiring those other disclosures help an entity better meet the proposed disclosure objectives?

d) Are the proposed overall and specific disclosure objectives and disclosure requirements worded in a way that would make it possible for preparers, auditors, regulators and enforcement bodies to assess whether information disclosed is sufficient to meet those objectives?

The overall disclosure objective is very generic. It is not clear whether it is designed to elicit information to help a user understand the "relationship between an entity's revenue and expenses" or how an entity's recognised revenue is influenced by the rate regulation (and hence the regulatory income and regulatory expense). We think the latter is more appropriate.

We note that the proposal does not propose a broader disclosure objective. However, in our experience, many entities subject to regulatory arrangements already include good disclosure of the nature of such arrangements and their effects on financial performance, position and cash flow given that this information is critical to an understanding of their operations. We suggest that consideration be given to broadening the disclosure requirements given this will largely codify already existing best practice.

Question 10—Effective date and transition

Appendix C to the Exposure Draft describes the proposed transition requirements. Paragraphs BC203–BC213 of the Basis for Conclusions describe the reasoning behind the Board's proposals.

a) Do you agree with these proposals?

b) Do you have any comments you wish the Board to consider when it sets the effective date for the Standard?

Transition

We have highlighted the significant operational concerns related to record keeping and the need to implement new accounting systems to track regulatory balances on an asset by asset basis.

If the model currently proposed in the proposal is retained, in particular a requirement for the tracking of individual assets, we believe an extended transition period of at least 24 months would be required to allow preparers enough time to implement the changes that would be needed. Furthermore, we suggest considering a practical expedient for a modified retrospective method of adoption. Many regulated assets have very long lives and full retrospective application could require an entity to identify differences potentially over many decades. In contrast, if the proposals are simplified to no longer require the tracking of individual assets, retrospective application could become more cost effective.

Business combinations

The proposal has an exception for business combinations which paragraph 213 of the BC describes as a "simpler approach". This differs from the optional exemption available for first-time adopters in IFRS 1, which would recognise any adjustment through opening retained earnings rather than goodwill. Most new Standards have simpler business combination-related transition provisions that do not require (or permit) an adjustment to goodwill.

We have concerns with both the consequences and meaningfulness of adjusting goodwill and believe that adjusting equity is more consistent with other requirements.

Question 11—Other IFRS Standards

Paragraphs B41–B47 of the Exposure Draft propose guidance on how the proposed requirements would interact with the requirements of other IFRS Standards. Appendix D to the Exposure Draft proposes amendments to other IFRS Standards. Paragraphs BC252–BC266 of the Basis for Conclusions describe the reasoning behind the Board's proposals.

a) Do you have any comments on these proposals? Should the Board provide any further guidance on how the requirements proposed in the Exposure Draft would interact with any other IFRS Standards? If yes, what is needed and why?

b) Do you have any comments on the proposed amendments to other IFRS Standards?

IFRIC 12 Service Concessions

We note that many service concessions include some form of price controls. Paragraph B47 of the proposal suggests that an entity could be in the scope of both IFRIC 12 and the proposed Standard. We think it is important that the proposals provide clear guidance, and examples, of the circumstances when both sets of requirements would apply.

We think that if the Board simplifies the model, by removing the requirement to include "IFRS Standards timing differences" in regulatory assets or liabilities, it reduces the risk of unintended consequences from the interaction between the proposals and IFRIC 12.

IAS 34 Interim Financial Statements

Many regulated businesses have cyclical (seasonal) variation. For example, water and power usage can vary by season. The proposal does not set out what assumptions an entity should apply when preparing its interim financial statements. For example, the actual sales quantities could be lower than the estimates used to set the rate on a smoothed annualised basis but higher than estimated on a seasonally adjusted basis. Would the entity recognise a regulatory asset or liability? IAS 34.37 states that revenues that are received seasonally, cyclically, or occasionally within a financial year cannot be anticipated or deferred if that accounting would not be appropriate at the end of the entity's financial year. This suggests that the entity would recognise a regulatory asset in the interim period because the unadjusted sales are lower than the assumed regulatory recovery, even though economically the entity is recovering more than expected. Some clarity around this would be beneficial.

IAS 36 Impairment of Assets

We also recommend that the Board includes guidance in respect of the impact of regulatory assets and liabilities for impairment testing purposes under IAS 36.

Question 12—Likely effects of the proposals

Paragraphs BC214–BC251 of the Basis for Conclusions set out the Board's analysis of the likely effects of implementing the Board's proposals.

a) Paragraphs BC222–BC244 provide the Board's analysis of the likely effects of implementing the proposals on information reported in the financial statements and on the quality of financial reporting. Do you agree with this analysis? Why or why not? If not, with which aspects of the analysis do you disagree and why?

b) Paragraphs BC245–BC250 provide the Board's analysis of the likely costs of implementing the proposals. Do you agree with this analysis? Why or why not? If not, with which aspects of the analysis do you disagree and why?

c) Do you have any other comments on how the Board should assess whether the likely benefits of implementing the proposals outweigh the likely costs of implementing them or on any other factors the Board should consider in analysing the likely effects?

We think that some aspects of the proposals will impose significant costs on entities while the related benefits remain unclear. As we have explained in our answer to Question 4, the aspects that we are concerned about relate to the recognition of regulatory assets and liabilities that stem from timing differences between the regulation and IFRS Standards requirements—such as assets under construction, regulatory and IFRS Standards depreciation mismatches and cash versus accrual requirements.

We are concerned that the effects analysis may underestimate the costs of complying with the proposals and overstates the informational benefits of these aspects of the proposed model—the latter because entities are likely to report alternative performance measures to adjust for these components of regulatory income.

Question 13—Other comments

Do you have any other comments on the proposals in the Exposure Draft or on the Illustrative Examples accompanying the Exposure Draft?

We suggest that a detailed analysis of the differences between the requirements in the proposed standard and in US GAAP be included in the Basis for Conclusions.

In some jurisdictions, the regulated rate to be charged to customers is reduced by the current year inflation of the regulatory asset base (the regulated rate includes 'economic depreciation' which is the depreciation on the regulatory asset basis net of inflation). In some cases, this inflation is then recovered in the regulated rate through an increased return of capital (i.e. depreciation of the regulatory asset base). Currently the only references to inflation are in B13 and Illustrative Example 7C.2. To the extent the Board retains its proposal to recognise regulatory assets and liabilities because of the difference in useful lives for the accounting compared to regulatory purposes, we believe that any inflation that has accrued at the reporting date and is entitled to be recovered through an increased return of capital in future periods, should be considered as a regulatory asset (or reduction of a regulatory liability).

The proposal does not include examples of a regulated entity using a fair value option for IFRS Standards purposes and how this might interact with the proposal. We suspect this would only be an issue if the Board continues with its proposal to create regulatory assets or liabilities because of differences in the timing of regulatory and IFRS Standards-compliant depreciation. Similarly, decommissioning costs are typically added to the cost of an asset and included in depreciation when applying IFRS Standards. This creates another timing difference. Illustrative Example 4 is unhelpful because it assumes that all of the supply of services is delivered, and the IFRS Standards expense for decommissioning is incurred, on day one. The accounting is more complex than that example implies. As we have emphasised, the proposals would be significantly less complex if the focus was on cost, quantity and performance factors.

Drafting Appendix

This Appendix lists drafting suggestions that we believe would aid preparers and other users of the proposed Standard.

Objective (paragraphs 1-2)

Paragraph 1: 'The objective of those principles' - replace 'those' with 'these'

Paragraph 2(a): '…That understanding will provide insights into the entity's ~~prospects for~~ expected future cash flows' – proposed deletion

Scope (paragraphs 3-6)

Paragraph 4: '…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.' – change to 'to be charged to customers in future periods. This asset reflects the fact that part of the total allowed compensation for goods or services already supplied will be included in revenue in the future'.

Paragraph 5: '…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.' – change to 'to be charged to customers in future periods. This liability reflects the fact that 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.'

Regulatory agreement (paragraphs 7-9)

We suggest adding a paragraph along the lines of the following:

> The term of a regulatory agreement may cover a longer period than that for which future rates have been set. In assessing whether there is an enforceable regulatory agreement an entity must consider the terms of any operating licence, or equivalent, and not just the period over which a pricing agreement is in place.

We have also indicated in our detailed response that entities should be required to disclose the nature of the regulatory agreement and any significant judgements or assumptions they have made about the period over which it is enforceable.

Differences in timing (paragraphs 13-17)

We suggest stating the result of applying the guidance in paragraphs 15-16 to the fact pattern presented in paragraphs 13-14, i.e. that regulatory income and a regulatory asset of CU20 is recognised.

Other differences relating to revenue recognition (paragraphs 18-19)

Paragraph 18: '…to a customer but is required not to recognise part or all of the resulting revenue…' – change to 'to a customer but is not permitted to recognise part or all of the resulting revenue…'

Paragraph 18(b): 'estimates of variable consideration are constrained until related uncertainty…' – change to 'estimates of variable consideration are constrained until any related uncertainty…'

Measurement (paragraphs 29-30)

Paragraph 30 add (c):

> (c) does not factor in existence risk which is considered only for recognition purposes (see paragraph 28).

Estimating future cash flows (paragraphs 31-44)

Paragraph 32: consider adding an 'e.g.' to the end of the final sentence to give some context around a type of future change to a regulatory agreement/legislation.

Paragraph 34(b): we noted this seemed slightly superfluous as we would expect the timing of the addition or deduction to automatically be part of an entity's considerations of the boundary of the regulatory agreement.

Paragraph 42: consider specifying that if circumstances change so that the other method better predicts the cash flows associated with the regulatory asset or liability an entity is entitled to change method.

Disclosure (paragraphs 72-83)

Paragraph 72(a): '…That understanding will provide insights into the entity's ~~prospects for~~ future cash flows' – proposed deletion.

Paragraph 73: '…That understanding contributes to providing insights into the entity's ~~prospects for~~ future cash flows over many periods…' – proposed deletion

Paragraph 73 states that "the information described in paragraph 72(a) contributes …" yet 72(a) contains the objective, not the information. The objectives in paragraphs 77 (regulatory income and expenses) and 79 (regulatory assets and liabilities) are much more focused and relevant objectives and help with the related disclosures in paragraphs 78 and 80. The main ideas in these paragraphs could be developed to give a clearer overarching objective. We also note that the objectives in paras 77 and 79 suggest that the overarching disclosure objective we prefer is what was intended.

We suggest a paragraph be added in line with that in IFRS 15:112: 'Information need not be disclosed in accordance with this IFRS Standard if it has already been provided in accordance with another IFRS Standard'.

Appendix A Defined terms

Definition of allowable expense: '…entitles an entity to recover by adding an amount in determining a regulated rate.' – change to '…entitles an entity to recover by including an amount in determining a regulated rate.'

Definitions of regulatory asset and regulatory liability: see suggested edits to paragraphs 4 and 5 of the proposal.

We suggest adding the definition of a rate regulator (see our response to Question 1).

Appendix B Application guidance

Total allowed compensation

Paragraph B3: see suggest edit to definition of allowable expense.

Paragraph B4: suggest changing '…some period' in the first sentence to '…a period'.

Paragraph B9: suggest changing '…some period' in the penultimate sentence to '…a period'.

Target profit

Paragraph B15: suggest adding clarification that expenditure on assets under construction that represents an allowable expense under a regulatory agreement may form part of total allowed compensation (c.f. the scenario described in paragraph B15).