

## STAFF PAPER

May 2017

## IASB Meeting—education session

<b>Project</b>	<b>Rate-regulated Activities</b>		
<b>Paper topic</b>	Developing the basis for the model		
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**Purpose of this education session**

1. The purpose of this education session is to continue the development of the underlying basis for a new accounting model (the model) for rate-regulated activities. The model aims to give users of financial statements relevant and understandable information that represents faithfully how the rate adjustment mechanism in a ‘*defined rate regulation*’ regulatory agreement affects the entity’s financial position, performance and future cash flows. The model aims to recognise, as assets and liabilities, supplementary rights and supplementary obligations arising from the regulatory agreement. For convenience, we use the labels ‘regulatory assets’ and ‘regulatory liabilities’ for those supplementary rights and supplementary obligations.
2. We aim to develop a clear description of the principles underpinning the model, the nature of the assets and liabilities that the model aims to recognise, and the overall mechanics of the model before we ask the Board to decide on detailed requirements. Consequently, we are not asking the Board to make decisions about the model in this meeting. Instead, the paper asks the Board whether our analysis is clear and whether it has any questions that could further improve clarity.

3. This paper expands the analysis discussed by the Board in April 2017 and responds to clarifying questions raised by Board members in the April meeting.<sup>1</sup>
4. This paper contains:
  - (a) Background:
    - (i) The regulatory agreement (paragraphs 6-15); and
    - (ii) Definitions of assets and liabilities (paragraphs 16-21).
  - (b) Characteristics of defined rate regulation (paragraphs 22-42);
  - (c) Accounting for the regulatory agreement:
    - (i) The relationship between the model and IFRS 15 *Revenue from Contracts with Customers* (paragraphs 46-50);
    - (ii) Why the model does not propose an intangible asset approach (paragraphs 51-54).
  - (d) Next Board discussion (paragraphs 55-58); and
  - (e) Questions for the Board (paragraph 59).

## Background

5. In this section, we outline how the regulatory agreement creates supplementary rights and obligations for an entity that conducts activities during the period that are subject to defined rate regulation. The model aims to recognise such supplementary rights and obligations as assets and liabilities.

### ***The regulatory agreement—customer vs entity perspective***

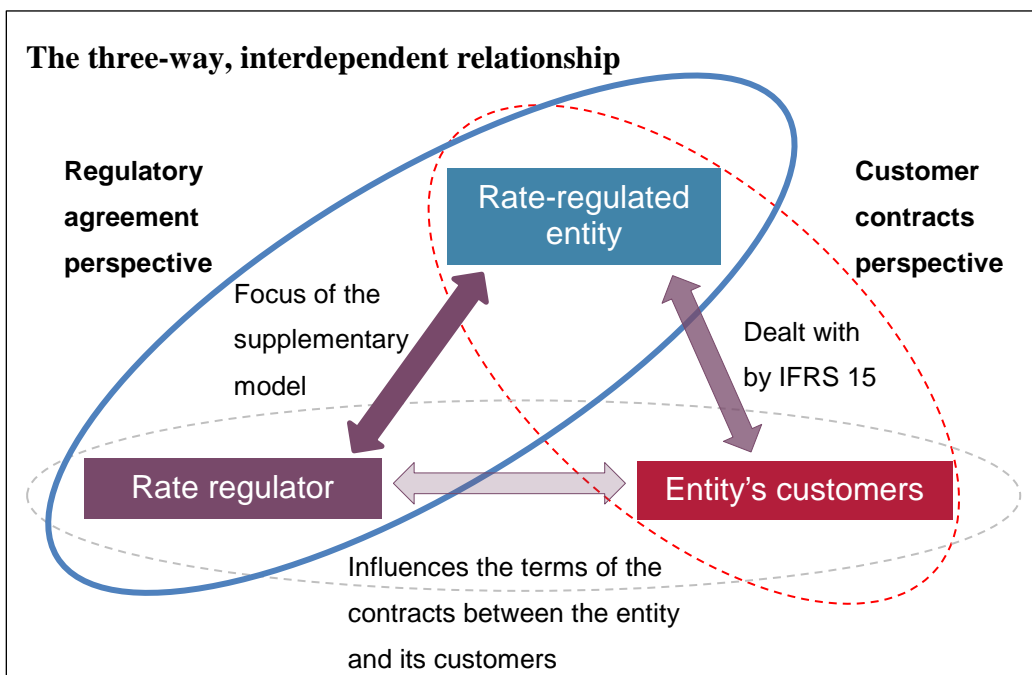
6. In defined rate regulation (see paragraph 23), the regulatory agreement between the rate regulator and the entity imposes service requirements on the entity that involve the delivery of goods or services to customers over more than one financial reporting period. The regulatory agreement may also require the entity to carry out other activities relating to government-imposed social or environmental policies, which may not relate directly to the delivery of goods or

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<sup>1</sup> See Agenda paper 9 *Summary of the model's approach*, April 2017.

services to customers. We use the term ‘regulatory requirements’ to cover both service requirements related to the delivery of goods or services to customers and other requirements related to other government-imposed policies.

7. In addition, the regulatory agreement establishes the entity’s entitlement to be compensated in exchange for satisfying its regulatory requirements. However, the rate regulator does not promise to pay the entity directly. Instead, the rate regulator uses its regulatory powers to intervene in the setting of terms and conditions in contracts between the entity and its individual customers. In particular, the regulatory agreement establishes the basis for setting the price that the entity will charge its customers in exchange for the goods or services it delivers to customers during each period covered by the regulatory agreement. (In this paper, we use the term ‘regulated rate’ to refer to that price.)
8. The rate regulator’s intervention in establishing the basis for setting the regulated rate creates a three-way, interdependent relationship between the entity, the rate regulator and the entity’s customers.



9. If the customer contracts are looked at in isolation, there is a simple price (P) x quantity (Q) relationship. The entity satisfies its performance obligations by delivering goods or services (Q) in a specified period at a specified price (the regulated rate, P). The individual customers are obliged to pay, and the entity is entitled to receive, the amount billed (P x Q).

10. However, if the customer contracts are looked at in the context of the regulatory agreement, and particularly the fact that it specifies the basis for setting the regulated rate, there is no longer a simple relationship between the quantity of goods or services delivered to customers during the period and the price charged for those goods or services. This is because the rate regulator uses the regulated rate as a mechanism to:
- (a) deliver to the entity the amount of compensation to which it is entitled in exchange for satisfying all of its regulatory requirements (see paragraph 6);
  - (b) improve the stability and predictability of pricing for customers; and
  - (c) spread the cost of the regulatory requirements across different classes and generations of existing and future customers.
11. As a result, when looking from the perspective of the regulatory agreement, the regulated rate in each period does not merely reflect the price of the goods delivered to customers during the same period. This is because the regulatory agreement:
- (a) may specify that the regulated rate to be used in the individual contracts with customers is based on estimated amounts and that the rate regulator will adjust the future rate to reflect allowable or chargeable estimation variances arising in the period;<sup>2</sup> and
  - (b) specifies how to determine what amounts are included in the regulated rate to compensate the entity for the various activities that the entity carries out to satisfy the regulatory requirements established by the regulatory agreement.
12. We have found it helpful, when considering the entity's rights and obligations in the regulatory agreement, to distinguish between two components of the regulated rate:

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<sup>2</sup> Not all variances between estimated amounts and actual amounts will result in adjustments to a future regulated rate. In this paper, 'allowable estimation variances' refer to amounts that the rate-setting mechanism will include in the rate calculation to increase the regulated future rate. Similarly, 'chargeable estimation variances' refer to amounts that the rate-setting mechanism will include in the rate calculation to decrease the regulated future rate.

- (a) the amount that reflects the satisfaction of regulatory requirements during the period, based on the estimates used to calculate this amount; and
  - (b) the amount that reflects the origination and reversal of estimation variances and of temporary differences arising when the regulated rate in one period includes amounts relating to required activities carried out by the entity in a different period (see paragraph 13).
13. The inclusion of a rate adjustment mechanism in the regulatory agreement creates rights and obligations for the entity that supplement those arising from the individual contracts between the entity and its customers. This is because the rate adjustment mechanism:
- (a) gives the entity a right to an increase in the future rate to reflect that:
    - (i) an allowable estimation variance has arisen; or
    - (ii) the entity has satisfied part or all of a regulatory requirement but the rate regulator has not yet included in the regulated rate an allowable amount relating to the satisfaction of that requirement (ie a temporary difference has arisen that will reverse when the regulated rate increases to reflect the satisfaction of the regulatory requirement in this period); and
  - (b) imposes on the entity an obligation to reduce a future rate to reflect that ‘excess’ compensation was received when:
    - (i) a chargeable estimation variance has arisen; or
    - (ii) the rate regulator has included in the current regulated rate an allowable amount relating to a regulatory requirement that has yet to be satisfied (ie a temporary difference has arisen that will reverse when the entity satisfies the regulatory requirement but the regulated rate is decreased to reflect the amount already included in the rate charged in this period).
14. The right to increase the future rate, or obligation to reduce the future rate, does not override the rights and obligations in current contracts with customers. Thus, the entity does not retrospectively adjust amounts already charged to customers

during the period. If events and activities during the period result in a right to increase the future rate, the entity does not send additional bills to existing customers requiring an additional payment for goods or services received during the period.<sup>3</sup> Instead, the supplementary right described in paragraph 13(a) will ultimately lead to an inflow of economic benefits when customers pay an increased regulated rate for future goods or services.

15. Similarly, if events and activities during the period result in an obligation to decrease the future rate, the entity does not send credit notes or refund payments to existing customers discounting the price of goods or services transferred to them during the period.<sup>4</sup> Instead, the entity will fulfil the supplementary obligation described in paragraph 13(b) by reducing the rate at which it will transfer goods or services in one or more future periods.

### ***Definitions of asset and liability***

16. Respondents to the Discussion Paper *Reporting the Financial Effects of Rate Regulation*, published in September 2014 (the Rate regulation DP), and participants in subsequent outreach asked us to explain how the model links to [the forthcoming revisions to] the *Conceptual Framework for Financial Reporting* (the *Conceptual Framework*), particularly the definitions of assets and liabilities. We outline, in paragraphs 17-21, the main aspects of the definitions and supporting guidance that we consider most pertinent to understanding the basis for the model. We have used the proposals in the Exposure Draft *Conceptual Framework for Financial Reporting* (the *Conceptual Framework ED*), updated when applicable for the Board's tentative decisions in subsequent discussions.

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<sup>3</sup> In some cases, the entity may have a right to send additional bills to existing customers requiring an additional payment for goods or services received during the period. In such cases, the entity has a financial asset that would be accounted for as a receivable using IFRS 9 *Financial Instruments*.

<sup>4</sup> In some cases, the entity may have an obligation to send credit notes or refund payments to existing customers discounting the price of goods or services transferred to them during the period. In such cases, the entity has a financial liability that would be accounted for as a payable using IFRS 9.

17. The Conceptual Framework ED provides the following definitions:
- (a) An asset is a present economic resource controlled by the entity as a result of past events. An economic resource is a right that has the potential to produce economic benefits.
  - (b) A liability is a present obligation of the entity to transfer an economic resource as a result of past events.
18. The definitions of assets and liabilities in the *Conceptual Framework* focus on rights and obligations. The guidance supporting the definitions highlights the importance of commercial substance and the need for contractual terms to have a discernible effect on the economics of a contract. In particular, paragraph 4.55 of the Conceptual Framework ED indicates that terms that bind neither party have no commercial substance and should be disregarded.

#### *Assets*<sup>5</sup>

19. The guidance accompanying the proposed definition of an asset highlights that for an entity to have an asset, it must have a right that both has the potential to produce economic benefits for the entity *beyond those available to all other parties* and is *controlled* by the entity. An entity controls an economic resource if it has the right to deploy the economic resource in its activities and if, in addition, any economic benefits from that resource flow to the entity (either directly or indirectly) rather than to another party. Control in this context does not imply that the entity can ensure that the resource will produce economic benefits in all circumstances.

#### *Liability*<sup>6</sup>

20. The guidance accompanying the proposed definition of a liability highlights that for an entity to have a liability, it must have an obligation to transfer an economic resource. Obligations to transfer an economic resource need not result in a direct outflow of cash. For example, such an obligation can exist if the obligation

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<sup>5</sup> See paragraphs 4.13–4.23 of the Conceptual Framework ED.

<sup>6</sup> See paragraphs 4.27–4.28 and 4.31–4.42 of the Conceptual Framework ED.

requires an exchange of economic resources with another party on unfavourable terms or if it requires the provision of services.

21. For an entity to have a liability, its obligation must be a present obligation that exists as a result of past events. An entity has a present obligation that exists as a result of past events only if the entity has already received economic benefits, or conducted activities, that will or may require it to transfer an economic resource that it would not otherwise have had to transfer. A present obligation can exist at the end of the reporting period even if the transfer of economic benefits cannot be enforced until some point in the future. In addition, an obligation may be expressed as being conditional on a particular future action that might be taken by the entity, such as conducting particular activities. The entity has an obligation if it has no practical ability to avoid taking that action.

### **Characteristics of ‘defined rate regulation’**

22. The majority of respondents to the Rate Regulation DP, and participants in subsequent outreach, suggested that defined rate regulation creates identifiable rights and obligations that are distinguishable from those of entities that are not subject to such rate regulation.
23. In this project, we have been using ‘defined rate regulation’ as a label for a form of economic regulation established through a formal regulatory framework, which:
- (a) establishes a basis for setting the regulated rate chargeable by an entity to its customers for the transfer of specified goods and/ or services;
  - (b) includes a mechanism to adjust the regulated rate to reflect:
    - (i) the correction of past estimation variances; or
    - (ii) the origination or reversal of temporary differences arising when the regulated rate in one period includes amounts relating to required activities carried out by the entity in a different period (see paragraph 13).
  - (c) is binding on both the entity and the rate regulator;
  - (d) establishes minimum service levels or other service requirements; and



- (e) imposes limitations on entry into an industry (and on exit from it).
24. In the following paragraphs we outline why we consider the characteristics listed in paragraph 23 to be important to support the basis for the model. In particular, we highlight how the characteristics could be analysed using the definitions of assets and liabilities in the *Conceptual Framework*. We do not express an opinion about whether *all* of the characteristics listed in paragraph 23 are necessary to identify the items that would fall within the scope of the model. However, we think that together they mean that the supplementary rights and obligations described in paragraph 13 meet the definitions of assets and liabilities.
25. In a future meeting, we will bring a paper with recommendations about how to define the scope of an IFRS Standard that would contain the model and would replace IFRS 14 *Regulatory Deferral Accounts*.<sup>7</sup> In that paper we will discuss what combination of characteristics, if not all of them, is sufficient to determine the scope of the model.

*Establishes a basis for setting the rate chargeable **and** includes a rate adjustment mechanism*

26. We consider together the two characteristics listed in paragraphs 23(a) and 23(b), ie the defined rate regulation (a) establishes a basis for setting the regulated rate and (b) includes a mechanism that adjusts the regulated rate to reflect the correction of past estimation variances or the origination or reversal of temporary differences. The rate adjustment mechanism can exist only as part of a mechanism that establishes the basis for setting the regulated rate chargeable.
27. Those two characteristics are necessary to ensure that:
- (a) the supplementary rights discussed in this paper have the potential to provide economic benefits not available to other entities; and
  - (b) the supplementary obligations discussed in this paper oblige the entity to transfer economic benefits.

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<sup>7</sup> IFRS 14 is a temporary IFRS Standard that permits first-time adopters to continue to recognise amounts related to rate regulation in accordance with their previous GAAP requirements when they adopt IFRS Standards. However, to enhance comparability with entities that already apply IFRS Standards and do not recognise such amounts, IFRS 14 requires that the effect of rate regulation must be presented separately from other items.

28. In normal competitive markets, all entities have a right to set prices and the price may be constrained by market conditions or other factors. In that setting, the right to set and increase prices does not produce economic benefits beyond those available to all other parties. Consequently, there is no right that meets the definition of an asset. Similarly, constraining factors do not create an obligation to decrease prices and so there is no obligation that meets the definition of a liability.
29. In contrast, the regulatory agreement creates rights and obligation only for entities that are bound by that agreement. We have found it helpful to distinguish two components of those rights and obligations:
- (a) the right to charge a regulated rate, set in accordance with a mechanism specified in the regulatory agreement (the characteristic in paragraph 23(a)); and
  - (b) the right or obligation to adjust the regulated rate for one or more future periods in accordance with a rate adjustment mechanism that that adjusts the rate to reflect one or both of:
    - (i) the correction of past estimation variances; or
    - (ii) the origination or reversal of temporary differences arising when the regulated rate in one period includes amounts relating to required activities carried out by the entity in a different period (see paragraph 13).
30. We consider that the characteristic that the regulatory agreement establishes the basis for setting the rate chargeable by an entity is necessary but not sufficient to create regulatory assets and liabilities. If an entity held the right described in paragraph 29(a) but did not hold the right or obligation mentioned in paragraph 29(b), the regulated rate would include only the component identified in paragraph 13(a), ie the amount that reflects the satisfaction of regulatory requirements during the period, based on the estimates used to calculate this amount. This means that the entity would not have the supplementary right or supplementary obligation described in paragraph 13. As a result, there would be no need to develop an accounting model for defined rate regulation. This is because, as described in paragraph 28, the right to set prices, even when those prices are constrained, does not create an asset or liability for the entity. In such

circumstances, the entity would simply recognise revenue at the price set in paragraph 29(a), in accordance with IFRS 15 *Revenue from Contracts with Customers*. It would also recognise the cost of goods or services sold in the same period.

31. The need to develop an accounting model for defined rate regulation arises from the right or obligation mentioned in paragraph 29(b), described as a ‘supplementary right’ or ‘supplementary obligation’ in paragraph 13. Consequently, we consider the rate adjustment mechanism listed in paragraph 23(b) to be an essential characteristic of defined rate regulation. The rate adjustment mechanism provides a clear distinction between defined rate regulation and ‘market regulation’.<sup>8</sup>

*Binding on both the entity and the rate regulator*

32. The model focuses on reflecting the entity’s rights and obligations created by a regulatory agreement that binds both the entity and the rate regulator. The regulatory agreement may take the form of a contractual licensing agreement signed by both parties. Alternatively, it may be imposed through statute.
33. Whatever form the regulatory agreement takes, it is important that its terms bind the parties to it in order for those terms to have a discernible effect on the economics of the regulatory agreement. Terms that bind neither party have no commercial substance (see paragraph 18).
34. The regulatory agreement nor the entity can compel the entity’s customers to buy the regulated goods or services. However, this does not mean that the entity’s right to charge its customers the regulated rate for any goods or services the customers buy cannot meet the definition of an asset. This is because, although an economic resource derives its value from its existing potential to produce future economic benefits, the economic resource is the existing right, not the future economic benefits.

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<sup>8</sup> Market regulation typically applies when competition in a market is insufficient to protect customers from suppliers making excessive profit. The rate regulator’s intervention is usually restricted to imposing a cap on the price that can be charged for the specified goods or services. However, the rate regulator does not establish the total amount of revenue or profit that an entity can earn. Consequently, the regulation does not include a ‘rate adjustment mechanism’ that determines the amount of profit or profit margin that an entity can earn.

35. Nevertheless, the revised *Conceptual Framework* notes that the Board might conclude that recognition of the asset is not appropriate if the probability of an inflow of economic benefits is low. We will consider the role of probability and uncertainty in both recognition and measurement of regulatory assets and regulatory liabilities in a future meeting.

*Minimum service levels or other service requirements*

36. If the regulatory agreement did not specify minimum service levels or other service requirements, the entity might be able to reduce service levels to nullify the effect of a future reduction in the reduced rate. Arguably, this characteristic is not a separate characteristic, but supports the characteristic that refers to specifying a basis for setting the regulatory rate.

*Limitations on entry into an industry (and exit from it)*

37. This characteristic helps to ensure that:
- (a) an entity's supplementary rights created by the rate-adjustment mechanism in the regulatory agreement have the potential to produce economic benefits; and
  - (b) an entity's supplementary obligations created by that mechanism have the potential to require the entity to transfer economic benefits.

*Supplementary right*

38. In order for an entity's supplementary right to meet the definition of an asset, the right must have the potential to produce economic benefits beyond those available to all other parties (see paragraph 19). If the market for the regulated goods or services being provided by the entity were to be open to competition, the right to charge the increased rate would not meet this test because all other competitors would have that right.
39. The regulatory limit on entry into the industry means that not all other parties have the right to charge the increased rate. Thus, the entity's supplementary right has the potential to produce economic benefits beyond those available to all others.

*Supplementary obligation*

40. In order for the entity's supplementary obligation to 'refund' compensation received through a reduction in the future rate to meet the definition of a liability, the entity must:
- (a) have no practical ability to avoid supplying regulated goods or services at the reduced rate; and
  - (b) have already received economic benefits, or conducted activities, that will require it to transfer an economic resource that it would otherwise not have had to transfer (see paragraph 21).
41. As we described in paragraph 13(b), an entity's supplementary obligation created by the rate adjustment mechanism arises because the entity has already received economic benefits (ie 'excess' compensation) that will require it to transfer an economic resource (by reducing a future rate) that it would otherwise not have had to transfer. Consequently, the condition in paragraph 40(b) is met.
42. Paragraphs 4.32-4.33 of the Conceptual Framework ED state that an entity would have no practical ability to avoid a transfer if the only way to avoid the transfer is by liquidating the entity or ceasing trading. This is because such an action would cause significant business disruption and have economic consequences significantly more adverse than the transfer itself. Consequently, it may not be essential to include the characteristic that defined rate regulation has limitations on exit from an industry. The economic consequences of exiting from a market may be sufficient. We will discuss this further when we bring a paper to the Board to establish the criteria to establish a scope for the model.

**Accounting for the regulatory agreement**

43. The principle of the model is to recognise the supplementary rights and supplementary obligations arising from the rate adjustment mechanism in the regulatory agreement. Those supplementary rights and supplementary obligations result from activities during the period and establish a right or obligation to charge a higher or lower regulated rate in a future period (see paragraph 13).

44. We recommend that the requirements of other IFRS Standards are applied, without amendment, before applying the model. This includes applying the requirements of IFRS 15.
45. The following paragraphs outline why we consider that IFRS 15 is the appropriate IFRS Standard to account for the entity's contracts with individual customers. We also explain why we are not proposing to use an intangible asset approach as the basis for the model (see paragraphs 51-54).

### ***IFRS 15 Revenue from Contracts with Customers***

46. IFRS 15 specifies the accounting for an individual contract with a customer and requires that an entity recognises revenue when (or as) the entity transfers a promised good or service (ie an asset) to a customer.
47. As described in paragraph 9, the rights and obligations arising from contracts with customers are reflected by the price-quantity relationship (P x Q). Information about this relationship is relevant to users of financial statements, whether the basis for setting the price P is established by the entity or by a rate regulator.
48. IFRS 15 is, therefore, the appropriate IFRS Standard to account for the entity's contracts with its individual customers. Applying the requirements of IFRS 15 provides relevant and understandable information to users of financial statements about the entity's revenue and related contractual rights to receive compensation from customers in exchange for goods or services delivered.
49. However, the financial effect of the entity's transactions with customers through those contracts can only be fully understood when viewed in the wider context of the regulatory agreement. This is because, as noted in paragraphs 11-13 and 29(b), the regulated rate used in the contracts with customers includes adjustments that arise from the regulatory adjustment mechanism and relate to other activities and other periods.
50. Presenting regulatory assets, liabilities and the related adjustments to profit or loss separately from the amounts recognised using IFRS 15 provides users of financial statements with relevant and understandable information that represents faithfully how the rate adjustment mechanism in the regulatory agreement affects the

entity's financial position, performance and future cash flows. As outlined in paragraphs 55-58, we will discuss presentation in the next Board meeting.

### ***Developing a new model without applying an intangible asset approach***

51. The regulatory agreement establishes a range of rights and obligations for the entity that encompass many aspects of the entity's rate-regulated business and how it is operated. This combination of rights and obligations might be seen as forming an intangible asset. However, we consider that the resulting intangible asset, if considered as a single unit of account, forms a part of, but is not separable from, the business as a whole or goodwill. This is because the regulatory agreement has a pervasive effect on the value of the entity's rate-regulated business.
52. The Rate regulation DP highlighted some problems with using the requirements of IAS 38 *Intangibles Assets* to reflect the rights and obligations arising from the regulatory agreement.<sup>9</sup> Consequently, the Rate regulation DP highlighted that developing an 'intangible asset model' for rate regulation would involve developing requirements different from those contained in IAS 38. The problems with using the requirements of IAS 38 include the following:
- (a) Some entities would be prohibited from recognising an intangible asset for the regulatory agreement because IAS 38 does not allow the initial recognition of intangible assets at amounts other than cost (paragraphs 21, 24 and 76 of IAS 38). This means that many rate-regulated entities would not recognise a regulatory intangible asset because many such entities do not pay a fee to acquire or renew a regulatory agreement.
  - (b) Most, if not all, entities would be prohibited from recognising the supplementary rights and obligations highlighted in paragraph 13 as changes in the value of any regulatory intangible asset. This is because IAS 38 permits an entity to subsequently measure an intangible asset at

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<sup>9</sup> See paragraphs 5.35-5.46 of the Rate regulation DP.

fair value only if its fair value can be measured by reference to an active market (see paragraphs 75-78 of IAS 38).

- (c) The supplementary rights and supplementary obligations highlighted in paragraph 13 arise because of the rate adjustment mechanism contained in the regulatory agreement. Any costs incurred by the entity that result in the creation of such supplementary rights and obligations are unlikely to be satisfy the requirements of IAS 38 to be classed as costs ‘incurred subsequently to add to, replace part of, or service’ any original intangible asset recognised (see paragraphs 18 and 20-23 of IAS 38).

53. Few respondents to the Rate regulation DP expressed support for developing an intangible asset model, for both conceptual and practical reasons.<sup>10</sup> The reasons identified through the responses to the Rate regulation DP and through subsequent outreach include:

- (a) Changes in the value of the regulatory agreement intangible asset may incorporate changes in the value of the business and internally generated goodwill. Such changes in value would, by their nature, include amounts that relate to future cash flows, transactions and events, including the associated profit of those future transactions. This would involve a significant level of measurement uncertainty in respect of future transactions and events.
- (b) Recognising overall changes to the value of an intangible asset would not communicate the timing of reversals in the temporary differences arising from the supplementary rights and obligations. This information is important to help users of financial statements predict the effects of the regulatory adjustment on the timing of cash flows.
- (c) If the net effect of the supplementary rights and supplementary obligations described in paragraph 13 is isolated and treated as a separate regulatory intangible asset, it is not clear how the net effect

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<sup>10</sup> See paragraphs 52-56 of Board Agenda Paper 9 *Initial analysis of responses to the Discussion Paper*, February 2015.



meets the definition of an intangible asset, particularly when the net effect results in a credit balance (ie a net regulatory liability); and

- (d) Developing a new intangible asset model for rate regulation could cause unintended consequences to the accounting for other intangibles assets and may create a conflict or confusion with the intangible asset model existing within IFRIC 12 *Service Concession Arrangements*.

54. Consequently, at this time, we are not looking to develop a model that would treat the regulatory agreement, or the supplementary rights and obligations that form a component of it, as an intangible asset within the scope of IAS 38. Instead, we are developing a model that focuses on identifying the supplementary rights and supplementary obligations as separate assets and liabilities. We consider that this provides users of financial statements with more relevant and understandable information that produces a more faithful representation of financial position and financial performance.

### **Next Board discussion**

55. We suggest that the assets and liabilities recognised using the model should be presented as separate line items in the statement of financial position, categorised as regulatory assets and regulatory liabilities. This is, in part, because the nature of the assets and liabilities does not fall clearly into existing categories such as property, plant and equipment, intangible assets, receivables, payables or provisions. We do not consider this to be controversial because many entities that currently recognise ‘regulatory assets and liabilities’ in accordance with local generally accepted accounting principles and practice (GAAP) or IFRS 14 already recognise them separately.
56. IFRS 14 also requires the movements in regulatory assets and liabilities that are recognised as adjustments in profit or loss to be presented, distinguished from revenue, income and expenses recognised in accordance with other IFRS Standards. However, the presentation of movements in regulatory assets and liabilities in profit or loss using local GAAPs is mixed—some movements are included within revenue, some within expense items and some are presented

separately, depending on the nature of the activity that created the regulatory asset or liability.

57. We stated above that we consider that revenue presented in accordance with IFRS 15 provides relevant and understandable information to users of financial statements about the entity's revenue and related contractual rights to receive compensation from customers in exchange for goods or services delivered (see paragraph 48). Consequently, we consider that presenting all regulatory adjustments to profit or loss separately from revenue, supported by disclosure about the causes of the adjustments, would provide users of financial statements with a more faithful and understandable representation of the entity's financial performance. It would also reduce complexity in the model.
58. We will bring an analysis of this issue to the next Board meeting. The analysis will include discussion about how regulatory assets and regulatory liabilities originate (ie what transactions or other events generate them). The nature of the originating transaction or other event will also influence the pattern and timing of reversal of any regulatory asset or regulatory liability recognised.

### Questions for the Board

59. We do not ask the Board to make decisions about the model at this meeting.

#### Questions for the Board

Do you consider the summary to be clear on the regulatory agreement and how it creates supplementary rights and obligations for the entity (paragraphs 6-15)?

Do you consider the summary to be clear on how the characteristics of defined rate regulatory support the conclusion that the supplementary rights and supplementary obligations created by the rate adjustment mechanism in rate regulation meet the definitions of assets and liabilities in the *Conceptual Framework* (paragraphs 22-42)?

Do you have any questions that you want us to respond to within the analysis to be discussed in the next Board meeting (paragraphs 55-58)?