Australian Government

Australian Accounting Standards Board

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Dr Andreas Barckow
Chairman
International Accounting Standards Board
London, United Kingdom
(submitted via the IASB website)

30 July 2021

Dear Dr Barckow,

AASB submission on IASB ED/2021/1 *Regulatory Assets and Regulatory Liabilities*

The Australian Accounting Standards Board (AASB) is pleased to have the opportunity to provide comments on ED/2021/1 *Regulatory Assets and Regulatory Liabilities* issued in January 2021.

In formulating these comments, the views of Australian stakeholders were sought and considered. This included targeted consultation with key stakeholders, such as preparers of financial statements, auditors and professional bodies, as well as consultation with the AASB's User Advisory Committee, which comprises a range of primary users of financial statements.

The AASB acknowledges the efforts of the International Accounting Standards Board (IASB) and broadly supports the direction of ED/2021/1 as the AASB believes the proposals would provide general purpose financial statement (GPFS) users with information that would help them understand which fluctuations in the relationship between an entity's revenue and expenses are caused by differences in timing due to regulatory rates.

However, as noted in the Appendix, the AASB does have some concerns with some of the proposals, including:

- the approach to regulatory returns relating to assets not yet available for use;
- determining total allowed compensation in a period in relation to performance incentives, especially those with an incomplete time frame, such as a period longer than a year;
- the treatment of allowable expenses that form part of the total allowed compensation, which might lead entities to report non-IFRS measures based on the compensation that the regulator determines for a reporting period;
- the lack of a constraining limitation in estimating uncertain future cash flows, which differs from the approach under IFRS 15; and
- the full retrospective transition approach could be onerous for entities to adopt.

Given these concerns and the complexity of the proposals, the AASB encourages the IASB to field test the proposals after consideration of the responses to the ED, to ensure that the (revised) proposals are practical and can be implemented without undue cost. Nearly all Australian financial statement preparers that would be subject to a resulting Standard have no experience of rate regulation

accounting as set out in ED/2021/1 because the proposals extend beyond consideration of cost and quantity variances. In addition, many do not have systems that track the regulatory asset base on an individual asset-by-asset basis.

If you have any questions regarding this submission, please contact me or Clark Anstis, Technical Principal (canstis@aasb.gov.au).

Yours sincerely,

Dr Keith Kendall
AASB Chair

APPENDIX

AASB responses to questions raised in the IASB Exposure Draft ED/2021/1

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).[1] 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?

1 A regulatory agreement is defined in the Exposure Draft as a set of enforceable rights and obligations that determine a regulated rate to be applied in contracts with customers.

The AASB agrees with the proposed objective and scope and considers the proposals will provide general purpose financial statement (GPFS) users with information that will help them understand which fluctuations in the relationship between an entity's revenue and expenses are caused by timing differences due to the effect of regulatory rates under regulatory agreements. The AASB has not

identified any situations where the proposed requirements would affect activities that are not subject to rate regulation.

The majority of feedback received from Australian stakeholders generally supported the proposals on the basis that they will establish robust and consistent reporting requirements to provide more accurate, useful and comparable information in GPFS. It was also suggested that the proposals could be supported as they are analogous to requirements in some other Standards, such as IAS 12 *Income Taxes*.

Regulatory agreements

The AASB also heard that some entities were unsure whether they would be captured by the proposals, as they considered that the scope of the ED is too broad and could require entities to consider another level of analysis to assess whether a resulting Standard would be relevant to their circumstances. This is because the Standard would apply to those entities with regulatory assets and liabilities, which goes beyond merely identifying whether the entity is subject to rate regulation. However, the AASB considers the proposed scope is appropriate and notes that, like any new Standard, entities would need to assess its relevance. Furthermore, it is unlikely that entities would have regulatory assets and liabilities at the date of initial application of a Standard without already being aware of the effects of regulatory agreements on their ability to set prices that they can charge to customers in the future for their products. Entities would need to assess whether they are subject to timing differences between revenue per IFRS 15 *Revenue from Contracts with Customers* and total allowed compensation.

It may assist entities to determine whether a Standard would be relevant to them if the scope of the Standard illustrated and clearly excluded price cap arrangements that do not give rise to any timing differences as described in the ED. For example, simple regulatory agreements may just set maximum prices, leaving it up to an entity to manage its supply costs as it sees fit. Under more complex arrangements, the negotiations at the end of a regulatory agreement for the following agreement may take into account volume and cost variances under the current agreement. However, the entity might have no rights and obligations relating to those variances until the next agreement is struck, and in that case no regulatory assets and liabilities relating to those variances would arise under the current agreement. A Standard would appear not to apply in such circumstances.

The AASB does not see a suitable basis on which to exclude regulatory agreements of particular types or subject to regulators with particular attributes. Substance over form should be followed, with the result that entities assess the relevance of a Standard to their own regulatory agreements.

There is also some uncertainty regarding identifying regulatory agreements where entities operate under expectations of continuing into the future as the supplier of regulated goods and services without necessarily having formal long-term agreements in place. Price determination agreements typically are negotiated between the entities and the regulator for shorter periods.

Service concession arrangements

Paragraph 8 in the ED notes that regulatory agreements may take the form of service concession arrangements (SCA), for example. The AASB is not aware whether any SCA in Australia would give rise to timing differences contemplated by the ED. However, it would be useful if the application to SCA was explained and illustrated further. For instance, if an SCA does result in such timing differences, these result in regulatory assets or liabilities that are additional to the financial asset or intangible asset that the operator would recognise under Interpretation IFRIC 12 *Service Concession Arrangements*.

The explanation in paragraph BC52 of the Basis for Conclusions that regulatory assets and liabilities are not financial assets and liabilities should be extended to address the case of SCA, if applicable, where the operator has a financial asset for amounts due from or at the direction of the grantor. The timing differences to be accounted for under rate regulation accounting still relate to regulated rates charged to customers, even if the grantor is to increase or reduce its payments to the operator at that time.

Insurance arrangements

The AASB did hear some concerns as to whether regulated insurance arrangements could be subject to regulatory accounting requirements. Given the complexities of insurance accounting under IFRS 17 *Insurance Contracts*, a specific exclusion for insurance arrangements might be appropriate and should be considered by the IASB or else the application to insurance arrangements addressed in detail.

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?

Regulatory assets and liabilities

The AASB agrees with the proposed fundamental definitions of regulatory assets and regulatory liabilities and that they are consistent with the *Conceptual Framework for Financial Reporting*, for the reasons noted in paragraphs BC37–BC47 of the Basis for Conclusions. A key aspect of regulatory assets

is that the right to charge a higher amount under regulated rates for the future supply of the goods or services is based on a past event – part of the total allowed compensation for goods or services already supplied has not yet been charged to customers. The right is therefore not a future asset.

Similarly, for regulatory liabilities, a key aspect is that the obligation to charge a lower amount under regulated rates for the future supply of the goods or services is based on a past event – part of the revenue charged to customers for goods or services already supplied represents total allowed compensation for goods or services to be supplied to customers in the future. The obligation is therefore not a future liability. The AASB agrees that a reduction in future cash inflows represents a transfer of economic resources.

The AASB agrees that regulatory assets and liabilities should be accounted for separately from other assets and liabilities arising from a regulatory agreement as those other elements would be subject to recognition, classification, presentation and disclosure requirements under other IFRS Standards. There is no apparent benefit in trying to modify those other requirements to incorporate regulatory assets and liabilities. Their separate presentation and disclosure should assist users of financial statements to assess their significance for an entity.

Total allowed compensation

The AASB also agrees with the proposed fundamental definition of total allowed compensation (TAC). The full amount of the compensation for goods or services supplied that a regulatory agreement entitles an entity to charge customers should be recognised in profit or loss (or other comprehensive income, when appropriate) in the period of supply, subject to revenue deferrals in accordance with IFRS 15 (as per ED paragraphs 18–19).

The basic approach of treating an allowable expense (and its recovery in TAC) as relating to the supply of goods or services in the period when the expense is recognised under Standards appears to be an appropriate approach. This principle underpins the recognition of regulatory assets and liabilities based on timing differences as to when amounts are recognised as revenue under Standards.

It is necessary for TAC to also cover other amounts that do not represent explicitly the recovery of allowed expenses, such as regulatory returns on the regulatory asset base and additional expense recoveries due to different measurements for regulatory purposes in comparison with financial reporting requirements. Such amounts are encompassed by the "profit component" of TAC, although some clarification of the proposals here may be helpful – see Question 3 comments.

Information usefulness

Some Australian stakeholders have significant reservations about the difficulties of estimating future cash flows under regulatory agreements and have raised concerns that the resulting regulatory assets, liabilities, income and expenses could be volatile, particularly where regulatory arrangements are not stable from one pricing determination to the next. Price determination periods of which the AASB is aware range from two to five years in term, which could result in significant changes in regulatory amounts recognised in the financial statements when a pricing determination changes significantly.

There appears to be general understanding of the effects of cost and quantity variances in giving rise to regulatory assets and liabilities, as these are explained in paragraphs 13–15 of the ED. However, the effects of timing differences in allowable expenses such as depreciation are much more difficult to

understand, despite the explanation in paragraphs B6–B8. Consequently, the usefulness of the resulting regulatory amounts might be limited without clarification of the effects of these timing differences until financial statement users have more experience with affected financial statements. Including the recovery of an allowable expense in the total allowed compensation for the period when that expense is recognised for financial reporting purposes is not intuitive, when the recovery cash flow through regulated rates occurs in a different period. The AASB is concerned that entities might elect to provide additional non-IFRS disclosures that remove the differences between the amount determined for reporting purposes and the recovery cash flows that the regulator has determined are appropriate for the entity to recover in a particular period.

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?

The AASB agrees generally with how an entity would determine total allowed compensation (TAC) for goods or services supplied in a period. However, the AASB has identified some concerns.

Assets not yet available for use

The AASB heard stakeholder concerns with the approach to regulatory returns relating to assets not yet available for use, noting that regulatory compensation during the construction period is clearly intended by the regulator to compensate for construction costs and related funding. Under paragraph B15, the regulatory return is proposed to form part of TAC only for goods or services supplied over the periods in which the asset is available for use and recovered through the regulated rates. This approach is an exception to the general approach to "target profit" as set out in paragraph B10, which treats an amount added in determining a regulated rate for goods or services supplied in a period as forming part of the TAC for the goods or services supplied in that period.

The IASB aims to justify this proposal by arguing that including the regulatory return in the TAC for goods or services supplied before the asset is in use would contradict the principle underlying the ED.

That principle is set out in paragraph 16 (and paragraph BC30) as an entity reflecting the TAC for goods or services supplied as part of its financial performance for the period in which those goods or services are supplied. However, the AASB considers that the exception relating to assets not yet available for use has not been adequately justified. If a regulatory agreement permits an entity to include a return on assets not yet available for use in rates charged to customers for goods or services supplied, then the regulator intends that the return provides compensation for the entity in that period, prior to the asset becoming available for use. From the regulator's perspective, the return is part of the TAC for the goods or services supplied in that period. This view would support applying the general approach to target profit, without the need for an exception, and can be argued as consistent with the principle underlying the ED.

The IASB also explains in paragraph BC98 that the exception would avoid a lack of comparability between (1) regulatory agreements that accumulate the construction-period regulatory returns until the asset is available for use and (2) agreements that include those returns in rates charged to customers during the construction period. However, since these two types of agreements are structured differently, the appropriate approach might be to reflect those differences instead of adding an exception to force the accounting for the second type to be the same as for the first type. Recognising the regulatory return in the period in which it arises would also obviate the need to recognise regulatory liabilities and allocate the regulatory return on a reasonable basis over the remaining periods in which the asset amount is recovered through regulated rates (example 3 illustrates the complexity of the approach proposed in the ED).

Contrast with construction performance incentives

The AASB notes that the proposed exception for regulatory returns relating to assets not yet available for use differs from the proposed approach to construction performance incentives. Under paragraph B18, the performance incentives related only to construction work would form part of or reduce the TAC for goods or services supplied in the construction period, prior to the asset becoming available for use. The AASB supports this approach.

The IASB acknowledges in paragraphs BC102–BC105 that this approach is "arguably" inconsistent with the principle underlying the model in the ED. The IASB concluded the approach is appropriate because the construction period is when the relevant performance occurs and the approach would provide more useful and understandable information, while also avoiding unnecessary costs of different policies for different performance incentives.

The AASB considers that this same justification could be applied to the approach to regulatory returns relating to assets not yet available for use, i.e. providing more useful and understandable information and avoiding the costs of different policies for different types of regulatory returns.

Performance incentives

The AASB supports the general approach of including performance incentives in the TAC for goods or services supplied in the period in which the performance giving rise to the incentive occurs (paragraph B17), and the application of this approach to construction performance incentives, as noted above.

The AASB has concerns over the difficulty for entities in estimating the amount of performance incentives that relate to an incomplete time frame, especially for incentives with a performance period longer than a year. An entity would apply either the 'most likely amount' method or the 'expected

value' method in estimating the uncertain future cash flows (paragraph 39), however it is not clear how an entity would apportion the estimated incentive amount to the relevant periods, in order to include the amount in the TAC for the goods or services supplied in each period. Significant estimations are therefore likely in practice, which potentially could be volatile. Consideration should therefore be given to including a constraining limitation similar to that for estimates of variable consideration under IFRS 15 (paragraph 56), which requires a significant reversal to be highly unlikely when the uncertainty is resolved. In some cases, it might not be appropriate to recognise any performance incentive until the performance time frame is complete.

Other TAC components

The proposed guidance in paragraphs B3–B9 regarding amounts that recover allowable expenses (less chargeable income) does not explicitly address the effect of quantity variances, which are illustrated in Example 2A. As the regulatory accounting effects of such quantity variances are likely to be the most easily understood by entities adopting rate regulation accounting for the first time, it would be helpful to explain these timing difference effects in the Appendix B application guidance, instead of leaving them to the Illustrative Examples, which would accompany a Standard but not form part of it.

In contrast, paragraph B7 does explain the treatment of timing differences arising in respect of depreciation expenses, which can result in significant regulatory assets and liabilities. Examples 2B and 2C then illustrate the effects of the regulatory agreement using a longer or shorter recovery period than the asset's useful life. Nevertheless, it would be helpful for paragraph B8, which deals with the remaining carrying amount of depreciable assets, or the examples to be extended to clarify the effect of any differences to their regulatory carrying amounts. It is also not clear whether it would be appropriate (or required) to calculate the timing difference as the difference between the carrying amount and the regulatory asset base for each asset subject to a regulatory agreement. The AASB recommends this is specifically addressed in the paragraphs of the Standard.

Furthermore, the recovery of allowable expenses as a component of TAC appears to be limited to amounts expensed under Standards. Any additional recovery due to a different measurement of balances such as property, plant and equipment for regulatory purposes would therefore appear to be treated as target profit components of total allowed compensation. The AASB recommends that the IASB clarify this, since target profit is presented as comprising the components of profit margins on allowable expenses, regulatory returns and performance incentives, which do not clearly encompass additional allowable expense amounts.

Further guidance

The normal presumption in the proposals and illustrative examples appears to be that the regulatory balances used as the basis for regulatory returns and the recovery of allowable expenses are the same as the balances or amounts recognised under Standards. In many or most Australian regulatory agreements, the regulator determines their own base amounts after considering an entity's pricing proposals. The regulatory asset base (the common term in Australia) might also be indexed with periodic inflation adjustment of the asset base.

There are some references in the ED to differences between amounts recognised under Standards and regulatory bases but these are not well-developed. The discussion in paragraph B13 addresses the regulatory return on a differently constituted or measured regulatory asset base. The general principle

of paragraph B10 for target profit is applied – whatever the amount of the regulatory return, include that in the TAC for goods or services supplied in the same period.

Additional illustrative examples would be very helpful here, for example to help entities distinguish when regulatory amounts should be treated as recoveries of allowable expenses versus regulatory returns on regulatory bases. The distinction is important, given the different approaches to including the amounts in TAC: expense recoveries are related to the recognition of expenses for financial reporting purposes but regulatory returns are related to the period in which the return arises.

The distinction is not clear where a regulator develops general regulatory amounts or bases that are not clearly linked to the amounts or even the items that are recognised under Standards. For example, regulatory agreements in the Australian energy sector generally include operating expenditure amounts and income tax amounts, based on the regulator's efficiency estimates. It is not clear how an entity should relate such regulatory amounts to specific expenses recognised under Standards where the components of the regulatory amounts are not specifically identified.

The illustrative examples assume an identifiable link between items and amounts for regulatory and financial reporting purposes, such as for the depreciation of plant and equipment. However, this can be completely lacking where a regulatory agreement establishes an aggregate regulatory asset base without identifying the specific items or amounts. In such a case, it would be helpful to clarify whether all allowed regulatory amounts relating to the regulatory asset balance should be treated as regulatory returns. Under this approach, timing differences would not arise in respect of the implicit differences between allowed depreciation and depreciation expense as it would not be feasible to identify differences between useful lives and recovery periods or relate depreciation recoveries to recognised depreciation expense. This would simplify the accounting considerably.

Perhaps it would be appropriate to address this as a unit of account issue. For example, the differences between allowed depreciation and depreciation expense in aggregate could be treated as the timing differences, but further guidance would be required regarding how to assess whether in aggregate there are differences in asset useful lives versus recovery periods. It is not clear whether paragraph 24 of the ED would accommodate this approach, with its emphasis on "individual" timing differences as a separate unit of account and its exception for rights and obligations with similar expiry patterns and risks.

Question 4 – Recognition

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).

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

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

(b) 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?

All regulatory assets and liabilities

The IASB noted in paragraph BC127 its understanding that if a regulatory asset or regulatory liability exists, the probability that it will give rise to an inflow or outflow of economic benefits is generally high because of the design of the regulated rate and because of regulatory oversight of an entity applying the regulatory agreement in determining the regulated rate. In the AASB's view, this supports the general approach of requiring an entity to recognise all its regulatory assets and liabilities (and the associated regulatory income and expenses).

However, the inclusion of a recognition threshold of 'more likely than not' in paragraph 28 of the ED immediately qualifies the "recognise all" requirement. This is considered in the following section.

Recognition threshold

The AASB notes that the *Conceptual Framework* (CF) no longer includes a probability threshold in the recognition criteria for assets and liabilities and resulting income and expenses. However, the CF does explain that judgement is required to assess whether recognition of an element will provide useful information to financial statement users (at an appropriate cost to the entity) – that is, relevant and representationally faithful information. Both existence uncertainty and outcome/measurement uncertainty affect this judgement.

It is open to the IASB to assist entities with these judgements through requirements or guidance in individual Standards. The AASB does not object to the proposed 'more likely than not' recognition threshold, which is consistent with the approach in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* for provisions. In general, the AASB does not see a significant role for this threshold in rate regulation accounting, based on the expectation that existence uncertainty would normally be minor in the context of the enforceable rights and obligations under regulatory agreements.

However, it could be of significance in relation to some TAC components. For example, there might be scope under a regulatory agreement for an entity to seek approval from the regulator to recover through regulated rates certain expenses incurred during the regulatory period that were not addressed in the agreement. In this case, the entity would need to assess whether in its view the regulator would agree to the recovery of those additional expenses. This could be subject to significant uncertainty if there is no precedent regarding treating such expenses as allowable expenses.

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?

The AASB agrees generally with the measurement proposals. Modified historical cost, using updated future cash flow estimates but an historical discount rate (unless changed in accordance with the regulatory agreement or otherwise by the regulator) is an appropriate general measurement basis.

The AASB received feedback from some stakeholders of concerns with the degree of estimations required by the proposals, noting that estimations can be very subjective. The AASB notes the regulatory environment often is dynamic as there may be numerous changes from the regulator during a regulatory period and, as a result, the proposals may create volatility. For example, a regulator can make decisions within a pricing period that can change the basis of previous cash flow estimates.

Consequently, as noted in Question 3 regarding the basis for allocating a performance incentive to TAC across multiple reporting periods, consideration should be given to including a constraining limitation similar to that for estimates of variable consideration under IFRS 15, so that significant reversals in future cash flow estimates are highly unlikely.

Assets and liabilities extending beyond the regulatory period

The ED and illustrative examples generally assume that the regulatory period and the effective life of assets are reasonably similar. However, this normally will not be the case, as most infrastructure plant and equipment has a useful life much longer than either the relatively short term of a pricing determination period (typically two to five years) or a long-term regulatory licence period, with some assets having very long lives, e.g. even ninety years and more for some network assets.

With regulatory periods potentially significantly shorter than asset lives, an entity would have to assess whether it has regulatory assets and liabilities if the relevant cash flows are expected to occur beyond the term of the current regulatory agreement. That is, the entity needs to assess the boundary of the regulatory agreement (paragraph B28). This will be affected by provisions (if any) in the regulatory agreement as to the treatment of outstanding regulatory assets and liabilities at the conclusion of a regulatory period. Additional guidance and examples in this respect would be helpful, to clarify the recognition of regulatory assets and liabilities in relation to assets with useful lives extending well beyond the regulatory period.

Impairment of regulatory assets

Paragraph BC141 indicates that there is no need for a separate impairment test for regulatory assets, since the future cash flows reflect the estimated changes caused by factors such as demand risk and credit risk. Paragraphs 37–38 address the uncertainty of cash flows and illustrate the effect of credit risk. The AASB considers that it could be useful to add a further example, perhaps labelled price risk. In

some cases, although an entity has the right to add an amount in setting future regulated rates, it might not be realistic in the light of public pressure regarding the rate of increase in regulated rates. Entities would need to consider such factors as well in estimating future cash flows, which adds to the subjectivity of the measurement basis.

The consequential amendments proposed in Appendix D of the ED would exclude regulatory assets from the scope of IAS 36 *Impairment of Assets*. However, the IASB should consider whether guidance needs to be added to IAS 36 in respect of impairment testing of the underlying infrastructure assets. Entities might find it problematic to distinguish the cash flows relating to a regulatory asset and those relating specifically to the property, plant and equipment since those cash flows may be assessed jointly by the entity and not regarded as independent.

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?

The AASB agrees generally with the proposal to use the discount rates specified in a regulatory agreement for the relevant regulatory assets and liabilities. The pricing proposals from entities in preparing for a new regulatory period typically go through a public consultation process with the regulator, resulting in public disclosure of an entity's proposed regulatory interest rates and the regulator's determinations. Using the regulatory rates would provide an objective basis for the discount rates. Some stakeholders have suggested that typically there is not a significant difference between proposed and final regulatory interest rates.

Minimum interest rate for regulatory assets

The AASB has some concerns over the proposal to permit an entity to apply a “minimum”, higher interest rate for a regulatory asset if it assesses the regulatory interest rate as insufficient to compensate for the time value of money and the uncertainty of the future cash flows. This adds subjectivity to the measurement basis, which might be reduced if further guidance is added as to suitable approaches to making that assessment and determining an alternative interest rate. An entity typically would not be able to look to similar assets within the same organisation that are not subject to rate regulation in order to estimate an alternative, minimum rate, given the specialised nature of most regulated assets.

No alternative interest rate for regulatory liabilities

The proposals would require the regulatory interest rate to be used without exception for regulatory liabilities. Paragraphs BC169–BC170 explain this approach as avoiding unnecessary cost and complexity for entities. The IASB appears happy to accept lower (higher) regulatory interest expense over time instead of lower (higher) regulatory expense upon the initial recognition of a lower (higher) regulatory liability if an interest rate higher (lower) than the regulatory rate was used.

The proposals therefore do not appear to be neutral in their treatment of regulatory assets and liabilities: regulatory assets should be measured using a minimum rate when higher than the regulatory rate so that the regulatory assets are reduced appropriately. This approach needs to be better justified, since using the regulatory interest rate without exception for regulatory assets might also be explained as avoiding unnecessary cost and complexity. Many regulatory agreements are likely to give rise to regulatory liabilities, with the recovery period shorter than the long useful life of assets covered by the regulatory asset base. The measurement of regulatory liabilities is just as important as the measurement of regulatory assets.

Other adjustment of regulatory interest rates

Some regulatory agreements specify the regulatory interest rate in real terms, i.e. adjusted for inflation, or possibly net of income tax effects. It would be useful to clarify that the relevant future cash flows should be estimated on a consistent basis, or else the regulatory interest rate should be adjusted to be consistent with the basis for the estimated cash flows.

Uneven regulatory interest rate

Paragraph 54 requires a series of different regulatory interest rates to be “translated” to a single discount rate to apply to that regulatory asset or liability throughout its life. It is not clear what translation process is contemplated without Illustrative Example 5. This example also covers a change to the regulatory interest rate, which paragraph 58(b)(i) also refers to paragraph 54 and translation to a single discount rate.

It would be preferable for paragraph 54 to state the principle to be applied, such as the single discount rate is the rate that discounts the (updated) estimated future cash flows to the carrying amount of the regulatory asset or liability at initial recognition or when the regulatory interest rate changes. Of course, if other methods were also contemplated, then Example 5 would not be regarded as providing interpretative guidance.

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?

The AASB has not determined a view on the accounting proposed for items affecting regulated rates only when related cash is paid or received – stakeholders did not comment either. Paragraphs 59–66 incorporate some complexities and it is only Illustrative Example 4 that assists in explaining the impact of the proposals. However, this is a simplified example, of the regulatory recovery of an expense where the related liability (provision) is measured at present value under IAS 37. An example where the related asset or liability is not measured at present value could assist in understanding and applying the requirements.

Paragraph BC174 notes that these proposals could apply to items recognised as income or expenses through the application of IAS 12 *Income Taxes*, for example. An illustration of such application would also be useful to clarify whether the regulatory asset/liability reflects only current tax amounts, or else both current and deferred tax amounts – does this depend on the terms of the regulatory agreement?

Presentation outside net regulatory income or expense

Paragraph 69 provides an exception to presenting all regulatory income or expense in profit or loss: when the related asset or liability is remeasured through other comprehensive income, the regulatory income or expense is also recognised in other comprehensive income. This would make it easier for an entity to explain the circumstances, as contemplated in paragraphs 84–85. The question therefore arises whether regulatory effects related to income tax payments (or receipts) should similarly be recognised in income tax expense rather than in the net regulatory income or expense presented immediately below revenue.

Question 8 – Presentation in the statement(s) of financial position

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 AASB agrees with the presentation proposals.

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 AASB agrees with the disclosure proposals. The specific disclosure objective relating to regulatory assets and liabilities in paragraph 79 is the same as the overall disclosure objective set out in paragraph 72(b). It would be more useful to generalise the overall disclosure objective, perhaps by reference to the statement of financial position. Otherwise, the need for both overall and specific disclosure objectives is unclear.

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?

The AASB received feedback from some stakeholders of concerns with the proposed retrospective application of a Standard, with some suggesting restricting the retrospective application to one previous price determination period (usually 4 or 5 years). It was also noted that regulated entities can have assets with useful lives of 100+ years and some were concerned about how far back into their accounting they could go to identify depreciation expense differences, for example.

The AASB recommends the IASB seek ways to either simplify or better explain the implementation of a final Standard. Very few Australian entities have ever recognised regulatory balances previously (under the Australian equivalent of IFRS 14 *Regulatory Deferral Accounts* or otherwise), and the requirements of retrospective application appear to be unclear and onerous.

Perhaps a key point to be emphasised is that the objective of retrospective application is to identify and measure the regulatory assets and liabilities that exist at the date of transition (i.e. the beginning of the earliest comparative period presented in the first financial statements in which the Standard is applied).

Entities should already be aware of the limitations on their ability to set future prices for goods or services pursuant to a regulatory agreement. The regulatory assets and liabilities that exist at the date of transition would reflect those limitations – and any clause in expired regulatory agreements or pricing determinations requiring compensation for outstanding regulatory assets and unfulfilled regulatory liabilities. The implementation effort might therefore be directed to measuring the regulatory assets and liabilities that have arisen in reasonably recent time frames, as well as introducing accounting systems to enable compliance with any resulting Standard, without the need to reconsider the accounting of decades past.

Clarification of what retrospective application requires would certainly help entities largely unfamiliar with rate regulation accounting. The costs of implementing the proposals could be substantial, including the development of new accounting systems to track regulatory balances on an individual asset basis, where this is possible, or otherwise on some aggregated basis, depending on the regulator's approach to determining the regulatory asset base. With a present focus on regulatory amounts as they arise, rather than total allowed compensation, many entities may find it impracticable to identify accumulated timing differences retrospectively.

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?

The AASB has not considered the interaction with other IFRS Standards.

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?

The AASB has no comments in response to Question 12.

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?

Inflation adjustments appear to be common in many Australian regulatory agreements. In many cases, the regulator reduces the rate that can be charged in a particular period by the inflation of the regulatory asset base in that period. This is only a timing difference because the regulator then allows recovery of the inflation through increased regulatory depreciation in future periods. Paragraph B13 refers to inflation adjustments of the regulatory asset base, without further exposition in the proposed Standard paragraphs. However, Example 7C.2 takes the approach that inflation adjustments are a form of target profit, and therefore that the adjustments do not affect regulatory assets because current-period inflation will affect regulated rates only in future periods. The AASB questions whether it would be more consistent with the proposed timing difference approach (to the extent it is retained) to treat such inflationary adjustments as a timing difference similar to that of the differences in asset useful lives and therefore reflected in regulatory assets (or reductions of regulatory liabilities).

Additional examples incorporating the annual revaluation of property, plant and equipment (a common approach in Australia) would also be helpful, as this would appear to compound the complexity of the accounting where the revaluation did not affect the regulatory asset base.