Staff paper

Agenda reference: 9A

IASB® meeting

Date	**July 2024**
Project	**Rate-regulated Activities**
Topic	**Extending the measurement proposals dealing with items affecting regulated rates on a cash basis**
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Objective

1. This paper sets out staff analysis and recommendations on feedback on the proposals in paragraph 61 of the Exposure Draft *Regulatory Assets and Regulatory Liabilities* (Exposure Draft) dealing with the measurement of items affecting regulated rates only when the related cash is paid or received (cash basis). In particular, this paper discusses requests to extend those measurement proposals to items affecting regulated rates on a different basis.

Staff recommendations

2. The staff recommend that the final Accounting Standard:

   (a) not extend the use of the measurement requirement proposed in paragraph 61 of the Exposure Draft dealing with items affecting regulated rates only when the related cash is paid or received to items affecting regulated rates on a different basis.

   (b) in specified circumstances, exempt an entity from discounting the estimates of future cash flows arising from a regulatory asset or regulatory liability, if the entity, having considered all reasonable and supportable information that is

available without undue cost or effort, is unable to estimate both the amount and timing of those future cash flows. This exemption would apply in circumstances when the regulatory asset or regulatory liability arises from an item of expense or income that:

(i) is related to liabilities or assets measured on a present value basis; and

(ii) affects regulated rates on an accrual basis.

(c) require an entity that chooses to apply the exemption in (b) to disclose that fact and the carrying amounts of regulatory assets and regulatory liabilities at the end of the reporting period to which the entity has applied that exemption.

(d) include expected credit losses affecting regulated rates only once there is no reasonable expectations of receiving the related cash as another example to which the measurement requirement proposed in paragraph 61 of the Exposure Draft can be applied.

Structure of the paper

3. This paper is structured as follows:

(a) proposals in the Exposure Draft (paragraphs 5–8);

(b) feedback (paragraph 9); and

(c) staff analysis (paragraphs 10–52).

4. This paper contains:

(a) Appendix A—examples of regulatory compensation for provisions or defined benefit (pension) obligations;

(b) Appendix B—application of the cash-flow-based measurement technique to pension costs affecting regulated rates on an accrual basis using local Generally Accepted Accounting Principles (GAAP); and

(c) Appendix C—an example of pension costs affecting regulated rates on an accrual basis using IFRS Accounting Standards with modifications.

Proposals in the Exposure Draft

5. Paragraph 59 of the Exposure Draft states:

> In some cases, a regulatory asset or regulatory liability arises because a regulatory agreement treats an item of expense or income as allowable or chargeable in determining the regulated rates only once 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 by applying, for example, IAS 12 *Income Taxes*, IAS 19 *Employee Benefits* or IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

6. Paragraph 61 of the Exposure Draft states that an entity shall measure the regulatory asset and regulatory liability described in paragraph 59 by:

   (a) using the measurement basis used in measuring the related liability or related asset by applying IFRS Accounting Standards; and

   (b) adjusting the measurement of the regulatory asset or regulatory liability to reflect any uncertainty present in it but not present in the related liability or related asset.

7. Paragraph BC175 of the Basis for Conclusions accompanying the Exposure Draft summarises the IASB's rationale for this proposal:

> …In the Board's view, this approach:
>
> (a) would provide users of financial statements with the most relevant and understandable information, because the cash flows arising from the regulatory assets or regulatory liabilities are a replica of the cash flows arising from the related liabilities or related assets, except for the effect of any uncertainty present in the regulatory asset or regulatory liability but not present in the related liability or related asset.
>
> (b) would provide users with more useful and more understandable information because it would avoid creating accounting mismatches in the statement(s) of financial performance that would result from using different measurement bases. […]
>
> (c) is consistent with the requirements in IFRS Standards for indemnification assets and for reimbursement assets. [...]

8. Paragraph 66 of the Exposure Draft proposes that an entity cease applying paragraph 61 when the entity pays cash to settle the related liability or receives cash that recovers the related asset.

Feedback

9. A few respondents—an accounting firm, an accountancy body in Asia-Oceania, a few preparers in North America and Europe, and a national standard-setter in Europe—said that a regulatory agreement may treat an item of expense or income as allowable or chargeable using a criterion other than the cash basis such as:

   (a) an accrual basis. For example, a regulator provides compensation for provisions or defined benefit (pension) obligations based on when the related liability is recognised as an expense or income in accordance with IFRS Accounting Standards or the local Generally Accepted Accounting Principles (GAAP). A few of these respondents were of the view that the measurement proposal in paragraph 61 of the Exposure Draft should be also applied to such items.

   (b) a basis analogous to the cash basis. For example, a regulator provides compensation for credit risk when an amount is determined to be irrecoverable—such as when all available means of recoverability have been exhausted. A few of these respondents asked whether the measurement proposal in paragraph 61 of the Exposure Draft could be also applied to such an item.

Staff analysis

10. In December 2023, the IASB tentatively decided to retain the measurement requirements proposed in paragraph 61 of the Exposure Draft for items affecting regulated rates on a cash basis.[1]

[1] IASB Update for December 2023 IASB meeting.

11. The Exposure Draft provides examples that illustrate the regulatory compensation for provisions and pension obligations on a cash basis.[2] However, a few respondents said that regulatory agreements may also compensate provisions or pension obligations on an accrual basis and that the proposals in paragraph 61 of the Exposure Draft should be also applied to these cases (paragraph 9(a)).

12. We sought input from a few respondents and members of the Consultative Group for Rate Regulation (Consultative Group) to help us understand:

    (a) the methodologies that regulators use to determine regulatory compensation for provisions or pension obligations to understand how common those methodologies might be.

    (b) differences in timing that arise from such regulatory compensation. In cases of regulatory compensation that is determined on an accrual basis using local GAAP, we sought feedback to understand the key differences in measurement requirements between local GAAP and IFRS Accounting Standards dealing with provisions and pension liabilities.

    (c) whether applying the cash-flow-based measurement technique to regulatory assets and regulatory liabilities that arise from items for which the regulatory compensation is determined on an accrual basis using either IFRS Accounting Standards or local GAAP would be operational and would provide useful information.

13. Appendix A summarises the feedback received from members of the Consultative Group and some preparers. According to the feedback, regulatory compensation for provisions uses the cash basis more commonly than the accrual basis. Both the cash and accrual bases are commonly used in regulatory compensation for pension obligations.

[2] The examples in the Exposure Draft also illustrate regulatory compensation for income taxes on a cash basis. Agenda Paper 9A of the May 2024 IASB meeting described some methods used by regulators to compensate entities for income tax.

14. This paper analyses regulatory assets or regulatory liabilities that arise from regulatory compensation for provisions and pension obligations. The concepts in the analysis are also applicable to a regulatory asset or regulatory liability that may arise from regulatory compensation for other liabilities or assets that are measured on a present value basis.

15. The analysis is structured as follows:

    (a) items affecting regulated rates on **an accrual basis** using **IFRS Accounting Standards** (paragraphs 16–25);

    (b) items affecting regulated rates on **an accrual basis** using **local GAAP** (paragraphs 26–45); and

    (c) items affecting regulated rates on a basis **analogous to the cash basis** (paragraphs 46–52).

Items affecting regulated rates on an accrual basis using IFRS Accounting Standards

16. Provisions and pension liabilities are measured at present value applying IFRS Accounting Standards. Regulatory compensation for these items may be determined on an accrual basis using IFRS Accounting Standards. We have learnt that the regulator typically provides compensation for both the present value of the liability and the unwinding of the discount on the liability (Appendix A). However, differences in timing arise from:

    (a) a time lag between recognition of an expense (T1) and its recovery through regulated rates (for example, T3); or

    (b) a difference between an estimate of an expense included in regulated rates for a period and the actual amount of the expense recognised in that period that is trued up in regulated rates charged in the future.

17. A few respondents—mainly preparers in North America—suggested extending the measurement proposal in paragraph 61 of the Exposure Draft to a regulatory asset or

regulatory liability that arises from a liability measured at present value applying IFRS Accounting Standards. In other words, an entity would measure that regulatory asset or regulatory liability using the measurement basis used in measuring the related liability. This would have the same effect as an exemption from discounting the estimates of future cash flows arising from that regulatory asset or regulatory liability.

18. This section analyses the suggestion from respondents to extend the measurement proposal in paragraph 61 of the Exposure Draft.

19. Consider an example illustrating a time lag between recognition of an expense and its recovery in regulated rates (paragraph 16(a)). Assume that an entity expects to pay environmental clean-up costs in T10 amounting to CU1,000.[3] In T1, the entity determines that the present value of the obligation is CU614 and the unwinding of the discount is CU31. A regulatory asset of CU645 arises in T1 because the entity is entitled to recover the present value of the provision (CU614) and the unwinding of the discount (CU31) recognised in T1 in regulated rates charged in T3. In T3, the regulatory asset reverses and the entity recognises revenue of CU645.

20. According to respondents who supported measuring a regulatory asset or regulatory liability using the measurement basis of the related liability:

    (a) the cash flows arising from the regulatory asset need not be discounted because the related liability (environmental provision) is measured at present value. The regulatory compensation for that liability includes both compensation for the present value and compensation for the unwinding of the discount. In the example described in paragraph 19, the regulated rates charged in T3 will include the unwinding of the discount arising in T1 on the provision that the entity will settle in T10. According to these respondents, that unwinding of the discount provides compensation for the time value of money and for uncertainty in the cash flows of the regulatory asset arising in T1 that the entity will recover in T3.

[3] Monetary amounts are denominated in ‘currency units’ (CU).

(b) this approach would avoid accounting mismatches that arise from using different measurement bases between the regulatory asset and the related liability. In the example described in paragraph 19, if the entity measures the regulatory asset using the measurement basis of the provision, in T1 the entity would measure the regulatory asset at CU645 and recognise the corresponding regulatory income. In T3, the entity would derecognise the regulatory asset and recognise the corresponding regulatory expense of CU645. The respondents said using the same measurement basis for the liability and the regulatory asset would result in a net nil amount in profit or loss for individual reporting periods and this measurement outcome would provide useful information.

21. The proposal in paragraph 61 of the Exposure Draft relies on the premise that cash flows arising from the regulatory asset (regulatory liability) are a replica of the cash flows arising from the related liability (related asset). Consequently, measuring the regulatory asset (regulatory liability) using the same measurement basis as that used for the related liability (related asset) would provide the most relevant and understandable information (paragraph 7).

22. In the case of a regulatory asset described in paragraph 19, its cash flows are **not a replica** of those arising from the related provision. There is a two-year time lag between when the regulatory asset is recognised and its recovery. For example, the recognition of the provision gives rise to a regulatory asset in T1 that will be recovered through regulated rates charged in T3. Similarly, the unwinding of the discount from T2 to T10 gives rise to additional regulatory assets that will be recovered from T4 to T12.

23. The entity calculates the present value of the provision and the unwinding of the related discount using a discount rate that reflects the time value of money and the uncertainty in the cash flows that will arise when the entity settles the provision in T10. That discount rate is different from the rate that reflects the time value of money and the uncertainty in the cash flows arising from the regulatory assets arising from T1 to T10 (recovered from T3 to T12). Consequently, an entity should discount the

cash flows arising from the regulatory assets from T1 to T10 using a rate that reflects the time value of money and the uncertainty in those cash flows.

24. As mentioned in paragraph 16(b), a regulator may allow the difference between the estimated and actual amounts of an expense to be trued up in regulated rates charged in the future. Our analysis in paragraphs 21–23 is also relevant to a regulatory asset or regulatory liability that arises from the true up of estimates to actuals.

25. Therefore, we think the IASB should not extend the use of the measurement proposal in paragraph 61 of the Exposure Draft to a regulatory asset or regulatory liability that arises from a liability or an asset measured at present value for which the regulatory compensation is based on an accrual basis using IFRS Accounting Standards. Instead, an entity should be required to measure the regulatory asset or regulatory liability by applying the cash-flow-based measurement technique proposed in the Exposure Draft.

Items affecting regulated rates on an accrual basis using local GAAP

26. Regulatory compensation for items such as pension obligations and provisions may be determined on an accrual basis using local GAAP. This section considers:

    (a) an example of differences in timing arising from regulatory compensation based on an accrual basis using local GAAP (paragraphs 27–29);

    (b) a possible extension of paragraph 61 of the Exposure Draft for such differences in timing (paragraphs 30–37); and

    (c) a possible relief to the cash-flow-based measurement technique for such differences in timing (paragraphs 38–45).

An example of differences in timing arising from regulatory compensation based on an accrual basis using local GAAP

27. Appendix B illustrates a simplified example of a pension obligation for which an entity is entitled to regulatory compensation on an accrual basis using local GAAP—that is, the regulatory compensation is based on a pension liability that is measured at present value applying local GAAP. There is also a time lag in recovery—the entity

is entitled to recover the amount of pension expense arising in a period (T) applying local GAAP through regulated rates charged in a future period (T+2).

28. In that example, the amount of pension expense recognised in a period applying IFRS Accounting Standards differs from the amount included in regulated rates charged in that period based on local GAAP. A difference in timing arises from the different pace of recognition of the pension expense applying IFRS Accounting Standards and its recovery through regulatory compensation based on local GAAP. The cumulative amount of pension expense based on local GAAP and IFRS Accounting Standards would be the same, reflecting the total amount of pension obligation that the entity has settled over time. In other words, any differences between the regulatory compensation based on the amount of pension expense determined applying local GAAP and the pension expense recognised applying IFRS Accounting Standards would reverse over time.

29. In summary, the difference in timing in paragraph 28 comprises differences between:

    (a) the amount of pension expense the entity recognised applying IFRS Accounting Standards and the amount of pension expense determined applying local GAAP; and

    (b) when the amount of pension expense based on local GAAP arises (T) and its recovery through regulated rates (T+2).

Possible extension of paragraph 61 of the Exposure Draft

30. A few respondents suggested extending paragraph 61 of the Exposure Draft to the measurement of a regulatory asset or regulatory liability arising from regulatory compensation for pension obligations described in paragraph 27. Some of these respondents raised concerns about applying the cash-flow-based measurement technique to such a regulatory asset or regulatory liability.

31. According to these respondents, an entity would have difficulty estimating the amount of pension expense applying local GAAP—and included in regulated rates charged—and the amount of pension expense recognised applying IFRS Accounting Standards

for individual future reporting periods. Consequently, the entity would be unable to estimate the amount of future cash flows arising from a regulatory asset or regulatory liability that would be recovered or fulfilled in individual future periods—that is, the entity would be unable to estimate the reversal pattern of a regulatory asset or regulatory liability. According to these respondents, the amount of pension liability measured applying IFRS Accounting Standards can be significantly different from that amount measured applying local GAAP.

32. The example in Appendix B illustrates the difficulty raised by respondents. The amount of pension expense for Year 1 based on IFRS Accounting Standards is higher than that based on local GAAP—and included in regulated rates charged in Year 3. Consequently, an amount of the regulatory asset arising in Year 1 will remain outstanding in Year 3 and will be recovered in future periods. In Year 1, the entity would need to determine the periods in which that outstanding amount of the regulatory asset would be recovered after Year 3 and the amounts to be recovered in each of those periods. This would require the entity to estimate the amount of pension expense based on local GAAP for Year 2 and potentially beyond.

33. We agree it is difficult to estimate the amount and timing of recovery or fulfilment of a regulatory asset or regulatory liability that arises from differences between local GAAP and IFRS Accounting Standards. This is because:

    (a) a regulatory asset or regulatory liability may comprise amounts that originated in multiple prior periods and may be recovered or fulfilled over multiple future periods. In particular:

        (i) in the simplified example in Appendix B, the only difference between local GAAP and IFRS Accounting Standards is the discount rate used to measure the pension liability. However, there may be multiple differences in the requirements between local GAAP and IFRS Accounting Standards, resulting in measurements of the pension liability that are significantly different.

        (ii) an entity needs to estimate the amount of the pension expense applying local GAAP and the amount applying IFRS Accounting Standards for

individual future reporting periods. This requires the entity to determine how a variety of assumptions used to measure the pension liability may change over time.

(b) differences in timing could fluctuate between being a regulatory asset and being a regulatory liability. This would add complexity to the attribution of cash flows arising from future regulatory compensation to the regulatory asset or regulatory liability being measured.

34. Paragraph 33 discusses differences in timing that arise from different measurement requirements between local GAAP and IFRS Accounting Standards. However, various types of differences may coexist within a difference in timing. If a regulatory asset or regulatory liability encompassed various differences (paragraph 29), this would add complexity to the estimation of the amount and timing of future cash flows arising from the regulatory asset or regulatory liability.

35. In some cases, a regulatory agreement determines compensation for pension obligations on an accrual basis using IFRS Accounting Standards, with modifications for specific components of a pension liability using another GAAP. Appendix C illustrates such a case and explains why estimating the amount and timing of future cash flows arising from a regulatory asset or regulatory liability would be difficult in such cases.

36. However, we think the difficulties described in paragraphs 31–35 would not warrant extending the use of paragraph 61 of the Exposure Draft to these regulatory assets or regulatory liabilities. Because the regulatory compensation is based on an accrual basis, the cash flows arising from such a regulatory asset or regulatory liability would not be a replica of those arising from the related pension liability.

37. Paragraphs 38–44 discuss a possible relief from applying the cash-flow-based measurement technique in some cases when the regulatory compensation is based on an accrual basis.

Possible relief to the cash-flow-based measurement technique

38. We think there are cases in which applying the cash-flow-based measurement technique may involve a level of measurement uncertainty that makes the resulting information less useful, resulting in benefits that may not outweigh the costs. This may be the case if it is very difficult for an entity to estimate **both the amount and timing** of future cash flows arising from a regulatory asset or regulatory liability.

39. Most of the cases we have identified in which it may be very difficult to estimate both the amount and timing of the future cash flows involved regulatory compensation that is based on local GAAP. However, differences in timing associated with such estimation difficulty could also arise from regulatory compensation that is based on an accrual basis using IFRS Accounting Standards with some modifications (see Appendix C). Conversely, a regulatory methodology that is based on local GAAP may not necessarily cause such estimation difficulty.

40. Therefore, we think in specified circumstances an entity should be exempted from discounting the estimates of future cash flows arising from a regulatory asset or regulatory liability, if the entity, having considered all reasonable and supportable information that is available without undue cost or effort, is unable to estimate both the amount and timing of those future cash flows. This exemption would apply in circumstances when the regulatory asset or regulatory liability arises from an item of expense or income that:

    (a) is related to liabilities or assets measured on a present value basis; and

    (b) affects regulated rates on an accrual basis.[4]

41. An exemption from discounting would allow an entity to provide information about the effects of a difference in timing on its financial position and financial performance, without the subjectivity involved in determining a measurement on a discounted basis. A regulatory asset that arises from different requirements between

[4] The Exposure Draft uses the description 'consider all reasonable and supportable information that is available without undue cost or effort' in the proposals dealing with estimating future cash flows arising from a regulatory asset and regulatory liability (paragraph 32 of the Exposure Draft). IFRS 9 *Financial Instruments* also uses a similar description in some of the requirements dealing with expected credit losses.

local GAAP and IFRS Accounting Standards typically does not attract any regulatory interest. An exemption from discounting would also relieve the entity of the additional complexity of estimating and using the minimum interest rate as the discount rate.

42. Having said that, we acknowledge the consequences of an exemption from discounting a regulatory asset or regulatory liability that:

    (a) may be recovered or fulfilled over many years. In such cases the effect of discounting could be material. However, the benefits of discounting may be counteracted by the level of measurement uncertainty.

    (b) arises from differences in GAAP—for example, in the case of a pension liability, differences between local GAAP and IFRS Accounting Standards may relate to both the use of different discount rates and the deferred recognition of actuarial gains or losses. Those different requirements may have dissimilar effects on the pattern of future cash flows. Users of financial statements will need other sources of information to assess how those effects may affect the entity's future cash flows.

43. We think an exemption from discounting would provide benefits to entities that would outweigh potential costs to users of financial statements.

44. If an entity elects to apply the exemption from discounting, we think the entity should be required to disclose that fact and the carrying amounts of regulatory assets and regulatory liabilities at the end of the reporting period to which the entity has applied that exemption. This information would help users to assess the potential effect of the exemption.

45. We recommend that the final Accounting Standard:

    (a) not extend the use of the measurement requirement proposed in paragraph 61 of the Exposure Draft dealing with items affecting regulated rates only when the related cash is paid or received to items affecting regulated rates on a different basis (paragraphs 25 and 36);

(b) in specified circumstances, exempt an entity from discounting the estimates of future cash flows arising from a regulatory asset or regulatory liability, if the entity, having considered all reasonable and supportable information that is available without undue cost or effort, is unable to estimate both the amount and timing of those future cash flows. This exemption would apply in circumstances when the regulatory asset or regulatory liability arises from an item of expense or income that:

(i) is related to liabilities or assets measured on a present value basis; and

(ii) affects regulated rates on an accrual basis (paragraphs 38–43); and

(c) require an entity that chooses to apply the exemption in (b) to disclose that fact and the carrying amounts of regulatory assets and regulatory liabilities at the end of the reporting period to which the entity has applied that exemption (paragraph 44).

Question for the IASB
1. Does the IASB agree with the staff recommendation in paragraph 45?

Items affecting regulated rates on a basis analogous to the cash basis

46. In some cases, an entity has an enforceable right to regulatory compensation for credit risk. Depending on the terms of the regulatory agreement, the entity may or may not reflect the cash flows it expects to receive from that compensation in the loss allowance for expected credit losses applying IFRS 9 *Financial Instruments*. If the cash flows from the regulatory compensation for credit risk are:

(a) reflected in the loss allowance, that compensation reduces the amount of expected credit loss recognised and hence, does not give rise to a difference in timing.

(b) not included in the calculation of the loss allowance, a difference in timing may arise from that compensation. Paragraphs 48–51 discuss a specific case of such a difference in timing.

47. In September 2023, the IASB discussed differences in timing that arise from the regulatory compensation for credit risk. At that meeting the staff noted that we plan to discuss the measurement of the related regulatory assets at a future meeting.[5]

48. This section discusses whether the measurement proposal in paragraph 61 of the Exposure Draft could be also applied to specific circumstances in which regulatory compensation for credit risk gives rise to differences in timing. In those circumstances, the regulator adds to regulated rates an amount due from customers when that amount is determined to be irrecoverable—for example, when an independent collection agency certifies the non-recoverability of that amount. Generally, this would occur after the amount becomes credit-impaired applying IFRS 9. A difference in timing arises because the regulator entitles an entity to include expected credit losses recognised for a period in regulated rates charged in a different period.

49. We think expected credit losses that affect regulated rates **when the related receivables are irrecoverable** would be analogous to an item of expense that affects regulated rates on **a cash basis**—that is, when an entity pays cash to settle the related liability. This is because the entity is entitled to include the credit loss in regulated rates only when the regulator considers there are no reasonable expectations of cash inflows—that is, the entity will not receive the contractual cash flows arising from the irrecoverable receivables that were due to the entity. This would be economically similar to payment of cash to settle a liability in the case of an item of expense that affects regulated rates on a cash basis.

50. The entity may also determine that it has no reasonable expectations of recovering the receivables applying IFRS 9. In this case, the entity would directly reduce the gross carrying amount of those receivables—that is, the entity would derecognise both the

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

irrecoverable receivables and the related loss allowance.[6] A few stakeholders said this would generally coincide with the regulator treating these amounts as irrecoverable and allowing recovery of these amounts through regulated rates charged. Consequently, derecognition of those irrecoverable receivables would coincide with their recovery through regulated rates—and hence, with recovery of the regulatory asset related to expected credit losses recognised on those receivables. In other words, if expected credit losses affect regulated rates only once there is no reasonable expectations of receiving the related cash, the cash flows arising from the regulatory asset would be a replica of the cash flows arising from the loss allowance. In this case, we think measuring the regulatory asset using the measurement basis used to measure the loss allowance on the receivables would provide useful information and would be simpler to apply than the cash-flow-based measurement technique. This would be consistent with the IASB's rationale for the measurement proposal in paragraph 61 of the Exposure Draft dealing with items affecting regulated rates on a cash basis.

51. This table illustrates how an item that is allowable when an amount is irrecoverable compares with an item that is allowable on a cash basis:

[6] Paragraph 5.4.4 of IFRS 9.

T_0	**Allowable on cash basis** Recognise expense and the related liability	**Allowable when amount is irrecoverable** Recognise expense and loss allowance on the related receivable
	Recognise regulatory asset and regulatory income	
T_n	Pay cash to settle the related liability → *cash outflow* Derecognise the related liability	No reasonable expectations of receiving cash from the related receivable → *a loss of cash inflow* Derecognise the related receivable and loss allowance
	Expense added to regulated rates Recognise revenue from supply of goods or services	Expense added to regulated rates Recognise revenue from supply of goods or services
	Derecognise regulatory asset and recognise regulatory expense	
	Cash flows from regulatory asset are a replica of those from the related liability	Cash flows from regulatory asset are a replica of those from loss allowance

52. Therefore, we recommend that the final Accounting Standard include expected credit losses affecting regulated rates only once there is no reasonable expectations of receiving the related cash as another example to which the measurement requirement proposed in paragraph 61 of the Exposure Draft can be applied.

Question for the IASB

2. Does the IASB agree with the staff recommendation in paragraph 52?

Appendix A—Examples of regulatory compensation for provisions or pension obligations

A1. This appendix summarises feedback received from respondents and members of the Consultative Group about:

(a) common methodologies used by regulators to determine regulatory compensation for provision or pensions obligations (paragraphs A2–A4); and

(b) differences in timing that arise from such regulatory compensation (paragraphs A5–A6).

Common methodologies

A2. The common methodologies used by regulators to determine regulatory compensation for provisions or pensions obligations are:

(a) the cash basis—an entity is entitled to recover the regulatory compensation only once the entity pays cash to settle the related provision or pension obligation.[7]

(b) an accrual basis—an entity is entitled to recover regulatory compensation as the entity recognises an item of expense or income related to the provision or pension obligation. The regulatory compensation may be determined based on IFRS Accounting Standards or local GAAP. The regulatory agreement may specify:

(i) a time lag between recognition of an expense and its recovery through regulated rates;

(ii) regulatory compensation based on an estimate of an expense with a true up to the actual amount in future regulated rates; or

(iii) a modification to the accrual basis for the recovery of specific components of an expense recognised in a period.

[7] Agenda Paper 9D discussed at the December 2023 IASB meeting.

A3. According to the feedback, in determining regulatory compensation for:

(a) provisions—the cash basis methodology is more commonly used by regulators than an accrual basis; and

(b) pension obligations—both the cash and accrual bases are methodologies commonly used by regulators.

A4. The feedback identified only one example involving regulatory compensation for provisions in which the regulator uses a methodology that is different from both cash and accrual bases.

Differences in timing

A5. This section summarises the feedback dealing with examples in which differences in timing arise from regulatory compensation for provisions or pension obligations that is determined based on:

(a) an accrual basis—that is, a liability that is measured applying:

(i) IFRS Accounting Standards (Table 1); or

(ii) local GAAP (Table 2); or

(b) other methodologies (Table 3).

A6. These tables summarise the item of expense that the entity recovers, the regulatory compensation, the related differences in timing and the jurisdictions where such regulatory compensation is observed.

Table 1—Regulatory compensation based on IFRS Accounting Standards			
Item being recovered	**Regulatory methodology**	**Differences in timing**	**Jurisdictions**
1. Provision accounted for applying IAS 37	A regulatory agreement entitles an entity to recover expenses arising from an environmental clean-up provision through regulated rates, with a time lag (for example, two years after an expense is recognised).	The entity recognises, as an expense, the present value of the provision on initial recognition and the unwinding of the discount over time. However, the entity recovers expenses recognised in a period through regulated rates charged in a future period (for example, two years after an expense is recognised). Therefore, a regulatory asset arises.	A few jurisdictions in North America and Europe.
2. Pension liability accounted for applying IAS 19	A regulatory agreement entitles an entity to recover the pension expense recognised in a period through regulated rates charged in the same period based on an estimate. That estimate is subsequently trued up to the actual amount in regulated rates charged in a future period.	The difference between the estimated and actual amounts of the pension expense recognised in a period is added to or deducted from future regulated rates. Therefore, a regulatory asset or regulatory liability arises.	A few jurisdictions in Africa and Asia-Oceania.
	A regulatory agreement applies a corridor approach to the recovery of actuarial losses or gains—that is, it defers the recovery of amounts within the 'corridor' and entitles an entity to recover a portion of the amount	Actuarial losses or gains recognised in a period are added to or deducted from regulated rates charged in future periods. Therefore, a regulatory asset or regulatory liability arises.	A jurisdiction in North America.

Table 1—Regulatory compensation based on IFRS Accounting Standards			
Item being recovered	**Regulatory methodology**	**Differences in timing**	**Jurisdictions**
	in excess of the 'corridor' in the next regulatory period (see Appendix C).		

Table 2—Regulatory compensation based on local GAAP			
Item being recovered	**Regulatory methodology**	**Differences in timing**	**Jurisdictions**
1. Provision capitalised as part of the cost of property, plant and equipment	A regulatory agreement entitles an entity to recover an asset decommissioning provision based on the related expenses determined for a period applying local GAAP. The local GAAP requires the entity to determine depreciation expense on the asset and interest expense related to the unwinding of the discount on the provision using the initial discount rate used in measuring the provision.	Applying IFRS Accounting Standards, the entity remeasures the provision using a discount rate that reflects current market assessments of the time value of money and the risks specific to the provision. Any remeasurement losses or gains are recognised as part of the cost of the asset using IFRS Accounting Standards.[8] For example, if the discount rate decreases, the resulting remeasurement loss increases depreciation expense and decreases interest	A jurisdiction in North America.

[8] Applying IAS 37 and IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities*.

Table 2—Regulatory compensation based on local GAAP			
Item being recovered	**Regulatory methodology**	**Differences in timing**	**Jurisdictions**
		expense in the future, albeit at a different pace. However, the regulatory compensation is based on local GAAP that does not update the initial discount rate. Therefore, a difference in timing arises because the depreciation expense and the interest expense have different recognition patterns between local GAAP and IFRS Accounting Standards.	
2. Pension liability	A regulatory agreement entitles an entity to recover pension expense determined applying local GAAP. In some cases, the regulatory compensation for: (a) the pension expense arising in a period is included in regulated rates charged in a future period; or (b) an estimate of the pension expense arising in a period is included in regulated rates charged in that period. That estimate is subsequently trued up to the actual amount in regulated rates charged in a future period.	A difference in timing arises from the difference between the regulatory compensation determined for a period based on local GAAP and the pension expense recognised in that period applying IFRS Accounting Standards. The difference in timing comprises: (a) differences between the amount of pension expense determined applying local GAAP and the amount recognised applying IFRS Accounting Standards. For example, local GAAP requires deferred	A few jurisdictions in North America and Europe.

Table 2—Regulatory compensation based on local GAAP			
Item being recovered	**Regulatory methodology**	**Differences in timing**	**Jurisdictions**
		recognition of actuarial losses or gains in profit or loss using, for example, a corridor approach as described in the second row of item (2) in Table 1. (b) other differences related to a time lag in recovery and the true up of estimates to actuals based on the pension expense in local GAAP (see items (a) and (b) in the second column of this table).	

Table 3—Regulatory compensation based on other methodologies			
Item being recovered	**Regulatory methodology**	**Differences in timing**	**Jurisdictions**
1. Provision capitalised as part of the cost of property, plant and equipment	A regulatory agreement entitles an entity to recover an estimate of the expenditure required to settle an asset decommissioning provision on a straight-line basis over the asset's useful life. If there is a change to	Applying IFRS Accounting Standards, the entity recognises: (a) the present value of the provision as part of depreciation expense over the asset's useful life; and	A jurisdiction in Asia-Oceania.

Table 3—Regulatory compensation based on other methodologies			
Item being recovered	**Regulatory methodology**	**Differences in timing**	**Jurisdictions**
	the estimate, the regulator will apply the change retrospectively and adjust its cumulative effect for past periods in regulated rates charged in the period of change.	(b) the unwinding of the discount as interest expense until the entity settles the provision. Therefore, a difference in timing arises because the regulatory compensation is determined at a different pace from the recognition of depreciation expense and interest expense applying IFRS Accounting Standards.	

Appendix B—Application of the cash-flow-based measurement technique to pension costs affecting regulated rates on an accrual basis using local GAAP

B1. Appendix B illustrates the application of the cash-flow-based measurement technique proposed in the Exposure Draft to an example of pension costs for which a regulatory agreement compensates on an accrual basis using local GAAP.

> **Example 1**
>
> A regulatory agreement compensates an entity for its pension obligation based on the amount of pension expense the entity incurs applying local GAAP in a reporting period, with a two-year time lag.
>
> This example assumes that the measurement requirements for pension liabilities in local GAAP and IAS 19 *Employee Benefits* are identical, except for the discount rate used to measure the pension liability.

B2. In Year 1, the entity estimates that the services its employees render in Years 1–3 will lead to an obligation to provide benefits of CU3,000 in Years 4–5 (CU1,500 each year). During Years 2–5, changes in the discount rate result in remeasurement gains arising from the pension liability.

B3. The regulator includes the amount of pension expense the entity incurs applying local GAAP during Years 1–5 in the regulatory compensation with a two-year time lag—that is, in regulated rates charged in Years 3–7. Table 1 shows the movements in the pension liability measured applying local GAAP. Table 2 shows the regulatory compensation included in regulated rates with a time lag.

Table 1—Pension liability based on local GAAP						
In CU / Years	1	2	3	4	5	Total
Opening balance	-	857	1,781	2,789	1,425	-
Service costs	857	891	930	-	-	2,678
Interest costs	-	40	89	146	78	353
Changes in interest rates	-	(7)	(11)	(10)	(3)	(31)
Movements	857	924	1,008	136	75	3,000
Payments	-	-	-	(1,500)	(1,500)	(3,000)
Closing balance	**857**	**1,781**	**2,789**	**1,425**	**-**	-

Table 2—Amount included in regulated rates charged based on local GAAP								
In CU / Years	1	2	3	4	5	6	7	Total
Pension liability based on local GAAP								
Opening balance	-	857	1,781	2,789	1,425	-	-	-
Amount recognised as expenses (Table 1)	857	924	1,008	136	75	-	-	3,000
Payments	-	-	-	(1,500)	(1,500)	-	-	(3,000)
Closing balance	**857**	**1,781**	**2,789**	**1,425**	**-**	**-**	**-**	-
Amount included in regulated rates	**0**	**0**	**857**	**924**	**1,008**	**136**	**75**	**3,000**

B4. IAS 19 requires the entity to measure the pension liability using a discount rate that differs from that required by local GAAP. Table 3 shows the movements in the pension liability measured applying IFRS Accounting Standards.

Table 3—Pension liability applying IFRS Accounting Standards						
In CU / Years	1	2	3	4	5	Total
Opening balance	-	901	1,837	2,829	1,436	-
Amounts recognised as expenses	901	936	992	107	64	3,000
Service costs	901	918	943	-	-	2,762
Interest costs	-	32	72	127	71	302
Changes in interest rates	-	(14)	(23)	(20)	(7)	(64)
Payments	-	-	-	(1,500)	(1,500)	(3,000)
Closing balance	**901**	**1,837**	**2,829**	**1,436**	**-**	-

B5. Table 4 illustrates the difference in timing that arises in this fact pattern. This difference in timing consists of:

(a) differences in GAAP—the different discount rates used to measure the pension liability causes differences between the pension expense included in regulated rates charged (based on local GAAP) and the pension expense recognised (based on IFRS Accounting Standards); and

(b) time lag—the amount of pension expense arising in T based on local GAAP is recovered through regulated rates charged in T+2.

Table 4—Difference in timing								
In CU / Years	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**Total**
Amount recognised in local GAAP (Table 1)	857	924	1,008	136	75	-	-	3,000
Amount recognised in IFRS (Table 3)	901	936	992	107	64	-	-	3,000
Differences in GAAP (a)	***44***	***12***	***(16)***	***(29)***	***(11)***	***-***	***-***	***-***
Amounts included in rates charged (Table 2)	-	-	857	924	1,008	136	75	3,000
Amounts recognised in local GAAP (Table 1)	857	924	1,008	136	75	-	-	3,000
Time lag (b)	***857***	***924***	***151***	***(788)***	***(933)***	***(136)***	***(75)***	***-***
Difference in timing (a) + (b)	901	936	135	(817)	(944)	(136)	(75)	-
Regulatory asset (undiscounted)	**901**	**1,837**	**1,972**	**1,155**	**211**	**75**	**-**	**-**

B6. Applying the cash-flow-based measurement technique, the entity would need to estimate the amount and timing of future cash flows that arise from the regulatory asset. The entity could make that estimation by:

(a) tracking when a difference in timing arising in a period (for example, CU901 in Year 1 in Table 3) would reverse or when a difference in timing included in the regulatory compensation for a period (for example, CU924 in Year 4 in Table 2) has originated. However, such tracking could be very difficult. The entity would be required to link the pension expense in IFRS Accounting Standards to the expense in local GAAP that would be included in regulatory compensation charged in future periods. This could be difficult because these amounts of pension expense arising in individual periods could be significantly different if there were multiple differences in GAAP.

(b) estimating an amount of the regulatory asset deemed to be included in the regulatory compensation for individual periods in the future using a reasonable and supportable basis. Consider the regulatory asset of CU901 (on an undiscounted basis) that is outstanding at the end of Year 1 (Table 4). The entity could use the first-in-first-out method to estimate that the regulatory asset is deemed to be recovered as follows: first from the regulatory compensation of CU857 for Year 3 (Table 2) and the remaining CU44 from the regulatory compensation of CU924 for Year 4 (Table 2). This would require the entity to estimate in Year 1 the amount of pension expense based

on local GAAP for Year 2 (and potentially beyond).[9] Paragraph 33 of this paper explains why this estimation might be difficult.

B7. Assuming that the entity is able to estimate an amount of the regulatory asset deemed to be included in regulatory compensation for individual reporting periods:

(a) Table 5 shows the movements in the carrying amount of the regulatory asset measured on a discounted basis.

(b) Table 6 shows the entity's statement of financial performance. The total comprehensive income for each period reflects the discount that arises in the current period from measuring an amount of the regulatory asset at present value and the unwinding of the discount that arose in prior periods.

(c) Table 7 shows the entity's statement of financial position.

Table 5—Reconciliation of carrying amount of regulatory asset (discounted)

In CU / Years	1	2	3	4	5	6	7
Opening balance	-	815	1,702	1,828	1,092	197	71
Amount recognised*	815	846	898	97	58	-	-
Regulatory interest income	-	41	85	91	55	10	4
Recovery	-	-	(857)	(924)	(1,008)	(136)	(75)
Movements	815	887	126	(736)	(895)	(126)	(71)
Closing balance	**815**	**1,702**	**1,828**	**1,092**	**197**	**71**	**-**

* Based on the amount of pension expense recognised in a period, discounted to the present value.

Table 6—Statement of financial performance

In CU / Years	1	2	3	4	5	6	7	TOTAL
Revenue (Table 2)	-	-	857	924	1,008	136	75	3,000
Regulatory income (regulatory expense) (Table 5)	815	887	126	(736)	(895)	(126)	(71)	-
Pension expense	(901)	(918)	(943)	-	-	-	-	(2,762)
Finance costs	-	(32)	(72)	(127)	(71)	-	-	(302)
Profit or loss	**(86)**	**(63)**	**(32)**	**61**	**42**	**10**	**4**	**(64)**
Other comprehensive income	**-**	**14**	**23**	**20**	**7**	**-**	**-**	**64**
Total comprehensive income	**(86)**	**(49)**	**(9)**	**81**	**49**	**10**	**4**	**-**

[9] This may be the case if, for example, the measurements of the pension liability differ significantly between IFRS Accounting Standards and local GAAP.

Table 7—Statement of financial position							
In CU / Years	1	2	3	4	5	6	7
Regulatory asset (Table 5)	815	1,702	1,828	1,092	197	71	-
Pension liability (Table 3)	901	1,837	2,829	1,436	-	-	-

B8. Paragraph 45 of this paper recommends in specified circumstances exempting an entity from discounting the estimates of future cash flows arising from a regulatory asset or regulatory liability, if the entity, having considered all reasonable and supportable information that is available without undue cost or effort, is unable to estimate both the amount and timing of those future cash flows. In determining a measurement on an undiscounted basis, the entity would need to estimate the total amount of cash flows arising from the regulatory asset or regulatory liability. In this fact pattern, at the end of Year 3, the amount of the regulatory asset on an undiscounted basis—and the total amount of cash flows arising—is CU1,972 (Table 4). The entity may estimate this amount by:

(a) calculating the regulatory balance that will be added to future regulated rates of CU1,932—representing the cumulative amount of pension expense based on local GAAP for Year 2 (CU924 in Table 2) and Year 3 (CU1,008 in Table 2); and

(b) adjusting the regulatory balance by CU40—representing the difference between the carrying amount of pension liability based on local GAAP (CU2,789 in Table 1) and that based on IFRS Accounting Standards (CU2,829 in Table 3).

B9. Applying the staff recommendation in paragraph 45(b) to this fact pattern:

(a) Table 8 shows the movements in the carrying amount of the regulatory asset. The carrying amount of the regulatory asset represents the cumulative amount of pension expense based on local GAAP for the latest two years, adjusted for the difference in the carrying amounts of the pension liability between local GAAP and IFRS Accounting Standards.

(b) Table 9 shows the entity's statement of financial performance. The zero amount of total comprehensive income for each period reflects the entity's

enforceable right to regulatory compensation that fully recovers its pension costs.

(c) Table 10 shows the entity's statement of financial position.

Table 8—Reconciliation of carrying amount of regulatory asset without discounting							
In CU / Years	**1**	**2**	**3**	**4**	**5**	**6**	**7**
Opening balance	-	901	1,837	1,972	1,155	211	75
Amount recognised	901	936	992	107	64	-	-
Regulatory interest income	-	-	-	-	-	-	-
Recovery	-	-	(857)	(924)	(1,008)	(136)	(75)
Movements	901	936	135	(817)	(944)	(136)	(75)
Closing balance	**901**	**1,837**	**1,972**	**1,155**	**211**	**75**	**-**

Table 9—Statement of financial performance without discounting								
In CU / Years	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**TOTAL**
Revenue (Table 2)	-	-	857	924	1,008	136	75	3,000
Regulatory income (regulatory expense) (Table 8)	901	936	135	(817)	(944)	(136)	(75)	-
Pension expense	(901)	(918)	(943)	-	-	-	-	(2,762)
Finance costs	-	(32)	(72)	(127)	(71)	-	-	(302)
Profit or loss	**-**	**(14)**	**(23)**	**(20)**	**(7)**	**-**	**-**	**(64)**
Other comprehensive income	**-**	**14**	**23**	**20**	**7**	**-**	**-**	**64**
Total comprehensive income	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**

Table 10—Statement of financial position without discounting							
In CU / Years	**1**	**2**	**3**	**4**	**5**	**6**	**7**
Regulatory asset (Table 8)	901	1,837	1,972	1,155	211	75	-
Pension liability (Table 3)	901	1,837	2,829	1,436	-	-	-

Appendix C—An example of pension costs affecting regulated rates on an accrual basis using IFRS Accounting Standards with modifications

C1. This appendix provides another example of a situation when estimating the amount and timing of future cash flows arising from a regulatory asset or regulatory liability would be difficult.

C2. In this example, the regulatory compensation for a pension obligation is calculated differently depending on whether a component of the pension obligation is presented in profit or loss or other comprehensive income:

(a) for components of the pension obligation that are presented in profit or loss—the compensation is determined on an accrual basis using IFRS Accounting Standards. This regulatory compensation may give rise to differences in timing because of a time lag between recognition and recovery or a true up of estimates to actuals (paragraph 16); and

(b) for components of the pension obligation that are presented in other comprehensive income—the entity has an enforceable present right to compensation for the actuarial losses or gains but defers the recovery using an approach described in paragraph C3. Consequently, a regulatory asset or regulatory liability arises that is specifically related to the recovery of actuarial losses or gains.

C3. The regulator applies a corridor approach for the recovery of actuarial losses or gains using another GAAP. Applying the corridor approach, the regulator defers recovery of the cumulative amount of actuarial losses or gains that is within the ‘corridor’. At the end of each regulatory period, the regulator determines a portion of the amount in excess of the ‘corridor’ to be added to or deducted from regulated rates charged in the next regulatory period.

C4. Similar to cases involving regulatory compensation that is based on local GAAP, it could be difficult to estimate the amount and timing of recovery or fulfilment of the regulatory asset or regulatory liability in paragraph C2(b). This is because:

(a) the regulatory compensation charged in a period cannot be broken down into differences in timing that originated in individual prior periods.

(b) recovery or fulfilment of a regulatory asset or regulatory liability related to amounts in excess of the 'corridor' will depend on the amounts of actuarial losses or gains arising in a regulatory period and the corridor—that is, the amounts of pension obligations and plan assets—at the end of that period. Estimating these amounts would involve uncertainty and subjectivity.

(c) a regulatory asset or regulatory liability related to amounts within the 'corridor' may be recovered or fulfilled over an indefinite period.