Staff paper

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IASB® meeting

Date	**July 2024**
Project	**Rate-regulated Activities**
Topic	**Extending the presentation 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 69 of the Exposure Draft *Regulatory Assets and Regulatory Liabilities* (Exposure Draft) dealing with the presentation 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 presentation proposals to items affecting regulated rates on a different basis. These are the same items for which Agenda Paper 9A analysed extending the measurement proposals in paragraph 61 of the Exposure Draft.

Staff recommendations

2. The staff recommend that the final Accounting Standard not extend the use of the presentation requirements proposed in paragraph 69 of the Exposure Draft dealing with items affecting regulated rates only when the related cash is paid or received.

3. Agenda Paper 9A recommends not extending the use of the measurement proposals in paragraph 61 of the Exposure Draft and instead recommends providing an exemption from discounting in specified circumstances. The recommendation in paragraph 2:

(a) assumes that the IASB agrees with the recommendation in Agenda Paper 9A not to extend the use of the measurement proposals in paragraph 61 of the Exposure Draft; and

(b) does not depend on whether the IASB agrees with the recommendation in Agenda Paper 9A to provide an exemption from discounting in specified circumstances.

Structure of the paper

4. This paper is structured as follows:

   (a) proposals in the Exposure Draft (paragraphs 6–7);

   (b) feedback (paragraphs 8–9); and

   (c) staff analysis (paragraphs 10–20).

5. The appendix to this paper illustrates the presentation of regulatory income or regulatory expense arising from remeasurements of a related defined benefit (pension) liability through other comprehensive income.

Proposals in the Exposure Draft

6. In the case of an item that affects regulated rates on a cash basis, paragraph 61 of the Exposure Draft proposes that an entity measures a regulatory asset or regulatory liability using the basis used in measuring the related liability or related asset.

7. Paragraph 69 of the Exposure Draft proposes that when an entity remeasures a regulatory asset or regulatory liability applying paragraph 61, the entity presents the resulting regulatory income or regulatory expense in other comprehensive income to the extent that the regulatory income or regulatory expense results from remeasuring the related liability or related asset through other comprehensive income.

Feedback

8. A few respondents—preparers in North America, an accounting firm and a national standard-setter in Europe—expressed the view that the proposed presentation should not be limited to items that a regulatory agreement treats as allowable or chargeable on a cash basis. These respondents said the presentation in other comprehensive income proposed in paragraph 69 of the Exposure Draft should apply to *all* regulatory income and regulatory expense that arise from a remeasurement of the related liability or related asset through other comprehensive income. These preparers in North America are respondents who also suggested extending the measurement proposals in paragraph 61 of the Exposure Draft to items affecting regulated rates on an accrual basis (Agenda Paper 9A).

9. According to these respondents who suggested extending the presentation proposals, the resulting presentation would be:

   (a) more understandable to users of financial statements. For example, remeasurements of a defined benefit (pension) liability may result in **material amounts of losses or gains** in other comprehensive income that may give rise to regulatory assets or regulatory liabilities. Presenting regulatory income or regulatory expense that arises from these regulatory assets or regulatory liabilities in other comprehensive income would avoid significant mismatches that would arise from presenting these items in profit or loss. Some of these respondents said presenting such regulatory income or regulatory expense in profit or loss would not provide a faithful representation of an entity's financial performance for the period (paragraphs 13–15).

   (b) consistent with previous conclusions reached by the IASB in IFRS 14 *Regulatory Deferral Accounts.* IFRS 14 requires an entity to present in other comprehensive income the net movement in all regulatory deferral account balances that relate to items recognised in other comprehensive income—that is, presentation in other comprehensive income is not limited to items treated by the regulatory agreement as allowable or chargeable on a cash basis.

When developing IFRS 14, the IASB was persuaded by those respondents who stated that presenting all net movements in regulatory deferral account balances in a single line item in profit or loss could be confusing or misleading when a material portion of the movement related to items that are recognised in other comprehensive income.[1]

Staff analysis

10. In December 2023, the IASB tentatively decided:[2]

    (a) to retain the presentation proposals in paragraph 69 of the Exposure Draft for a regulatory asset or regulatory liability that is remeasured applying paragraph 61 of the Exposure Draft; and

    (b) to clarify that an entity is required to reclassify regulatory income or regulatory expense presented in other comprehensive income to profit or loss if IFRS Accounting Standards require the entity to reclassify the related expense or income to profit or loss.

11. In developing the presentation proposals in paragraph 69 of the Exposure Draft, the IASB placed importance on specific factors:

    (a) the regulatory asset (regulatory liability) would be measured using the measurement basis used in measuring the related liability (related asset). The measurement of the regulatory asset (regulatory liability) reflects the fact that its cash flows are a replica of the cash flows arising from the related liability (related asset).

    (b) in the case of regulatory income (regulatory expense) that results from remeasurements through other comprehensive income, its presentation in other comprehensive income would result in the statement of profit or loss providing more relevant information or a more faithful representation of the

[1] Paragraph BC59(c) of the Basis for Conclusions accompanying IFRS 14.

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

entity's financial performance for the period.[3] In particular, the IASB concluded that presenting such regulatory income (regulatory expense) in profit or loss would mean that the same underlying remeasurement would lead to two opposite effects: one in profit or loss for the regulatory asset or regulatory liability and the other in other comprehensive income for the related liability or related asset.[4] The users of financial statements we have contacted have supported these presentation proposals.

12. Of the respondents who suggested extending the presentation proposals in paragraph 69 of the Exposure Draft, most cited pension costs as an example of remeasurements through other comprehensive income that are compensated on a basis different from cash.[5]

13. We have learned of a specific regulatory methodology for compensating pension costs that is common in Canada. In those schemes the regulator would determine the regulatory compensation for a pension obligation on an accrual basis using IFRS Accounting Standards with some modifications.[6] For example, compensation is determined separately for:

    (a) components of the pension obligation that are recognised in profit or loss—the 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; and

    (b) components of the pension obligation that are recognised in other comprehensive income—the regulatory agreement gives an entity an enforceable present right to recover actuarial losses or gains in other comprehensive income but defers the recovery of actuarial losses or gains by

[3] Paragraphs 7.16–7.17 of the *Conceptual Framework for Financial Reporting*.

[4] Paragraphs BC184–BC185 of the Basis for Conclusions accompanying the Exposure Draft.

[5] Gains or losses on cash flow hedges is another item in other comprehensive income that may be applicable to rate-regulated entities. Feedback shows that regulators may add to or deduct from regulated rates realised losses or realised gains from derivatives—that is, regulators may treat these losses or gains as allowable or chargeable on a cash basis.

[6] Appendix C of Agenda Paper 9A provides an example that illustrates this methodology.

applying a corridor approach. Consequently, **a regulatory asset or regulatory liability arises that is specifically related to the recovery of actuarial losses or gains**. Under this approach, the regulatory agreement 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.

14. Respondents who suggested extending the presentation proposals are subject to schemes that compensate pension costs in a manner similar to that described in paragraph 13. These entities currently present in other comprehensive income regulatory income or regulatory expense related to actuarial losses or gains recognised in other comprehensive income. These entities present such regulatory income or regulatory expense applying either IFRS 14 (paragraph 9(b)) or the generally accepted accounting principles (GAAP) in the United States. Some of these entities that currently prepare their financial statements in accordance with US GAAP will adopt IFRS Accounting Standards when the final Standard is issued.

15. As mentioned in paragraph 9(a), the amounts in other comprehensive income can be material. According to a respondent, presenting in profit or loss the regulatory income associated with a remeasurement loss in other comprehensive income would have increased the entity's profit before income taxes by C$1.8 billion to approximately C$3.6 billion.[7] This respondent thought this presentation would not provide a faithful representation of an entity's financial performance for the period.

16. In some other cases, the regulatory compensation is determined for *all components* of a pension obligation together on an accrual basis using the local GAAP. In these cases, splitting the regulatory compensation for the pension obligation—and movements in the related regulatory asset or regulatory liability—between components of the pension obligation in profit or loss and those in other

[7] Comment letter can be found here. These amounts are expressed in Canadian dollars (C$) and based on 2020 annual financial statements prepared in accordance with US GAAP.

comprehensive income may be impracticable. This is consistent with feedback from a European preparer representative body.

17. Paragraph 13 describes the case in which the regulatory agreement provides *separate compensation* for the component of the pension obligation recognised in other comprehensive income applying IFRS Accounting Standards. In this case, we acknowledge that presenting the related regulatory income or regulatory expense in other comprehensive income might help users of financial statements to understand the relationship between the separate compensation and that specific component of the pension obligation.

18. Moreover, this understanding might be enhanced if an entity had also applied the exemption from discounting recommended in Agenda Paper 9A for some items of expense or income that affect regulated rates on an accrual basis. An exemption from discounting would have the same effect as measuring the regulatory asset or regulatory liability using the measurement basis used to measure the pension liability. Applying the presentation proposals in paragraph 69 of the Exposure Draft, the entity would have presented equal but opposite amounts of the regulatory income or regulatory expense and the actuarial losses or gains in other comprehensive income. In addition, the entity would not subsequently reclassify to profit or loss both the actuarial losses or gains and the related regulatory income or regulatory expense previously included in other comprehensive income. This would preserve the matching of amounts in other comprehensive income.

19. We have not found examples of the fact pattern described in paragraph 13 in other jurisdictions. In addition, we think extending the use of the presentation proposals in paragraph 69 of the Exposure Draft might:

   (a) challenge the objective of the accounting model proposed in the Exposure Draft. The accounting model is intended to provide information that supplements the information provided by applying IFRS 15 *Revenue from Customers with Customers*. The IASB tentatively decided to require an entity to classify regulatory income or regulatory expense as revenue and to present regulatory income or regulatory expense as a separate line in the statement(s) of financial performance.[8]

(b) result in the statement of profit or loss providing less relevant information and a less faithful representation of the entity's financial performance for the period. This is because the statement of profit or loss would not reflect all regulatory income and regulatory expense arising from regulatory assets and regulatory liabilities that are measured applying the cash-flow-based measurement technique.

(c) dilute the benefits of presenting equal but opposite amounts in other comprehensive income if the cash flows arising from the regulatory asset or regulatory liability are not a replica of the cash flows arising from the pension liability.

(d) add complexity to the presentation requirements in the final Standard.

20. On balance, we think the disadvantages of extending the proposals in paragraph 69 of the Exposure Draft (paragraph 19) outweigh the benefits (paragraphs 17–18).

21. We therefore recommend that the final Accounting Standard not extend the use of the presentation requirements proposed in paragraph 69 of the Exposure Draft dealing with items affecting regulated rates only when the related cash is paid or received.

Question for the IASB
1. Does the IASB agree with the staff recommendation in paragraph 21?

[8] Agenda Paper 9B discussed at the December 2023 IASB meeting.

Appendix—Presentation of regulatory income or regulatory expense arising from remeasurements through other comprehensive income

A1. This appendix illustrates the presentation of regulatory income or regulatory expense using an example of a regulatory agreement that provides separate compensation for the component of the pension obligation recognised in other comprehensive income.

Example 1

A regulatory agreement compensates an entity for its pension obligation based on the amount of pension expense the entity recognised applying IAS 19 *Employee Benefits*. The regulatory compensation for:

(a) amounts recognised in profit or loss in a period is included in regulated rates charged for that period based on estimates. This example assumes that the estimates are the same as the actual amounts recognised. Consequently, no difference in timing arises.

(b) amounts recognised in other comprehensive income in a period is included in regulated rates charged over the expected average remaining service periods of the employees. Consequently, differences in timing arise between the amounts recognised in other comprehensive income and the amounts included in regulated rates.

A2. In Year 1, the entity estimates that the services its employees render in Years 1–5 will lead to an obligation to provide benefits of CU9,000 in Years 6–7 (CU4,500 each year).[9] At the end of Year 2, the entity estimates that the benefits it will provide will increase to CU10,000 (CU5,000 each in Years 6 and 7). The entity remeasures the pension liability and recognises the resulting actuarial loss of CU321 in Year 2. The example assumes no actuarial gains or losses arise during Years 3–5. Table 1 shows the movements in the pension liability measured applying IAS 19.

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

Table 1—Pension liability applying IFRS Accounting Standards								
In CU / Years	1	2	3	4	5	6	7	TOTAL
Opening balance	-	1,377	3,212	5,060	7,083	9,297	4,762	-
Service costs	1,377	1,445	1,687	1,770	1,860	-	-	8,139
Interest costs	-	69	161	253	354	465	238	1,540
Actuarial losses	-	321	-	-	-	-	-	321
Payments	-	-	-	-	-	(5,000)	(5,000)	(10,000)
Closing balance	**1,377**	**3,212**	**5,060**	**7,083**	**9,297**	**4,762**	**-**	**-**

A3. The regulator includes the actuarial loss arising in Year 2 in regulated rates charged over the remaining service periods—that is, CU107 each year over Years 3–5. Table 2 shows the regulatory compensation included in regulated rates. Table 3 shows the differences in timing that arise from the recovery of the actuarial loss over time.

Table 2—Amount included in regulated rates								
In CU / Years	1	2	3	4	5	6	7	TOTAL
Pension expense in profit or loss	1,377	1,514	1,848	2,023	2,214	465	238	9,679
Service costs	1,377	1,445	1,687	1,770	1,860	-	-	8,139
Interest costs	-	69	161	253	354	465	238	1,540
Regulatory compensation [a]	**1,377**	**1,514**	**1,848**	**2,023**	**2,214**	**465**	**238**	**9,679**
Pension expense in other comprehensive income	-	321	-	-	-	-	-	321
Regulatory compensation [b]	**-**	**-**	**107**	**107**	**107**	**-**	**-**	**321**
Amount included in regulated rates [a] + [b]	**1,377**	**1,514**	**1,955**	**2,130**	**2,321**	**465**	**238**	**10,000**

Table 3—Differences in timing								
In CU / Years	1	2	3	4	5	6	7	TOTAL
Amount recognised in profit or loss (Table 2)	1,377	1,514	1,848	2,023	2,214	465	238	9,679
Amount recognised in other comprehensive income (Table 2)	-	321	-	-	-	-	-	321
Amount recognised	**1,377**	**1,835**	**1,848**	**2,023**	**2,214**	**465**	**238**	**10,000**
Amount included in regulated rates (Table 2)	**1,377**	**1,514**	**1,955**	**2,130**	**2,321**	**465**	**238**	**10,000**
Differences in timing	-	321	(107)	(107)	(107)	-	-	-
Regulatory asset (undiscounted)	**-**	**321**	**214**	**107**	**-**	**-**	**-**	**-**

A4. Agenda Paper 9A 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.

A5. In this simplified example, it would be possible to determine the amount and timing of the cash flows without undue cost or effort—the actuarial loss arising in Year 2 is fully recovered over Years 3–5. However, paragraph 13 of this paper describes the case in which an entity is entitled to include in regulated rates only a portion of the cumulative amount of actuarial losses or gains in excess of the 'corridor', determined in a future period. In this case, it may be difficult for the entity to estimate in Year 2 both the amount and timing of the future cash flows arising from the related regulatory asset without undue cost or effort. For the purposes of illustration, we have assumed in this example that the entity determines that the regulatory asset related to the actuarial loss arising in Year 2 meets the condition for applying the exemption from discounting in paragraph A4. Consequently, the entity measures the regulatory asset without discounting (Table 3). The exemption from discounting results in equal but opposite amounts of regulatory income (regulatory expense) and actuarial losses (gains).

A6. As mentioned in paragraph 8 of this paper, respondents have requested the IASB extend the presentation proposals in paragraph 69 of the Exposure Draft to this fact pattern. Table 4 shows the entity's statement(s) of financial performance reflecting this request:

(a) other comprehensive income for Year 2 will reflect both the actuarial loss of CU321 and the related regulatory income of the same amount. These amounts will not be subsequently reclassified to profit or loss applying IAS 19 and the IASB's tentative decision in paragraph 10(b) of this paper.

(b) profit or loss for Years 3–5 will reflect regulatory expense of CU107 each year as the entity recovers the actuarial loss of the same amount through regulated rates charged—and hence, included in revenue.

Table 4—Statement of financial performance applying paragraph 69 of the Exposure Draft

In CU / Years	1	2	3	4	5	6	7	TOTAL
Revenue (Table 2)	1,377	1,514	1,955	2,130	2,321	465	238	10,000
Regulatory income (regulatory expense)*	-	-	(107)	(107)	(107)	-	-	(321)
Pension expense	(1,377)	(1,445)	(1,687)	(1,770)	(1,860)	-	-	(8,139)
Interest expense on pension liability	-	(69)	(161)	(253)	(354)	(465)	(238)	(1,540)
Profit or loss	-	-	-	-	-	-	-	-
Regulatory income (regulatory expense)	-	321	-	-	-	-	-	321
Actuarial losses	-	(321)	-	-	-	-	-	(321)
Other comprehensive income	-	-	-	-	-	-	-	-
Total comprehensive income	-	-	-	-	-	-	-	-

* See 'differences in timing' in Table 3.

A7. Table 5 shows the entity's statement(s) of financial performance applying the staff recommendation in this paper:

(a) profit or loss for Year 2 will reflect regulatory income of CU321 related to the actuarial loss of the same amount recognised in other comprehensive income. The actuarial loss in other comprehensive income will not be subsequently reclassified to profit or loss applying IAS 19.

(b) profit or loss and other comprehensive income for Years 3–5 will be the same as that in Table 4.

Table 5—Statement of financial performance								
In CU / Years	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**TOTAL**
Revenue (Table 2)	1,377	1,514	1,955	2,130	2,321	465	238	10,000
Regulatory income (regulatory expense)*	-	321	(107)	(107)	(107)	-	-	-
Pension expense	(1,377)	(1,445)	(1,687)	(1,770)	(1,860)	-	-	(8,139)
Interest expense on pension liability	-	(69)	(161)	(253)	(354)	(465)	(238)	(1,540)
Profit or loss	**-**	**321**	**-**	**-**	**-**	**-**	**-**	**321**
Actuarial losses	-	(321)	-	-	-	-	-	(321)
Other comprehensive income	**-**	**(321)**	**-**	**-**	**-**	**-**	**-**	**(321)**
Total comprehensive income	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
* See 'differences in timing' in Table 3.								