International Organization of Securities Commissions
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المنظمة الدولية لهيئات الأوراق المالية

July 26, 2021

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Our Ref: 2021/O/MS/C1/IASB/49

RE: Exposure Draft 2021-1 – Regulatory Assets and Liabilities

Dear International Accounting Standards Board (IASB or the "Board") Members,

The International Organization of Securities Commissions (IOSCO) Committee on Issuer Accounting, Audit and Disclosure (Committee 1) thanks you for the opportunity to provide our comments on the Exposure Draft on Regulatory Assets and Regulatory Liabilities.

IOSCO is committed to promoting the integrity of the international markets through promotion of high-quality accounting standards, including rigorous application and enforcement. Members of Committee 1 seek to further IOSCO's mission through thoughtful consideration of accounting and disclosure concerns and pursuit of improved transparency of global financial reporting. Unless otherwise noted, the comments provided herein reflect the consensus among members of Committee 1 and are not intended to include all the comments that might be provided by individual securities regulator members on behalf of their respective jurisdictions.

General observations

Members are supportive of the Board's decision to develop proposals for regulated assets and liabilities that are based on the principle that an entity should reflect the total allowed compensation for goods or services supplied as part of its reported financial performance for the period in which the entity supplies those goods or services. We believe this model, which is based on the enforceability of rights in a regulatory agreement, will provide stakeholders relevant information in assessing the financial performance and financial position of entities who are subject to rate regulation.

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Objective and scope

Members agree with the objective and the Board's decision not to change the accounting for any other rights and obligations created by a regulatory agreement and for other assets or liabilities. Members also agree with the proposed scope that would result in the proposed requirements applying to all regulatory agreements, including arrangements that may not have historically been thought of as regulatory agreements but nevertheless are subject to a form of rate making (e.g. service concession arrangements). However, to assist preparers in identifying arrangements that would not traditionally have been viewed as a regulatory agreement, members request that additional guidance and examples be provided on what constitutes a regulatory agreement to assist with assessing when activities would, or would not, be within the scope of the standard.

Regulatory assets, regulatory liabilities and total allowed compensation

Members agree with the proposed regulatory asset and regulatory liability definitions and that each meet the definitions of assets and liabilities within the *Conceptual Framework for Financial Reporting* (Conceptual Framework). Members also agree that an entity should account for regulatory assets and regulatory liabilities separately from the rest of the regulatory agreement.

Members agree with the concept of total allowed compensation and are of the view that this approach, which includes components reported in profit or loss, has the potential to provide more useful information to investors than a cost deferral model.

While members agree with the proposed guidance on how an entity would determine total allowed compensation, we suggest one clarification to the guidance in paragraphs B13-B15 regarding regulatory returns on a balance relating to assets not yet available for use. In our experience, this regulatory approach is commonly known as an allowance for funds used during construction ("AFUDC"), a term that is identified in example 7C.3 of the Illustrative Examples. We believe amending paragraphs B13-B15 to directly refer to the AFUDC approach would help clarify the intended scope of that guidance to readers.

Recognition

Members agree that an entity should recognize all its regulatory assets and regulatory liabilities, and that a 'more likely than not' recognition threshold should be applied. We also agree that it is appropriate to have the same recognition threshold for regulatory assets and regulatory liabilities given the nature of items commonly provided for in regulatory agreements and the frequency with which certain items can change from a liability to an asset position and vice versa. However, given that the 'more likely than not' recognition threshold is being applied to regulatory assets primarily to prevent an asymmetric recognition threshold with regulatory liabilities in a single regulatory agreement, some members think this

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information should be included in the core of the standard or the implementation guidance given this method for recording assets differs from most other standards.

Measurement

Members agree with the proposal to measure regulatory assets and regulatory liabilities at historical costs, modified at each reporting period by using updated estimates of future cash flows. Members also agree with the proposal to estimate those cash flows applying whichever of two methods – the 'most likely amount' method or 'expected value' method – better predicts the cash flows.

Given that the measurement of regulatory assets and regulatory liabilities is limited to the enforceable period of the regulatory agreement, we believe more guidance or additional examples should be included to address situations in which the expected recovery or fulfillment could extend past the period formally set out in the regulatory agreement. In our experience, the renewal process differs greatly, and the determination of the enforceable boundary could be particularly significant in situations in which regulatory agreements are typically short-term with frequent renewals (e.g., a regulator needs to annually agree to extend the agreement). In these instances, it is not clear whether an entity is required to exclude any expected cash flows that are expected to fall outside the annual contractual period in the form of the agreement in measuring the asset or liability in all circumstances, or if there is some judgment available in concluding that the enforceable boundary can be interpreted to be beyond the contractual period when certain factors exist with respect to the renewal process (e.g., the renewal is more likely than not) .

Members also recommend that additional guidance be provided on subsequent events given the nature of rate cases that often result in connection with regulatory agreements. For example, we note that rate cases may be used to settle discrete issues that arise based on past events (for example, unexpected costs incurred as a result of severe weather) that are similar to litigation disputes, used periodically to determine ongoing rates under the regulatory agreement, and some rate cases may include elements of both. While we appreciate that the Board may prefer not to introduce new guidance on analyzing subsequent events, since this is a common area of significant judgement we recommend inclusion of an example to illustrate whether and when rate case rulings that occur subsequent to the reporting date impact measurement of regulatory assets and regulatory liabilities.

Discount rate

Some members are supportive of the proposed approach of requiring the use of the regulatory interest rate as the discount rate given the Board's view in BC167 that regulated rates are typically designed to support entities' financial viability. Some of these members also noted that the regulatory body is essentially the 'market maker' with respect to the recovery of regulatory assets and regulatory liabilities, which further supports that the interest rate established would generally be a market rate. Additionally, since the Board

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anticipates infrequent circumstances when the regulatory rate is insufficient, these members question the requirement to assess whether there is any indication that the regulatory rate is insufficient in each circumstance. Alternatively, these members recommend that the Board introduce a rebuttable presumption that the regulatory rate is to be used in each circumstance unless there is clear and persuasive evidence that the regulatory rate is not a market rate.

Some members are not supportive of the approach of using the regulatory interest rate since this approach is not consistent with existing IFRS standards. For example, given that the regulatory assets essentially represent payment from customers for goods and services, it is not clear why the Board is not requiring a discount rate determined in accordance with IFRS 15 when there is a significant financing component in a contract. Alternatively, since BC163(b) states the Board's view that regulatory interest rates typically range from zero to a rate approximating an entity's weighted average cost of capital (WACC), it is not clear why the Board is not requiring that an entity's WACC be used as the basis for determining the discount rate.

Despite the differing views on determining what discount rate should be used, members are supportive of using an identical discount rate for both regulatory assets and regulatory liabilities given that the timing of future cash flows could change from an asset to a liability, or vice versa, each reporting period. The complexity and cost of tracking and revising the discount rate in each circumstance is unlikely to provide relevant information to a reader.

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

We are supportive of the proposed approach for measuring line items of expense or income that affect regulated rates only when related cash is paid or received provided that any regulatory asset or regulatory liability recorded meets the definition of asset or liability in the Conceptual Framework. Some members are not clear why a regulatory asset would be recognized in some circumstances given that the regulatory agreement does not create an enforceable right of recovery until the cash is paid and the terms of reimbursement could change if payment is not made within the boundary of the existing regulatory agreement. These members recommend that additional discussion beyond BC175 be provided to explain why these circumstances would meet the definition of an asset in the Conceptual Framework.

Members also recommend that additional guidance be provided on the following, which could be achieved by expanding illustrative example 7A.12:

- For a regulatory asset that is measured based on the measurement of the related liability under other IFRSs, no profit element will be incorporated into the measurement prior to the time of payment, and therefore a question arises of whether the regulatory asset should be remeasured immediately upon cash payment based on the expected future cash flows (with corresponding

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regulatory income recorded) or if any incremental income should be recorded over the recovery period.

- For a regulatory asset that was recorded as a result of regulatory income that was split between the statement of profit or loss and comprehensive income, a question arises of whether the profit element on that regulatory asset would need to be bifurcated between the statement of profit or loss and comprehensive income when the asset is recovered or whether the entire portion of the profit element could be recorded in the statement of profit or loss.

Presentation and disclosure

Members agree with the method of presentation in the statement of financial performance proposed in paragraphs 67-69 of the Exposure Draft.

Members agree with the proposed disclosure requirements but recommend that greater emphasis be provided on the requirement to disclose significant estimates and judgments, including:

- An entity's assessment of the boundary of a regulatory agreement and how the boundary impacts the measurement of regulatory assets and liabilities; and
- If a minimum rate is calculated and used to measure regulatory assets, a description of how that minimum rate was estimated.

Other comments

Members request that the Board reconsider the use of the term "performance incentive" in paragraphs B16-B20. The term "incentive" normally has a positive connotation and would not normally be used to describe a "penalty" that arises from an agreement. To avoid confusion, we recommend that "incentive or penalty" be used consistently in the noted paragraphs.

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We appreciate your thoughtful consideration of the views provided in this letter.

If you have any questions or need additional information, please do not hesitate to contact Cameron McInnis, Chair of the Accounting Subcommittee of Committee 1 at +1 416-593-3675 or myself. In case of any written communication, please mark a copy to me.

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Yours sincerely,

Makoto Sonoda

Chair
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