Applying IFRS

A closer look at IFRS 20 – the new Regulatory Assets and Regulatory Liabilities Standard

September 2026

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What you need to know

- IFRS 20 *Regulatory Assets and Regulatory Liabilities* addresses investors' demand for better information about total allowed compensation arising from rate-regulated activities, thereby enhancing the usefulness of financial statements. The standard supplements existing IFRS accounting standards by providing additional information about the effects of rate regulation, rather than replacing information reported under those standards. IFRS 20 applies only to entities subject to a regulatory agreement that creates a specific subset of rights and obligations.
- IFRS 20 sets out the requirements for the recognition, measurement, presentation and disclosure of regulatory assets, regulatory liabilities, regulatory income and regulatory expense, arising from differences in timing created by regulatory agreements.
- Limited amendments have been made to other IFRS accounting standards, including IFRS 1 *First-time Adoption of International Financial Reporting Standards*, IFRS 3 *Business Combinations* and IFRS 18 *Presentation and Disclosure in Financial Statements*.
- IFRS 20 and the consequential amendments to other standards are effective for reporting periods beginning on or after 1 January 2029, with earlier application permitted.
- Entities may elect to apply a retrospective approach applying IAS 8 *Basis of Preparation of Financial Statements* or a modified retrospective approach with certain transition reliefs, both requiring adjusted comparative information.

Overview of IFRS 20

This publication discusses the new requirements of IFRS 20; which addresses the recognition, measurement, presentation and disclosure of regulatory assets, regulatory liabilities, regulatory income and regulatory expense.

IFRS 20 supplements, but does not replace, the information the entity provides by applying IFRS 15 and other IFRS accounting standards.

IFRS 20 introduces requirements that will result in new information that supplements the information an entity already provides by applying other IFRS accounting standards, including IFRS 15 *Revenue from Contracts with Customers*. The information required by IFRS 20 enables users of financial statements to understand the total allowed compensation for regulatory goods or services supplied in each reporting period and the related rights and obligations. The income, expenses, assets and liabilities an entity reports by applying IFRS 20 supplement, but do not replace, the information the entity provides by applying IFRS 15 and other IFRS accounting standards.

To implement these requirements, entities may need to make changes to their data collection processes, information systems, internal procedures and controls, and their financial reporting processes. Identifying the relevant enforceable present rights and obligations that arise from regulatory agreements and providing the required disclosure may require significant judgement and resources. In particular, implementation may require greater coordination across an entity's financial reporting, legal, regulatory and investor relations functions than is typically required under existing reporting frameworks.

The focus of this publication is on the new requirements; the extent to which IFRS 20 differs from the requirements under IFRS 14 *Regulatory Deferral Accounts* is not addressed considering also that IFRS 14 allowed first-time adopters that recognised regulatory deferral account balances in accordance with their previous GAAP to continue to do so when making the transition to IFRS accounting standards.

IFRS 20, once effective, will also make consequential amendments to other IFRS accounting standards including IFRS 1, IFRS 3 and IFRS 18.

IFRS 20 and the consequential amendments to other IFRS accounting standards, which have to be adopted at the same time, are effective for periods beginning on or after 1 January 2029. The transitional requirements allow entities to select between the retrospective approach applying IAS 8 and the modified retrospective approach with certain transition reliefs. Regardless of the approach applied, the transitional provisions specifically require adjusted comparative information for the annual reporting period immediately preceding the date of initial application; they also set out requirements for the interim financial statements in the first year of adoption. Earlier application is permitted and will need to be disclosed (see section 10 for further details). IFRS 20, once effective, will replace IFRS 14.

Most of the illustrations included in this publication are based on the illustrative examples issued by the International Accounting Standards Board (the IASB) to accompany IFRS 20, which do not form part of it. These illustrations are tailored for the discussion in this publication and, therefore, do not repeat the complete examples as issued by the IASB.

This publication has been prepared on the basis that IFRS 18 is effective. Therefore, all references to IFRS requirements incorporate the amendments introduced by IFRS 18, although the standard becomes mandatorily effective only for annual periods beginning on or after 1 January 2027.

At the time of writing this publication, some jurisdictions with their own endorsement processes are assessing whether to keep the effective date set out by the IASB or delay it by one or more years. Therefore, entities need to follow this development when planning their first time implementation projects for IFRS 20.

How we see it

While there might appear to be ample time before the effective date of IFRS 20, entities are encouraged to determine the impact of the new standard in a timely manner.

For entities that do not already apply IFRS 14, IFRS 20 will require for the first time, the recognition of regulatory assets and regulatory liabilities in the financial statements. As such, management will need to plan ahead as the transition process may require significant time and resources across financial reporting, legal, IT and other functions to prepare and disclose information for current and comparative reporting periods. Implementation planning should also include adequate training and engagement with key stakeholders.

Furthermore, entities may need to enhance existing systems and processes to better integrate financial reporting and regulatory reporting data, as well as implement additional controls to support the ongoing preparation of IFRS-compliant financial statements. Apart from financial reporting, IFRS 20 is also expected to affect financial planning and forecasting. Accordingly, entities need to consider its potential implications for other areas, such as internal performance measures, financial covenants and share-based payment arrangements.

The views expressed in this publication reflect EY's perspectives as of September 2026. As practice develops and further analysis of IFRS 20 and the related consequential amendments is undertaken, additional application and implementation issues may be identified, and the views expressed in this publication may evolve accordingly.

1 Introduction

IFRS 20 is a new accounting standard that addresses how entities subject to a regulatory agreement that sets the rate they can charge to their customers, need to reflect the accounting effects of that agreement in their financial statements. The standard introduces specific requirements to identify a subset of rights and obligations created by a regulatory agreement and recognise related regulatory assets, regulatory liabilities, and the corresponding regulatory income or regulatory expense. *[IFRS 20.1, IFRS 20.2]*.

The standard's core principle is that an entity recognises the total allowed compensation for regulatory goods or services in the same reporting period that the entity supplies those regulatory goods or services.

The standard's core principle is that an entity recognises the total allowed compensation for regulatory goods or services in the same reporting period that the entity supplies those regulatory goods or services. A key aspect of the IASB's rationale for issuing IFRS 20 is that IFRS 15, when applied on a standalone basis, may not fully reflect the compensation to which an entity is entitled for regulatory goods or services supplied in a reporting period. *[IFRS 20.3]*.

For entities subject to specific forms of rate regulation, the amount of revenue from contracts with customers recognised in accordance with IFRS 15 (IFRS 15 revenue) reflects the regulated rates charged to customers during the reporting period. However, regulatory agreements frequently require a portion of the compensation for regulatory goods or services supplied in one period to be recovered from, or refunded to, customers through regulated rates in a different period.

Consequently, IFRS 15 revenue in a period may differ from the total compensation earned for the regulatory goods or services supplied during that same period. The IASB considered that this may make it difficult for users of financial statements to understand the entity's financial performance and prospects for future cash flows. *[IFRS 20.BC9]*.

IFRS 20 addresses this informational gap. Rather than replacing IFRS 15, the standard supplements the information provided by IFRS 15 by requiring entities to recognise regulatory assets, regulatory liabilities, regulatory income and regulatory expense arising from differences in timing. *[IFRS 20.5]*.

Differences in timing can arise if a regulatory agreement includes part or all of the total allowed compensation for regulatory goods or services supplied in one reporting period in determining the regulated rates charged to customers in a different period (past or future). Where such differences in timing arise, the information resulting from the application of IFRS 15 is incomplete because the IFRS 15 revenue recognised in that period does not include all of the total allowed compensation for regulatory goods or services supplied in that period, or includes part or all of the total allowed compensation for regulatory goods or services supplied in a different period (past or future). *[IFRS 20.BC8, IFRS 20.BC49]*.

Recognising regulatory assets and regulatory liabilities, together with the related regulatory income or regulatory expense, changes how financial performance is reported by reflecting the total allowed compensation in the period in which the regulatory goods or services are supplied. The subsequent recovery of a regulatory asset, or fulfilment of a regulatory liability, results in regulatory expense or regulatory income that offsets amounts included in IFRS 15 revenue in a different period. The recognition of regulatory assets or regulatory liabilities has no impact on an entity's cash flows as the accounting results in non-cash adjustments to improve the usefulness of the resulting financial information. However, the requirement in IFRS 20 is intended to result in an entity providing more complete information about differences in timing than would otherwise be available to users of financial statements. As such, it results in information that enables users to better understand how differences in timing affect an entity's financial performance and financial position, offering insights into the entity's future cash flows. *[IFRS 20.BC10]*.

IFRS 20 replaces the interim guidance in IFRS 14 and provides a comprehensive model applicable to entities with regulatory agreements regardless of the sectors to which they belong. IFRS 20 is applicable to all regulatory assets and all regulatory liabilities with the only exception being related to regulated premiums charged in insurance contracts in the scope of IFRS 17 *Insurance Contracts* (see section 3.3.1). *[IFRS 20.4].*

A brief summary of each of the following sections is set out below. More detailed guidance and illustrative examples can be found in the respective sections, which will discuss the application of the new standard and specific scenarios:

- Section 2 discusses the key concepts under IFRS 20.
- Section 3 discusses IFRS 20's objective, which is to ensure financial statements faithfully represent how regulatory income and regulatory expense affect the entity's financial performance and how regulatory assets and regulatory liabilities affect its financial position.
- Section 4 discusses IFRS 20's recognition requirements. The standard requires the recognition of all in-scope regulatory assets and liabilities at the end of each reporting period. When there is uncertainty about whether a regulatory asset or liability exists, IFRS 20 sets a probability threshold: the entity recognises the regulatory asset or liability if it is more likely than not that the asset or liability exists. The recognition requirements also include specific recognition criteria related to regulatory depreciation of a regulatory capital base.
- Section 5 discusses the measurement requirements. IFRS 20 adopts a cash-flow-based measurement technique for regulatory assets and liabilities. The starting point is an up-to-date estimate of all future cash flows that will arise from the regulatory asset or liability within the boundary of the regulatory agreement. Secondly, the standard considers the effects of time value of money: the future cash flows are discounted to present value. The discount rate used is typically the regulatory interest rate (implicitly or explicitly) specified by the regulatory agreement for that type of balance.
- Section 6 discusses the derecognition requirements in accordance with IFRS 20.
- Section 7 discusses IFRS 20's requirement to separately present items resulting from its application in the statement (or statements) of financial performance and statement of financial position. Finally, this section also addresses the statement of cash flows.
- Section 8 discusses the disclosure requirements, with the overall objective to disclose in the notes, information about regulatory income, regulatory expense, regulatory assets and regulatory liabilities which, together with the information required by other IFRS accounting standards, will provide insights to users of financial statements into the effects of regulatory agreements on the entity's statement of financial performance and statement of financial position.
- Section 9 discusses the consequential amendments to other standards, including to IFRS 1, IFRS 3 and IFRS 18.
- Section 10 discusses IFRS 20's transition requirements.

How we see it

IFRS 20 provides a framework for reflecting the economic performance of entities operating under rate-regulated activities. The introduction of regulatory assets and liabilities means that a regulated entity's financial statements will no longer fluctuate simply due to the timing of IFRS 15 revenues versus entitlements– instead, earnings will consistently portray the amounts the entity is entitled to for the provision of regulatory goods and services in each reporting period.

The core mechanics involve identifying differences in timing and related enforceable present rights and obligations, recognising corresponding assets or liabilities, and measuring them in line with expected future cash flows (discounted at the regulatory rate and reflecting an unbiased estimate of uncertain cash flows). Presentation and disclosures are intended to improve transparency and comparability.

2 Key concepts

2.1 What is a regulatory agreement?

A regulatory agreement is defined by IFRS 20 as an agreement that creates a set of enforceable rights and enforceable obligations that prescribe how a regulator determines a regulated rate (or a range for the regulated rate) that an entity charges for goods or services supplied to customers in a period. *[IFRS 20.11]*.

The standard notes that regulatory agreements come in many forms, varying across jurisdictions and sectors, as such, IFRS 20 provides the following examples: a contractual licensing agreement, a service concession agreement and a set of rights and obligations specified by law or regulation. *[IFRS 20.12]*.

Regulatory agreements come in many forms, varying across jurisdictions and industries.

IFRS 20 sets out the most common types of compensation provided or deductions made by regulatory agreements through regulated rates. See section 2.3 for further details.

A regulatory agreement might not provide all the types of compensation or make all the types of deductions as described in the standard, might provide other types of compensation or make other types of deductions or might use different terminology to refer to the types of compensation or deductions. Hence, an entity uses judgement in analysing the terms and conditions of a regulatory agreement to determine what types of compensation or deductions the regulatory agreement provides or makes. If the regulatory agreement provides a type of compensation or makes a type of deduction other than those described in the standard, the entity uses its judgement to determine when that compensation or deduction forms part of the total allowed compensation. See section 2.3 for discussion on total allowed compensation. *[IFRS 20.21]*.

Examples of different terminology identified during the development of IFRS 20 are:

- Total allowed compensation: revenue requirement or authorised revenue[1]
- Regulatory capital base: regulatory asset base or regulatory asset value[2]

A key concept to both the recognition and measurement of regulatory assets and regulatory liabilities is the boundary of the regulatory agreement. The boundary of a regulatory agreement is determined by which cash flows are supported by enforceable present rights and obligations and, therefore, is included in measuring regulatory assets and regulatory liabilities. Specifically, cash flows within the boundary only comprise the following *[IFRS 20.35, IFRS 20.B73]*.:

- An enforceable present right to add, or an enforceable present obligation to deduct, amounts when determining future regulated rates in future periods in which the entity also has an enforceable present right or obligation to supply regulatory goods or services. *[IFRS 20.35(a)]*. For future regulated-rate cash flows, this requires a two-part assessment. The entity has to: (a) have an enforceable present right or obligation to supply the regulated goods or services at the relevant future date; and (b) have an enforceable present right to recover a regulatory asset, or an enforceable present obligation to fulfil a regulatory liability, through

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[1] IASB Staff Paper AP9A, Project: Rate-regulated Activities, Topic: Components of total allowed compensation, IASB, July 2022. Available on the IFRS Foundation's website.

[2] IASB Staff Paper AP9C, Project: Rate-regulated Activities, Topic: Total allowed compensation—Overview, IASB, May 2022. Available on the IFRS Foundation's website.

regulated rates to be charged in those future periods. *[IFRS 20.BC179, IFRS 20.B74]*.

- An enforceable present right to receive or enforceable present obligation to pay compensation on termination of the regulatory agreement. *[IFRS 20.35(b)]*. The term 'compensation on termination of a regulatory agreement' refers to the rights and obligations the entity would have if the regulatory or another party were to terminate the regulatory agreement at the end of the reporting period for reasons other than the entity's failure to perform as specified in the agreement. That is, whether the entity has an enforceable present right to receive compensation relating to regulatory assets that have not yet been recovered or an enforceable present obligation to pay compensation relating to regulatory liabilities that have not yet been fulfilled. There may be uncertainty about the existence of an enforceable present right to receive compensation or an enforceable present obligation to pay compensation on termination of a regulatory agreement. If such uncertainty exists, cash flows within the boundary of the regulatory agreement are those for which the entity determines it is more likely than not that such a right or obligation exists. *[IFRS 20.B81-B84]*.

Sometimes, whether a regulatory asset or regulatory liability exists is uncertain. The IASB decided that, in such cases, an entity is required to recognise the regulatory asset or regulatory liability if it is more likely than not that it exists—and it meets the recognition criteria set out in the standard if applicable. The IASB considered other alternatives such as specifying no recognition threshold or specifying a recognition threshold with a higher probability than 'more likely than not', such as the 'virtually certain' one in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* that applies on contingent assets. The IASB acknowledged that IFRS 20 would be simpler for an entity to apply if there were no recognition threshold because an entity would not be required to assess whether regulatory assets or regulatory liabilities exist. The IASB also considered specifying a higher probability recognition threshold to reduce the subjectivity involved in making such an assessment. However, the IASB's view was that without a recognition threshold entities might not always provide relevant information, and a higher probability recognition threshold might result in entities' financial statements being less complete. Consequently, the IASB concluded that a 'more likely than not' threshold would achieve a better cost-benefit balance than either of the alternatives. *[IFRS 20.BC120]*.

In assessing whether the entity has an enforceable present right or obligation to supply regulatory goods or services at a future date, the analysis considers renewal and termination rights (whether explicit or implicit) held by any party. That is, if another party has an enforceable present right to prevent the renewal, an entity may not have an enforceable present right to supply regulatory goods or services. However, the guidance applies a substance-based filter: a right held by any party is disregarded if there are no circumstances in which that party has the practical ability to exercise it. Examples given by the standard are circumstances where the economic consequences of exercising the right are significantly more adverse for the holder than the consequences of not exercising, where exercising the right would trigger liquidation/cessation of trade, or would cause major disruption to an essential public service. *[IFRS 20.B75-77]*.

In some cases, an entity might conclude that it has an enforceable present right or obligation to supply regulatory goods or services for an indefinite period. This may be the case, for example, where the regulatory framework entitles the entity to operate indefinitely, or where renewals are viewed as an administrative formality (occurring unless there is a significant breach and renewal costs are insignificant), so that the entity is, in substance, obliged or

entitled to supply regulated goods or services for an indefinite period. *[IFRS 20.B78]*.

The following illustration of an entity's determination of the boundary of a regulatory agreement is based on an illustrative example of IFRS 20: *[IFRS 20.IE289-IE299]*

Illustration 2-1: Boundary of a regulatory agreement

Fact pattern

Entity A entered into a service concession arrangement that requires Entity A to supply regulatory goods or services over 30 years. Entity A operates in a jurisdiction where service concessions are renewed in a public tender process that is highly competitive.

The service concession arrangement specifies that on termination of the arrangement Entity A would be entitled to receive compensation from the regulator or any incoming operator for any unrecovered balances, including regulatory assets. The regulator has discretion in determining the type of compensation Entity A will receive on termination of the arrangement.

Entity A recognises a regulatory asset related to a pension liability by applying IFRS 20. Entity A expects the regulatory asset to result in an unrecovered amount at the end of the service concession arrangement.

Analysis

Entity A measures the regulatory asset related to the pension liability by including all estimated future cash flows that are within the boundary of the service concession arrangement. Entity A determines those cash flows by considering paragraphs B73–B84 of IFRS 20.

Entity A assesses whether cash flows from regulated rates charged to customers in the future are within the boundary of the service concession arrangement by applying paragraph B74 of IFRS 20. In particular, Entity A assesses whether it has:

(a) An enforceable present right or an enforceable present obligation to supply regulatory goods or services at a future date; and

(b) An enforceable present right to recover regulatory assets or an enforceable present obligation to fulfil regulatory liabilities through regulated rates charged to customers in the future.

Entity A determines that it has an enforceable present right or an enforceable present obligation to supply regulatory goods or services for the 30-year term of the service concession arrangement. Entity A also considers the new bid process that is required at the end of the 30-year term. Entity A determines that it has neither an enforceable present right nor an enforceable present obligation to supply regulatory goods or services beyond the 30-year term.

Entity A assesses the terms of the service concession arrangement relating to the determination of the regulated rates. Entity A concludes it has an enforceable present right to recover regulatory assets or an enforceable present obligation to fulfil regulatory liabilities by adding or deducting amounts in determining the regulated rates to be charged up to Year 30.

Entity A also assesses whether it has an enforceable present right to receive compensation on termination of the arrangement for any unrecovered amounts at the end of Year 30. Entity A concludes that, if the service concession arrangement was terminated at the end of the reporting period for reasons other than its failure to perform as specified in the arrangement, it would have an enforceable present right to receive compensation.

Illustration 2-1: Boundary of a regulatory agreement (cont'd)

Entity A concludes that all estimated future cash flows arising from regulatory assets or regulatory liabilities are within the boundary of the arrangement. Those estimated future cash flows include cash flows arising from the regulatory asset related to the pension liability beyond the 30-year term of the service concession arrangement.

Therefore, Entity A includes in the measurement of the regulatory asset related to the pension liability all estimated future cash flows arising from the recovery of the regulatory asset, including cash flows from compensation on termination of the regulatory agreement.

How we see it

In practice, the determination of the boundary of the regulatory agreement may require significant judgement.

It will not be appropriate for entities to automatically assume that the boundary is limited to the current regulatory period or the current licence term. In many regulatory frameworks, enforceable present rights and obligations may extend beyond those periods, particularly where the entity has enforceable present rights to compensation upon termination or where renewals are, in substance, expected to occur indefinitely. Uncertainty about the consequences for an entity of a termination or inability to renew may represent further challenges in the determination of the boundary of the regulatory agreement.

Consequently, a robust assessment of the legal and regulatory framework, renewal provisions and termination compensation mechanisms may be critical in determining the measurement of regulatory assets and regulatory liabilities.

2.2 Regulator and regulated rate

One of the two conditions for a regulatory asset or a regulatory liability to exist is that an entity and a regulator are parties to a regulatory agreement that prescribes the regulated rate the entity charges for goods or services it supplies to customers. See section 2.3 for a discussion of the other condition. *[IFRS 20.9(a), IFRS 20.B8]*.

A regulator is defined by IFRS 20 as a body that is required by law or regulation to apply a regulatory agreement to determine a regulated rate (or a range for the regulated rate). *[IFRS 20.11]*.

The regulator must be a body with powers conferred by law or regulation.

The regulator, therefore, is a body with powers conferred by law or regulation. The standard is intended to rule out any self-regulation and explicitly rules out the case where a parent entity sets rates to be charged by its subsidiaries. *[IFRS 20.B9]*.

The standard notes that, in some cases, a regulator might determine a range for a regulated rate and allow an entity some discretion to set the regulated rate within that range. Therefore, where the use of cap or floor thresholds offers some flexibility to entities, this does not rule out the recognition of regulatory assets or regulatory liabilities. *[IFRS 20.B10(b)]*.

The standard also states that regulatory assets or regulatory liabilities can arise in cases where an entity or a related party sets rates in accordance with a specified legal or regulatory framework and that framework is subject to oversight or approval by a body that is required to do so by law or regulation. *[IFRS 20.B10(a)]*.

The following illustration of facts and circumstances in which regulatory assets or regulatory liabilities may arise is based on an illustrative example included in IFRS 20: *[IFRS 20.B10]*

Illustration 2-2: Regulatory framework

Fact pattern

Law or regulation gives an entity the ability to set the rates it charges customers for goods or services supplied to them. In setting the rates, the entity must follow the pricing principles set out in law or regulation.

A government agency is required by law or regulation to ensure the entity sets the rates in accordance with applicable law or regulation. As a result, customers are able to appeal against the rates to the government agency, if there are grounds to suspect that the entity breached the pricing principles set out in law or regulation.

Analysis

In this situation, although the entity sets the rates, it does so in accordance with law or regulation. A regulator, the government agency, oversees whether the entity applies law or regulation appropriately. Consequently, regulatory assets or regulatory liabilities might arise in this situation.

2.3 Regulatory goods or services and total allowed compensation

Regulatory goods or services are defined by IFRS 20 as goods or services supplied by an entity to comply with the regulatory agreement. The standard provides the following examples:

- Supplying goods or services to customers;
- Maintaining a network, including routine maintenance and standing ready to repair damage to the network;
- Making changes to the capacity of a network (for example, additions and upgrades or decommissioning); and
- Satisfying other objectives set by the regulator (for example, improving the quality and efficiency of services supplied to customers, or decreasing or increasing customer usage). *[IFRS 20.15]*.

A regulatory asset or regulatory liability can exist only if part, or all, of the total allowed compensation is charged in a different period.

The amount of compensation to which a regulatory agreement entitles an entity to charge customers for the supply of regulatory goods and services in a reporting period is the total allowed compensation. The amount might be charged through regulated rates in either the same period as the entity supplies the regulatory goods or services, or a different period. The concept of total allowed compensation plays an important role in the principle underlying IFRS 20, which is that an entity recognises the total allowed compensation for regulatory goods or services in the same reporting period that the entity supplies those goods or services. *[IFRS 20.3, IFRS 20.14, IFRS 20.18]*.

As discussed in section 2.2, one of the two conditions for a regulatory asset or a regulatory liability to exist is that an entity and a regulator are parties to a regulatory agreement that prescribes the regulated rate the entity charges for goods or services it supplies to customers. *[IFRS 20.9(a)]*.

The other condition for a regulatory asset or a regulatory liability to exist is that part, or all, of the total allowed compensation for regulatory goods or services supplied by the entity in a reporting period is charged to customers using regulated rates in a different period (past or future), creating a difference in timing. *[IFRS 20.9(b)]*.

Although regulatory assets and regulatory liabilities are the most visible outcome of IFRS 20, the IASB designed the standard around the concept of total allowed compensation. The standard is based on the principle that an entity recognises the total allowed compensation for regulatory goods or services in the same reporting period in which those regulatory goods or services are supplied. Regulatory assets and regulatory liabilities are, therefore, not the objective of the accounting model; rather, they are the mechanism used to ensure that total allowed compensation is recognised in the appropriate reporting period. *[IFRS 20.18]*.

The following table provides examples of common types of compensation provided or deductions made by regulatory agreements through regulated rates, and establishes when the compensation or deductions form part of total allowed compensation *[IFRS 20.19]*:

Types of compensation provided or deductions made by a regulatory agreement through regulated rates	
Compensation or deductions	**When the compensation or deductions form part of total allowed compensation**
Compensation for allowable expenses and deductions for chargeable income	In the reporting period in which an entity recognises allowable expenses or chargeable income by applying IFRS accounting standards
Regulatory returns, excluding those identified in the next row	In the reporting period in which a regulatory agreement applies a rate of return to a regulatory capital base
Regulatory returns (or part of those returns) on assets not yet available for use, where: 1. The return is only a debt return or both a debt and equity return, 2. The entity capitalises borrowing costs related to those assets applying IAS 23 *Borrowing Costs*, and 3. The entity's regulatory capital base has a direct relationship with those assets.	In the reporting period in which an entity recognises the borrowing costs as an expense
Compensation or deductions for performance incentives	In the reporting period in which an entity's performance occurs
Compensation for inflation provided separately from regulatory depreciation	In the reporting period in which the inflation arises

An entity treats compensation provided by inflation adjustments to the regulatory capital base as part of the total allowed compensation for the reporting period in which the inflation is recovered through regulatory depreciation included in determining the regulated rates charged to customers (See section 4.6 for further discussion). *[IFRS 20.20]*.

The standard also addresses differences in timing that arise from the under-recovery or over-recovery of allowed revenue (see section 4.8). *[IFRS 20.23]*.

2.4 Differences in timing vs measurement differences

Often the total allowed compensation for regulatory goods or services supplied is typically included in the regulated rates charged to customers in the reporting period when those goods or services are supplied. In this case, an entity recognises the total allowed compensation for regulatory goods or services supplied as revenue from contracts with customers (IFRS 15 revenue) in the same reporting period that the entity supplies those goods or services. See Illustration 3-1 in section 3.3, which illustrates the concept of a difference in timing.

However, differences in timing can arise if a regulatory agreement includes part, or all, of the total allowed compensation for regulatory goods or services supplied in one reporting period in determining the regulated rates charged to customers in a different period (past or future). Such differences in timing might give rise to regulatory assets or regulatory liabilities. *[IFRS 20.16]*.

Requirements in IFRS 15 may result in the recognition of a part, or all, of the total allowed compensation in a different period than the reporting period in which the regulatory goods or services are supplied. IFRS 20 provides the example of paragraph 56 of IFRS 15 that constrains the estimates of variable consideration until the associated uncertainty is resolved. Such differences do not give rise to regulatory assets or regulatory liabilities. *[IFRS 20.17]*.

Measurement differences do not give rise to regulatory assets or regulatory liabilities.

In some cases, the total amount of compensation or deduction for an allowable expense or chargeable income determined by a regulatory agreement for all periods differs from the total amount of the expense or income an entity will recognise for all periods by applying IFRS accounting standards. This could arise when the regulatory agreement is using benchmark amounts, or the regulatory agreement does not allow adjustments where estimates differ from actuals. IFRS 20 refers to such differences as measurement differences. Measurement differences do not give rise to regulatory assets or regulatory liabilities because they do not reflect differences in timing. Instead, an entity reflects the measurement difference in the statement of financial performance in the period in which the entity recognises the IFRS 15 revenue and the related expense or income. *[IFRS 20.B26-B27, IFRS 20.BC57-BC60]*.

The following illustration of the accounting for measurement differences is based on an illustrative example in IFRS 20: *[IFRS 20.B27]*

Illustration 2-3: Measurement difference

Fact pattern

A regulatory agreement might determine the compensation for an allowable expense in a reporting period based on an estimate.

The regulatory agreement might also prohibit an entity from adjusting future regulated rates to be charged to customers to reflect any difference between the estimate and the actual expense recognised.

Analysis

The difference between the compensation determined based on estimate and the related allowable expense determined by applying IFRS accounting standards is a measurement difference, not a difference in timing. The measurement difference is reflected in the statement of financial performance in the reporting period through the recognition of IFRS 15 revenue, which includes compensation based on the estimate, and the recognition of the expense for the actual amount.

In other cases, a difference in timing and a measurement difference might occur concurrently. For example, where a regulatory agreement determines compensation for an allowable expense recognised in a reporting period by applying an amount based on an estimate and this compensation will be added to future regulated rates adjusted to reflect the actual allowable expense incurred.

If so, the future cash flows arising from the regulatory asset or regulatory liability, and hence its measurement, are determined by the amount of the compensation or the deduction (the estimate), not by the amount of allowable expense or chargeable income recognised by applying IFRS accounting standards (the actual expense or income). The measurement difference (the difference between the estimate and the actual expense or income) is reflected in the statement(s) of financial performance in the reporting period through the recognition of regulatory income or regulatory expense for the compensation or deduction and the recognition of the income or expense of the related item. *[IFRS 20.B28, IFRS 20.B29]*.

2.5 What are regulatory assets and regulatory liabilities?

A fundamental aspect of IFRS 20 is the IASB's conclusion that regulatory assets and regulatory liabilities satisfy the definitions of assets and liabilities in the *Conceptual Framework for Financial Reporting* (Conceptual Framework).

The IASB concluded that a regulatory asset constitutes a present economic resource because it represents an enforceable present right to add an amount in determining future regulated rates. That right has the potential to generate future economic benefits and is controlled by the entity as a consequence of past events, namely the supply of regulatory goods or services for which compensation has not yet been included in IFRS 15 revenue.

Similarly, the IASB concluded that a regulatory liability constitutes a present obligation because the entity has already received compensation through regulated rates for regulatory goods or services that are to be supplied in future periods. As a consequence, the entity has an enforceable present obligation to transfer an economic resource by deducting an amount in determining future regulated rates, thereby reducing future cash inflows that it would otherwise be received.

The definitions of a regulatory asset and a regulatory liability in IFRS 20 refer to the existence of an enforceable present right or obligation created by a regulatory agreement and the presence of difference in timing (to add or deduct an amount in determining a regulated rate to be charged to customers in future periods). Accordingly, the IASB concluded that these definitions are consistent with the definitions of assets and liabilities in the Conceptual Framework. *[IFRS 20.6-8, IFRS 20.BC19-BC25]*.

IFRS 20 establishes the recognition and measurement requirements for a specific subset of rights and obligations arising from regulatory agreements.

Regulatory assets and regulatory liabilities are a subset of the rights and obligations created by a regulatory agreement. *[IFRS 20.2]*.

A regulatory agreement might create only regulatory assets, only regulatory liabilities or both regulatory assets and regulatory liabilities. *[IFRS 20.13]*.

The assessment of whether an enforceable present right or present obligation exists requires judgement and considers all reasonable and supportable information that is available without undue cost or effort. Such information might relate to the legal and regulatory framework or a specific difference in timing. See section 4.1.2 for more details. *[IFRS 20.B4]*.

The rights created by a regulatory agreement for an entity include: (a) a right to add an amount in determining a regulated rate to be charged to customers

in future periods; and (b) a right to charge a regulated rate for goods or services the entity will supply to customers in future periods. *[IFRS 20.BC20].*

This constrained right in (a) above distinguishes an entity subject to a regulatory agreement from other entities, that is, a rate-regulated entity does not have a right to raise its prices above the regulated rate. An entity not subject to a regulatory agreement can typically set any price for its goods or services, constrained only by what its customers are prepared to pay and perhaps, for example, by law. That less constrained right is, however, typically available to all parties without significant cost, and hence, does not represent an asset. *[IFRS 20.BC21–22].*

A regulatory liability represents a present obligation to deduct an amount in determining a regulated rate to be charged to customers in future periods, since part, or all, of the total allowed compensation for regulatory goods or services to be supplied in the future has already been included in IFRS 15 revenue. The IASB noted that an entity not subject to a regulatory agreement might have an economic incentive to decrease its prices. However, such an incentive does not create an enforceable present obligation and thus does not create a liability. *[IFRS 20.BC23, IFRS.20.BC25]*.

2.6 What are regulatory income and regulatory expense?

Regulatory income and regulatory expense are income or expense arising from changes in a regulatory asset or regulatory liability. *[IFRS 20.10]*.

Regulatory income and regulatory expenses depict how timing differences originate and reverse over time.

Regulatory income and regulatory expense reflect the effects of changes in regulatory assets and regulatory liabilities arising from differences in timing. Regulatory income arises from the origination of regulatory assets and the fulfilment of regulatory liabilities. Regulatory expense arises from the origination of regulatory liabilities and the recovery of regulatory assets. Accordingly, together they depict how timing differences originate and reverse over time, as the entity recovers or fulfils its regulatory rights and obligations. *[IFRS 20.BC11]*.

Not all changes in regulatory assets or regulatory liabilities give rise to regulatory income or regulatory expense - for example, the acquisition of regulatory assets or assumption of regulatory liabilities in a business combination does not give rise to regulatory income or regulatory expense. See section 9.2 for more details. In addition, exchange differences resulting from translation into a presentation currency in accordance with IAS 21 *The Effects of Changes in Foreign Exchange Rates* are not regulatory income or regulatory expense. *[IFRS 20.10]*.

2.7 Unit of account

Subject to specific conditions, entities account for a group of differences in timing as a single unit of account.

An entity accounts for the right or obligation arising from an individual difference in timing, or from a group of differences in timing, that are created by the same regulatory agreement, have similar expiry patterns and are subject to similar risks, as a single unit of account. *[IFRS 20.24].*

The IASB observed that where differences in timing are created by the same regulatory agreement, have similar expiry patterns, and are subject to similar risks, those differences are likely to have similar implications for the entity's prospects for future cash flows. Therefore, the IASB concluded that treating such differences in timing as a single unit of account would provide information that is as relevant as the information provided by treating each individual difference in timing as a separate unit of account. *[IFRS 20.BC115].*

IFRS 20 provides specific guidance, in relation to regulatory return that is treated as compensation for capitalised borrowing costs and regulatory depreciation of a regulatory capital base that has a direct relationship with

depreciable or amortisable assets. See Sections 4.3.2.2 and 4.2.1 respectively for more details. *[IFRS 20.25, IFRS 20.BC116]*.

How we see it

Collaboration among an entity's legal, regulatory and financial reporting functions will be required in order to identify and account for each timing difference within the scope of IFRS 20. Furthermore, entities will have to carefully assess whether differences in timing need to be considered as a single unit of account, which would affect the costs of applying the standard, both initially and subsequently. Finally, systems and processes would need to be able to track timing differences in order to determine the effect in the primary financial statements and collate information to be disclosed in the notes to the financial statements.

3 The objective, definitions and scope of IFRS 20

3.1 The objective of IFRS 20

IFRS 20 enables users to better understand how differences in timing affect an entity's financial performance and financial position, offering insights into the entity's future cash flows.

The objective of IFRS 20 is to ensure an entity provides relevant information that faithfully represents how regulatory income and regulatory expense affect the entity's financial performance, and how regulatory assets and regulatory liabilities affect its financial position. *[IFRS 20.1]*.

As discussed in section 2.3, the standard's core principle is that an entity recognises the total allowed compensation for regulatory goods or services in the same reporting period that the entity supplies those regulatory goods or services. The requirements in IFRS 20 are intended to result in an entity providing more complete information where differences in timing arise than would otherwise be available to users of financial statements. This information, provided in accordance with these requirements, enables users to better understand how differences in timing affect an entity's financial performance and financial position, offering insights into the entity's future cash flows. *[IFRS 20.18, IFRS 20.BC10]*.

3.2 Definitions

The definitions that are relevant to the application of IFRS 20 are included in Appendix B of this publication.

How we see it

Given that regulatory agreements come in many forms, varying across jurisdictions and sectors, entities will need to carefully understand how these definitions fit with their applicable regulations and their specific facts and circumstances including situations where there are changes to the regulation. Some terms used in the regulatory agreement may not be defined, requiring additional analysis in order to apply the standard.

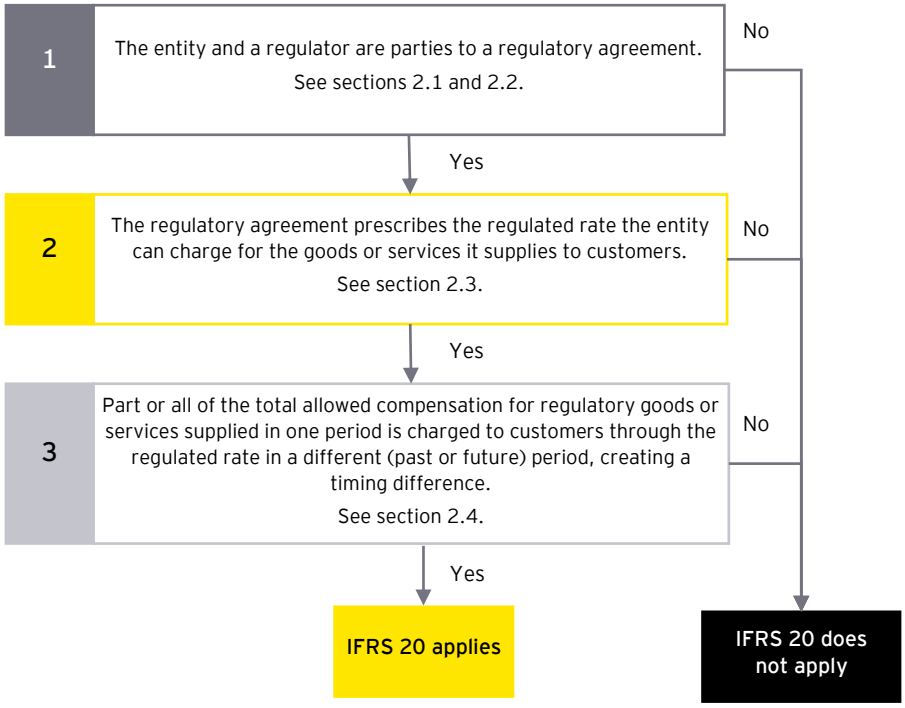
3.3 Scope

An entity applies IFRS 20 to all of its regulatory assets and its regulatory liabilities except for regulatory assets and regulatory liabilities that arise if premiums charged in insurance contracts within the scope of IFRS 17 are regulated. *[IFRS 20.4]*.

See the decision tree below as an illustration of how to determine whether the regulatory agreement falls in the scope of IFRS 20.

Assessing whether IFRS 20 Regulatory Assets and Regulatory Liabilities applies

Except for regulatory assets and regulatory liabilities arising from the regulation of premiums charged in insurance contracts within the scope of IFRS 17, regulatory assets and regulatory liabilities can only exist when the following three criteria are met.



As discussed in section 1, IFRS 20 specifies how to account for regulatory assets and regulatory liabilities, resulting in information that supplements the information arising from the application of other IFRS accounting standards, primarily IFRS 15. Hence, an entity applies other IFRS accounting standards to account for other rights and obligations created by a regulatory agreement before applying IFRS 20. *[IFRS 20.5]*.

The following illustration of the interaction between IFRS 20 and IFRS 15 is based on an illustrative example in IFRS 20: *[IFRS 20.16]*

Illustration 3-1: Interaction with IFRS 15

Fact pattern

Assume that the regulated rate an entity charged for goods or services supplied to customers in 20X1 was based on estimated input costs of CU100. However, the entity recognised actual input costs in that year of CU120. Assume also that the regulatory agreement gives the entity an enforceable present right to add the resulting CU20 under-recovery of those input costs in determining the regulated rate to be charged to customers in 20X2. For simplicity, this example ignores the effect of regulatory interest.

Analysis

In this example, the entity's IFRS 15 revenue for 20X1 includes compensation of CU100 based on the estimated input costs. Compensation for the CU20 under-recovery of input costs in 20X1 will be added in determining the regulated rates to be charged to customers in 20X2, hence, it will be included in IFRS 15 revenue in 20X2. However, that compensation of CU20 forms part of the total allowed compensation for regulatory goods or services supplied in 20X1, not for those supplied in 20X2. The total allowed compensation for regulatory goods or services supplied in 20X1 is, therefore, CU120.

The example above shows how an entity applying IFRS 20 reflects its total allowed compensation in its statement of financial performance and statement of financial position.

In year 20X1, regulated rates were set to allow the entity to recognise CU100 of IFRS 15 revenue. However, considering that the allowed actual input costs were CU120, the entity has a present right to an additional compensation of CU20, resulting in a total allowed compensation for that reporting period of CU120. Accordingly, it recognises a regulatory asset against regulatory income in 20X1 of CU20. In year 20X1, the total allowed compensation of CU120 will be made up by IFRS 15 revenue of CU100 and regulatory income of CU 20.

In year 20X2, rates were increased in order to recover the additional CU20, hence the additional CU20 is part of the IFRS 15 revenue for 20X2. Accordingly, the entity while recognising the additional CU20 of IFRS 15 revenue, it derecognises the regulatory asset that was recognised in 20X1; this results in aligning the results in the statement of financial performance to the total allowed compensation for the year 20X2.

How we see it

While IFRS 20 is expected to affect many entities in specific sectors (for example, the oil and gas sector, and the power and utilities sector), the guidance in the standard is sector-agnostic. This means entities in other sectors may also be (partially) affected if some, or all, of the entity's activities fall within the scope of the standard. Accordingly, entities operating in other sectors such as (ground, sea or air) transportation, infrastructure, telecommunications, waste management and environmental services, and healthcare need to carefully assess their activities to determine if some of their activities fall within the scope of IFRS 20.

3.3.1 Insurance contracts within the scope of IFRS 17

The IASB observed that in some situations, premiums charged in insurance contracts within the scope of IFRS 17 are regulated. During the development of IFRS 20, stakeholders identified a limited number of insurance contracts that might create regulatory assets or regulatory liabilities. Without the scope exclusion, an entity would have been required to assess whether any cash flows arising from contracts that fall outside the boundary of the insurance contracts (as defined by IFRS 17) give rise to differences in timing that meet the definition of a regulatory asset or regulatory liability. A paper by the IASB staff[3] discusses examples that included compulsory public auto insurance arrangements in a specific region and a specific type of compulsory insurance (where issuers are required by law to participate in a pooling arrangement). In both cases, stakeholders noted that a regulator determines the premiums charged by these entities and that issuers may be exposed to enforceable rights and/or obligations in relation to future premiums. *[IFRS 20.BC33]*.

3 IASB Staff Paper AP9B, Project: Rate-regulated Activities, Topic: Scope - Interaction with IFRS 17, IASB, April 2024. Available on the IFRS Foundation's website.

The IASB has not identified any situations that suggest an entity applying IFRS 17 to insurance contracts might have significant rights and obligations unaccounted for. The IASB concluded that the benefits of a scope exclusion would outweigh the costs of not recognising regulatory assets and regulatory liabilities that might arise from insurance contracts within the scope of IFRS 17. *[IFRS 20.BC33-34]*.

3.3.2 Financial instruments within the scope of IFRS 9 *Financial Instruments*

During the development of IFRS 20, some stakeholders observed that, in some situations, interest rates in financial instruments are regulated. These stakeholders asked the IASB whether such regulation could give rise to differences in timing. The IASB observed that the regulation of interest rates is typically limited to setting a cap or floor on interest rates. The aim of this type of regulation is to prevent an entity from charging rates outside those caps or floors. However, this type of regulation creates neither an enforceable present right nor an enforceable present obligation for the entity to adjust future interest rates. Furthermore, the IASB identified no examples of financial instruments that might give rise to regulatory assets or regulatory liabilities. Consequently, the IASB concluded that it would be unnecessary to exclude from the scope of IFRS 20 regulatory assets or regulatory liabilities that arise from financial instruments with a regulated interest rate. *[IFRS 20.BC32]*.

3.3.3 Relationship between IFRS 20 and IFRIC 12 *Service Concession Arrangements*

Entities are required to apply IFRIC 12 and other IFRS accounting standards to account for rights and obligations arising from public-to-private service concession arrangements before applying IFRS 20 to any remaining rights and obligations.

During the development of IFRS 20, stakeholders expressed concern about the interaction with IFRIC 12. In response to these concerns, the IASB decided to clarify the interaction by stating that entities are required to apply IFRIC 12 and other IFRS accounting standards to account for rights and obligations arising from public-to-private service concession arrangements before applying IFRS 20 to any remaining rights and obligations. *[IFRS 20.B92]*.

Applying IFRIC 12, an entity may account for the consideration arising from the construction or upgrade services provided in accordance with the arrangement as an intangible asset, a financial asset or both. *[IFRIC 12.15]*.

Where this gives rise to an intangible asset, IFRS 20 notes that it is possible for a regulatory asset or liability to arise from regulatory depreciation of the regulatory capital base (that is, the portion of the regulatory capital base that comprises the constructed or upgraded assets), which provides compensation for the amortisation expense of that intangible asset. That would happen if there is a difference in timing arising from a difference between the recovery period or recovery pattern of the items of infrastructure in the regulatory capital base and the useful life or amortisation method of the intangible asset. IFRS 20 would then require an entity to determine whether its regulatory capital base (or a part thereof) has a direct relationship with its intangible asset. *[IFRS 20.B93, IFRS 20.B94(a)]*.

Where the consideration for construction services gives rise to a financial asset, the financial asset would represent an unconditional contractual right to receive cash or another financial asset. Although the existence of any regulatory assets or regulatory liabilities will depend on an entity's facts or circumstances, the IASB does not expect regulatory assets or regulatory liabilities to arise in most such cases. *[IFRS 20.BC240]*.

Where the service concession arrangement gives rise to both an intangible asset and a financial asset, the entity determines whether a difference in timing arises by considering any difference between:

- The recovery period or recovery pattern of a part of the regulatory capital base, specifically, the portion of the assets in the regulatory capital base that relates to the intangible asset; and
- The useful life or amortisation method of the intangible asset. *[IFRS 20.B94(b)]*

The following illustration of the interaction between IFRS 20 and IFRIC 12 is based on an illustrative example of IFRS 20: *[IFRS 20.IE276-IE282]*

Illustration 3-2: Applying IFRS 20 and IFRIC 12 – Regulatory assets and regulatory liabilities

Fact pattern

Entity A enters into a 10-year service concession arrangement with a regulator to construct a plant in Years 1–2 (construction phase) and use the plant to supply goods or services to customers in Years 3–10 (operating phase). During the construction phase, the entity provides construction services to the regulator in exchange for an intangible asset- that is, a right to charge customers for the goods or services supplied to them in Years 3–10.

During the operating phase of the service concession arrangement, Entity A buys an input that is necessary to supply goods or services to customers. The input price is subject to high volatility.

The service concession arrangement with a regulator:

(a) Provides Entity A the right to recover the actual cost of the input. The regulated rate for a period includes an estimate of the input cost that Entity A is expected to recognise for the period.

(b) Requires differences between the actual and estimated input costs to be added to or deducted from the regulated rates to be charged to customers in the following reporting period.

At the end of Year 3, Entity A recognises higher than estimated input costs.

Analysis

Applying other IFRS standards and paragraph B92 of IFRS 20 results in the following accounting for years 1, 2 and 3.

Years 1 and 2:

- Step 1: Entity A first applies IFRIC 12 and other IFRS accounting standards to account for rights and obligations arising from the service concession arrangement before applying IFRS 20 to any remaining rights and obligations that meet the definition of regulatory assets or regulatory liabilities. In particular, Entity A recognised an intangible asset for its right to charge customers for the goods or services supplied in the future.
- Step 2: Applying IFRS 20 - for simplicity, there are no regulatory assets or obligations created in Years 1-2 for this example.

Year 3:

- Step 1: Applying other IFRS accounting standards, including the amortisation of the intangible asset. The service concession arrangement gives Entity A an enforceable present right to add the difference between actual and estimated input costs incurred in Year 3 in determining the regulated rates to be charged to customers in Year 4. Therefore, applying IFRIC 12 and other IFRS accounting standards, Entity A does not account for this right as an asset.
- Step 2: Applying paragraph 26 of IFRS 20, Entity A recognises a regulatory asset and regulatory income in Year 3. This reflects Entity A's enforceable present right to add the difference between actual and estimated input costs in determining the regulated rates to be charged to customers in Year 4.

4 Recognition

An entity recognises all regulatory assets and liabilities existing at the end of the reporting period, subject to certain constraints.

An entity is required to recognise:

- All regulatory assets and all regulatory liabilities existing at the end of a reporting period; and
- All regulatory income and all regulatory expense arising during a reporting period. *[IFRS 20.26]*.

4.1 Uncertain regulatory assets or regulatory liabilities

Where it is uncertain whether a regulatory asset or regulatory liability exists, an entity assesses whether the regulatory asset or regulatory liability is more likely than not to exist. An entity recognises the regulatory asset or regulatory liability if it is more likely than not to exist. Specific additional conditions are discussed in section 4.2 for regulatory depreciation of a regulatory capital base and where compensation is based on a benchmark determined using unobservable inputs. *[IFRS 20.27]*.

Uncertainty about the existence of a regulatory asset or regulatory liability might arise from uncertainty about:

- The existence of a present right or present obligation; and/or
- The enforceability of the present right or present obligation.

An entity considers both types of uncertainty and makes a combined assessment of whether it is more likely than not that an enforceable present right or enforceable present obligation exists. An entity might determine that a present right or present obligation would be enforceable, even if the existence of that right or obligation is not certain. In assessing whether an enforceable present right or enforceable present obligation exists, an entity considers the overall balance of the evidence. *[IFRS 20.28, IFRS 20.BC35]*.

IFRS 20 notes that uncertainty might arise about the existence of a present right or present obligation during the life of the regulatory asset or regulatory liability. If such uncertainty exists, cash flows within the boundary of a regulatory agreement are those for which the entity determines it is more likely than not that such a right or obligation exists. *[IFRS 20.B80]*.

See section 5 for a discussion on how uncertainty about the amount or timing of future cash flows affects the measurement of a regulatory asset or a regulatory liability.

4.1.1 Assessing existence

The IASB observed that there will be circumstances in which it may be difficult for an entity to assess whether it is more likely than not that a regulatory asset or regulatory liability exists. The IASB noted that such cases may include cash flows arising from regulatory assets or regulatory liabilities added to or deducted from regulated rates far in the future, for example, some regulatory assets arising from decommissioning liabilities or pension liabilities. However, the IASB expects these circumstances to be uncommon and typically to affect only specific regulatory assets or regulatory liabilities. *[IFRS 20.BC121, IFRS 20.BC185]*.

4.1.2 Assessing enforceability

An entity assesses whether an enforceable present right or enforceable present obligation exists using judgement considering all reasonable and supportable information that is available without undue cost or effort. Such information might relate to:

- The legal and regulatory framework; or

- A specific difference in timing. *[IFRS 20.B4]*.

Whether rights and obligations created by a regulatory agreement are enforceable is a matter of law. An enforceable present right or enforceable present obligation need not be explicitly specified in the regulatory agreement. An entity needs to consider whether enforceable present rights or enforceable present obligations exist in the context of the applicable legal and regulatory framework that ensures a party's rights and obligations are upheld. Applicable regulatory decisions or court rulings provide evidence about the existence of enforceable present rights or enforceable present obligations. An entity needs to consider any applicable laws or legal precedents that could supplement or override the terms of the regulatory agreement. Other factors might provide evidence in specific jurisdictions. The weight given to each fact or circumstance in the assessment might depend on the legal and regulatory framework within which the entity operates and the effectiveness of the enforcement processes. *[IFRS 20.B3-B7]*.

Facts and circumstances that might provide evidence of the existence of an enforceable present right or enforceable present obligation in relation to a specific difference in timing include:

- Confirmation from a regulator of amounts to be added to or deducted from future regulated rates;
- Explicit requirements or guidelines in a regulatory agreement;
- Evidence that allowable expenses have been incurred;
- Direct precedents—an entity's experience with its regulator's interpretation of the regulatory agreement to which they are parties in similar circumstances;
- Indirect precedents, such as (i) the experience of other entities regulated by the same regulator, (ii) the decisions of other regulators, or (iii) court rulings in similar circumstances;
- Preliminary views expressed by a regulator; and
- Advice from qualified, experienced legal or other advisers. *[IFRS 20.B6]*.

In addition, the standard provides the following examples of situations in which the entity might determine that such an enforceable present right or enforceable present obligation exists when:

- The regulatory process for determining the regulated rate is set out in law and guarantees that the entity will recover its costs and earn a return on amounts included in the regulatory capital base; or
- The regulator has historically applied a consistent approach to cost recovery in determining the regulated rates and there is no indication of uncertainty about this approach or potential changes to it. *[IFRS 20.B79]*.

IFRS 20 addresses explicitly the assessment of enforceability in relation to:

- An asset that is not yet available for use: an entity assesses, during that period, whether it has an enforceable present right for the regulatory return accrued to date to be added in determining the regulated rates to be charged in future periods. To make this assessment, an entity considers what rights it would have if the regulator or another party were to terminate the regulatory agreement at the end of the reporting period for a reason other than the entity's failure to perform as specified in the agreement. *[IFRS 20.B40]*.
- Performance incentives relating to an entity's performance beyond the reporting period: an entity assesses whether, in the case that the regulator or another party were to terminate the regulatory agreement at the end of the reporting period for reasons other than the entity's failure to perform as specified in the agreement, it would have an enforceable present right to receive or an enforceable present obligation to pay an amount that reflects its performance to date. *[IFRS 20.B46]*.

How we see it

Assessing the existence of an enforceable present right or obligation requires judgement and a comprehensive understanding of the relevant legal and regulatory framework. Since this could be a new process involving distinct areas of expertise for some entities, we believe that sufficient resources and time should be allocated for this assessment. We observe that some entities already report information about regulatory balances in their financial statements using various accounting practices (for example, entities that apply IFRS 14). Judgement is required to determine to what extent these regulatory balances can continue to be reported applying IFRS 20. For example, different recognition thresholds (i.e., a recognition threshold different than more likely than not) may have previously been used to recognise regulatory assets or liabilities.

When evaluating whether a present right or present obligation is enforceable under IFRS 20, an entity needs to focus on the enforceability of the present rights or present obligations arising from specific differences in timing, rather than the enforceability of a regulatory agreement itself.

4.2 Constraints on recognition

IFRS 20 includes specific recognition constraints for particular regulatory assets and regulatory liabilities. These include:

- Regulatory assets or regulatory liabilities arising from regulatory depreciation of a regulatory capital base, which are recognised if and only if the regulatory capital base has a direct relationship with a related item or items (see section 4.2.1); *[IFRS 20.29]*.
- Compensation for an allowable expense for a period using unobservable inputs (e.g., an estimate of the expenses of an entity's peer group) before the regulator determined the actual benchmark expenses (which may only happen after the entity's financial statements are authorised for issue). In such cases, an entity recognises any resulting regulatory asset or regulatory liability only when the regulator determines the compensation based on the actual benchmark. *[IFRS 20.31]*.
- Compensation provided by inflation adjustments to the regulatory capital base form part of the total allowed compensation for the reporting period in which the inflation is recovered through regulatory depreciation included in determining the regulated rates charged to customers (See section 4.6 for further discussion). *[IFRS 20.20]*.

4.2.1 Relationship between an entity's regulatory capital base and a related item or items

An entity recognises a regulatory asset or regulatory liability arising from regulatory depreciation of a regulatory capital base if, and only if, the regulatory capital base has a direct relationship with a related item or items. The regulatory capital base is defined in IFRS 20 as assets and other items that a regulatory agreement entitles an entity to recover by adding an amount for regulatory depreciation in determining a regulated rate to be charged to customers. *[IFRS 20.29, IFRS20.Appendix A]*.

IFRS 20 provides the following examples of related items:

- Items recognised by an entity as depreciable or amortisable assets by applying IFRS accounting standards (which may include both assets that are available for use and assets not yet available for use);

- An allowable expense added to, or chargeable income deducted from the regulatory capital base other than expenses or income arising from depreciable or amortisable assets; and
- Other amounts added to, or deducted from, the regulatory capital base, for example, performance incentives (see section 4.7) and the under-recovery or over-recovery of allowed revenue (see section 4.8). *[IFRS 20.B32, IFRS 20.B60]*.

Under IFRS 20, a related item is an item that gives rise to amounts for which a regulatory agreement creates a right to compensation to be provided, or an obligation for a deduction to be made, through regulatory depreciation. An entity's regulatory capital base has a direct relationship with a related item or items if the entity is able to track, by amount and reporting period, how regulatory depreciation provides compensation or makes a deduction for the amounts arising from the related item or items. *[IFRS 20.29-30]*.

For instance, Illustration 4-1 below presents a simple scenario in which a capital base has a direct relationship with an entity's depreciable and amortisable assets, such that the regulator determines the regulatory capital base and regulatory depreciation based on amounts recognised under IFRS accounting standards, enabling the entity to recover those assets, with regulatory depreciation reflecting the related depreciation and amortisation expense recognised by the entity.

In some cases, a regulatory agreement provides compensation for amounts that will arise from depreciable or amortisable assets separately from regulatory depreciation. Such compensation reduces the regulatory depreciation that would otherwise be provided. If such separate compensation does not relate specifically to capitalised borrowing costs and is provided while the assets are not yet available for use, an entity treats any regulatory liabilities arising from the compensation as arising from regulatory depreciation of an entity's regulatory capital base. *[IFRS 20.B59]*.

This concept has been introduced because there are two general types of regulatory schemes, which were identified during the standard setting process:

- Cost-based (commonly known as 'cost-of-service' or 'return-on-base rate'); and
- Incentive-based (including revenue-cap or price-cap regulation).

Some regulatory schemes, however, could be considered to be a hybrid containing features of both. That is, an entity's regulatory capital base could comprise parts that have a direct relationship with a related item or items and a part that does not have such a relationship. *[IFRS 20.B61]*.

The existence (or lack of) a direct relationship between an entity's regulatory capital base and its related item or items, generally depends on the regulatory scheme under which the entity operates.

In many cost-based schemes, there may be relatively less uncertainty as to whether the entity will recover its costs. For example, the regulatory requirements may be closely aligned with the accounting requirements, meaning that a direct relationship between an entity's regulatory capital base and its related item or items arises. In such schemes, regulators typically require entities to reconcile their regulatory capital base to their related item or items and to track any differences. The regulation is often based on a mechanism that allows an entity to recover its costs (cost-based schemes).

Typically, in incentive-based schemes, the regulatory requirements are independent of the accounting requirements. Under such schemes, there is likely no direct relationship between the regulatory capital base and an entity's related item or items. The entity is incentivised to operate efficiently and as a result, there is a risk that it may not recover its costs.

In these schemes, the regulatory capital base is only a regulatory tool for the regulator to derive the allowed revenue to which an entity is entitled for a period. That is, the regulatory capital base is largely disconnected from the entity's related item(s) and it would be impracticable to identify the relationship between the regulatory capital base and an entity's related item(s) up to IFRS asset class level for a variety of reasons. For example, both the componentisation of the items included in the regulatory capital base and their level of aggregation differ from those of an entity's fixed asset register for accounting purposes, the regulatory capital base may be adjusted by inflation or it may be adjusted for differences between forecasted and actual amounts in lump sum amounts rather than at an individual asset level.[4]

These observations are general indicators only. Classification of a regulatory scheme as cost-based, incentive-based or hybrid is not determinative for the accounting in accordance with IFRS 20. The assessment required by IFRS 20 depends on whether the entity is able to track, by amount and reporting period, how regulatory depreciation provides compensation or makes deductions for related items. *[IFRS 20.30, IFRS 20.B60–B68]*.

The consideration of all reasonable and supportable information that is available without undue cost or effort to determine whether or not there is a direct relationship may require significant judgement. Such information includes the regulatory methodology underlying the determination of its regulatory capital base, the determination of the regulatory depreciation, and how the regulator monitors whether regulatory depreciation provides compensation or makes a deduction for amounts arising from a related item or items. *[IFRS 20.B62]*.

During outreach, many stakeholders noted that, particularly in incentive-based regulatory schemes, the regulatory capital base may differ significantly from the assets and other items recognised in applying IFRS accounting standards. In such circumstances, entities may be unable to identify a meaningful link between regulatory depreciation and the related accounting expenses.

The IASB concluded that recognising regulatory assets and regulatory liabilities in these circumstances could result in significant measurement uncertainty and may not provide useful information to users of financial statements. Accordingly, IFRS 20 requires the recognition of regulatory assets and regulatory liabilities arising from regulatory depreciation of a regulatory capital base if and only if the entity can track, by amount and reporting period, how regulatory depreciation provides compensation or makes a deduction for the amounts arising from the related item(s). *[IFRS 20.29-30]*.

This requirement seeks to balance faithful representation, comparability, and cost-benefit considerations. *[IFRS 20.BC134; Feedback Statement, section 1.2]*.

The standard observes that two different types of relationship can coexist between an entity's regulatory capital base and its related item or items. This might be the case if a regulatory agreement determines part of an entity's regulatory capital base differently from another part of that base. In such cases, the entity treats each part of the regulatory capital base as a separate base. The entity determines, for each base, whether that base has a direct relationship with some related item or items.

IFRS 20 requires an entity to determine whether its regulatory capital base has a direct relationship with its depreciable or amortisable assets by considering the smallest aggregation of assets for which the entity is able to do the tracking (starting at the individual asset level, then moving on to

4 IASB Staff Paper AP9A,Features of different regulatory schemes, IASB, May 2022. Available on the IFRS Foundation's website.

the level that represents any disaggregation of an IFRS asset class, to end up at the IFRS asset class as the highest possible level). The aggregation, therefore, cannot be larger than an IFRS asset class, which is defined in other IFRS accounting standards (including IAS 16 *Property, Plant and Equipment*, IAS 38 *Intangible Assets* and IFRS 16 *Leases*) as a grouping of assets of a similar nature and use in an entity's operations. *[IFRS 20.B64, IFRS 20.B65]*.

4.2.1.1 Indicators of a direct relationship with depreciable or amortisable assets

IFRS 20 provides the following non-exhaustive list of indicators that an entity's regulatory capital base has a direct relationship with its depreciable or amortisable assets:

- The assets or classes in the regulatory capital base are sufficiently similar to the depreciable or amortisable assets or IFRS asset classes for the entity to be able to track any differences between assets or classes in the regulatory capital base and the related assets or IFRS asset classes; or
- The regulator determines an amount of regulatory depreciation to provide compensation for the depreciation or amortisation expense determined by applying IFRS accounting standards. *[IFRS 20.B67]*.

In contrast, non-exhaustive list of indicators included in the standard for the lack of a direct relationship are that:

- The regulator determines the regulatory capital base by using information that differs significantly from information about the entity's depreciable or amortisable assets accounted for by applying IFRS accounting standards; or
- The regulator determines regulatory depreciation by considering factors unrelated to the depreciation or amortisation of depreciable or amortisable assets. *[IFRS 20.B68]*.

The non-exhaustive list of indicators for determining whether the regulatory capital base has a direct relationship with a depreciable or amortisable asset can be summarised, as follows:

	Direct relationship	Indirect relationship
Regulatory depreciation	Compensates for depreciation or amortisation expense determined by applying IFRS accounting standards	Based on factors unrelated to depreciation or amortisation expense determined by applying IFRS accounting standards
Regulatory capital base	Similar to the depreciable or amortisable assets or IFRS asset classes	Based on other sources than the depreciable or amortisable assets or IFRS asset classes

These indicators are not exhaustive. An entity might give more weight to some indicators than others in determining whether its regulatory capital base has a direct relationship with a related item or items. Nonetheless, an entity is permitted to presume its regulatory capital base does not have a direct relationship with depreciable or amortisable assets if neither of the indicators that an entity's regulatory capital base has a direct relationship with its depreciable or amortisable assets as described above are present. *[IFRS 20.B63]*.

The following illustration of an entity's determination of the relationship between its regulatory capital base and its depreciable and amortisable assets is based on an illustrative example of IFRS 20: *[IFRS 20.IE6-IE14]*

Illustration 4-1: Regulatory capital base has a direct relationship with depreciable and amortisable assets

Fact pattern

Entity A is entitled to regulatory depreciation of its regulatory capital base.

The regulator determines the regulatory capital base and regulatory depreciation to enable Entity A to recover its depreciable and amortisable assets. The regulator determines the regulatory capital base using depreciable and amortisable assets that Entity A accounts for by applying IFRS accounting standards. The regulator determines regulatory depreciation to provide compensation for depreciation and amortisation expense based on the depreciation and amortisation expense Entity A recognises by applying IFRS accounting standards.

Entity A's regulatory capital base and its depreciable and amortisable assets have many similarities, for example:

(a) Most of the items in the regulatory capital base are depreciable and amortisable assets;

(b) Most of the classes in the regulatory capital base are the same as the asset classes as determined by applying IFRS accounting standards (that is, IFRS asset classes);

(c) All assets in the regulatory capital base are measured using the same measurement basis as the related depreciable and amortisable assets, that is, historical cost; and

(d) The regulatory recovery periods and patterns for most of the assets in the regulatory capital base are the same as the useful lives and depreciation methods of the related depreciable and amortisable assets determined by applying IFRS accounting standards.

The regulatory capital base also includes lump-sum adjustments that the regulator determines for the overall amount of assets in the regulatory capital base. Entity A is able to allocate those adjustments to IFRS asset classes using a reasonable and supportable basis.

When differences arise between classes in the regulatory capital base and IFRS asset classes, they are mainly due to the lump-sum adjustments described above. Entity A is able to track such differences over the recovery periods of the regulatory classes and the useful lives of the IFRS asset classes.

Analysis

Entity A considers paragraphs B60–B68 of IFRS 20 to determine the relationship between its regulatory capital base and its depreciable or amortisable assets.

Applying paragraph B62 of IFRS 20, Entity A considers all reasonable and supportable information that is available without undue cost or effort, including:

(a) The regulatory methodology underlying the determination of the regulatory capital base and regulatory depreciation; and

(b) How the regulator monitors whether the regulatory depreciation provides compensation for the depreciation or amortisation expense.

Entity A determines that each IFRS asset class is the smallest aggregation of assets for which it is able to track, by amount and reporting period, how regulatory depreciation provides compensation for depreciation or amortisation expense. Therefore, Entity A concludes that its regulatory capital base has a direct relationship with its depreciable or amortisable assets in each IFRS asset class.

The following illustration of an entity's determination of the relationship between its regulatory capital base and its depreciable and amortisable assets is based on an illustrative example of IFRS 20. *[IFRS 20.IE36-IE43]*

Illustration 4-2: Regulatory capital base does not have a direct relationship with depreciable and amortisable assets

Fact pattern

Entity A is entitled to an amount of allowed revenue that includes regulatory depreciation of its regulatory capital base. The regulator determines the allowed revenue using Entity A's budgeted costs, adjusted by efficiency targets. In doing so, the regulator weakens the link between the allowed revenue for a period and the costs incurred by Entity A during that period.

The regulator determines the regulatory capital base using mainly capital expenditure, as specified by the regulatory agreement, instead of information about Entity A's depreciable and amortisable assets measured using IAS 16. Therefore, Entity A's regulatory capital base and its depreciable and amortisable assets differ substantially. In particular, the regulatory capital base: (a) includes items that do not qualify for capitalisation applying IFRS accounting standards; (b) uses different asset classes in the regulatory capital base; (c) uses differing recovery periods (e.g., based on the average economic lives of the assets within class, which have a wide range of useful lives; (d) the regulatory capital base is adjusted for inflation.

The regulator determines the regulatory depreciation to be included in the allowed revenue for a period by considering factors that are unrelated to the depreciation and amortisation expense Entity A recognises in that period by applying IFRS accounting standards; i.e., by referring to a past period's regulatory depreciation, adjusted to exclude specific amounts and to reflect the expected level of investment and the targeted efficiency.

Analysis

Entity A considers paragraphs B60–B68 of IFRS 20 to determine the relationship between its regulatory capital base and its depreciable or amortisable assets.

Applying paragraph B62 of IFRS 20, Entity A considers all reasonable and supportable information that is available without undue cost or effort, including:

(a) The regulatory methodology underlying the determination of the regulatory capital base and regulatory depreciation; and

(b) How the regulator monitors whether the regulatory depreciation provides compensation for the depreciation or amortisation expense.

Entity A determines that the assets and classes in the regulatory capital base differ substantially from its depreciable or amortisable assets and from the IFRS asset classes. Entity A concludes that it is unable to track differences between the classes in the regulatory capital base and the IFRS asset classes. Entity A also determines that the regulator neither considers depreciation or amortisation expense in determining regulatory depreciation nor monitors how regulatory depreciation provides compensation for depreciation or amortisation expense.

Therefore, Entity A determines that it is unable to track, by amount and reporting period, how regulatory depreciation provides compensation for depreciation or amortisation expense for any IFRS asset class. Entity A makes its determination considering the indicators in paragraphs B67–B68 of IFRS 20 of whether a regulatory capital base has a direct relationship with depreciable or amortisable assets. Entity A concludes that its regulatory capital base does not have a direct relationship with its depreciable and amortisable assets.

The following illustration, which clarifies how, in the context of a service concession, an entity determines the relationship between its regulatory capital base and its intangible asset, is based on an illustrative example of IFRS 20: *[IFRS 20.IE259-IE269]*.

Illustration 4-3: Relationship between an entity's regulatory capital base and an intangible asset

Fact pattern

Entity A (operator) enters into a five-year service concession arrangement (in the scope of IFRIC 12) with a regulator (grantor) to construct assets in Year 1 (construction phase) and use these assets to supply goods or services to customers in Years 2–5 (operating phase).

The regulator includes in Entity A's regulatory capital base the items of infrastructure (assets) that arise from the construction services. The regulator measures the assets based on the consideration the entity receives for those services. The regulator determines the classes and depreciation rates for the assets using the requirements in IFRS accounting standards. For simplicity, this example assumes that the regulatory capital base comprises only those assets and that all assets have a useful life of five years beginning from Year 2.

Entity A estimates that the construction costs will be CU9,000 and the consideration for the construction services will be CU10,000. The service concession arrangement entitles Entity A to recover this consideration during Years 2–5 by giving Entity A:

(a) An unconditional right to receive cash from the regulator for the construction services in the form of a guarantee to the entity for a minimum amount of CU2,000. That guaranteed amount is receivable at the end of the service concession arrangement in Year 5. For simplicity, this example assumes that the regulatory agreement does not provide interest for the receivable. Entity A accounts for this right as a financial asset by applying IFRS 9 *Financial Instruments*.

(b) A right to charge customers for goods or services supplied to them during Years 2–5 for the remainder of the consideration - that is, CU8,000. Entity A accounts for this right as an intangible asset by applying IAS 38 *Intangible Assets* and amortises the intangible asset over the operating phase of the service concession arrangement of four years.

Analysis

Entity A considers paragraphs B60–B78 and B94 of IFRS 20 to determine the relationship between its regulatory capital base and its intangible asset. Entity A considers the items in the regulatory capital base– specifically, the portion of the assets in the regulatory capital base that relates to the intangible asset, instead of the regulatory capital base as a whole.

Applying paragraph B62 of IFRS 20, Entity A considers all reasonable and supportable information that is available without undue cost or effort, including:

(a) The regulatory methodology underlying the determination of the regulatory capital base and regulatory depreciation on the portion of the assets in the regulatory capital base that relates to the intangible asset; and

(b) How the regulator monitors whether the regulatory depreciation described in (a) provides compensation for the amortisation expense of the intangible asset.

Illustration 4-3: Relationship between an entity's regulatory capital base and an intangible asset (cont'd)

The intangible asset reflects the portion of the assets in the regulatory capital base to be recovered over the operating phase of the service concession arrangement. Entity A determines that it is able to track, by amount and reporting period, how regulatory depreciation on that portion of the assets provides compensation for the amortisation expense of the intangible asset. Therefore, Entity A determines that a part of its regulatory capital base has a direct relationship with its intangible asset.

How we see it

IFRS 20 includes the presumption that an entity has no direct relationship with depreciable or amortisable assets when neither of the two indicators that support the existence of a direct relationship exist. This is intended to simplify the assessment for those regulatory agreements where the regulated rate is based on information clearly unrelated to the entity's specific facts and circumstances (for example, when based on amounts of capital expenditure included in the regulatory agreement and/or general statistics) and to avoid entities undertaking excessive work to demonstrate they cannot track differences. We note that, whereas the second indicator is a matter of fact, the assessment of whether the first indicator (in particular, the meaning of 'sufficiently similar') exists in the entity's specific facts and circumstances may require significant judgement that also considers how the regulator determines the compensation or deduction mechanism through regulatory depreciation in practice (for example, how the regulator practically exercises its responsibilities).

4.2.1.2 Indicators of a direct relationship with related items other than depreciable or amortisable assets

Whilst the focus is primarily on depreciable or amortisable assets, the regulatory capital base can also have a direct relationship with other items. IFRS 20 includes the following non-exhaustive list of indicators specifically for those other items:

- The regulatory capital base has a direct relationship with the entity's depreciable or amortisable assets; or
- The regulator monitors how regulatory depreciation provides compensation or makes a deduction for the amounts arising from the related items separately from the rest of the regulatory capital base. *[IFRS 20.B69]*.

The standard also provides an example where the regulatory monitoring provides the entity with the information necessary to track, by amount and reporting period, how items in the regulatory capital base that relate to allowable expenses arising in a reporting period are recovered through regulatory depreciation. *[IFRS 20.B69]*.

In contrast, the standard also provides the following indicator that there is no direct relationship between the regulatory capital base and other items: the entity is unable, using reasonable and supportable information without undue cost or effort, to allocate to related items adjustments to the regulatory capital base or regulatory depreciation. IFRS 20 notes one reason for this may be that the regulator determines regulatory depreciation by considering the regulatory capital base as a whole. *[IFRS 20.B70]*.

The following illustration of an entity's determination of the relationship between its regulatory capital base and its related items other than depreciable and amortisable assets is based on an illustrative example of IFRS 20: *[IFRS 20.IE44-IE47]*

Illustration 4-4: Regulatory capital base does not have a direct relationship with depreciable and amortisable assets, but includes specific items that are tracked separately

Fact pattern

Illustration 4-4 assumes the same fact pattern as Illustration 4-2 above, except that the regulatory capital base also includes specific allowable expenses that did not arise from depreciable and amortisable assets.

The regulator monitors the recovery of these specific allowable expenses separately from the rest of the regulatory capital base. The regulator determines the amount of regulatory depreciation related to these specific allowable expenses by using a separate depreciation schedule.

Analysis

Applying paragraph B61 of IFRS 20, Entity A determines the relationship for that part of the regulatory capital base that comprises the specific allowable expenses separately from the remaining part of the regulatory capital base. Entity A determines that it is able to track, by amount and reporting period, how regulatory depreciation provides compensation for specific allowable expenses arising in each reporting period. Therefore, Entity A concludes that a part of its regulatory capital base has a direct relationship with the specific allowable expenses.

4.2.1.3 Reassessment of the direct relationship

IFRS 20 requires an entity to reassess whether its regulatory capital base has a direct relationship with a related item or items if facts or circumstances change or new information becomes available and if that change or new information could alter that relationship. The standard provides an example of a change in the regulatory agreement. However, in principle, any of the changes in facts and circumstances which triggers a change in the future cash flows could also be a reason for a change in the direct relationship (see section 5.3.1). *[IFRS 20.B71]*.

4.3 Differences in timing relating to allowable expenses

An allowable expense is an item of expense, as defined in IFRS accounting standards, for which a regulatory agreement provides compensation by adding an amount in determining a regulated rate to be charged by an entity. The compensation for an allowable expense forms part of the total allowed compensation for the reporting period in which an entity recognises the allowable expense by applying IFRS accounting standards. *[IFRS 20.19, IFRS 20.B14]*.

A difference in timing arises if the regulator includes compensation for an allowable expense in determining regulated rates charged in a period that differs from the reporting period in which the entity recognises the allowable expense by applying IFRS accounting standards. In particular:

- A difference in timing arises if the entity has an enforceable present right to add compensation for an allowable expense in determining future regulated rates because the entity has recognised the allowable expense by applying IFRS accounting standards, but the compensation has not been included in the IFRS 15 revenue already recognised.

- A difference in timing arises if the entity has an enforceable present obligation to deduct compensation for an allowable expense from future regulated rates because the IFRS 15 revenue already recognised includes the compensation, but the entity will recognise the allowable expense in the future by applying IFRS accounting standards. *[IFRS 20.B15–B16]*.

See section 4.3.1 for more detail on the accounting consequences when the compensation for allowable expenses is related to an entity's regulatory capital base.

See section 4.3.2 for more detail on the accounting consequences when the compensation for allowable expenses is provided separately from regulatory depreciation.

4.3.1 Compensation for allowable expenses provided through regulatory depreciation

Examples of compensation for allowable expenses provided through regulatory depreciation are depreciation expense or amortisation expense. In that case, where a direct relationship exists (See section 4.2.1.1), differences in timing may arise if the recovery period or patterns of the items included in the regulatory capital base related to depreciable or amortisable assets differs from their useful lives or depreciation or amortisation method. *[IFRS 20.B17]*.

The following illustration of the accounting for regulatory assets or regulatory liabilities arising from compensation for an allowable expense is based on two illustrative examples of IFRS 20: *[IFRS 20.IE68-IE78]*

Illustration 4-5: Regulatory recovery period longer than an asset's useful life

Fact pattern

This example assumes that:

(a) The entity's regulatory capital base has a direct relationship with its depreciable or amortisable assets.

(b) The regulatory capital base consists of only one item of plant.

(c) The entity completed the construction of the item of plant during Year 0, and this item became available for use on the first day of Year 1. The cost of the item of plant was CU1,000, both for regulatory purposes and as determined by applying IAS 16.

(d) The item of plant has a useful life of four years and the entity recognises depreciation expense on a straight-line basis over this period. However, the regulatory agreement entitles the entity to recover the cost of the plant through the regulated rates charged to customers over five years.

(e) The regulatory agreement entitles Entity A to a regulatory return calculated as 8% of the unrecovered balance of the regulatory capital base at the beginning of the year.

(f) The regulatory agreement provides Entity A rights to compensation relating to its regulatory capital base, comprising regulatory depreciation and a regulatory return.

The table below shows the regulatory compensation related to the entity's regulatory capital base for Years 1–5. The regulatory compensation is included in determining the regulated rates charged in Years 1–5 and hence in IFRS 15 revenue in the same period.

Illustration 4-5: Regulatory recovery period longer than an asset's useful life (cont'd)

Compensation related to the regulatory capital base						
In CU	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Total**
Regulatory capital base						
Opening balance [A]	1,000	800	600	400	200	**—**
Regulatory depreciation[(a)]	(200)	(200)	(200)	(200)	(200)	**(1,000)**
Closing balance	**800**	**600**	**400**	**200**	**—**	**—**
Compensation related to the regulatory capital base						
Regulatory depreciation	200	200	200	200	200	**1,000**
Regulatory returns = 8% × [A]	80	64	48	32	16	**240**
Regulatory compensation—IFRS 15 revenue	**280**	**264**	**248**	**232**	**216**	**1,240**

(a) The regulatory depreciation in this table reflects the pace of recovery specified in the regulatory agreement.

Analysis

Entity A considers the types of compensation and applies the requirements in paragraph 19 of IFRS 20 to determine when that compensation forms part of total allowed compensation. The total allowed compensation comprises regulatory depreciation, applying paragraph B15 of IFRS 20, which forms part of the total allowed compensation for the reporting period in which Entity A recognises depreciation expense by applying IAS 16. The table below shows the total allowed compensation for Years 1-5, which comprises:

(a) Regulatory depreciation—applying paragraph B15 of IFRS 20, the regulatory depreciation forms part of the total allowed compensation for the reporting period in which Entity A recognises depreciation expense by applying IAS 16; and

(b) Regulatory return—applying paragraph B33 of IFRS 20, the regulatory return forms part of the total allowed compensation for the reporting period in which the rate of return is applied to the regulatory capital base.

Illustration 4-5: Regulatory recovery period longer than an asset's useful life (cont'd)

Total allowed compensation (TAC)						
In CU	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Total**
Regulatory depreciation as part of TAC	250	250	250	250	—	**1,000**
Regulatory return as part of TAC	80	64	48	32	16	**240**
Total allowed compensation	**330**	**314**	**298**	**282**	**16**	**1,240**
IFRS 15 revenue	280	264	248	232	216	**1,240**
Regulatory income (regulatory expense)	**50**	**50**	**50**	**50**	**(200)**	**—**
Of which:						
Under-recovery: the part of total allowed compensation not yet included in IFRS 15 revenue	50	50	50	50	—	**—**
Regulatory asset[(a)]	50	100	150	200	—	**—**

(a) The regulatory asset arises from regulatory depreciation. Entity A recovers the regulatory asset in Year 5. No differences in timing arise from regulatory returns.

Regulatory depreciation provides compensation for the depreciation expense. This compensation gives rise to differences in timing because the asset's regulatory recovery period is longer than its useful life, and, thus, part of the total allowed compensation for regulatory goods or services supplied in Years 1–4 will be included in IFRS 15 revenue in Year 5. Therefore, Entity A recognises a regulatory asset in Year 1 against the recognition of regulatory income (see above table). During Years 2–4 the carrying amount of the regulatory asset increases because of an increase in the amount that Entity A is entitled to add in determining the regulated rates to be charged to customers in Year 5.

The regulatory returns are calculated by applying the rate of return of 8% to the unrecovered balance of the regulatory capital base at the beginning of each of Years 1–5. Regulatory returns are included in the regulated rates charged in each of these years and hence included in IFRS 15 revenue in each of these years. This coincides with the periods when regulatory returns form part of the total allowed compensation. Therefore, no differences in timing arise from the regulatory returns.

Illustration 4-5: Regulatory recovery period longer than an asset's useful life (cont'd)

The regulatory asset arises from regulatory depreciation. Entity A measures the regulatory asset by discounting the estimated future cash flows arising from the regulatory asset. The regulatory interest rate for this regulatory asset is the rate of return that the regulatory agreement applies to the regulatory capital base. Because the regulatory interest rate is also the discount rate, the discounted amount of the regulatory asset in Year 1 equals the sum of the estimated future cash flows excluding the future cash flows from regulatory interest. In subsequent years, the discounted amount will equal the sum of the estimated future cash flows excluding the future cash flows from regulatory interest that has not yet accrued. For example, at the end of Year 4, if the estimated future cash flows are not subject to uncertainty, the discounted amount of the regulatory asset is CU200 (CU216 – CU16) (see table below).

The table below shows the reconciliation of the regulatory asset.

Reconciliation of the carrying amount of the regulatory asset					
In CU	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**
Opening carrying amount [A]	—	50	100	150	200
Amount recognised	50	50	50	50	—
Regulatory interest income = 8% × [A]	—	4	8	12	16
Amount recovered	—	(4)	(8)	(12)	(216)
Closing carrying amount	**50**	**100**	**150**	**200**	**—**

Assuming no other transactions take place in Years 1–5, Entity A's statement of financial performance for these years is shown in the table below.

Statement of financial performance						
In CU	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Total**
IFRS 15 revenue[(a)]	280	264	248	232	216	**1,240**
Regulatory income (regulatory expense)	50	50	50	50	(200)	**—**
Total revenue	330	314	298	282	16	**1,240**
Depreciation expense	(250)	(250)	(250)	(250)	—	**(1,000)**
Profit	**80**	**64**	**48**	**32**	**16**	**240**

(a) This illustration uses the simplifying assumption that Entity A has only one item of plant in its regulatory capital base. A more realistic fact pattern would include several assets in the regulatory capital base. These other assets would be used to supply goods or services to customers in Year 5.

The profit in each of Years 1–5 reflects the fact that the regulatory agreement entitles Entity A to regulatory returns during Years 1–5.

Illustration 4-6: Related item other than depreciable or amortisable assets

Fact pattern

Entity A applies IFRS accounting standards in the current reporting period to recognise an overhead expense that does not arise from depreciable or amortisable assets.

The regulatory agreement treats that expense as allowable, requires the overhead expense to be added to the regulatory capital base, and compensates Entity A for the overhead expense through the regulatory depreciation of the regulatory capital base in future periods. The entity's regulatory capital base has a direct relationship with related items other than depreciable or amortisable assets.

The regulator monitors the provision of compensation for the overhead expense through regulatory depreciation separately from other items in the regulatory capital base. The regulator determines the amount of regulatory depreciation related to that expense using a separate depreciation schedule.

Analysis

Entity A applies paragraphs B60–B63 and B69–B70 of IFRS 20 and determines that it is able to track, by amount and reporting period, how regulatory depreciation provides compensation for the overhead expense. Therefore, Entity A concludes that its regulatory capital base has a direct relationship with this allowable expense.

Applying paragraph B15 of IFRS 20, the amount of the regulatory depreciation that provides compensation for this allowable expense forms part of the total allowed compensation for the reporting period in which Entity A recognises the allowable expense. Because the regulatory agreement requires Entity A to add this expense to the regulatory capital base, the amount of the regulatory depreciation that provides compensation for the allowable expense will be included in IFRS 15 revenue in the future.

Entity A recognises as a regulatory asset, and accordingly regulatory income, its enforceable present right to add an amount in determining the regulated rates to be charged to customers in future periods. This amount compensates Entity A for the allowable expense included in its regulatory capital base through regulatory depreciation.

4.3.2 Compensation for allowable expenses separate from regulatory depreciation

Compensation for allowable expenses might be provided through a component of compensation separate from regulatory depreciation. *[IFRS 20.B18]*

Examples of differences in timing that arise from compensation provided through a component of compensation separate from regulatory depreciation include:

- Differences in timing that arise if compensation for an allowable expense is included in determining the regulated rates charged to customers either earlier or later than an entity recognises the allowable expense by applying IFRS accounting standards. For example:
  - An entity recognises depreciation expense or amortisation expense as an asset is used to supply regulatory goods or services. However, the regulatory agreement provided compensation for the depreciation expense or amortisation expense in advance, separately from regulatory depreciation.

    - An entity recognises an allowable expense in a period by applying IFRS accounting standards. However, the regulatory agreement provides compensation for the allowable expense in determining the regulated rates charged to customers only when an entity settles the related liability in cash, or soon after that (see section 5.1.2 for a discussion on specific measurement requirements related to this case).
    - An entity recognises expected credit losses in a period by applying IFRS 9. However, the regulatory agreement provides compensation for such losses in determining the regulated rates charged to customers only when the regulator determines that there is no reasonable expectation of the entity receiving the related cash (see section 5.1.2 for a discussion on specific measurement requirements related to this case).
    - An entity recognises an allowable expense in a period. However, the regulatory agreement provides compensation for that allowable expense by applying another accounting framework used to prepare financial statements. The timing of the compensation determined by applying that accounting framework differs from the timing of the recognition of the allowable expense determined by applying IFRS accounting standards.
- Differences in timing that arise from differences between the estimated and actual compensation. For example, the regulatory agreement determines compensation for an allowable expense to be added in determining the regulated rates charged to customers based on estimated amounts. However, the regulatory agreement specifies that any difference between the estimated and actual amounts is added or deducted in determining the regulated rates to be charged to customers in future periods. *[IFRS 20.B19]*

In some cases, a regulatory agreement provides compensation for amounts that will arise from depreciable or amortisable assets separately from regulatory depreciation. Such compensation reduces the regulatory depreciation that would otherwise be provided. If such separate compensation does not relate specifically to capitalised borrowing costs and is provided while the assets are not yet available for use, an entity treats any regulatory liabilities arising from the compensation as arising from regulatory depreciation of an entity's regulatory capital base. *[IFRS 20.B59]*.

See sections 4.3.2.1 - 5 for a detailed discussion of allowable expenses in the form of input costs, borrowing costs, pensions, provisions and taxes.

4.3.2.1 Input costs

Regulatory assets or liabilities are recognised when (a part of) the compensation for allowable expenses (such as input costs) is not included in the regulated rates charged to customers in the reporting period in which an entity recognises the allowable expense by applying IFRS accounting standards. Examples of input costs are overhead, staff and material costs. An example of applying IFRS 20 to input costs is provided in Illustration 4 in section 3.3 *[IFRS 20.19]*

The following illustration of the accounting for regulatory assets and regulatory liabilities arising from compensation for an allowable expense is based on an illustrative example of IFRS 20: *[IFRS 20.IE108-IE118]*

Illustration 4-7: Compensation for an allowable expense (input costs) at an amount that differs from the amount of the expense

Fact pattern

In Year 1, Entity A recognises an otherwise allowable regulatory expense of CU900 by applying IFRS accounting standards.

The regulatory agreement provides Entity A compensation for that expense and specifies that the compensation is determined using benchmarking techniques. The regulator determines that the compensation for the expense for Year 1 is CU1,000. That compensation is included in determining the regulated rates charged and, hence, in IFRS 15 revenue in the same year.

The compensation of CU1,000 that is determined using benchmarking techniques comprises:

(a) Recovery of the actual allowable expense recognised in Year 1 of CU900; and

(b) An efficiency gain of CU100, calculated as the difference between the regulator determined compensation and the actual allowable expense recognised in Year 1 (CU1,000 – CU900).

The regulatory agreement requires that the efficiency gain of CU100 is shared between:

(a) Entity A at 60%—that is, Entity A is entitled to benefit from an amount of CU60 (60% of CU100); and

(b) Customers at 40%—that is, Entity A has an enforceable present obligation to deduct an amount of CU40 (40% of CU100) in determining the regulated rates to be charged in Year 3.

Entity A also recognises input costs of CU500 as an expense and the related compensation as IFRS 15 revenue during Years 1–3.

The regulatory agreement does not specify an interest rate for the regulatory liability arising in Year 1.

Analysis

Applying paragraph B15 of IFRS 20, Entity A determines that the compensation for the allowable expense recognised in Year 1 forms part of the total allowed compensation for the same year. Therefore, no difference in timing arises from the amount of the compensation that relates to Entity A's allowable recognised expense of CU900 and its share of the efficiency gain of CU60. Entity A:

(a) Applies paragraph B26 of IFRS 20 and determines that the amount of CU60 is a measurement difference that will not reverse over time; and

(b) Reflects the measurement difference in the statement of financial performance in the period in which Entity A recognises the IFRS 15 revenue and the related allowable expense, that is, in Year 1.

The remaining amount of the compensation of CU40 is the customers' share of the efficiency gain that will be deducted in determining the regulated rates for Year 3. A difference in timing arises because part of the total allowed compensation for regulatory goods or services to be supplied in Year 3 has already been included in IFRS 15 revenue in Year 1.

Illustration 4-7: Compensation for an allowable expense (input costs) at an amount that differs from the amount of the expense (cont'd)

Applying paragraph 26 of IFRS 20, Entity A recognises a regulatory liability and regulatory expense at the end of Year 1. Applying paragraph 48 of IFRS 20, Entity A concludes that the regulatory interest rate is nil. Therefore, Entity A measures the regulatory liability using a discount rate of 0%. In Year 3, Entity A fulfils the regulatory liability by deducting CU40 from regulated rates charged to customers and, hence, from IFRS 15 revenue. Therefore, in Year 3 Entity A also derecognises the regulatory liability and recognises regulatory income of CU40.

4.3.2.2 Borrowing costs

Regulatory agreements may compensate entities' borrowing costs through regulatory depreciation (that is, the regulatory return on the regulatory capital base) or separately from regulatory depreciation (that is, a separate component of compensation included in the regulated rates). See section 4.5 for further discussion on compensating entities' borrowing costs through regulatory depreciation (that is, the regulatory return on the regulatory capital base).

In the case of compensation for an allowable expense separate from regulatory depreciation, compensation for an allowable expense forms part of the total allowed compensation for the reporting period in which an entity recognises the allowable expense by applying IFRS accounting standards. *[IFRS 20.B15]*

The following illustration of the recognition for regulatory assets and regulatory liabilities arising from compensation for borrowing costs is based on an illustrative example of IFRS 20: *[IFRS 20.IE119-IE126]*

Illustration 4-8: Compensation for borrowing costs provided separately from regulatory returns

Fact pattern

Entity A starts construction of an item of property, plant and equipment (the asset) on the first day of Year 1 and completes construction on the last day of Year 2. Entity A incurs construction costs of CU5,000 evenly over each of Years 1–2 (that is, total construction costs of CU10,000). Entity A also incurs borrowing costs at an interest rate of 3%, which the entity capitalises in accordance with IAS 23. The asset is available for use on the first day of Year 3 and has a useful life of three years. Entity A recognises depreciation expense as determined by applying IAS 16 using the straight-line method over Years 3–5.

The regulatory agreement provides Entity A with regulatory returns consisting of an equity return on the regulatory capital base. The regulatory capital base includes the construction costs of the asset not yet available for use. The regulatory agreement also provides compensation specifically for borrowing costs Entity A incurs in a reporting period, including borrowing costs capitalised as part of the cost of the asset. That compensation is provided through a component of the compensation separate from both the regulatory returns and the regulatory depreciation of the regulatory capital base. Compensation for borrowing costs is determined using an estimate of the borrowing costs for the period and is included in determining the regulated rates charged and, hence, in IFRS 15 revenue in the same period. Any difference between the estimated and actual amounts of borrowing costs for a period is not added or deducted in determining the regulated rates charged in future periods. For simplicity, this example assumes that:

Illustration 4-8: Compensation for borrowing costs provided separately from regulatory returns (cont'd)

(a) Entity A incurs borrowing costs only for the construction of the asset and capitalises those borrowing costs during Years 1–2 (respectively, CU81 and CU234 for years 1 and 2, CU315 in total);

(b) Entity A finances the construction of the asset entirely with borrowings and repays the borrowings when the construction is complete;

(c) Entity A recovers the cost of the asset through the regulatory depreciation of the regulatory capital base evenly over the asset's useful life; and

(d) The regulator uses estimated borrowing costs of CU96 for Year 1 and CU224 for Year 2 in determining the compensation for those costs.

Analysis

In this example:

(a) The regulatory returns on the regulatory capital base consist of only an equity return. Entity A applies paragraph B33 of IFRS 20 to account for the regulatory returns on the regulatory capital base. The regulatory returns form part of the total allowed compensation for the reporting period in which the regulatory agreement applies the rate of return to the regulatory capital base. Therefore, no difference in timing arises from the regulatory returns during Years 1–2.

(b) The compensation relates specifically to borrowing costs that Entity A has capitalised, that is, compensation for an allowable expense. Entity A applies paragraphs B18–B19 of IFRS 20 to account for that compensation. The compensation for borrowing costs is provided through a component of compensation separate from regulatory depreciation of the regulatory capital base. Therefore, the recognition of a regulatory asset or regulatory liability arising from that compensation does not depend on Entity A's regulatory capital base having a direct relationship with its depreciable and amortisable assets.

Applying paragraph B15 of IFRS 20, Entity A determines that the compensation for borrowing costs forms part of the total allowed compensation for the reporting period in which the entity recognises borrowing costs as an expense, that is, the period in which the borrowing costs are included as part of the depreciation expense for the asset.

A difference in timing arises during Years 1–2 because the amounts included in the regulated rates charged, and, hence, in IFRS 15 revenue, provide compensation for capitalised borrowing costs that will be included as part of depreciation expense over the asset's useful life (Years 3–5).

Therefore, Entity A recognises a regulatory liability and regulatory expense of CU320 arising from the compensation for borrowing costs during Years 1–2. Entity A fulfils the regulatory liability and recognises regulatory income during Years 3–5.

Applying paragraph B26 of IFRS 20, Entity A determines that the difference between the compensation of CU320 and the borrowing costs of CU315 is a measurement difference. Entity A reflects the measurement difference in the statement of financial performance in the periods it recognises regulatory income as the regulatory liability is fulfilled and the borrowing costs as part of depreciation expense, that is, in Years 3–5.

4.3.2.3 Pensions

The standard addresses the following three scenarios in which regulatory agreements treat pension costs in the illustrative examples of IFRS 20 *[IFRS 20.IE148-IE156]*:

- Pension costs are compensated through regulated rates based on the related item of expense or income determined by applying IAS 19. This is addressed in the example below;
- Pension costs are compensated based on the estimated cash payments as agreed with the regulator. See section 2.4 above for a discussion on the accounting for measurement differences, that is: where the regulatory agreement does not allow the entity to adjust future regulated rates to be charged to customers to reflect any difference between the estimate and the actual expense recognised;
- Pension costs are compensated based on the actual cash payments made as allowable expenses. This is addressed in section 5.1.2.

The following illustration of the recognition for regulatory assets arising from compensation for pension costs is based on an illustrative example of IFRS 20: *[IFRS 20.IE148-IE156]*

Illustration 4-9: Compensation for pension costs that affect regulated rates based on the related item of expense or income determined by applying IFRS accounting standards

Fact pattern

Entity A operates an unfunded pension plan for a group of employees and pays benefits to those employees when the benefits fall due. On the first day of Year 1, Entity A estimates that the services this group of employees render in Years 1–3 will lead to an obligation to pay benefits of CU15,000 at the end of each of Years 4–5. Entity A measures the pension liability by applying IAS 19. During Years 2–5, Entity A recognises a remeasurement gain or loss arising from changes in the discount rate used to measure the pension liability.

For simplicity, this example assumes no other remeasurement gains or losses arise from the pension liability.

The regulatory agreement entitles Entity A to compensation for pension costs for a period based on the related expense or income it recognises in that period by applying IAS 19, with a two-year time lag. The regulatory agreement does not specify an interest rate for a regulatory asset or regulatory liability that arises from compensation for pension costs.

Analysis

Entity A is entitled to compensation for allowable expenses, that is, the pension expenses recognised by applying IAS 19. Applying paragraph B15 of IFRS 20, compensation for pension expenses recognised in a reporting period forms part of the total allowed compensation for that period.

The regulatory agreement entitles Entity A to include the compensation for pension expenses recognised in a reporting period in regulated rates charged with a two-year time lag. Therefore, a difference in timing arises from the compensation related to pension expenses.

Applying paragraphs 34–51 of IFRS 20, Entity A measures the related regulatory asset arising in Years 1–5. The regulatory agreement does not specify an interest rate for the regulatory asset. Applying paragraph 48 of IFRS 20, Entity A concludes that the regulatory interest rate is nil. Therefore, Entity A measures the regulatory asset using a discount rate of 0%.

Illustration 4-9: Compensation for pension costs that affect regulated rates based on the related item of expense or income determined by applying IFRS accounting standards (cont'd)

In its statement of financial performance, applying IAS 19, Entity A includes the remeasurement gain or loss in other comprehensive income and will not reclassify the remeasurement gain or loss to the statement of profit or loss in a subsequent period.

Applying paragraph 64 of IFRS 20, Entity A includes in other comprehensive income any regulatory expense or regulatory income related to the recognition of the remeasurement gain or loss. Entity A will not reclassify the regulatory expense or regulatory income included in other comprehensive income to the statement of profit or loss. (See section 7.2)

As Entity A recovers the pension expenses through the regulated rates charged over Years 3–7, the entity derecognises the regulatory asset and presents the related regulatory expense in the statement of profit or loss.

4.3.2.4 Provisions

The standard addresses the following two scenarios in which regulatory agreements treat provisions in the illustrative examples of IFRS 20 *[IFRS 20.IE157-IE175]*:

- Compensation for costs that affect regulated rates based on the related item of expense determined by applying another accounting framework (that is according to a different framework other than IFRS accounting standards). This is illustrated by the example below.
- Compensation for costs that affect regulated rates only when an entity pays the related cash. This is addressed in section 5.1.2.

An alternative scenario to those listed above is where the compensation for costs is based on the related item of expense or income determined by applying IFRS accounting standards. See Illustration 4-9 above where a similar fact pattern is addressed in the context of pension costs.

Where the total amount of the compensation over all periods does not equal the total amount of the expense recognised over all periods by applying IFRS accounting standards, this difference represents a measurement difference. See section 2.4 for the accounting. *[IFRS 20.B29]*.

Where the total amounts are aligned, it is possible that the regulatory agreement's methodology gives rise to differences between the amount of compensation used to determine the regulated rates charged in the period and the related expense recognised in that period by applying IFRS accounting standards. These are differences in timing because part or all of the compensation for the expense the entity recognises in the reporting period is included in determining the regulated rates charged in a different period. *[IFRS 20.B29]*.

The following illustration of the recognition for regulatory assets and regulatory liabilities arising from compensation for decommissioning costs is based on an illustrative example of IFRS 20: *[IFRS 20.IE162-IE175]*

Illustration 4-10: Compensation for decommissioning costs that affect regulated rates based on the related item of expense determined by applying another accounting framework

Fact pattern

Entity A has an asset that becomes available for use on the last day of Year 1. Entity A accounts for the asset as an item of property, plant and equipment by applying IAS 16. The asset has a five-year useful life and is depreciated on a straight-line basis. Entity A has an obligation to decommission the asset at the end of Year 6. Entity A estimates it will settle the provision at the end of Year 6 for CU10,000.

Applying IAS 37, Entity A recognises a decommissioning provision at the end of Year 1. It measures the provision by discounting the estimated decommissioning cost to its present value using a discount rate determined by applying IAS 37.

Applying IAS 16, Entity A recognises the present value of the decommissioning costs as part of the cost of the asset.

The regulatory agreement provides Entity A compensation for decommissioning costs and specifies that decommissioning expense is an allowable expense. The regulator does not include the decommissioning costs in Entity A's regulatory capital base. Therefore, the compensation for these costs is provided separately from regulatory depreciation of the regulatory capital base.

At initial recognition of the decommissioning provision, the measurement of the provision determined by applying the other accounting framework and IFRS accounting standards is the same. The compensation for the decommissioning expense determined for a reporting period by applying the other accounting framework is included in determining the regulated

rates charged and, hence, in IFRS 15 revenue in the same period.

Analysis

Differences arise between:

(a) The amount of regulatory compensation (determined by applying the other accounting framework in accordance with the regulatory agreement) included in the regulated rates Entity A charges in a period; and

(b) The amount of decommissioning expense (comprising depreciation expense and financing expense) Entity A recognises in that period by applying IFRS accounting standards.

These differences will reverse over time because the total amount of decommissioning expense Entity A recognises for Years 2–6 is the same as the total IFRS 15 revenue the entity recognises for the regulatory compensation for those years. Therefore, these differences are differences in timing as described in paragraph B29 of IFRS 20, not measurement differences as described in paragraph B26 of IFRS 20.

4.3.2.5 Taxes

The standard addresses the following two scenarios in which regulatory agreements treat taxes in the illustrative examples of IFRS 20 *[IFRS 20.IE176-IE179, IFRS 20.IE180-IE191]*:

- Compensation for income taxes that affect regulated rates based on amounts recognised as expense or income by applying IAS 12. See Illustration 4-11 below.

- Compensation for income taxes that affect regulated rates only when an entity pays the related cash. This is addressed in section 5.1.2.

An entity recognises tax expense or tax income by applying IAS 12. Where such tax expense or tax income is treated as an allowable expense by the regulatory agreement, it is possible for a difference in timing to arise. That happens if part or all of the compensation or deduction for such tax expense or tax income is included in determining the regulated rates charged to customers in a different period from when the tax expense or income is recognised. *[IFRS 20.B23]*.

It is possible for differences in timing between the recognition of revenue under IFRS 15 and the recovery or reversal of that revenue through regulated rates to give rise not only to regulatory assets or regulatory liabilities, but also to tax consequences accounted for in accordance with IAS 12, typically in the form of deferred tax assets or liabilities. One example is where a regulatory agreement provides compensation or makes a deduction in determining the regulated rates charged in a reporting period for current tax expense or income but not for deferred tax expense or income for that period. *[IFRS 20.B24]*.

IFRS 20 explains that, when the regulatory agreement allows or requires those deferred taxes to be reflected in future regulated rates, such that the entity has an enforceable right to recover them or an enforceable obligation to return them, they give rise to additional differences in timing that need to be accounted for consistently with the underlying regulatory asset or liability. That is: by recognising an additional regulatory asset or liability at the time when the deferred tax expense or deferred tax income is recognised. In such cases, the measurement of the regulatory asset or regulatory liability related to the deferred tax reflects that iterative process, resulting in an amount for the regulatory asset or regulatory liability that includes the compensation or deduction for its own tax effect. The entity, therefore, needs to analyse the tax consequences recognised applying IAS 12 together with the regulatory mechanism that determines when those tax effects are reflected in regulated rates. *[IFRS 20.B25]*.

The following illustration of the recognition for regulatory assets and regulatory liabilities arising from compensation for income taxes is based on an illustrative example of IFRS 20: *[IFRS 20.IE180-IE191]*

Illustration 4-11: Compensation for income taxes that affect regulated rates based on amounts recognised as expense or income by applying IAS 12

Fact pattern

The regulatory agreement entitles Entity A to compensation for income taxes. The regulatory agreement determines compensation for income taxes for a period based on the current tax expense for that period. The tax law specifies that taxable profit for a period includes IFRS 15 revenue for that period and that the tax rate is 40%.

In Year 1, Entity A's performance results in a performance penalty of CU60. The regulatory agreement makes a deduction for the penalty in determining the regulated rates Entity A charges in Year 2. A deduction from the regulated rates charged, and, hence, from IFRS 15 revenue, in a period reduces taxable profit for that period, resulting in a reduction of the amount of income taxes for that period (current tax income). Consequently, a deduction for the penalty from the regulated rates Entity A charges in Year 2 results in another deduction for current tax income from the regulated rates in that year. In summary, the regulatory agreement makes a deduction for both the penalty and the tax effects of the deduction for the penalty.

Illustration 4-11: Compensation for income taxes that affect regulated rates based on amounts recognised as expense or income by applying IAS 12 (cont'd)

The regulatory agreement does not specify an interest rate for a regulatory liability that arises from performance penalties or compensation for income taxes.

Analysis

Applying paragraph B42 of IFRS 20, Entity A determines that the penalty reduces the total allowed compensation for the reporting period in which its performance occurs, that is, Year 1. A difference in timing arises in Year 1 because the penalty will be deducted in determining the regulated rates charged for Year 2. Therefore, Entity A recognises a regulatory liability and regulatory expense of CU60 in Year 1.

Applying paragraph B25 of IFRS 20, Entity A applies IAS 12 to account for differences between the carrying amount of the regulatory liability and its tax base.

Applying IAS 12, Entity A:

(a) Determines that the regulatory liability has a tax base of zero, resulting in a deductible temporary difference; and

(b) Recognises a deferred tax asset and deferred tax income of CU24 (CU60 × 40%) in Year 1.

Applying paragraphs B23–B25 of IFRS 20, Entity A determines that the deferred tax income of CU24 it recognises in Year 1 reduces the total allowed compensation for that year. However, the deferred tax income will be deducted in determining the regulated rates only when the related current tax income is recognised, that is, in Year 2. Therefore, the deferred tax income gives rise to another regulatory liability, that is, a regulatory liability of CU24 arising from the tax effects of the regulatory liability related to the penalty. Applying IAS 12, this regulatory liability also results in a deductible temporary difference. That deductible temporary difference results in an additional amount of deferred tax asset and deferred tax income that gives rise to an additional amount of regulatory liability in successive iterations.

In Year 1, Entity A recognises a regulatory liability and regulatory expense of CU40 (CU24 ÷ (1 − 40%)) arising from the tax effects of the regulatory liability related to the penalty. The amount of CU40 is the grossed up amount that includes the deduction for the tax effects of the regulatory liability related to the deferred tax income, measured initially at CU24. Entity A also increases the carrying amount of the deferred tax asset by CU16 (CU40 × 40%) by applying IAS 12.

The regulator makes deductions of CU100 when determining the regulated rates to be charged in Year 2. Hence, IFRS 15 revenue Entity A recognises in Year 2 includes these deductions, comprising:

(a) An amount of CU60 for the penalty; and

(b) An amount of CU40 (CU24 + CU16) for the related tax effects .

Therefore, Entity A fulfils the regulatory liabilities related to the penalty and income taxes in Year 2. Entity A also recognises the resulting regulatory income of CU100. Applying IAS 12, Entity A:

(a) Recognises current tax income of CU40 (CU100 × 40%) arising from the deductions from IFRS 15 revenue; and

(b) Derecognises the deferred tax asset—and recognises the resulting deferred tax expense—of CU40.

How we see it

Understanding if the regulatory framework allows or requires tax effects to be reflected in future regulated rates may require significant judgement and the involvement of tax specialists. To the extent tax effects are reflected in future regulated rates, entities need to monitor developments in relevant tax law and regulations that may affect the regulatory assets or regulatory liabilities in future reporting period.

4.4 Differences in timing arising from deductions for chargeable income

Chargeable income is an item of income, as defined in IFRS accounting standards, for which a regulatory agreement makes a deduction of an amount in determining a regulated rate to be charged by an entity. The regulatory agreement might determine the deduction for chargeable income at an amount that differs from the income recognised by applying IFRS accounting standards. *[IFRS 20.B20]*.

A deduction for chargeable income reduces the total allowed compensation for the reporting period in which the entity recognises the chargeable income by applying IFRS accounting standards. Therefore, a difference in timing arises if the entity recognises chargeable income by applying IFRS accounting standards in a reporting period that differs from the period in which the regulatory agreement makes the deduction for that chargeable income in determining the regulated rates charged to customers. *[IFRS 20.B21]*.

As with compensation for allowable expenses, deductions for chargeable income are either:

- Deductions for chargeable income made by reducing regulatory depreciation (see section 4.2.1 for a discussion on accounting for timing differences arising from regulatory depreciation). For example, an entity's regulatory capital base might be reduced by a deduction for a gain on disposal of a depreciable asset recognised by applying IFRS accounting standards. A difference in timing will arise when the deduction will be made in determining the regulated rates charged to customers in future periods.
- Deductions for chargeable income made separately from regulatory depreciation in determining the regulated rates to be charged to customers. For example, a regulatory agreement might make a deduction in determining the regulated rates for a gain arising from a commodity futures contract. A difference in timing arises if the entity recognises the gain by applying IFRS accounting standards in a reporting period that differs from the period in which the deduction is made in determining the regulated rates charged to customers, which results in the recognition of a regulatory liability. *[IFRS 20.B22]*.

4.5 Differences in timing relating to regulatory returns

Regulatory agreements generally apply a rate of return to an entity's regulatory capital base for a period, resulting in a regulatory return to which the entity is entitled for the period. *[IFRS 20.B30]*.

Except in the circumstances described in section 4.5.1 below, a regulatory return forms part of the total allowed compensation for the reporting period in which the regulatory agreement applies the rate of return to a regulatory capital base. *[IFRS 20.B33]*.

Differences in timing arise if a regulatory agreement includes part or all of a regulatory return in determining the regulated rates charged to customers in a different reporting period from the period in which the agreement applies the rate of return to the regulatory capital base. *[IFRS 20.B34]*.

4.5.1 Regulatory returns on assets not yet available for use

In some cases, regulatory compensation relates to assets not yet available for use and, at the same time, borrowing costs are capitalised in accordance with IAS 23. In such circumstances, a structural misalignment arises between the timing at which the regulator allows the entity to earn a return, often already during the construction phase through regulated rates, and the timing at which the related borrowing costs are recognised in profit or loss under IFRS accounting standards, that is, in subsequent periods through depreciation or amortisation. IFRS 20 generally treats regulatory returns on assets not yet available for use as part of the total allowed compensation for the period in which the regulatory agreement applies the rate of return to the regulatory capital base, that is, when the entity supplies regulatory goods or services related to the construction of an asset. *[IFRS 20.BC65]*.

However, IFRS 20 has specific requirements for circumstances in which:

- Part or all of regulatory returns are compensation for borrowing costs related to assets not yet available for use;
- The entity capitalises borrowing costs related to those assets applying IAS 23; and
- The entity's regulatory capital base has a direct relationship with those assets. *[IFRS 20.B35]*.

In those circumstances, that part of the regulatory return forms part of the total allowed compensation for the period in which the borrowing costs are recognised as an expense. *[IFRS 20.B36]*.

To apply these requirements, an entity analyses whether the regulatory returns comprise only a debt return or comprise both a debt return and an equity return. This analysis determines which part of the regulatory returns, if any, is treated as compensation for borrowing costs capitalised applying IAS 23 and when that compensation forms part of total allowed compensation.

The recognition for the regulatory returns is, as follows:

- If the regulatory returns comprise **only a debt return**, the regulatory returns form part of the total allowed compensation during the period in which the assets are available for use (i.e., the period in which the borrowing costs are recognised as an expense).
- If the regulatory returns comprise **both a debt and equity return,** the total regulatory return is analysed as two separate components:
  - The amount of the capitalised borrowing costs forms part of the total allowed compensation during the period in which the assets are available for use (i.e., the period in which the borrowing costs are recognised as an expense); and
  - The remaining regulatory returns form part of the total allowed compensation during the period in which the assets are not yet available for use.

This means that regulatory returns in excess of the amount treated as compensation for capitalised borrowing costs form part of the total allowed compensation in the period in which the regulatory agreement applies the rate of return to the regulatory capital base (i.e., the period in which the asset is not yet available for use). A difference in timing may, nevertheless, arise if those regulatory returns are included in determining regulated rates charged to customers in a different period. *[IFRS 20.B36]*

The following table provides an overview of the regulatory assets and regulatory liabilities that might arise from differences in timing relating to the regulatory returns. The general requirement under IFRS 20 is that an entity determines an individual difference in timing arising from regulatory depreciation of a regulatory capital base for each aggregation of assets that has a direct relationship with depreciable or amortisable assets. However, an entity is permitted to determine such individual differences in timing using the disaggregation of the capitalised borrowing costs the entity uses to calculate depreciation or amortisation expense related to those costs. *[IFRS 20.B37]*:

When the regulatory return is included in determining the regulated rates charged to customers	Components of regulatory returns	
	Only a debt return	**Both a debt and equity return**
While an asset is not yet available for use	A difference in timing, resulting in a regulatory liability amounting to the regulatory return.	A difference in timing, resulting in a regulatory liability amounting to the capitalised borrowing costs
While an asset is available for use	No difference in timing	A difference in timing, resulting in a regulatory asset amounting to the regulatory return in excess of the capitalised borrowing costs

See section 4.1.2 for the requirement in IFRS 20 related to the specific circumstance when an entity recognises a regulatory asset during the period when the asset is not yet available for use. The standard requires an entity to assess, during that period, whether it has an enforceable present right for the regulatory return accrued to date to be added in determining the regulated rates to be charged in future periods. *[IFRS 20.B40]*.

IFRS 20 further explains that the effect of the differences in timing described in the table above in the statement of profit or loss differs because of the different reporting periods in which the regulatory return forms part of total allowed compensation:

- If the regulatory return comprises only a debt return: any difference between the regulatory return and the capitalised borrowing costs is a measurement difference that is recognised in profit or loss in the periods in which the assets are available for use; and
- If the regulatory return comprises both a debt and equity return: the regulatory return in excess of the capitalised borrowing costs is recognised in the profit or loss in the periods in which the rate of return is applied to the regulatory capital base (that is, the periods in which the assets are not yet available for use). *[IFRS 20.B38]*.

Section 4.6 addresses differences in timing related to inflation and the specific circumstances when a regulatory agreement applies a real rate of return to a regulatory capital base that is adjusted by inflation. However, IFRS 20 explicitly addresses the specific case where the regulatory return that comprises both a debt and equity return on an asset not yet available for use is determined on a real basis. In such cases, an entity determines any regulatory asset or regulatory liability by applying a real interest rate to the

inflation-adjusted borrowings related to the assets not yet available for use. *[IFRS 20.B39].*

In some cases, a regulatory agreement provides compensation for amounts that will arise from depreciable or amortisable assets separately from regulatory depreciation. Such compensation reduces the regulatory depreciation that would otherwise be provided. If such separate compensation does not relate specifically to capitalised borrowing costs and is provided while the assets are not yet available for use, an entity treats any regulatory liabilities arising from the compensation as resulting from regulatory depreciation of an entity's regulatory capital base. *[IFRS 20.B59]*.

The following illustration of the recognition for regulatory assets and regulatory liabilities arising from regulatory returns on an asset not yet available for use is based on two illustrative examples of IFRS 20: *[IFRS 20.IE193-IE201, IFRS 20.IE202-IE211].*

Illustration 4-12: Regulatory returns on an asset not yet available for use

Fact pattern 1 - Regulatory returns (debt and equity returns) included in determining the regulated rates charged during the construction period

Entity A starts construction of an item of property, plant and equipment (the asset) on the first day of Year 1 and completes construction on the last day of Year 2. Entity A incurs:

(a) Construction costs of CU5,000 evenly over each of Years 1–2 (that is, total construction costs of CU10,000)

(b) Borrowing costs of CU81 in Year 1 and CU234 in Year 2 based on an interest rate of 3%, which the entity capitalises in accordance with IAS 23

The cost of the asset is CU10,315 as determined applying IAS 16. The asset is available for use on the first day of Year 3 and has a useful life of three years. Entity A recognises depreciation expense as determined by applying IAS 16 using the straight-line method over Years 3–5.

The regulatory agreement specifies that Entity A includes the cost of the asset, excluding the capitalised borrowing costs, in determining regulatory depreciation of its regulatory capital base once the asset is available for use and recovers the asset through regulated rates evenly over three years (Years 3–5). For simplicity, this example illustrates the compensation related to the regulatory capital base only to the extent related to this asset. The regulatory agreement also entitles Entity A to a rate of return of 8%, which comprises both a debt and equity return:

(a) While the asset is not yet available for use (Years 1–2). A rate of return of 8% is applied to the average balance between the actual opening balance and the estimated closing balance of the asset for each year. The regulatory return for each year is included in determining the regulated rates charged in the same year. For simplicity, this example assumes that the actual closing balance of the asset for each year equals the estimate.

(b) While the asset is available for use (Years 3–5), a rate of return of 8% is applied to the unrecovered balance of the regulatory capital base at the beginning of each year and the regulatory return is included in determining the regulated rates charged in the same year.

Illustration 4-12: Regulatory returns on an asset not yet available for use (cont'd)

Analysis

Entity A capitalises borrowing costs incurred in the construction of the asset during Years 1–2 following the guidance in other IFRS accounting standards. Applying paragraphs B35–B40 of IFRS 20, Entity A:

(a) Treats part of the regulatory returns included in determining the regulated rates charged during Years 1–2 as compensation for an allowable expense, that is, the capitalised borrowing costs that will be included as part of depreciation expense over the asset's useful life (Years 3–5); and

(b) Determines that the regulatory returns in excess of the capitalised borrowing costs form part of the total allowed compensation during the reporting periods in which the regulatory agreement applies the rate of return to the regulatory capital base (Years 1–2), that is, for the periods in which the asset is not yet available for use.

The compensation for capitalised borrowing costs forms part of the total allowed compensation for the reporting periods in which the asset is available for use (Years 3–5). Entity A accounts for a regulatory liability arising from the regulatory returns amounting to the capitalised borrowing costs during the reporting periods in which the asset is not yet available for use. During Years 1–2, Entity A's statement of financial performance reflects the excess of regulatory returns over the capitalised borrowing costs. The regulatory liability is fulfilled over the reporting periods in which the asset is available for use, that is, the asset's useful life. Consequently, during Years 3–5, Entity A's statement of financial performance reflects equal but opposite amounts, that is:

(a) Regulatory income consisting of the fulfilment of the regulatory liability arising from the regulatory returns amounting to the capitalised borrowing costs; and

(b) Depreciation expense including the capitalised borrowing costs.

Fact pattern 2 - Regulatory returns (debt and equity returns) included in regulated rates charged during the operation period

This example assumes the same fact pattern as above, except that the regulatory agreement entitles Entity A:

(a) To accrue regulatory returns of 8%, comprising both a debt and equity return on the average balance between the opening balance (including regulatory returns already accrued) and the closing balance of the asset for each year while the asset is not yet available for use (Years 1–2); and

(b) To recover both the construction costs and the regulatory returns added to the regulatory capital base through regulated rates charged to customers evenly over three years while the asset is available for use (Years 3–5).

Analysis

Entity A capitalises borrowing costs incurred in the construction of the asset during Years 1–2. Applying paragraphs B35–B40 of IFRS 20, Entity A determines that the regulatory returns in excess of the capitalised borrowing costs during Years 1–2 form part of the total allowed compensation during that period, that is, the period in which the asset is not yet available for use.

Illustration 4-12: Regulatory returns on an asset not yet available for use (cont'd)

Regulatory returns accrued while the asset is not yet available for use are included in determining the regulated rates charged and, hence, in IFRS 15 revenue while the asset is available for use. Applying paragraphs B35–B40 of IFRS 20, Entity A accounts for a regulatory asset arising from the regulatory returns in excess of the capitalised borrowing costs during the reporting periods in which the asset is not yet available for use. That regulatory asset is recovered through regulated rates charged during the reporting periods in which the asset is available for use, that is, the asset's useful life.

During Years 1–2, Entity A's statement of financial performance reflects the excess of regulatory returns over the capitalised borrowing costs.

During Years 3–5, Entity A's statement of financial performance reflects equal but opposite amounts:

(a) IFRS 15 revenue includes the regulatory returns accrued while the asset is not yet available for use;

(b) Regulatory expense consists of the recovery of the regulatory asset arising from the regulatory returns in excess of the capitalised borrowing costs; and

(c) Depreciation expense includes the capitalised borrowing costs.

4.6 Differences in timing relating to inflation

Compensation for inflation arising in a reporting period might be provided through the regulatory capital base (included in the nominal regulatory return or through inflation adjustments) or through a separate component of compensation. *[IFRS 20.B51].*

Regulatory agreements generally apply a rate of return to an entity's regulatory capital base for a period, resulting in a regulatory return to which the entity is entitled for the period. Regulatory agreements might provide regulatory returns on a nominal or a real basis. A nominal regulatory return includes compensation for inflation. *[IFRS 20.B30, IFRS 20.B31].*

A regulatory return forms part of the total allowed compensation for the reporting period in which the regulatory agreement applies the rate of return to a regulatory capital base, except in specific circumstances related to assets not yet available for use discussed in section 4.5.1. *[IFRS 20.B33].* However, in some cases, a regulatory agreement applies a real rate of return to a regulatory capital base that is adjusted by inflation. In these situations, an entity treats compensation provided by inflation adjustments to the regulatory capital base as forming part of the total allowed compensation for the reporting period in which the inflation is recovered through regulatory depreciation included in determining the regulated rates charged to customers. Such an inflation adjustment applied to a regulatory capital base that includes assets to be used to supply regulatory goods or services in the future, and that are recovered over time, indicates that the compensation for inflation relates to those future regulatory goods or services. For example, an entity does not recognise any amounts for regulatory assets or regulatory liabilities when a regulatory agreement applies a real rate of return to a regulatory capital base that is adjusted by inflation. *[IFRS 20.20, IFRS 20.B52, IFRS 20.BC101].*

Where compensation for inflation arising in a reporting period is provided through a separate component of compensation, such compensation forms part of the total allowed compensation in that reporting period. In such case, differences in timing result from differences between the estimated and

actual inflation rates for the current reporting period, if the regulatory agreement requires the entity to add or deduct these differences for determining the regulated rates to be charged to customers in future periods. *[IFRS 20.B53, IFRS 20.B54]*.

Inflation was one of the more extensively debated aspects of the IASB's rate-regulated activities project. Some viewed such adjustments as a difference in timing, that is a right to compensation for regulatory goods or services an entity supplies in the period in which inflation arises that is recovered through regulatory depreciation in the future. Others viewed such adjustments as a measurement difference, that is: a right to higher regulatory depreciation that provides additional compensation for assets included in a regulatory capital that an entity will use to supply regulatory goods or services in the future. *[IFRS 20.BC93]*.

The IASB observed that both views had conceptual merit. However, it also concluded that requiring entities to separately identify and measure regulatory assets arising from inflation adjustments could be difficult or costly for a population of entities. *[IFRS 20.BC105]*.

Accordingly, IFRS 20 requires entities to treat compensation provided by inflation adjustments to a regulatory capital base as forming part of total allowed compensation in the period in which the inflation is recovered through regulatory depreciation included in determining regulated rates charged to customers. As a result, there is no difference in timing and no regulatory asset or liability to recognise. *[IFRS 20.BC106; Feedback Statement, section 1.2]*.

The following illustration of the recognition for regulatory assets and regulatory liabilities arising from compensation for inflation is based on an illustrative example of IFRS 20: *[IFRS 20.IE226-IE236]*.

Illustration 4-13: Compensation for inflation provided separately from regulatory depreciation

Fact pattern

A regulatory agreement provides compensation for inflation arising in a reporting period through the allowed revenue for that period. The regulatory agreement entitles Entity A to recover the allowed revenue for a reporting period through the regulated rates charged during that period. The regulatory agreement also specifies that the amount of allowed revenue for a reporting period is determined by considering the amount of allowed revenue for the previous period adjusted by the expected inflation rate for the current period.

In accordance with the regulatory agreement, the regulator determines that the amount of allowed revenue for Year 5 is CU10,200. That amount is based on the allowed revenue for Year 4 of CU10,000, adjusted for the expected inflation during Year 5 of CU200 (2% of CU10,000).

The regulatory agreement requires that differences between the estimated and actual inflation rates for Year 5 be added or deducted in determining the regulated rates to be charged in Year 6. In Year 5, the actual inflation rate is 3%.

The regulatory agreement does not specify an interest rate for regulatory assets or regulatory liabilities arising from differences between the estimated and actual inflation rates.

For simplicity, this example assumes that the estimated and actual inflation rates were the same for the previous years.

Illustration 4-13: Compensation for inflation provided separately from regulatory depreciation (cont'd)

The regulator uses the allowed revenue of CU10,200 and an estimated quantity of goods or services to be supplied to customers in Year 5 in determining the regulated rates to be charged to customers in Year 5. This example assumes actual quantities supplied equal estimated quantities and, hence, the amount of allowed revenue Entity A charges customers through the regulated rates during Year 5 is included in IFRS 15 revenue for that year.

Analysis

Applying paragraph B53 of IFRS 20, compensation for inflation in Year 5 forms part of the total allowed compensation for Year 5.

In accordance with the regulatory agreement, Entity A is entitled to compensation for inflation in Year 5 of CU300 (3% of CU10,000). Entity A included an amount of CU200 in determining the regulated rates charged to customers during Year 5. Consequently, Entity A is entitled to add an amount of CU100 in determining the regulated rates to be charged in Year 6.

Applying paragraph 26 of IFRS 20, Entity A recognises a regulatory asset and regulatory income at the end of Year 5 and measures it by applying paragraphs 34–51 of IFRS 20. Applying paragraph 48 of IFRS 20, Entity A concludes that the regulatory interest rate is nil. Therefore, Entity A measures the regulatory asset using a discount rate of 0%.

In Year 6, Entity A recovers the regulatory asset by adding CU100 to the regulated rates charged to customers and includes this amount in IFRS 15 revenue. Therefore, in Year 6, Entity A also derecognises the regulatory asset and recognises regulatory expense of CU100.

4.7 Differences in timing relating to performance incentives

A regulatory agreement might reward or penalise an entity with performance incentives for meeting or failing to meet performance criteria. These criteria could include, for example, targeted levels of service quality, reliability or customer satisfaction. Or they might relate to an entity's efficiency in incurring capital and operating expenditure or performance in constructing an item of property, plant or equipment. *[IFRS 20.B41]*.

Performance incentives form part of the total allowed compensation for the reporting period in which an entity's performance occurs. To determine the period in which the entity's performance occurs, the entity considers the regulatory agreement's terms relating to the performance incentives, together with other facts and circumstances. *[IFRS 20.B42]*.

A difference in timing arises if the period in which a performance incentive is included in regulated rates charged to customers differs from the period in which an entity's performance occurs. *[IFRS 20.B43]*.

The accounting can be more challenging where performance incentives:

- Relate to a period that extends beyond the reporting period: in such cases, at the end of the reporting period, an entity assesses whether it has an enforceable present right to add or enforceable present obligation to deduct an amount that reflects its performance to date in determining the regulated rates to be charged in future periods. *[IFRS 20.B45]*.
- Depend on more than one performance criterion: in such cases, an entity assesses to what extent the amounts have become unconditional, and hence form part of the total allowed compensation for the reporting period(s) in which the regulatory goods or services were provided, or whether the amounts that remain conditional relate only to an entity's

performance in future periods, in which case, it will form part of the total allowed compensation of the specified future periods. *[IFRS 20.B48, IFRS 20.B49]*.

- Are determined using a rate of return (such as an additional 1%) applied to the regulatory capital base for a specified period. In such cases, an entity accounts for the performance incentive separately (applying the requirements discussed in this section) and not as if it were part of the regulatory return. *[IFRS 20.B44]*.

See section 5.1.1.1 in relation to the methods to estimate the total amount of the performance incentive and to determine the portion of that estimated amount that reflects performance to date using a reasonable and supportable basis. *[IFRS 20.B47]*.

In some cases, a regulatory agreement specifies that a performance incentive related to an entity's performance for a period is added to or deducted from the entity's regulatory capital base. In such cases, differences in timing arise because the compensation or deduction for an entity's performance for a period is provided or made through regulatory depreciation in future periods. *[IFRS 20.B50]*.

Also see section 4.1.2 for a discussion on the assessment of enforceability when performance incentives relate to an entity's performance beyond the reporting period. IFRS 20 requires that an entity assesses whether, if the regulator or another party were to terminate the regulatory agreement at the end of the reporting period for reasons other than the entity's failure to perform as specified in the agreement, it would have an enforceable present right to receive or an enforceable present obligation to pay an amount that reflects its performance to date. *[IFRS 20.B46]*.

The following illustration of the accounting for regulatory assets and regulatory liabilities arising from a performance incentive is based on an illustrative example of IFRS 20: *[IFRS 20.IE218-IE225]*.

Illustration 4-14: Performance incentive - Performance period that extends beyond the reporting period

Fact pattern

Under the terms of a regulatory agreement, Entity A is subject to a performance incentive that relates to its performance over Years 1–5 in the construction of assets that it uses to supply regulatory goods or services. The performance incentive will result in a bonus or penalty based on 10% of the overall efficiency gain or loss arising from the difference between the construction cost targets and the actual costs Entity A incurs over Years 1–5. The regulatory agreement specifies that the bonus or penalty is added or deducted in determining the regulated rates to be charged to customers in Year 6.

Entity A estimates that it will incur a performance penalty for an overall efficiency loss over the performance period because of rising construction costs. Entity A estimates the amount of the performance penalty using the expected value method.

Analysis

The performance incentive relates to Entity A's performance over Years 1–5, instead of its performance for each of those years. Entity A estimates that it will incur a performance penalty over the performance period. Applying paragraph B42 of IFRS 20, Entity A determines that the performance penalty reduces the total allowed compensation in the reporting periods in which the entity's performance occurs. Therefore, a difference in timing arises during Years 1–5 because the performance penalty will be deducted in determining the regulated rates to be charged in Year 6.

Illustration 4-14: Performance incentive - Performance period that extends beyond the reporting period (cont'd)

Applying paragraphs B45–B47 of IFRS 20, Entity A assesses whether, at the end of Year 1, it has an enforceable present obligation to deduct an amount that reflects its performance to date in determining regulated rates to be charged in future periods. To make this assessment, Entity A considers what rights and obligations it would have if the regulator or another party were to terminate the regulatory agreement at the end of Year 1 for reasons other than the entity's failure to perform as specified in the agreement.

At the end of Year 1, Entity A's performance to date is a portion of the performance over Years 1–5 for which the entity estimates it will incur a penalty. Entity A determines that it has rights and obligations to continue performing over the performance period. Entity A concludes that, at the end of Year 1, it has an enforceable present obligation to deduct an amount that reflects its performance to date.

Applying paragraph 26 of IFRS 20, Entity A recognises a regulatory liability. Entity A applies paragraph B47 of IFRS 20:

(a) To estimate the total amount of the performance penalty over Years 1–5.

(b) To determine performance to date at the end of Year 1 as the portion of the estimated amount in (a) above that relates to Year 1 using a reasonable and supportable basis.

4.8 Differences in timing relating to allowed revenue

IFRS 20 defines allowed revenue as the total amount of compensation that a regulatory agreement entitles an entity to charge customers through regulated rates in a period. In many regulatory frameworks, regulated rates are established using estimates of volumes, costs or other regulatory assumptions, that is, an entity's allowed revenue is determined for a period and then divided over the estimated quantity of goods or services to be supplied to customers during that period. As a result, the amount actually recovered from customers during a reporting period may differ from the amount of allowed revenue to which the entity was entitled for that period. *[IFRS 20.B55]*.

Such volume variances and other forms of under-recovery or over-recovery of allowed revenue are among the most common sources of differences in timing.

Where the regulatory agreement provides the entity with an enforceable present right to recover an under-recovery (that is, the entity charged less than the allowed revenue for the reporting period), IFRS 20 requires the entity to recognise a regulatory asset to reflect the outstanding part of the total allowed compensation in the current reporting period. Where the regulatory agreement provides the entity with an enforceable present obligation to refund an over-recovery (that is, the entity charged more than the allowed revenue for the reporting period), IFRS 20 requires the entity to recognise a regulatory liability to recognise the fact that the entity will need to deduct a part of the amount billed to customers in future reporting periods. Consequently, financial statements reflect the compensation earned during the reporting period (that is, the total allowed compensation) rather than merely the amount billed to customers. *[IFRS 20.B55-B56]*.

A difference in timing arises if the amount of allowed revenue under-recovered or over-recovered in a reporting period is added or deducted in determining the regulated rates in future periods. Often amounts of allowed

revenue under-recovered or over-recovered in a reporting period arise from differences between the estimated and actual quantity of goods or services supplied in the period, that is; differences due to volume variances. *[IFRS 20.BC111]*.

More specifically, a difference in timing arises where regulated rates include adjustments for:

- Amounts that form part of total allowed compensation in a different period; *[IFRS 20.B56]*.
- Volume variances, that is, compensation for under-recovered or deductions for over-recovered past allowed revenues. *[IFRS 20.B57, IFRS 20.B58]*.

In some cases, a regulatory agreement specifies that compensation or a deduction for an under-recovered or over-recovered amount of allowed revenue for a period is added to or deducted from the entity's regulatory capital base. If so, differences in timing arise because the compensation or deduction for an entity's under-recovered or over-recovered amount of allowed revenue for a reporting period is provided or made through regulatory depreciation in future periods. See section 4.4 for the discussion on the recognition of regulatory assets and regulatory liabilities arising from regulatory depreciation of a regulatory capital base. *[IFRS 20.B58]*.

The following illustration of the accounting for regulatory assets and regulatory liabilities arising from amounts of allowed revenue is based on an illustrative example of IFRS 20: *[IFRS 20.IE237-IE249]*.

Illustration 4-15: Allowed revenue and volume variances

Fact pattern

Entity A starts supplying regulatory goods or services on the first day of Year 1.

The regulator determines that the regulated rate to be charged to customers in Year 1 is CU2 per unit. That regulated rate is based on:

(a) Allowed revenue of CU240. This amount includes compensation for fixed input costs of CU100 and compensation for other operating costs of CU140 on an estimated basis; and

(b) An estimated quantity of 120 units to be supplied to customers.

In determining the regulated rate to be charged to customers in Year 2, the regulatory agreement gives Entity A the right to add or the obligation to deduct:

(a) The amount of allowed revenue under-recovered or over-recovered in Year 1; and

(b) Differences between the estimated fixed input costs and actual fixed input costs incurred by the entity in Year 1.

When determining the regulated rates for Year 2, the regulator decides to treat amounts under-recovered or over-recovered as a single adjustment. The regulatory agreement does not specify an interest rate for regulatory assets or regulatory liabilities arising from amounts under-recovered or over-recovered.

The regulatory agreement prohibits Entity A from adjusting future regulated rates for any differences between the estimated and actual amounts of other operating costs recognised during Year 1.

Illustration 4-15: Allowed revenue and volume variances (cont'd)

In Year 1, Entity A:

(a) Supplies 100 units, compared with the estimated quantity of 120 units. Consequently, the amount of allowed revenue under-recovered is CU40

(b) Recognises fixed input costs of CU120 applying IFRS accounting standards, compared with the estimate of CU100. Consequently, Entity A incurs higher than estimated fixed input costs by an amount of CU20

(c) Recognises other operating costs of CU135 by applying IFRS accounting standards, compared with the estimate of CU140. Consequently, Entity A incurs lower than estimated other operating costs by an amount of CU5

Analysis

During Year 1, Entity A under-recovers:

(a) Allowed revenue at an amount of CU40 because estimated quantities are higher than actual quantities supplied. Applying paragraph B57 of IFRS 20, the amount of allowed revenue under-recovered in Year 1 gives rise to a difference in timing. Entity A has a right to add the under-recovery of the allowed revenue of CU40 to the regulated rates charged in Year 2.

(b) Fixed input costs of CU20. Applying paragraph B15 of IFRS 20, the fixed input costs recognised as an expense in Year 1 form part of the total allowed compensation for that period. Entity A has a right to add the under-recovery of fixed input costs of CU20 to the regulated rates charged in Year 2.

Entity A has two distinct rights: the right to recover the allowed revenue and the right to recover the fixed input costs by adding the under-recovered amounts to future regulated rates. Entity A's right to recover the allowed revenue amount for Year 1 (which was determined based on estimates of the fixed input costs and other operating costs) is distinct from any other rights and obligations that Entity A might have in relation to the compensation for items included in the allowed revenue determined for Year 1.

The regulated rates charged during Year 1 include compensation for other operating costs of CU140 on an estimated basis. In Year 1, Entity A recognises other operating costs of CU135. The regulatory agreement prohibits Entity A from adjusting future regulated rates for the CU5 difference between the estimated and actual costs. As determined by applying paragraph B26 of IFRS 20, that difference is a measurement difference that will not reverse over time. Entity A reflects the difference of CU5 (a gain) in the statement of financial performance in Year 1, that is, the period in which the entity recognises IFRS 15 revenue and other operating costs.

Applying paragraph 24 of IFRS 20, Entity A concludes that the rights arising from the differences in timing meet the conditions to be treated as a single unit of account, that is, they are created by the same regulatory agreement, have a similar expiry pattern and are subject to similar risks (See section 2.7). Therefore, applying paragraph 26 of IFRS 20, Entity A recognises a regulatory asset of CU60 at the end of Year 1.

Applying paragraphs 34–51 of IFRS 20, Entity A measures the regulatory asset arising in Year 1. Applying paragraph 48 of IFRS 20, Entity A concludes that the regulatory interest rate is nil. Therefore, Entity A measures the regulatory asset using a discount rate of 0%.

5 Measurement

An entity measures regulatory assets and regulatory liabilities using a cash-flow-based measurement technique.

An entity measures regulatory assets and regulatory liabilities using a cash-flow-based measurement technique. This measurement model involves two primary inputs:

- An up-to-date estimate of all future cash flows arising from the recovery of a regulatory asset or fulfilment of a regulatory liability; and
- A discount rate (the regulatory interest rate) that will be used to determine the present value of those cash flows. *[IFRS 20.34]*.

IFRS 20 provides an exception to this measurement model for items that affect regulated rates only when the related cash is paid or received (see section 5.1.2 below).

An entity reassesses the boundary of a regulatory agreement at the end of each reporting period and updates the carrying amount of regulatory assets or regulatory liabilities if such a reassessment results in changes to the estimated cash flows. *[IFRS 20.B86, IFRS 20.B87]*.

5.1 Estimating future cash flows

An entity's estimate of future cash flows includes all estimated future cash flows arising from the recovery of a regulatory asset or the fulfilment of a regulatory liability that are within the boundary of the regulatory agreement. These cash flows include both:

- Cash flows for which an entity has an enforceable present right to add or an enforceable present obligation to deduct amounts, in determining the regulated rates to be charged to customers in future periods in which the entity has an enforceable present right or enforceable present obligation to supply regulatory goods or services; and
- Cash flows arising from an enforceable present right to receive, or an enforceable present obligation to pay, compensation on termination of a regulatory agreement. *[IFRS 20.35]*.

In estimating future cash flows, an entity is required to consider all reasonable and supportable information that is available without undue cost or effort about:

- Past events
- Conditions existing at the reporting date;
- Market variables at the end of the reporting period
- Current expectations about future non-market variables.

An entity does not consider expectations regarding changes in the regulatory agreement or in law or regulation. Assumptions about future market variables need to be consistent with observable market prices at the measurement date. The observable market prices are defined as variables that can be observed in, or derived directly from, markets (for example, interest rates). *[IFRS 20.37, IFRS 20.BC175]*.

An entity's enforceable present right or enforceable present obligation to supply regulatory goods or services at a future date might be affected by a right, held by any party, to renew the regulatory agreement or to terminate it. The (in)ability to extend the duration of, or another party's ability to terminate a regulatory agreement could affect the amount, timing and uncertainty of future cash flows. IFRS 20 states that a right held by any party is disregarded if the party has no practical ability to exercise that right in any circumstances. Examples given in the standard of where the party has no practical ability to exercise their right refer to the consequences of exercising that right for the entity (liquidation or ceasing to trade), the holder (where exercising would have significantly more adverse consequences than not

exercising) or the regulator (would lead to major disruption in the provision of an essential service). *[IFRS 20.B76, IFRS 20.B77].*

IFRS 20 provides for the possibility that an entity concludes that it has an enforceable present right or enforceable present obligation to supply regulatory goods or services for an indefinite period, for example, due to specific wording in the legal or regulatory framework or because the renewal is viewed as an administrative procedure. There might be uncertainty about the existence of enforceable present rights to recover regulatory assets and obligations to fulfil regulatory liabilities through regulated rates to be charged to customers in the future. Consequently, an entity might be required to exercise judgement. The entity would consider its legal and regulatory framework in assessing whether it is more likely than not that it has an enforceable present right to recover a regulatory asset or an enforceable present obligation to fulfil a regulatory liability through regulated rates to be charged in the future. If the entity concluded it is more likely than not that it has such an enforceable present right or such an enforceable present obligation, those cash flows would fall within the boundary of a regulatory agreement. *[IFRS 20.B78, IFRS 20.BC185].*

Estimated cash flows include cash flows arising from regulatory interest on the regulatory asset or regulatory liability being measured. However, regulatory interest is excluded from estimated cash flows if an entity applies the exemption from discounting regulatory assets or regulatory liabilities. (see section 5.2). *[IFRS 20.38].*

If regulated rates are denominated in a foreign currency, an entity treats any related regulatory assets or regulatory liabilities as monetary items when applying IAS 21 *The Effects of Changes in Foreign Exchange Rates*. *[IFRS 20.44].*

The exchange differences resulting from translation into a presentation currency are not considered regulatory income or regulatory expense. Consequently, exchange differences arising from translating regulatory assets or regulatory liabilities denominated in a foreign currency are recognised applying IAS 21, but are not regulatory income or regulatory expense. *[IFRS 20.10].*

How we see it

When measuring regulatory assets and regulatory liabilities, an entity considers all reasonable and supportable information that is available at the reporting date without undue cost or effort to estimate future cash flows. The collection and consideration of that information may require significant effort and resources as, in the past, this information was generally not used in the context of the preparation of IFRS financial statements.

Furthermore, we believe that significant judgement could be required when applying the guidance above in circumstances where entities operate under expired agreements and renewal procedures have not yet commenced. All relevant facts and circumstances, including any compensation on termination, would need to be carefully assessed to determine whether cash flows related to periods after the expired regulatory agreement are within the boundary of the regulatory agreement.

5.1.1 Uncertain future cash flows

Where the amount or timing of future cash flows arising from a regulatory asset or regulatory liability is uncertain, the cash flows within the boundary of a regulatory agreement are those for which the entity determines it is more likely than not that such a right or obligation exists. An entity estimates uncertain cash flows using an unbiased range of possible market and non-market variables at the reporting date. The outcomes to be considered include those in which the regulatory asset or regulatory liability does not exist or produces no future cash flows. *[IFRS 20.37, IFRS 20.41, IFRS 20.B80].*

Credit risk and demand risk are highlighted in the standard as examples of factors that might create uncertainty in the amount or timing of future cash flows. Credit risk is defined as the risk that some customers will not pay the amounts charged. Demand risk is defined as the risk that arises from changes between the estimated and actual demand for goods or services an entity supplies to customers in a period. *[IFRS 20.B88].*

The effect of these factors depends on whether the entity or customers bear the risk. An entity bears a risk to the extent that it is not compensated under the regulatory agreement for the effects of uncertainty.

When the entity bears the risk, the effects of uncertainty are factored into the estimate of future cash flows arising from a regulatory asset or regulatory liability. For example, if an entity is not compensated (immediately) for credit risk under the regulatory agreement, it bears the (part of the) risk that it might not be able to collect from its customers and takes this risk into account in the measurement of its regulatory assets and regulatory liabilities. This may happen if an entity is entitled to recover through regulated rates an amount due from customers only when the amount is determined to be irrecoverable according to regulatory criteria (such as certification from an independent collection agency or the customer going into liquidation). To avoid overstating the effect, the entity estimates the uncollectible amounts by considering the net cash flows that are expected to arise in the same period from regulatory assets and liabilities that are created by the same regulatory agreement. An entity allocates the estimate of uncollectible amounts to regulatory assets only. If an entity is fully compensated (i.e., including compensation for the change in timing of cash flows) for the outcome of an uncertainty, there is no effect on measurement. *[IFRS 20.39, IFRS 20.B89].*

Where the customer bears the risk, this means a regulatory agreement provides compensation to an entity for the outcome of an uncertainty in determining future regulated rates. In such cases, an entity includes the effects of the uncertainty and the compensation for the outcome of the uncertainty in the range of possible cash flows when estimating the future cash flows arising from a regulatory asset or regulatory liability. *[IFRS 20.B90].*

While there could be various factors that create uncertainty in future cash flows and all sources of uncertainty need to be considered, IFRS 20 is clear that estimates of future cash flows arising from a regulatory liability do not reflect the entity's own non-performance risk. *[IFRS 20.40].*

IFRS 20 provides the example of an entity that expects to be unable to collect some amounts from customers in a future period, but the regulatory agreement provides compensation for such uncollected amounts in a period after they have not been collected. When measuring a regulatory asset, the entity will include in the estimated future cash flows for a period the expectation that some amounts will be uncollected and include the expectation of compensation for such amounts in the estimated cash flows for the later period in which the regulatory agreement provides the compensation. *[IFRS 20.B91].*

5.1.1.1 Selecting a method to estimate uncertain future cash flows

IFRS 20 provides for two methods to estimate uncertain future cash flows:

- The most likely amount – this is the single most likely amount in a range of possible cash flow outcomes. This method might be more relevant if the possible outcomes are clustered around a single outcome or if there are only two possible outcomes and they vary widely.
- The expected value – this is the sum of the probably-weighted amounts in a range of possible cash flow outcomes. This method might be more relevant if there is a wide range of possible outcomes. *[IFRS 20.42]*.

The use of these methods is consistent with the requirements in IFRS 15 relating to estimates of variable consideration and IFRIC 23 *Uncertainty over Income Tax Treatments* in addressing uncertainty in income tax positions.

Selecting a method for estimating uncertain future cash flows is not an accounting policy choice. An entity selects the method that it expects will provide the most relevant information for a given regulatory asset or regulatory liability, that is the method that will better predict the ultimate cash flows. In addition, an entity also needs to determine whether more relevant information will result from considering each regulatory asset or each regulatory liability individually or whether they should be considered with other regulatory assets and regulatory liabilities. For example, if an uncertainty affects multiple regulatory assets and regulatory liabilities, more relevant information might result from considering the impact of the uncertainty on the group of affected regulatory assets and regulatory liabilities. *[IFRS 20.43]*.

Section 5.3.1 addresses the circumstances in which IFRS 20 requires an entity to reassess the selected method of estimating uncertain future cash flows arising from a regulatory asset or regulatory liability. *[IFRS 20.55]*.

The table below lists a number of examples that were addressed during the development of the standard[5]:

Example	Method selected	Reason
The probability of the most likely amount of CU100 is high (80%) and the possible outcomes are clustered around the most likely amount.	Most likely amount	The most likely amount is expected to provide useful information because it is highly probable.
The probability of the most likely amount of CU100 is low (40%) and the other possible outcomes differ widely from the most likely amount.	Expected value	The most likely amount would not better predict the cash flows because it is more likely than not the future cash flows that will arise from the regulatory asset or regulatory liability will be significantly different from the most likely amount.

5 IASB Staff Paper AP9B, Project: Rate-regulated Activities, Topic: Estimating uncertain future cash flows, IASB, June 2023. Available on the IFRS Foundation's website.

Example	Method selected	Reason
The probability of the most likely amount of CU0 is low (40%) and all the other possible outcomes are higher.	Expected value	The most likely amount would result in a regulatory asset or regulatory liability measured at zero, even though it is more likely than not that the regulatory asset or regulatory liability will result in future cash flows

5.1.2 Items that affect regulated rates only when related cash is paid or received

There are certain circumstances in which a regulatory asset or regulatory liability arises because related amounts are included in regulated rates only when paid or received in cash, or soon after that, rather than when such amounts are recognised as income or expenses under IFRS accounting standards. *[IFRS 20.58]*.

IFRS 20 provides a simplified measurement approach for two related, but distinct, fact patterns:

- In the first case, a regulatory agreement may provide compensation for an allowable expense, or make a deduction for chargeable income, in determining regulated rates only when the entity pays or receives the related cash, or soon after that. In such cases, a regulatory asset or regulatory liability may arise if the related expense or income is recognised applying IFRS accounting standards in a different reporting period from the period in which the cash is paid or received. *[IFRS 20.58]*.
- In the second case, a regulatory asset may arise when a regulatory agreement provides compensation for credit losses only when the regulator determines that there is no reasonable expectation of the entity receiving the related cash, rather than when the entity recognises impairment losses applying IFRS 9. *[IFRS 20.59]*.

In both cases, IFRS 20 requires the entity to measure the regulatory asset or regulatory liability using the carrying amount of the related liability, related asset or related loss allowance recognised applying IFRS accounting standards, adjusted for differences between that item and the regulatory asset or regulatory liability. Such a difference might be caused by: (i) an uncertainty present in the related liability, related asset or related loss allowance, but not in the regulatory asset or regulatory liability; or (ii) an uncertainty present in the regulatory asset or regulatory liability, but not in the related liability, related asset or related loss allowance. Such uncertainties might arise from estimation, credit or demand risk. *[IFRS 20.60]*.

Where the regulatory asset or regulatory liability discussed above is recovered or fulfilled after significant time has passed, judgement might be required in relation to the boundary of the regulatory agreement. See section 2.1 for more information.

IFRS 20 specifies the circumstances when for each case an entity is required to cease applying the simplified measurement approach and measure any remaining part of the regulatory asset or regulatory liability by applying the general requirements of IFRS 20: *[IFRS 20.61]*.

- In the first case (paragraph 58 of IFRS 20): when the entity pays cash to settle the related liability, or receives cash to recover the related asset;
- In the second case (paragraph 59 of IFRS 20): when the regulator has determined there is no reasonable expectation of the entity receiving the related cash;

- In both cases (paragraphs 58 and 59 of IFRS 20): when the entity derecognises the related liability, related asset or related loss allowance for any other reason.

Where an entity is required to cease applying the simplified measurement approach, and measure any remaining part of the regulatory asset or regulatory liability by applying the general requirements of IFRS 20, see section 5.1 above for more information.

The illustrative examples accompanying IFRS 20 include examples of where this alternative measurement could happen: in relation to taxes, pension costs and a provision for environmental costs.

The first illustration addresses the measurement for regulatory assets and regulatory liabilities where taxes affect regulated rates only when an entity pays the related cash: *[IFRS 20.IE176-IE179]*.

Illustration 5-1: Compensation for income taxes that affect regulated rates only when an entity pays the related cash

Fact pattern

Entity A recognises a deferred tax liability and deferred tax expense arising from an asset in the current reporting period by applying IAS 12 *Income Taxes*. The regulatory agreement provides Entity A with compensation for the income tax expense in determining the regulated rates charged to customers when the entity has paid the related cash.

Analysis

Applying paragraph B15 of IFRS 20, the compensation for the tax expense recognised in the current reporting period forms part of the total allowed compensation for the same period. Because the compensation will affect regulated rates only when Entity A pays the related cash in a future period, this part of the total allowed compensation for regulatory goods or services already supplied has not yet been included in IFRS 15 revenue.

Applying paragraph 26 of IFRS 20, Entity A recognises as a regulatory asset its enforceable present right to add the compensation for the tax expense recognised in the current reporting period in determining the regulated rates to be charged to customers in future periods.

Applying paragraph 60 of IFRS 20, Entity A measures this regulatory asset by:

(a) Using the carrying amount of the deferred tax liability resulting from applying IAS 12; and

(b) Adjusting that carrying amount to reflect any differences between the deferred tax liability and the regulatory asset (for example, uncertainty present in the regulatory asset but not present in the deferred tax liability).

The second illustration addresses the measurement for regulatory assets where a provision affects regulated rates only when an entity pays the related cash: *[IFRS 20.IE157-IE161]*.

Illustration 5-2: Compensation for environmental costs that affect regulated rates only when an entity pays the related cash

Fact pattern

In the current reporting period, Entity A incurs an obligation for environmental clean-up costs and, therefore, recognises a provision by applying IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. Entity A also recognises expenses:

(a) On recognition of the provision, for the environmental clean-up costs, measured at present value; and

(b) Subsequently, for the finance cost arising from the unwinding of the discount.

The regulatory agreement gives Entity A the right to add the environmental clean-up costs and the finance cost in determining the regulated rates only when it pays the related cash in a future period.

Analysis

Applying paragraph B15 of IFRS 20, the compensation for the environmental clean-up costs and the finance cost that Entity A recognises as an expense in a reporting period forms part of the total allowed compensation for the same period. Because the compensation for these costs will affect regulated rates only when Entity A pays the related cash in a future period, this part of the total allowed compensation for regulatory goods or services already supplied has not yet been included in IFRS 15 revenue.

Applying paragraph 26 of IFRS 20, Entity A recognises as a regulatory asset its enforceable present right to add the compensation for these costs in determining the regulated rates to be charged to customers in future periods. Applying paragraph 60 of IFRS 20, Entity A measures this regulatory asset by:

(a) Using the carrying amount of the provision resulting from applying IAS f37; and

(b) Adjusting that carrying amount to reflect any differences between the provision and the regulatory asset (for example, uncertainty present in the regulatory asset but not present in the provision).

5.2 Discounting estimated future cash flows

Regulatory assets and regulatory liabilities are measured by discounting the estimated future cash flows arising from those regulatory assets and regulatory liabilities using the regulatory interest rate. The regulatory interest rate is defined as the rate specified or implied by a regulatory agreement to provide compensation for the time period until recovery of a regulatory asset or to make a deduction for the time period until fulfilment of a regulatory liability. *[IFRS 20.45]*.

Implementing the requirements on discounting is usually straightforward. In many cases, the simplest way for an entity to discount the estimated future cash flows:

- At initial recognition is to calculate the sum of the estimated future cash flows, excluding the cash flows from regulatory interest; and
- At the end of each reporting period is to calculate the sum of the estimated future cash flows, excluding the cash flows from regulatory interest that has not yet accrued. *[IFRS 20.BC210]*.

When required to do so, an entity determines the implied regulatory interest rate as the rate that at initial recognition, discounts the estimates of future cash flows arising from a regulatory asset or regulatory liability, which

include regulatory interest cash flows, back to an amount that equals the sum of the estimated future cash flows, excluding regulatory interest. *[IFRS 20.49]*.

In some cases, IFRS 20 requires an entity to derive an implied regulatory interest rate from the terms of a regulatory agreement. An entity derives an implied regulatory interest rate if the regulatory agreement includes any of these terms:

- Regulatory interest may not be charged evenly over the life of a regulatory asset or regulatory liability. For example, a regulatory agreement might allow for a period of time after initial recognition before a regulatory asset or regulatory liability begins to accrue interest. In this case, an entity will derive an implied regulatory interest rate. *[IFRS 20.48(a)]*.
- A regulatory agreement specifies an interest rate that does not apply to regulatory interest accrued in past periods, instead of a compound interest rate. *[IFRS 20.48(b)]*.
- A regulatory agreement may not specify an interest rate but, instead, adjusts the amount of compensation provided or a deduction made for an item to also provide compensation or make a deduction for the time period until the recovery of the related regulatory asset or the fulfilment of the related regulatory liability. In this case, an entity uses its judgement to determine whether a regulatory agreement provides compensation or makes a deduction for such a time period. The discount rate is nil if the regulatory agreement does not specify an interest rate, nor provide compensation or make a deduction to compensate for the passing of time (for example in relation to regulatory interest accrued in past periods). *[IFRS 20.48(c)]*.

IFRS 20 includes the following specific clarifications and reliefs in applying the discounting requirements:

- For a regulatory asset or regulatory liability that arises from regulatory depreciation of a regulatory capital base, the regulatory interest rate is the rate of return that the regulatory agreement applies to the regulatory capital base. *[IFRS 20.46]*.
- If the period between initial recognition of the regulatory asset or regulatory liability and the date on which regulatory interest starts to accrue is one year or less, an entity is only required to discount the estimated future cash flows once the interest starts to apply. *[IFRS 20.50]*.
- For regulatory interest rates linked to an interest rate benchmark, an entity disregards possible future changes in the benchmark until they occur. When the benchmark changes, the entity updates the estimated future cash flows and discounts them using the new regulatory interest rate. The subsequent measurement requirements under this scenario are discussed below in section 5.3.2. *[IFRS 20.51]*.

The following illustration of the measurement for a regulatory asset or regulatory liability that has uneven interest rates is based on an illustrative example of IFRS 20: *[IFRS 20.IE250-IE257]*.

Illustration 5-3: Uneven interest rates

Fact pattern

During Year 1, Entity A recognises expenses of CU1,000. The regulatory agreement entitles Entity A to recover these expenses through regulated rates charged to customers evenly over Years 4–5, together with interest at 10% on the unrecovered regulatory balance at the beginning of Years 4–5. The regulatory agreement specifies no interest for Years 1–3.

Illustration 5-3: Uneven interest rates (cont'd)

Accordingly, at the end of Year 1, Entity A estimates it will recover the regulatory asset by including CU600 in the regulated rates charged in Year 4 and CU550 in Year 5. No recovery takes place in Years 2–3. The table below shows the estimated changes in the unrecovered regulatory balance.

Regulatory balance					
In CU	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**
Opening balance	—	1,000	1,000	1,000	500
Addition	1,000	—	—	—	—
Regulatory interest	—	—	—	100	50
Recovery	—	—	—	(600)	(550)
Closing balance	**1,000**	**1,000**	**1,000**	**500**	**—**

Analysis

Applying paragraph 45 of IFRS 20, Entity A is required to discount the estimates of future cash flows, including regulatory interest, using the implied regulatory interest rate. In this example, the implied regulatory interest rate is the rate that at initial recognition discounts the estimated future cash flows of CU600 and CU550, which are expected to occur in Years 4–5, back to CU1,000 in Year 1. That is, back to the amount that equals the sum of the estimated future cash flows, excluding regulatory interest. The implied regulatory interest rate derived from the terms of the regulatory agreement that Entity A is required to use throughout the life of the regulatory asset is calculated to be 4.11%.

The table below shows the reconciliation of the regulatory asset, using a rate of 4.11% as the discount rate.

Reconciliation of the carrying amount of the regulatory asset					
In CU	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**
Opening carrying amount	–	1,000	1,041	1,084	528
Addition	1,000	–	–	–	–
Regulatory interest income	–	41	43	44	22
Amount recovered	–	–	–	(600)	(550)
Closing carrying amount	**1,000**	**1,041**	**1,084**	**528**	**–**

5.3 Subsequent measurement

In measuring a regulatory asset or regulatory liability after its initial recognition, at the end of each reporting period an entity is required to:

- Update the estimated amounts and timings of future cash flows arising from the regulatory asset or regulatory liability; and
- Continue to use the discount rate determined at initial recognition, unless the regulatory agreement requires a change to the regulatory interest rate (see section 5.3.2 below). *[IFRS 20.52]*.

An entity must reassess at the end of each reporting period the boundary of a regulatory agreement.

In addition, an entity reassesses at the end of each reporting period, the boundary of a regulatory agreement. If this reassessment changes the cash flows within the boundary of a regulatory agreement, the entity updates the carrying amount of any affected regulatory assets or regulatory liabilities. *[IFRS 20.B86, IFRS 20.B87]*.

As discussed in section 2.6, the definitions of regulatory income and regulatory expense refer to any change in a regulatory asset or a regulatory liability. See section 7 for more information on how regulatory income and regulatory expense should be presented.

IAS 36 *Impairment of Assets* excludes regulatory assets from the scope of the standard. See section 9.6 for more information. *[IAS 36.2]*.

5.3.1 Update to future cash flows

An entity updates the estimated future cash flows arising from a regulatory asset or regulatory liability at the end of each reporting period to reflect, for example:

- Recovery of part or all of the regulatory asset or fulfilment of part or all of the regulatory liability; and
- Any changes in estimates of the amount or timing of future cash flows because of a change in facts and circumstances or because of new information. *[IFRS 20.53]*.

Changes in facts and circumstances or new information include:

- Resolution of an uncertainty, for example:
  - Confirmation that the entity has met, or not met, performance criteria or the outcome of court rulings; or
  - The regulator's agreement or disagreement with regulatory filings made by the entity or by other entities;
- Actions by a regulator, other than those in the previous bullet point, for example, the exercise of a right to renew or terminate a regulatory agreement, causing a change in the boundary of the regulatory agreement;
- Changes in credit risk or demand risk;
- Changes in the regulatory interest rate (see section 5.3.2 below); or
- Changes in a regulatory agreement or in law or regulation. *[IFRS 20.54]*.

A change in facts and circumstances would require a reassessment of the method an entity uses to measure uncertain cash flows if such a change would yield more relevant information, that is, it better predicts the ultimate cash flows. For example, as a result of changes in facts and circumstances, an entity may determine that it would be appropriate to start applying the expected value method to estimate uncertain future cash flows, whereas, previously, the most likely amount was used. Such a change could be required if the likelihood of the most likely outcome changes significantly or the probability distribution coalesces around limited, but very different, outcomes. *[IFRS 20.55]*.

5.3.2 Change to the regulatory interest rate

As estimated future cash flows include those cash flows relating to regulatory interest, future cash flows will change when there is a change in the regulatory interest rate. The regulatory interest rate specified or implied by a regulatory agreement changes after initial recognition of a regulatory asset or liability because of a change in the regulatory agreement or an interest rate benchmark to which the regulatory interest rate is linked. *[IFRS 20.56]*.

When there is a change to the regulatory interest rate, an entity needs to:

- Update the future cash flows previously estimated;
- Discount the estimated future cash flows using the new regulatory interest rate. The new regulatory interest rate is the new interest rate specified in the regulatory agreement or the new implied regulatory interest rate determined, as described in section 5.2. The new implied regulatory interest rate discounts all the updated future cash flows to

the carrying amount of the regulatory asset or regulatory liability immediately before the new rate applied. *[IFRS 20.57].*

An interest rate change resulting from the regulatory agreement's use of uneven interest rates over the life of a regulatory asset or regulatory liability, as discussed above in section 5.2, is not expected to have accounting consequences as the regulatory agreement was not changed and, accordingly, these interest rates changes were already reflected in the initial recognition of the regulatory asset or regulatory liability. Specifically, when the interest rate benchmark changes, the entity will update the estimated future cash flows and discount them using the new regulatory interest rate. In most cases, the measurement of such a regulatory asset or regulatory liability would equal the sum of the estimated future cash flows, excluding the cash flows from regulatory interest that has not yet accrued. *[IFRS 20.56-57,IFRS 20.BC226-227]*.

IFRS 20 requires the entity to disregard the effects of possible future changes in market variables. See section 5.1 for more details. *[IFRS 20.37(a)]*. The measurement is, therefore, different from the case where regulatory interest rates are fixed in the regulatory agreement but not charged evenly over the life of a regulatory asset or regulatory liability (See section 5.2 above).

6 Derecognition

An entity derecognises part or all of a regulatory asset or regulatory liability when that part or all of the amount recognised no longer meets the definition of a regulatory asset or regulatory liability.

An entity derecognises part or all of a regulatory asset or regulatory liability when that part or all of the amount recognised no longer meets the definition of a regulatory asset or regulatory liability. *[IFRS 20.32].*

Most commonly, derecognition will occur in the normal course as an entity recovers part or all of its regulatory assets and fulfils its regulatory liabilities by updating the estimates of future cash flows as the entity recovers or fulfils the regulatory asset or regulatory liability. Given the requirements in IFRS 20 to remeasure regulatory assets and regulatory liabilities using updated future cash flow estimates at the end of each reporting period, therefore, in many cases, an entity would not need to consider explicitly when and how its regulatory assets and regulatory liabilities should be derecognised. *[IFRS 20.BC165].*

IFRS 20 also addresses other circumstances that would result in the derecognition of regulatory assets and regulatory liabilities.

A typical example is when part or all of the regulatory asset or regulatory liability no longer meets the recognition criteria (see section 4 above). In such cases, an entity derecognises the part of the regulatory asset or regulatory liability that ceases to meet the recognition criteria and recognises any related regulatory expense or regulatory income in the statement of profit or loss. *[IFRS 20.33].*

This would occur if the regulatory asset or regulatory liability:

- Is no longer more likely than not to exist at the end of the reporting period; or
- Relates to amounts that are reflected in the entity's regulatory capital base when that regulatory capital base has no direct relationship with the related item or items. See section 4.2.1.3. *[IFRS 20.B72].*

In addition, a more specific circumstance is when part or all of the regulatory asset or regulatory liability is settled or waived by a regulator or another party. In such cases, an entity needs to:

- Recognise an asset or liability if required by other IFRS accounting standards (for example, a financial asset or financial liability applying IFRS 9); and
- Recognise the difference between the amount derecognised and any new asset or liability recognised applying another IFRS accounting standards in the statement of profit or loss. *[IFRS 20.32(b), IFRS 20.B85]*

As an example, such a situation would occur upon the termination of a regulatory agreement by the regulator or another party for reasons other than the entity's failure to perform as specified in the regulatory agreement. It is possible that an entity would have a right to receive compensation for regulatory assets that have not yet been recovered or an obligation to pay compensation for regulatory liabilities that have not yet been fulfilled. This treatment is not limited to the cancellation or termination of a regulatory agreement and could apply to a broad range of circumstances where full or partial settlement of a regulatory asset or regulatory liability takes place with parties other than customers (see Illustration 6-1 below).
[IFRS 20.B81, IFRS 20.B83].

Illustration 6-1: Regulatory asset settled by a regulator

Fact pattern

Entity A recognises a regulatory asset in the amount of CU20. The regulator settles the regulatory asset by providing Entity A with cash compensation of CU15 payable in 30 days.

Analysis

Applying paragraph 32(b) of IFRS 20, Entity A:

(a) Derecognises the regulatory asset of CU20;

(b) Recognises a financial asset of CU15 in accordance with IFRS 9; and

(c) Recognises CU5 as an expense in the statement of profit or loss.

IFRS 20.32(b)(ii) requires the difference between the amount derecognised and any new asset or liability recognised applying another IFRS accounting standard to be recognised in profit or loss. IFRS 20 does not specify the line item in which such difference is presented.

6.1 Securitisation transactions

The IASB considered whether to provide requirements on derecognition of regulatory assets because of a securitisation transaction. However, the IASB decided not to provide such requirements, noting that any such guidance would be complex and the securitisation of regulatory assets is uncommon in most jurisdictions. In the absence of specific guidance, IAS 8 requires an entity to use its judgement in developing and applying an accounting policy for such transactions. *[IFRS 20.BC167].*

How we see it

IFRS 20 does not address the accounting for securitisations of regulatory assets. In the absence of guidance in IFRS 20 on derecognition of regulatory assets through securitisation transactions, an entity would need to develop an accounting policy in accordance with IAS 8. Among possible alternatives, entities might consider the derecognition guidance in IFRS 9 as part of the evaluation.

7 Classification and presentation

7.1 Statement of profit or loss

IFRS 20 requires an entity to classify all regulatory income and all regulatory expense, including regulatory interest income and regulatory interest expense, as revenue.

IFRS 20 requires an entity to classify all regulatory income and all regulatory expense, including regulatory interest income and regulatory interest expense, as revenue. The entity presents all regulatory income minus all regulatory expense as a separate line item in the statement of profit or loss. The only exception from this general requirement is when IFRS 20 requires presentation in other comprehensive income (see section 7.2 below). *[IFRS 20.62, IFRS 20.63, IFRS 20.64]*.

The IASB's intention with this presentation is to provide users with a more complete picture of the income an entity is entitled to from its ordinary activities during the period, by supplementing IFRS 15 revenue with regulatory income or expense arising from differences in timing. The IASB noted that this is also in line with the standard's core principle that the total allowed compensation for regulatory goods or services is recognised in the reporting period in which the regulatory goods or services are supplied. *[IFRS 20.BC242]*.

The IASB concluded that regulatory income and regulatory expense are sufficiently distinct from other sources of revenue to warrant separate presentation. The IASB also concluded that separate presentation would enable users of financial statements to understand how the entity's financial performance was affected by the supply of regulatory goods or services in one period and by the inclusion of part or all of the total allowed compensation for supplying those goods or services in the regulated rates charged to customers, and, hence, in revenue from contracts with customers, in a different period. *[IFRS 20.BC246, IFRS 18.BC241A]*.

In relation to the requirement to present all regulatory income minus all regulatory expense in a single line, see the discussion on regulatory income and regulatory expense in section 2.6. The definitions show that together they depict how differences in timing originate and reverse over time, as the entity recovers or fulfils its regulatory rights and obligations.

The following illustration of the classification and presentation of regulatory assets and regulatory liabilities is based on an illustrative example of IFRS 20: *[IFRS 20.IE311-IE317]*.

Illustration 7-1: Classification and presentation of regulatory assets and regulatory liabilities (part related to the statement of profit or loss)

Entity A recognised a regulatory asset relating to its right to recover pension costs. Entity A operates an unfunded pension plan and pays benefits to employees when the benefits fall due. The regulatory agreement provides Entity A the right to add compensation for pension costs to regulated rates in a future period only when the entity pays the benefits and settles its obligations under the plan.

All regulatory assets and regulatory liabilities belong to wholly-owned subsidiaries (i.e., no amounts are attributable to non-controlling interests). Entity A has no discontinued operations and does not show earnings per share, either basic or diluted.

Illustration 7-1: Classification and presentation of regulatory assets and regulatory liabilities (part related to the statement of profit or loss) (cont'd)

Entity A:

(a) Presents profit or loss and other comprehensive income in two statements.

(b) Concludes that the most useful structured summary of its expenses is provided by presenting in the operating category of the statement of profit or loss expenses classified by nature.

Entity A presents all regulatory income, including regulatory interest income, net of all regulatory expenses, as a single line item in the statement of profit or loss.

Statement of profit or loss		
In CU	**Year 1**	**Year 0**
Revenue from contracts with customers	440,000	420,000
Regulatory income minus regulatory expense	6,831	3,193
Revenue	**446,831**	**423,193**
Other operating income	8,937	8,464
Purchase of electricity	(113,366)	(108,639)
Staff costs	(90,025)	(86,479)
Depreciation and amortisation expense	(53,620)	(50,783)
Maintenance	(38,166)	(42,950)
Other operating expenses	(5,072)	(7,128)
Operating profit	**155,519**	**135,678**
Share of profit of associates	7,090	4,700
Investment income	11,608	11,029
Profit before financing and income taxes	**174,217**	**151,407**
Interest expense on borrowings and lease liabilities	(12,000)	(14,750)
Interest expense on pension liabilities and provisions	(1,470)	(2,151)
Profit before income taxes	**160,747**	**134,506**
Income tax expense	(32,290)	(26,962)
Profit	**128,457**	**107,544**

7.2 Statement of other comprehensive income

IFRS 20 requires the entity to also include in OCI regulatory income or regulatory expense arising because of the recognition of the item of income or expense in OCI.

When applying other IFRS accounting standards, an entity includes an item of income or expense in other comprehensive income (OCI), IFRS 20 requires the entity to also include in OCI regulatory income or regulatory expense arising because of the recognition of that item of income or expense in OCI. *[IFRS 20.64]*.

IFRS 20 states, in relation to the measurement, that the regulatory income or regulatory expense to be included in other comprehensive income is the regulatory income or regulatory expense that arises in a reporting period because an entity recognises the related expense or related income that is included in other comprehensive income in that period. The entity determines such regulatory income or regulatory expense based on the amount of the compensation or deduction for that related expense or related income. *[IFRS 20.65]*.

As for the presentation, IFRS 20 requires the entity to:

- Classify regulatory income and regulatory expense included in other comprehensive income, as required by IFRS 18, in one of two categories: (a) income and expenses that will be reclassified to profit or loss when

specific conditions are met; and (b) income and expenses that will not be reclassified to profit or loss. *[IFRS 20.64(a)]*.

- Present regulatory income and regulatory expense separately from the related expense or related income. *[IFRS 20.64(b)]*.

In relation to subsequent reclassification, IFRS 20 requires that regulatory income or regulatory expense included in OCI is reclassified to the statement of profit or loss if and only if the entity reclassifies the related income or expense to the statement of profit or loss in accordance with other IFRS accounting standards. Such items are presented in the statement of profit or loss as revenue (similarly to the regulatory income and regulatory expense that is directly recognised in the statement of profit or loss). This means that when an entity derecognises a regulatory asset or regulatory liability at a different date (for example, due to the adjustments addressed in section 5.1.2), it will not result in the reclassification of regulatory income or regulatory expense included in OCI to the statement of profit or loss. *[IFRS 20.64(c), IFRS 20.66]*.

The following illustration of the classification and presentation of regulatory assets and regulatory liabilities is based on an illustrative example of IFRS 20: *[IFRS 20.IE311-IE317]*.

Illustration 7-2: Classification and presentation of regulatory assets and regulatory liabilities (part related to the statement of OCI)

This Illustration continues with the same fact pattern as in Illustration 7-1.

However, in relation to the statement of OCI, Entity A:

(a) Presents profit or loss and other comprehensive income in two statements

(b) Presents items of other comprehensive income included in the statement before tax effects, with one amount shown for the aggregate amount of income tax relating to those items in each category of other comprehensive income

Entity A includes a single line item in the statement of other comprehensive income for regulatory income or regulatory expense relating to items of income or expense included in other comprehensive income.

Statement of other comprehensive income		
In CU	**Year 1**	**Year 0**
Profit	128,457	107,544
Income and expenses that will not be reclassified to profit or loss:		
Gains (losses) on remeasurements of defined benefit pension plans	(2,000)	(1,700)
Regulatory income minus regulatory expense related to remeasurements of defined benefit pension plans	2,000	1,700
Share of other comprehensive income of associates	702	302
Income tax relating to income and expenses that will not be reclassified to profit or loss	(140)	(60)
Other comprehensive income, net of tax	562	242
Total comprehensive income	129,019	107,786

IFRS 20 requires regulatory assets and regulatory liabilities to be presented as separate line items in the statement of financial position.

7.3 Statement of financial position

An entity presents in its statement of financial position:

- Regulatory assets and regulatory liabilities as separate line items; and
- Current and non-current regulatory assets, and current and non-current regulatory liabilities, as separate classifications in accordance with IFRS 18, except when the entity presents all assets and liabilities in order of liquidity. *[IFRS 20.67, IFRS 18.103]*.

The following illustration of the classification and presentation of regulatory assets and regulatory liabilities is based on an illustrative example of IFRS 20: *[IFRS 20.IE311-IE317]*.

Illustration 7-3: Classification and presentation of regulatory assets and regulatory liabilities (part related to the statement of financial position)

This Illustration continues with the same fact pattern as in Illustration 7-1.

In CU	Year 1	Year 0
Assets		
Non-current assets		
Property, plant and equipment	824,228	833,500
Goodwill	90,800	91,200
Other intangible assets	57,820	58,750
Investments in associates	30,510	26,430
Regulatory assets	27,540	15,640
Total non-current assets	**1,030,898**	**1,025,520**
Current assets		
Inventories	33,190	28,140
Regulatory assets	3,060	1,730
Trade receivables	92,445	106,440
Cash and cash equivalents	202,160	180,570
Total current assets	**330,855**	**316,880**
Total assets	**1,361,753**	**1,342,400**

In CU	Year 1	Year 0
Equity and liabilities		
Equity attributable to owners of the parent		
Share capital	620,000	600,000
Retained earnings	272,957	164,500
Other components of equity	12,646	21,200
Total equity attributable to owners of the parent	**905,603**	**785,700**
Non-controlling interests	67,604	45,800
Total equity	**973,207**	**831,500**
Non-current liabilities		
Borrowings	225,047	313,721
Lease liabilities	5,953	6,279
Pension liabilities	20,300	9,000
Provisions	26,550	62,870
Regulatory liabilities	10,280	6,600
Total non-current liabilities	**288,130**	**398,470**

Illustration 7-3: Classification and presentation of regulatory assets and regulatory liabilities (part related to the statement of financial position) (cont'd)

In CU	Year 1	Year 0
Current liabilities		
Borrowings	7,914	7,592
Lease liabilities	1,086	7,408
Provisions	5,000	4,800
Regulatory liabilities	1,149	740
Trade payables	85,267	91,890
Total current liabilities	**100,416**	**112,430**
Total liabilities	**388,546**	**510,900**
Total equity and liabilities	**1,361,753**	**1,342,400**

7.4 Statement of cash flows

Neither IFRS 20 nor the consequential amendments to other IFRS accounting standards addresses how the statement of cash flows would be affected by the new standard.

During the development of IFRS 20, the IASB staff (in an agenda paper[6]) referred to the guidance in IAS 7 on reporting cash flows from operating activities using the direct and the indirect methods. IAS 7 refers to making adjustments for:

- Changes during the period in inventories and operating receivables and payables;
- Other non-cash items; and
- Other items for which the cash effects are investing or financing cash flows. *[IAS 7.19-20]*.

The IASB staff noted that changes in regulatory assets and regulatory liabilities share some similarities with operating receivables and payables, as they form part of the same transaction cycle.

This observation was discussed during the development of IFRS 20 but was not included as a specific requirement in IFRS 20 or as a consequential amendment to IAS 7.

How we see it

As discussed in section 1, the recognition of regulatory assets or regulatory liabilities has no impact on an entity's cash flows as the accounting results in non-cash adjustments to improve the usefulness of the resulting financial information. In determining their cash flows from operating activities, entities will therefore need to consider to which extent an additional adjustment is needed as a result of the application of IFRS 20.

6 IASB Staff Paper AP9B, Project: Rate-regulated Activities, Topic: Amendments to IAS 8 and suggested amendments to other IFRS Accounting Standards, IASB, May 2024. Available on the IFRS Foundation's website.

8 Disclosure

8.1 Disclosure objectives

IFRS 20 requires the disclosure of information to enable users to understand the entity's total allowed compensation, its regulatory assets and liabilities at the end of the reporting period and the amount, timing and uncertainty of future cash flows.

The overall objective of the disclosure requirements in IFRS 20 is to require an entity to disclose in the notes, information about regulatory income, regulatory expense, regulatory assets and regulatory liabilities which, together with the information required by other IFRS accounting standards, provides users of financial statements with insight on:

- The total allowed compensation for regulatory goods or services supplied by the entity in a reporting period, and, hence, the entity's financial performance and prospects for future cash flows.
- The entity's regulatory assets and regulatory liabilities at the end of a reporting period and the amount, timing and uncertainty of the entity's future cash flows. *[IFRS 20.68]*.

IFRS 20's first specific disclosure objective requires an entity to disclose information that enables users of financial statements to understand the amounts that are recognised in the statement of financial position and statement(s) of financial performance for regulatory assets, regulatory liabilities, regulatory income and regulatory expense. In addition, the disclosure objective requires an entity to disclose information that enables users of financial statements to understand the nature of unrecognised regulatory assets or unrecognised regulatory liabilities and the reason they have not been recognised. This information provides insights into: (a) the total allowed compensation for regulatory goods or services supplied by the entity in a reporting period; and (b) the amount, timing and uncertainty of the entity's future cash flows. *[IFRS 20.69, IFRS 20.70]*.

IFRS 20's second specific disclosure objective requires an entity to disclose information that enables users of financial statements to understand the relationship between an entity's regulatory capital base and a related item or items. That information is expected to provide insights into the nature of a regulatory agreement, the effect of a regulatory agreement on an entity's financial position and financial performance and it will also enable users to make comparisons between entities subject to different regulatory agreements. *[IFRS 20.82]*.

How we see it

Entities should consider the IFRS 18 requirements on the roles of the primary financial statements and the notes. Determining the appropriate level of granularity necessary to meet the disclosure objectives of IFRS 20 requires judgement to ensure that material information about the applicable rate regulation(s) is presented at an appropriate level of aggregation and disaggregation, while maintaining a useful structured summary and providing material information to users of financial statements. As with all requirements in IFRS accounting standards, only material information is required to be presented or disclosed.

8.2 Level of aggregation and disaggregation

An entity determines the level of aggregation or disaggregation of information, necessary to satisfy the overall disclosure objective. If the information disclosed applying the specific disclosure requirements discussed in sections 8.3 to 8.7 below is insufficient to meet the disclosure objective, an entity is required to disclose additional information to satisfy those objectives.

IFRS 18 sets out requirements relating to the aggregation and disaggregation of information. In applying those requirements, IFRS 20 requires an entity to consider whether to use the same aggregation or disaggregation of regulatory income, regulatory expense, regulatory assets and regulatory liabilities as applied in the information provided for other purposes, for example disclosures presented outside the financial statements, such as in regulatory reporting. *[IFRS 20.B95]*.

Examples of characteristics that might be appropriate as a basis to aggregate or disaggregate the information required by IFRS 20 include:

- Type of rate-regulated activity- for example, electricity distribution, gas distribution, water supply;
- Geographical location;
- Type of regulatory agreement- for example, service concession arrangements or contractual licencing agreements;
- Type of items that the regulatory assets or regulatory liabilities relate to - for example, recovery of input cost variances, performance incentives, recovery of income taxes, recovery of pension costs; and
- Exposure to substantially different risks or uncertainties. *[IFRS 20.B96]*.

IFRS 20 states that the appropriate aggregation or disaggregation might differ for different information and will also depend on the disclosure requirement and disclosure objective to which the information contributes. *[IFRS 20.B97]*.

8.3 Reconciliations of regulatory assets and regulatory liabilities

IFRS 20 requires an entity to disclose, in a table, reconciliations from the opening to the closing carrying amounts of regulatory assets and from the opening to the closing carrying amounts of regulatory liabilities. *[IFRS 20.72]*. Specifically, an entity is required to disclose reconciliations of the changes in the carrying amount of a regulatory asset or regulatory liability arising from:

- The origination of regulatory assets during the reporting period;
- The origination of regulatory liabilities during the reporting period;
- The recovery of regulatory assets during the reporting period;
- The fulfilment of regulatory liabilities during the reporting period;
- Regulatory interest income on regulatory assets or regulatory interest expense on regulatory liabilities;
- Other components of regulatory income or regulatory expense, for example, changes in the carrying amount of a regulatory asset or regulatory liability arising from remeasurements of the regulatory asset or regulatory liability or changes in the boundary of a regulatory agreement; and
- Changes in regulatory assets and regulatory liabilities that did not give rise to regulatory income or regulatory expense, for example, regulatory assets acquired or regulatory liabilities assumed in a business combination. *[IFRS 20.73]*.

IFRS 20 notes specifically that the last two items require additional explanation in the notes. *[IFRS 20.74]*.

In the reconciliations, an entity groups the changes described above into:

- Changes included in the statement of profit or loss;
- Changes included in other comprehensive income; and
- Other changes not included in the two bullets above. *[IFRS 20.72]*.

The following illustration of the disclosure requirements related to regulatory assets and regulatory liabilities is based on an illustrative example of IFRS 20: *[IFRS 20.IE306-IE310]*.

Illustration 8-1: Reconciliation of regulatory assets and regulatory liabilities - Aggregation by types of activities and types of items

Fact pattern

Entity A operates in two sectors in Region Y: electricity transmission and electricity distribution. During Year 1, Entity A recognises regulatory assets and regulatory liabilities.

Analysis

Applying paragraphs B95–B97 of IFRS 20, Entity A considers its facts and circumstances and decides to aggregate the information required by paragraphs 72–73 of IFRS 20 by type of activity (for example, electricity transmission) and by type of items the regulatory assets and regulatory liabilities relate to (for example, cost variances).

Reconciliation of the carrying amount of regulatory assets

	Electricity transmission (ET)				Electricity distribution (ED)				
In CU	Cost variances	Perfor-mance incentives	Pension	Total ET	Cost Variance	Perfor-mance incentives	Pension	Total ED	Total
Opening carrying amount	5,226	380	6,000	11,606	2,574	190	3,000	5,764	17,370
Profit or loss									
Origination	5,025	250	4,190	9,465	2,475	120	2,060	4,655	14,120
Recovery	(4,020)	(135)	(1,000)	(5,155)	(1,980)	(65)	(500)	(2,545)	(7,700)
Regulatory interest income	100	13	170	283	50	7	80	137	420
Other components[(a)]	–	30	–	30	–	10	4,000	4,010	4,040
Other comprehensive income									
Remeasurements[(b)]	–	–	1,340	1,340	–	–	660	660	2,000
Other changes that do not affect profit or loss or other comprehensive income									
Business combination[(c)]	50	–	300	350	–	–	–	–	350
Closing carrying amount	6,381	538	11,000	17,919	3,119	262	9,300	12,681	30,600

(a) Other components include: (i) CU30 (Electricity transmission) and CU10 (Electricity distribution) related to the remeasurement of regulatory assets relating to performance incentives; and (ii) CU4,000 (Electricity distribution) related to a change in the boundary of the regulatory agreement.

(b) The balance included in other comprehensive income relates to the remeasurement of the defined benefit pension plan, which is presented in other comprehensive income in accordance with IAS 19. In accordance with paragraph 64 of IFRS 20, Entity A also includes the related regulatory income or regulatory expense in other comprehensive income.

(c) During Year 1 Entity A acquired control of a regulated business with regulatory assets of CU350 and regulatory liabilities of CU40.

Reconciliation of the carrying amount of regulatory liabilities

	Electricity transmission (ET)				Electricity distribution (ED)				
In CU	Cost variances	Perfor-mance incentives	Volume variance	Total ET	Cost Variance	Perfor-mance incentives	Volume variance	Total ED	Total
Opening carrying amount	**(400)**	**(255)**	**–**	**(655)**	**(200)**	**(125)**	**(6,360)**	**(6,685)**	**(7,340)**
Profit or loss									
Origination	(2,545)	(120)	–	(2,665)	(1,255)	(55)	(4,614)	(5,924)	(8,589)
Fulfilment	1,340	100	–	1,440	660	50	2,500	3,210	4,650
Regulatory interest expense	(50)	(10)	–	(60)	(25)	(5)	–	(30)	(90)
Remeasurements[(a)]	–	(15)	–	(15)	–	(5)	–	(5)	(20)
Other changes that do not affect profit or loss or other comprehensive income									
Business combination[(b)]	(40)	–	–	(40)	–	–	–	–	(40)
Closing carrying amount	**(1,695)**	**(300)**	**–**	**(1,995)**	**(820)**	**(140)**	**(8,474)**	**(9,434)**	**(11,429)**

(a) The amounts of CU15 (Electricity transmission) and CU5 (Electricity distribution) relate to the remeasurement of regulatory liabilities relating to performance incentives.

(b) During Year 1 Entity A acquired control of a regulated business with regulatory liabilities of CU40.

8.4 Regulatory assets and regulatory liabilities measured using a cash-flow based measurement technique

This section is only relevant for entities with regulatory assets or regulatory liabilities that are measured using a cash-flow based measurement technique as discussed in section 5 above.

IFRS 20 requires the entity to disclose quantitative information, using time bands, about when it expects to recover the regulatory assets and fulfil the regulatory liabilities. The entity discloses the quantitative information disaggregated between:

- Regulatory assets and regulatory liabilities for which a regulatory agreement provides or charges a regulatory interest rate that is not nil; and
- Regulatory assets and regulatory liabilities for which a regulatory agreement provides or charges a regulatory interest rate of nil. *[IFRS 20.75]*.

The quantitative information needs to represent undiscounted cash flows, excluding regulatory interest cash flows, based on reasonable and supportable assumptions about the timing of future cash flows that are consistent between periods. *[IFRS 20.76]*.

Judgement may be needed to determine an appropriate number of time bands for the quantitative information. As an example, the standard refers to four time bands: not later than one year; later than one year and not later than three years; later than three years and not later than five years; and later than five years. *[IFRS 20.77]*.

In addition, IFRS 20 requires the disclosure of the following information:

- The discount rate, or ranges of discount rates, used in measuring regulatory assets and regulatory liabilities for which a regulatory agreement provides or charges a regulatory interest rate
- An explanation of how uncertainties affect the recovery of regulatory assets or fulfilment of regulatory liabilities
- If the exemption from discounting estimated future cash flows is applied (see section 5.2), the carrying amounts of regulatory assets and of regulatory liabilities at the end of the reporting period to which the exemption is applied *[IFRS 20.78]*.

8.5 Items measured using another IFRS measurement basis

This section is only relevant for entities with regulatory assets or regulatory liabilities that are measured using another IFRS measurement basis (see section 5.1.2).

The measurement of some regulatory assets and regulatory liabilities is determined based on the measurement of the related liability or related asset by applying the relevant standard. In that case, IFRS 20 requires the entity to provide information about the regulatory assets and regulatory liabilities and the related liabilities and related assets that explains:

- The relationship between the carrying amounts, and changes therein, of the regulatory assets or regulatory liabilities and the carrying amounts, and changes therein, of the related liabilities or related assets;
- The relationship between the risks associated with the regulatory assets or regulatory liabilities and the risks associated with the related liabilities or related assets; and

- How uncertainties affect the recovery of regulatory assets or fulfilment of regulatory liabilities. *[IFRS 20.79]*.

The standard provides the example of pension costs and states that an entity will need to consider how to disclose the information required by IFRS 20 and the information required by IAS 19 in a manner that shows these relationships. *[IFRS 20.80]*.

8.6 Unrecognised regulatory assets and regulatory liabilities

IFRS 20 requires the disclosure of information about unrecognised regulatory assets and unrecognised regulatory liabilities, including the type of compensation or charge they relate to and the reason they have not been recognised (for example, because the entity has concluded that its regulatory capital base does not have a direct relationship with its property, plant and equipment). *[IFRS 20.81]*.

The IASB decided not to require an entity to disclose the amounts of unrecognised regulatory assets and unrecognised regulatory liabilities as such information could be difficult and costly to obtain. *[IFRS 20.81, IFRS 20.BC277]*.

8.7 Regulatory capital base relationship disclosures

IFRS 20 requires an entity to disclose:

- The type of relationship, direct or not direct, between its regulatory capital base and a related item or items;
- The reasons why the entity determined that the relationship is of that type;
- Any change to or from a direct relationship, and the reason for the change; and
- The regulatory approach, nominal or real, used by the regulator to compensate the entity for inflation on its regulatory capital base. *[IFRS 20.83]*.

9 Consequential amendments to other IFRS

IFRS 20 introduced consequential amendments to other IFRS accounting standards. Whilst most of the amendments are of an editorial nature, the more significant consequential amendments are discussed in the sub-sections below. An entity is required to apply these consequential amendments when it applies IFRS 20. For more information on transition, see section 10 below.

9.1 IFRS 1 First-time Adoption of International Financial Reporting Standards

IFRS 20 introduced consequential amendments to IFRS 1 to address how entities that adopt IFRS accounting standards for the first time apply the new requirements for regulatory assets and regulatory liabilities.

IFRS 1 has been amended to require a first-time adopter to apply IFRS 20 at its date of transition to IFRS accounting standards. Any regulatory assets and regulatory liabilities recognised at that date need to meet the definitions and recognition criteria in IFRS 20 and be measured in accordance with its requirements. IFRS 1 no longer permits a first-time adopter to continue recognising regulatory deferral account balances by applying an approach permitted by IFRS 14. This reflects the IASB's conclusion that IFRS 20 replaces IFRS 14 and introduces a fundamentally different accounting model based on enforceable rights and obligations rather than deferred cost balances.

IFRS 20 allows first-time adopters to apply the transition reliefs available to entities applying the modified retrospective transition approach (see section 10.4. *[IFRS 1.D37]*.

In addition, first-time adopters that have assets whose carrying amounts were determined under previous GAAP but that do not qualify for capitalisation in accordance with IFRS accounting standards may elect to use the previous GAAP carrying amounts of such an item as deemed cost. However, in that case, the transition relief on regulatory returns on assets not yet available for use cannot be applied. *[IFRS 1.D8B, IFRS 1.D37]*.

The IASB noted that retrospective application could be costly and difficult for first-time adopters and, consequently, the IASB permitted the use of the transition reliefs in IFRS 20. *[IFRS 1.BC63N]*.

IFRS 1 additionally requires a first-time adopter to disclose the use of any IFRS 20-related transition reliefs, and, if appropriate, describe how it has applied them, enabling users of financial statements to understand the effect of those reliefs on the entity's opening IFRS statement of financial position. *[IFRS 1.31D]*.

9.2 IFRS 3 Business Combinations

The amended IFRS 3, once effective, will require entities identified as acquirers to recognise and measure all regulatory assets acquired and regulatory liabilities assumed in a business combination in accordance with IFRS 20. *[IFRS 3.28C]*.

The IASB considered whether an entity should recognise and measure regulatory assets acquired and regulatory liabilities assumed in a business combination applying the recognition and measurement principles in IFRS 20, or in accordance with IFRS 3. Requiring regulatory assets and regulatory liabilities acquired to be initially recognised at fair value in accordance with IFRS 3, but subsequently measured in accordance with IFRS 20, could result in post-acquisition gains or losses arising from the change in measurement basis. The IASB concluded that requiring an entity to recognise and measure regulatory assets acquired, or regulatory liabilities assumed, in a business

combination in accordance with IFRS 20 would provide information that is relevant to users of financial statements. Accordingly, the IASB amended IFRS 3 to provide an exception to the recognition and measurement principles in IFRS 3 for regulatory assets acquired and regulatory liabilities assumed in a business combination. The IASB also considered that an entity might incur significant costs in determining the discount rate necessary to measure regulatory assets and regulatory liabilities at fair value. *[IFRS 3.BC303A]*.

How we see it

Recognising regulatory assets and liabilities measured in accordance with IFRS 20 in a business combination requires entities to carefully distinguish between the future cash flows within and outside the boundary of the regulatory agreement.

9.3 IFRS 5 Non-current Assets Held for Sale and Discontinued Operations

The IASB decided to exclude regulatory assets from the measurement requirements of IFRS 5. When an asset group or disposal group is classified as held for sale, any regulatory assets included in that group continue to be recognised and measured in accordance with IFRS 20, rather than being remeasured under IFRS 5. Similarly, regulatory liabilities included in a disposal group are not affected by the measurement requirements of IFRS 5. *[IFRS 5.5]*.

The IASB decided to exclude regulatory assets as it would be difficult for an entity to determine the fair value of regulatory assets because determining the discount rate can be complex. The IASB also decided that the measurement requirements in IFRS 20 would provide useful information. Hence, the IASB expected that the cost would outweigh any incremental benefits. *[IFRS 5.BC14F]*.

The amendments to IFRS 5 also ensure consistency between IFRS 5 and IAS 36, which was amended concurrently to exclude regulatory assets from its scope. As a result, regulatory assets are neither tested for impairment under IAS 36 nor remeasured under IFRS 5 on classification as held for sale. Any changes in the carrying amount of regulatory assets continue to be recognised only through the application of IFRS 20.

These amendments do not affect the classification, presentation or disclosure requirements of IFRS 5. An entity is still required to disclose information about disposal groups classified as held for sale or discontinued operations in accordance with IFRS 5. However, the measurement of regulatory assets and regulatory liabilities included in those groups remains governed exclusively by IFRS 20.

9.4 IFRS 18 Presentation and Disclosure in Financial Statements

The IASB amended IFRS 18 to ensure that the presentation and disclosure of regulatory income, regulatory expense, regulatory assets and regulatory liabilities are clearly aligned with the new accounting model for rate-regulated activities.

In particular, the IASB decided to make the following clarifications:

- Regulatory interest income and regulatory interest expense are presented in the operating category of the statement of financial performance. *[IFRS 18.64]*.

- All regulatory income minus all regulatory expense are presented as a separate line item in the statement of profit or loss *[IFRS 18.75(d)]*.
- Regulatory assets and regulatory liabilities are presented as separate line items in the statement of financial position. *[IFRS 18.103]*.

See section 7 for a discussion of the presentation requirements.

9.5 IFRS 19 Subsidiaries without Public Accountability: Disclosures

The IASB decided to require an entity applying IFRS 19 and IFRS 20 to apply all the disclosure requirements in IFRS 20. *[IFRS 19.4(b)]*.

The main reasons for the IASB's decision were the limited potential for reducing the disclosure requirements, the benefits of (at least initially) requiring all disclosures and the expectation that reducing the disclosure requirements would not benefit many entities as few are expected to apply both IFRS 19 and IFRS 20. *[IFRS 19.BC125]*.

9.6 IAS 36 Impairment of Assets

The IASB decided to exclude regulatory assets from the scope of IAS 36. *[IAS 36.2]*.

As a result, regulatory assets recognised under IFRS 20 are not subject to impairment testing under IAS 36, either individually or as part of a cash-generating unit. Any changes in the carrying amount of a regulatory asset arise solely from the application of IFRS 20, including updates to estimates of future cash flows, changes in regulatory interest rates, or derecognition when the regulatory asset is recovered or ceases to meet the definition of a regulatory asset. The IASB noted that the exclusion is consistent with other scope exclusions in IAS 36, that is for assets where other IFRS accounting standards include requirements that ensure the assets are carried at appropriate amounts. *[IAS 36.BC8A]*.

Nevertheless, the IASB acknowledged that, in some cases, the cash flows arising from regulatory assets might not be largely independent of the cash flows generated by other assets. The IASB also acknowledged that an entity might find it difficult to determine the recoverable amount of a cash-generating unit before consideration of regulatory assets or regulatory liabilities. In such cases, an entity applying IAS 36 might include regulatory assets or regulatory liabilities in determining the recoverable amount of a cash-generating unit. *[IAS 36.BC8C]*.

How we see it

We believe that entities need to revise their impairment testing procedures in order to avoid double counting of future cash flows that are inherently related to the recognition of regulatory assets.

10 Effective date and transition

10.1 Effective date

IFRS 20 is applicable for annual reporting periods beginning on or after 1 January 2029. When IFRS 20 is applied, IFRS 14 is withdrawn.

Earlier application is permitted. If an entity applies IFRS 20 earlier than reporting periods beginning on or after 1 January 2029, an entity is required to disclose that fact. *[IFRS 20.C1, IFRS 20.C18]*.

10.2 Transition requirements– general requirements

For the purposes of the transition requirements:

- The date of initial application is the beginning of the annual reporting period in which an entity first applies IFRS 20 (i.e., 1 January 2029 for an entity with an annual reporting period ending 31 December 2029 first applying the standard at its effective date).
- The transition date is the beginning of the annual reporting period immediately preceding the date of initial application (i.e., 1 January 2028 for an entity first applying the standard for the annual reporting period ending 31 December 2029) which reports only one comparative period.
- The transition date is the beginning of the annual reporting period of the earliest comparative period (i.e., 1 January 2027 for an entity first applying the standard for the annual reporting period ending 31 December 2029) which reports two comparative periods. *[IFRS 20.C1-C2(a)]*.

IFRS 20 requires an entity to apply the requirements using one of the following approaches:

- Retrospectively in accordance with IAS 8, as discussed in section 10.3; or
- Using the modified retrospective approach, as discussed in section 10.4. *[IFRS 20.C3]*.

Regardless of the transition approach chosen, an entity is required to present adjusted comparative information.

Regardless of the approach chosen, an entity is required to:

- Recognise the net adjustment on transition, in opening retained earnings (or other component of equity, as appropriate) at the transition date, which means that an entity is required to:
- Recognise and measure regulatory assets and regulatory liabilities as if IFRS 20 had always been applied;
- Derecognise all regulatory balances that the entity would not have recognised as regulatory assets or regulatory liabilities if IFRS 20 had always been applied;
- Recognise any deferred tax effects of the adjustments described in previous steps;
- Present adjusted comparative information for the annual reporting period immediately preceding the date of initial application; and
- Disclose the amount of the adjustment for the annual reporting period immediately preceding the date of initial application for each financial statement line item affected and, if IAS 33 *Earnings per Share* applies to the entity, for basic and diluted earnings per share. *[IFRS 20.C4-C6]*.

An entity is permitted, but not required to:

- Present adjusted comparative information for any earlier periods presented before the beginning of the annual reporting period immediately preceding the date of initial application;

- Disclose the amount of the adjustment for the current period or any earlier comparative periods presented before the beginning of the annual reporting period immediately preceding the date of initial application for each financial statement line item affected and, if IAS 33 applies to the entity, for basic and diluted earnings per share;
- Provide the disclosures required by IFRS 20 for any earlier comparative periods presented before the beginning of the annual reporting period immediately preceding the date of initial application. *[IFRS 20.C7]*.

If an entity presents in its primary financial statements or discloses in the notes unadjusted comparative information for any earlier periods, it is required to clearly identify the information that has not been adjusted, disclose that it has been prepared on a different basis, and explain that basis. *[IFRS 20.C8]*.

10.2.1 Past business combinations

The IASB considered how an entity should account for the net amount of the adjustment on transition related to regulatory assets acquired and regulatory liabilities assumed in a past business combination. Specifically, the IASB considered whether to require an entity:

- To adjust the opening balance of retained earnings (or other component of equity); or
- To adjust the carrying amount of goodwill from a past business combination. *[IFRS 20.BC299]*.

The IASB concluded that some adjustments might be unrelated to the goodwill recognised at the acquisition date, and, therefore, adjusting the opening balance of retained earnings (or other component of equity) instead of adjusting goodwill would avoid the need for the entity to differentiate between regulatory assets acquired and regulatory liabilities assumed in a past business combination and those acquired or assumed in a different way. The IASB decided that transition adjustments are recognised in opening retained earnings (or another component of equity), with no adjustment made to goodwill recognised in a past business combination. *[IFRS 20.BC300]*.

10.2.2 Disclosures about the effect of transition

At transition to IFRS 20, entities need to provide the disclosures required by IAS 8 applicable to changes in accounting policies other than those exempted as discussed in section 10.2 above (i.e., the items the entity is permitted but not required to disclose).

IAS 8 requires the following disclosures upon initial application of an IFRS accounting standard:

- The title of the IFRS accounting standard (i.e., IFRS 20)
- A statement that the change in accounting policy is made in accordance with the transitional provisions
- The nature of the change in accounting policy
- Where applicable, a description of the transitional provisions (i.e., an entity would need to explain whether and how it had applied the retrospective or the modified retrospective approach)
- When applicable, the transitional provisions that might have an effect on future periods
- The amount of any adjustment relating to periods prior to the accounting periods presented in the financial statements, to the extent practicable
- If retrospective application is impracticable, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy is consistently applied. *[IAS 8.28]*.

In addition, an entity electing to use the modified retrospective approach (see section 10.4 below) discloses which of the transition reliefs it has applied; and describes, if appropriate, how it has applied those transition reliefs. *[IFRS 20.C13]*.

10.3 Retrospective approach applying IAS 8

Retrospective application in accordance with IAS 8 requires an entity to adjust the opening balance of each affected component of equity for the earliest prior period presented and the other comparative amounts disclosed for each period presented, as if the new accounting policy had always been applied. IAS 8 provides one exception to this principle: when it is impracticable to determine either the period-specific effects or the cumulative effect of the change. *[IAS 8.22]*.

For a detailed discussion of the requirements of IAS 8, see Chapter 3 of International GAAP 2026.

The balances derecognised upon the initial application of IFRS 20 would include balances recognised previously under IFRS 14. The requirement to recognise any net difference in equity means that no adjustment is made to the carrying amounts of goodwill from any previous business combination.

10.4 Modified retrospective approach

An entity applying the modified retrospective approach may use one or more of the following transition reliefs *[IFRS 20.C9]*.:

- An entity may elect to apply the requirements for regulatory returns on assets not yet available for use (see section 4.5.1) only to assets that are not yet available for use at the transition date. *[IFRS 20.C10]*.
- An entity may elect to disregard any implied regulatory interest rates (see section 5.2) that would have been derived from the terms of the regulatory agreement before the transition date. *[IFRS 20.C11]*.
- An entity may use hindsight in applying the requirements in IFRS 20. For example, an entity may use hindsight when estimating the cash flows of a regulatory asset or a regulatory liability. *[IFRS 20.C12]*.

10.5 Interim reporting

This section is relevant if an entity applies IAS 34 *Interim Financial Reporting* in preparing condensed interim financial statements.

In the first year of applying IFRS 20, any interim financial statements include each heading and subtotal the entity expects to use in applying IFRS 20 in its annual financial statements. IFRS 20, therefore, overrides the requirement in IAS 34 that refers to the heading and subtotals of the most recent annual financial statements (that do not reflect the changes needed to apply IFRS 20). After it has issued its first set of annual financial statements prepared in accordance with IFRS 20, an entity applies the requirement in IAS 34 to include, at a minimum, each of the headings and subtotals that were included in its most recent annual financial statements in its condensed interim financial statements. *[IFRS 20.C14]*.

IFRS 20 overrides the requirement in IAS 34 that refers to the heading and subtotals of the most recent annual financial statements (that do not reflect the changes needed to apply IFRS 20).

Any interim financial statements prepared applying IAS 34 during the first year of applying IFRS 20, also need to include the following:

- Adjusted comparative information for the comparative interim period and the cumulative comparative interim period of the immediately preceding financial year. An entity is permitted, but not required to present adjusted comparative information for any earlier comparative interim periods and cumulative comparative interim periods presented.

- In the notes, the amounts previously presented for each line item in the financial statements for the comparative interim period and cumulative comparative interim period of the immediately preceding financial year. An entity is permitted, but not required to disclose such information for:
  - The current interim period and the cumulative current interim period; or
  - Any earlier interim periods before the comparative interim period and the cumulative comparative interim period of the immediately preceding financial year. *[IFRS 20.C15-16].*

The standard also addresses specifically the situation where an entity presents in its primary financial statements, or discloses in the notes, unadjusted comparative information for any earlier interim periods presented. In that case, IFRS 20 requires the entity to clearly identify the information that has not been adjusted, disclose that it has been prepared on a different basis, and explain that basis. *[IFRS 20.C17].*

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Appendix B: Defined terms

Extract from IFRS 20

Appendix A

Defined terms

This appendix is an integral part of the IFRS Accounting Standard.

allowable expense	An item of expense, as defined in IFRS Accounting Standards, for which a **regulatory agreement** provides compensation by adding an amount in determining a **regulated rate** to be charged by an entity.
allowed revenue	The total amount of compensation that a **regulatory agreement** entitles an entity to charge customers through **regulated rates** in a period.
chargeable income	An item of income, as defined in IFRS Accounting Standards, for which a **regulatory agreement** makes a deduction of an amount in determining a **regulated rate** to be charged by an entity.
regulated rate	A price determined by a **regulator** that an entity charges for goods or services supplied to customers in a period.
regulator	A body that is required by law or regulation to apply a **regulatory agreement** to determine a **regulated rate** (or a range for the **regulated rate**).
regulatory agreement	An agreement that creates a set of enforceable rights and enforceable obligations that prescribes how a **regulator** determines a **regulated rate** (or a range for the **regulated rate**).
regulatory asset	An enforceable present right, created by a **regulatory agreement**, to add an amount in determining a **regulated rate** to be charged to customers in future periods because part or all of the **total allowed compensation** for **regulatory goods or services** already supplied has not yet been included in revenue recognised from contracts with customers applying IFRS 15.
regulatory capital base	Assets and other items that a **regulatory agreement** entitles an entity to recover by adding an amount for **regulatory depreciation** in determining a **regulated rate** to be charged to customers.
regulatory depreciation	The systematic allocation by a **regulator** of an amount of a **regulatory capital base** to be added in determining a **regulated rate**.
regulatory expense	Expense arising from changes in a **regulatory asset** or a **regulatory liability**.
regulatory goods or services	Goods or services supplied by an entity to comply with a **regulatory agreement**.

regulatory income	Income arising from changes in a **regulatory asset** or a **regulatory liability**.
regulatory interest rate	The interest rate specified or implied by a **regulatory agreement** to provide compensation for the time period until recovery of a **regulatory asset** or to make a deduction for the time period until fulfilment of a **regulatory liability**.
regulatory liability	An enforceable present obligation, created by a **regulatory agreement**, to deduct an amount in determining a **regulated rate** to be charged to customers in future periods because part or all of the **total allowed compensation** for **regulatory goods or services** to be supplied in the future has already been included in revenue recognised from contracts with customers applying IFRS 15.
regulatory return	The return on the **regulatory capital base** resulting from the rate of return a **regulatory agreement** applies to a **regulatory capital base**.
total allowed compensation (for regulatory goods or services)	The amount of compensation to which a **regulatory agreement** entitles an entity for **regulatory goods or services** supplied in a reporting period. The amount might be charged through **regulated rates** in either the same period as the entity supplies the **regulatory goods or services**, or a different period.
Term defined in another IFRS Accounting Standard and used in this Standard with the same meaning	
customer (defined in IFRS 15)	A party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration.

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