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International Accounting Standards Board
Columbus Building, 7 Westferry Circus
Canary Wharf, London, E14 4HD
United Kingdom

Comments on the Exposure Draft *Regulatory Assets and Regulatory Liabilities*

To the IASB Board Members:

The Japanese Institute of Certified Public Accountants (“we” and “our”) appreciates the continued efforts of the International Accounting Standards Board on this project, and welcomes the opportunity to comment on the Exposure Draft *Regulatory Assets and Regulatory Liabilities* (“ED”).

We believe the development and application of the (draft) Standard for regulated assets and regulated liabilities would contribute to the improvement of financial information preparation by faithfully representing the effect of rate regulation. At the same time, we are concerned that the proposed scope is not clear enough in the ED. The Standard for rate regulation seems to be focusing on transactions under which quantity provided would not significantly change regardless of an increase or decrease in a regulated rate (i.e. ‘unit price’) determined under a regulatory agreement. In other words, we assume the Standard is developed for entities with a large number of customers. We believe the application scope should be explicitly stated in the Standard, stating that it is for entities having transactions with a large number of customers.

Further, the scope of a ‘regulatory agreement’ seems to be too wide in the proposed ED. To make it clear that a regulated rate determined under a regulatory agreement is

different from a price determined through general business activities, it should be clearly stated that the ED is applicable to regulatory agreements under which regulated rates are determined only when they are supported by 'laws and regulations or other rules.'

Lastly, according to paragraph 28 of the ED, if it is uncertain whether a regulatory asset or a regulatory liability exists, an entity shall recognise the regulatory asset or regulatory liability if it is more likely than not that it exists. If we can clarify the application scope and the definition of a 'regulatory agreement' as suggested above, then entities would need to use less judgement to determine the uncertainty of existence. We believe this would make it easier for entities to apply the ED.

Please find our comments to the questions raised in the ED, in the following pages.

Question 1—Objective and scope

Paragraph 1 of the Exposure Draft sets out the proposed objective: an entity should provide relevant information that faithfully represents how regulatory income and regulatory expense affect the entity's financial performance, and how regulatory assets and regulatory liabilities affect its financial position.

Paragraph 3 of the Exposure Draft proposes that an entity apply the [draft] Standard to all its regulatory assets and all its regulatory liabilities. Regulatory assets and regulatory liabilities are created by a regulatory agreement that determines the regulated rate in such a way that part of the total allowed compensation for goods or services supplied in one period is charged to customers through the regulated rates for goods or services supplied in a different period (past or future).¹ The [draft] Standard would not apply to any other rights or obligations created by the regulatory agreement—an entity would continue to apply other IFRS Standards in accounting for the effects of those other rights or obligations.

Paragraphs BC78–BC86 of the Basis for Conclusions describe the reasoning behind the Board's proposals. They also explain why the Exposure Draft does not restrict the scope of the proposed requirements to apply only to regulatory agreements with a particular legal form or only to those enforced by a regulator with particular attributes.

- (a) Do you agree with the objective of the Exposure Draft? Why or why not?
- (b) Do you agree with the proposed scope of the Exposure Draft? Why or why not? If not, what scope do you suggest and why?
- (c) Do you agree that the proposals in the Exposure Draft are clear enough to enable an entity to determine whether a regulatory agreement gives rise to regulatory assets and regulatory liabilities? If not, what additional requirements do you recommend and why?
- (d) Do you agree that the requirements proposed in the Exposure Draft should apply to all regulatory agreements and not only to those that have a particular legal form or those enforced by a regulator with particular attributes? Why or why not? If not, how and why should the Board specify what form a regulatory agreement should have, and how and why should it define a regulator?
- (e) Have you identified any situations in which the proposed requirements would affect activities that you do not view as subject to rate regulation? If so, please describe the situations, state whether you have any concerns about those effects and explain what your concerns are.
- (f) Do you agree that an entity should not recognise any assets or liabilities created by a regulatory agreement other than regulatory assets and regulatory liabilities and

other assets and liabilities, if any, that are already required or permitted to be recognised by IFRS Standards?

Comment:

(a) We agree with the proposal.

By faithfully representing the effect of rate regulation, we believe the development and application of the (draft) Standard would contribute to the improvement of financial information.

(b) We disagree with the proposal.

We do not think the proposed scope is clear enough in the ED. It appears the proposed scope is based on an assumption that the Standard is applicable to entities with a large number of customers, which should be explicitly stated in the scope of the ED.

(c) We disagree with the proposal.

The scope of a ‘regulatory agreement’ seems to be too wide in the proposed ED. The Standard should clearly state that a regulated rate is strictly limited to a price determined under ‘laws and regulations or other rules’ and is different from a price determined through general business activities.

(d) We agree with the proposal.

We do not think it is appropriate to limit the requirements to a specific industry or situation. Further, an accounting treatment should not be determined based on how far the market is influenced by a business activity, such as monopoly and oligopoly.

A regulatory agreement is defined in the ED to be enforceable. We agree enforceable regulatory agreements should not be limited to those that have a particular legal form or those enforced by a regulator with particular attributes.

Question 2—Regulatory assets and regulatory liabilities

The Exposure Draft defines a regulatory asset as an enforceable present right, created by a regulatory agreement, to add an amount in determining a regulated rate to be charged to customers in future periods because part of the total allowed compensation for goods or services already supplied will be included in revenue in the future.

The Exposure Draft defines a regulatory liability as an enforceable present obligation, created by a regulatory agreement, to deduct an amount in determining a regulated rate to be charged to customers in future periods because the revenue already recognised

includes an amount that will provide part of the total allowed compensation for goods or services to be supplied in the future.

Paragraphs BC36–BC62 of the Basis for Conclusions discuss what regulatory assets and regulatory liabilities are and why the Board proposes that an entity account for them separately.

- (a) Do you agree with the proposed definitions? Why or why not? If not, what changes do you suggest and why?
- (b) The proposed definitions refer to total allowed compensation for goods or services. Total allowed compensation would include the recovery of allowable expenses and a profit component (paragraphs BC87–BC113 of the Basis for Conclusions). This concept differs from the concepts underlying some current accounting approaches for the effects of rate regulation, which focus on cost deferral and may not involve a profit component (paragraphs BC224 and BC233–BC244 of the Basis for Conclusions). Do you agree with the focus on total allowed compensation, including both the recovery of allowable expenses and a profit component? Why or why not?
- (c) Do you agree that regulatory assets and regulatory liabilities meet the definitions of assets and liabilities within the Conceptual Framework for Financial Reporting (paragraphs BC37–BC47)? Why or why not?
- (d) Do you agree that an entity should account for regulatory assets and regulatory liabilities separately from the rest of the regulatory agreement (paragraphs BC58–BC62)? Why or why not?
- (e) Have you identified any situations in which the proposed definitions would result in regulatory assets or regulatory liabilities being recognised when their recognition would provide information that is not useful to users of financial statements?

Comment:

- (a) We agree with the proposal.

In order to solve the issue of ‘cost deferral,’ we understand the proposal applies the so-called ‘revenue approach,’ whose concept is based on the ‘recovery’ of future revenue. Accordingly, we support the proposal, which seems to be more reasonable as a solution.

- (b) We agree with the proposal.

We agree that the total allowed compensation should include not only the recovery of allowable expenses but also a profit component because, in accordance with a

regulatory agreement, a regulatory asset represents an increase in revenue in the future for goods or services already supplied and a regulatory liability as a deduction of already-recognised revenue in future periods.

(c) We agree with the proposal.

According to the IASB's conclusion in paragraphs BC39 for regulatory assets and BC45 for regulatory liabilities, we agree that they meet the definitions of assets and liabilities.

Question 3—Total allowed compensation

Paragraphs B3–B27 of the Exposure Draft set out how an entity would determine whether components of total allowed compensation included in determining the regulated rates charged to customers in a period, and hence included in the revenue recognised in the period, relate to goods or services supplied in the same period, or to goods or services supplied in a different period. Paragraphs BC87–BC113 of the Basis for Conclusions explain the reasoning behind the Board's proposals.

- (a) Do you agree with the proposed guidance on how an entity would determine total allowed compensation for goods or services supplied in a period if a regulatory agreement provides:
- (i) regulatory returns calculated by applying a return rate to a base, such as a regulatory capital base (paragraphs B13–B14 and BC92–BC95)?
 - (ii) regulatory returns on a balance relating to assets not yet available for use (paragraphs B15 and BC96–BC100)?
 - (iii) performance incentives (paragraphs B16–B20 and BC101–BC110)?
- (b) Do you agree with how the proposed guidance in paragraphs B3–B27 would treat all components of total allowed compensation not listed in question 3(a)? Why or why not? If not, what approach do you recommend and why?
- (c) Should the Board provide any further guidance on how to apply the concept of total allowed compensation? If so, what guidance is needed and why?

Comment:

(a) We are against the proposed guidance.

The calculation of total allowed compensation should be conducted based on the nature of rate regulation. Thus, we do not think the proposed guidance is useful enough for illustrating a detailed calculation.

(b) We do not support the proposed guidance for the same reason as mentioned above.

(c) We do not think any further guidance is required.

Question 4—Recognition

Paragraphs 25–28 of the Exposure Draft propose that:

- an entity recognise all its regulatory assets and regulatory liabilities; and
- if it is uncertain whether a regulatory asset or regulatory liability exists, an entity should recognise that regulatory asset or regulatory liability if it is more likely than not that it exists. It could be certain that a regulatory asset or regulatory liability exists even if it is uncertain whether that asset or liability will ultimately generate any inflows or outflows of cash. Uncertainty of outcome would be addressed in measurement (Question 5).

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

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

(b) Do you agree that a ‘more likely than not’ recognition threshold should apply when it is uncertain whether a regulatory asset or regulatory liability exists? Why or why not? If not, what recognition threshold do you suggest and why?

Comment:

(a) We agree with the proposal.

Regulated rates can be adjusted in future periods by recognising all regulatory assets and regulatory liabilities.

(b) We do not agree with the proposal.

If the Standard requires a regulatory asset and regulatory liability should be recognised based on ‘laws and regulations or other rules,’ we can say that their existence is confirmed. In such cases, a ‘more likely than not’ recognition threshold need not be introduced.

Question 5—Measurement

Paragraph 29 of the Exposure Draft specifies the measurement basis. Paragraphs 29–45 of the Exposure Draft propose that an entity measure regulatory assets and regulatory liabilities at historical cost, modified by using updated estimates of future

cash flows. An entity would implement that measurement basis by applying a cash-flow-based measurement technique. That technique would involve estimating future cash flows—including future cash flows arising from regulatory interest—and updating those estimates at the end of each reporting period to reflect conditions existing at that date. The future cash flows would be discounted (in most cases at the regulatory interest rate—see Question 6). Paragraphs BC130–BC158 of the Basis for Conclusions describe the reasoning behind the Board’s proposals.

(a) Do you agree with the proposed measurement basis? Why or why not? If not, what basis do you suggest and why?

(b) Do you agree with the proposed cash-flow-based measurement technique? Why or why not? If not, what technique do you suggest and why?

If cash flows arising from a regulatory asset or regulatory liability are uncertain, the Exposure Draft proposes that an entity estimate those cash flows applying whichever of two methods—the ‘most likely amount’ method or ‘expected value’ method—better predicts the cash flows. The entity should apply the chosen method consistently from initial recognition to recovery or fulfilment. Paragraphs BC136–BC139 of the Basis for Conclusions describe the reasoning behind the Board’s proposal.

(c) Do you agree with this proposal? Why or why not? If not, what approach do you suggest and why?

Comment:

(a) We agree with the proposal.

(b) We agree with the proposal only if the following is met.

For the purpose of measuring regulated rates, we believe the determination of whether or not to include cash flows arising from interest depends on each regulation. Therefore, to be more precise, we recommend adding the underlined wording to the ED: ‘including future cash flows arising from regulatory interest, if any.’

(c) We agree with the proposal.

When future cash flows are uncertain, the Board’s proposal to estimate the amount by using the most likely amount method or the expected value method, whichever better predicts the cash flows, is consistent with requirements in other IFRS Standards, including IFRS 15. Therefore, it appears reasonable that the Standard follows the existing measurement technique.

However, assuming a regulatory asset and regulatory liability would be recognised

based on ‘laws and regulations or other rules,’ it is unlikely that a significant uncertainty about recovery would arise. Thus, in practice, the expected value method using probability-weighted amounts might not be used frequently.

Question 6—Discount rate

Paragraphs 46–49 of the Exposure Draft propose that an entity discount the estimated future cash flows used in measuring regulatory assets and regulatory liabilities. Except in specified circumstances, the discount rate would be the regulatory interest rate that the regulatory agreement provides. Paragraphs BC159–BC166 of the Basis for Conclusions describe the reasoning behind the Board’s proposals.

(a) Do you agree with these proposals? Why or why not? If not, what approach do you suggest and why?

Paragraphs 50–53 of the Exposure Draft set out proposed requirements for an entity to estimate the minimum interest rate and to use this rate to discount the estimated future cash flows if the regulatory interest rate provided for a regulatory asset is insufficient to compensate the entity. The Board is proposing no similar requirement for regulatory liabilities. For a regulatory liability, an entity would use the regulatory interest rate as the discount rate in all circumstances. Paragraphs BC167–BC170 of the Basis for Conclusions describe the reasoning behind the Board’s proposals.

(b) Do you agree with these proposed requirements for cases when the regulatory interest rate provided for a regulatory asset is insufficient? Why or why not?

(c) Have you identified any other situations in which it would be appropriate to use a discount rate that is not the regulatory interest rate? If so, please describe the situations, state what discount rate you recommend and explain why it would be a more appropriate discount rate than the regulatory interest rate.

Paragraph 54 of the Exposure Draft addresses cases when a regulatory agreement provides regulatory interest unevenly by applying a series of different regulatory interest rates in successive periods. It proposes that an entity should translate those rates into a single discount rate for use throughout the life of the regulatory asset or regulatory liability.

(d) Do you agree with the proposal? Why or why not? If not, what do you recommend and why?

Comment:

(a) We do not agree with the proposal.

If the IASB plans to pursue the proposal to use a regulatory interest rate that a

regulatory agreement provides as for the discount rate, then we highly recommend the Board provide guidance for cases when a regulatory interest rate is not provided in a regulatory agreement. Also, we suggest the Board should provide a practical expedient exempting entities from discounting when the effects are insignificant.

We understand regulatory interest rates are not always provided in a regulatory agreement. It would be quite useful to provide guidance on how to determine the interest rate in such cases. Also, when regulatory assets are recovered and regulatory liabilities are fulfilled over a short period, such as within one year, a practical expedient exempting entities from discounting should be provided, considering the cost-benefit.

(b) We do not agree with the proposal.

If a regulatory interest rate is provided in a regulatory agreement, the rate should be used for discounting calculation purposes.

Question 7—Items affecting regulated rates only when related cash is paid or received

In some cases, a regulatory agreement includes an item of expense or income in determining the regulated rates in the period only when an entity pays or receives the related cash, or soon after that, instead of when the entity recognises that item as expense or income in its financial statements. Paragraphs 59–66 of the Exposure Draft propose that in such cases, an entity would measure any resulting regulatory asset or regulatory liability using the measurement basis that the entity would use in measuring the related liability or related asset by applying IFRS Standards. An entity would adjust that measurement to reflect any uncertainty that is present in the regulatory asset or regulatory liability but not present in the related liability or related asset. Paragraphs BC174–BC177 of the Basis for Conclusions describe the reasoning behind the Board’s proposals.

(a) Do you agree with the measurement proposals when items of expense or income affect regulated rates only when related cash is paid or received? Why or why not? If not, what approach do you suggest for such items and why?

When these measurement proposals apply and result in regulatory income or regulatory expense arising from remeasuring the related liability or related asset through other comprehensive income, paragraph 69 of the Exposure Draft proposes that an entity would also present the resulting regulatory income or regulatory expense in other comprehensive income. Paragraphs BC183–BC186 of the Basis for Conclusions

describe the reasoning behind the Board's proposal.

- (b) Do you agree with the proposal to present regulatory income or regulatory expense in other comprehensive income in this case? Why or why not? If not, what approach do you suggest and why?

Comment:

- (a) We do not support the measurement proposals.

The proposals would add more requirements to the current IFRS Standards, which would only complicate accounting treatments further. In addition, an item of expense or income could be affected by amounts measured under non-IFRS accounting standards in determining regulated rates, not when an entity pays or receives cash. In such cases, it is uncertain whether regulatory assets and regulatory liabilities would be recognised under the measurement proposals.

- (b) As we do not agree with the measurement proposals, we have no further comment.

Question 8—Presentation in the statement(s) of financial performance

Paragraph 67 of the Exposure Draft proposes that an entity present all regulatory income minus all regulatory expense as a separate line item immediately below revenue. Paragraph 68 proposes that regulatory income includes regulatory interest income and regulatory expense includes regulatory interest expense. Paragraphs BC178–BC182 of the Basis for Conclusions describe the reasoning behind the Board's proposals.

- (a) Do you agree that an entity should present all regulatory income minus all regulatory expense as a separate line item immediately below revenue (except in the case described in Question 7(b))? Why or why not? If not, what approach do you suggest and why?
- (b) Do you agree with the proposed inclusion of regulatory interest income and regulatory interest expense within the line item immediately below revenue? Why or why not? If not, what approach do you suggest and why?

Comment:

- (a) We agree with the proposal.

- (b) We agree with the proposal.

Question 9—Disclosure

Paragraph 72 of the Exposure Draft describes the proposed overall objective of the disclosure requirements. That objective focuses on information about an entity's regulatory income, regulatory expense, regulatory assets and regulatory liabilities, for reasons explained in paragraphs BC187–BC202 of the Basis for Conclusions. The Board does not propose a broader objective of providing users of financial statements with information about the nature of the regulatory agreement, the risks associated with it and its effects on the entity's financial performance, financial position or cash flows.

(a) Do you agree that the overall disclosure objective should focus on information about an entity's regulatory income, regulatory expense, regulatory assets and regulatory liabilities? Why or why not? If not, what focus do you suggest and why?

(b) Do you have any other comments on the proposed overall disclosure objective?

Paragraphs 77–83 of the Exposure Draft set out the Board's proposals for specific disclosure objectives and disclosure requirements.

(c) Do you have any comments on these proposals? Should any other disclosures be required? If so, how would requiring those other disclosures help an entity better meet the proposed disclosure objectives?

(d) Are the proposed overall and specific disclosure objectives and disclosure requirements worded in a way that would make it possible for preparers, auditors, regulators and enforcement bodies to assess whether information disclosed is sufficient to meet those objectives?

Comment:

(a) We agree with the proposal.

(b) No comment.

Question 10—Effective date and transition

Appendix C to the Exposure Draft describes the proposed transition requirements.

Paragraphs BC203–BC213 of the Basis for Conclusions describe the reasoning behind the Board's proposals.

(a) Do you agree with these proposals?

(b) Do you have any comments you wish the Board to consider when it sets the effective date for the Standard?

Comment:

- (b) We recommend the IASB carefully determine the mandatory effective date to allow sufficient time for entities in jurisdictions where no accounting requirements for rate regulation exists or where the practice of rate regulation accounting is quite different from the ED so that they are also well-prepared for the application.

Question 11—Other IFRS Standards

Paragraphs B41–B47 of the Exposure Draft propose guidance on how the proposed requirements would interact with the requirements of other IFRS Standards.

Appendix D to the Exposure Draft proposes amendments to other IFRS Standards.

Paragraphs BC252–BC266 of the Basis for Conclusions describe the reasoning behind the Board’s proposals.

- (a) Do you have any comments on these proposals? Should the Board provide any further guidance on how the requirements proposed in the Exposure Draft would interact with any other IFRS Standards? If yes, what is needed and why?
- (b) Do you have any comments on the proposed amendments to other IFRS Standards?

Comment:

(a) No comment.

(b) No comment.

Question 12—Likely effects of the proposals

Paragraphs BC214–BC251 of the Basis for Conclusions set out the Board’s analysis of the likely effects of implementing the Board’s proposals.

- (a) Paragraphs BC222–BC244 provide the Board’s analysis of the likely effects of implementing the proposals on information reported in the financial statements and on the quality of financial reporting. Do you agree with this analysis? Why or why not? If not, with which aspects of the analysis do you disagree and why?
- (b) Paragraphs BC245–BC250 provide the Board’s analysis of the likely costs of implementing the proposals. Do you agree with this analysis? Why or why not? If not, with which aspects of the analysis do you disagree and why?
- (c) Do you have any other comments on how the Board should assess whether the likely benefits of implementing the proposals outweigh the likely costs of implementing them or on any other factors the Board should consider in analysing the likely effects?

Comment:

No comment.

Question 13—Other comments

Do you have any other comments on the proposals in the Exposure Draft or on the Illustrative Examples accompanying the Exposure Draft?
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Comment:

No comment.

Yours faithfully,

Takako Fujimoto

Executive Board Member — Business Accounting Standards and Practice/Corporate Disclosure

The Japanese Institute of Certified Public Accountants