EB-2022-0200

Enbridge Gas Inc.

Application to change its natural gas rates and other charges beginning January 1, 2024

IGUA Compendium

Depreciation

GOWLING WLG

unregulated storage. Enbridge Gas engaged Ernst & Young LLP (EY) to assist management in its determination of the Company's harmonized unregulated storage allocation methodology. The aligned methodology for Enbridge Gas adopts the Union methodology of allocating general plant assets to unregulated storage. Further details, including impacts to 2024 Test Year depreciation expense are provided at Exhibit 1, Tab 13, Schedule 2.

3.5. Summary of Impacts of Harmonization of Depreciation Policies at Rebasing

33. Enbridge Gas is proposing a depreciation expense of $892 million for the 2024 Test Year. A comparison of the proposed depreciation rates and the provision for the 2024 Test Year is provided at Attachment 2. /u

4. Energy Transition Considerations

34. In developing the proposed depreciation rates, Enbridge Gas and Concentric considered the introduction of an Economic Planning Horizon (EPH) or truncation date to reflect the potential impact that energy transition could have on the economic life of Enbridge Gas's system.

35. Enbridge Gas and Concentric concluded that introducing an EPH is not appropriate at this time. As provided at Exhibit 1, Tab 10, Schedule 5, Section 3, there remains significant uncertainty around the impacts that energy transition could potentially have on Enbridge Gas's system. However, future depreciation studies may warrant the introduction of a regional or system wide EPH, as the energy transition unfolds and more information on the future utilization of Enbridge Gas's assets becomes available.

revenue requirement would increase by $1.5 billion and $93 million[17] respectively. The annual increase in revenue requirement thereafter is estimated to be $3.1 million;

b) Administrative costs required to set up, monitor and maintain the fund, and the administrative burden to access the funds would also increase costs;
c) Tax issues associated with establishing a fund are complex and would require significant legal and tax involvement to resolve;
d) Enbridge Gas has not identified any precedents in which a utility has voluntarily set up a segregated fund for SRC costs; and
e) Enbridge Gas does not expect a large-scale retirement of assets and anticipates that assets will be in use and useful for many years to come.

42. In addition to the above drawbacks, participants in the Customer Engagement Survey, as provided at Exhibit 1, Tab 6, Schedule 1, Attachment 1, page 9, were asked whether Enbridge Gas should have the flexibility to use reserves to avoid borrowing money. Participants expressed support in giving Enbridge Gas flexibility if it means potential savings for customers.

43. Enbridge Gas concludes that it is in the best interest of customers not to set up a segregated fund for SRC amounts at this point in time. As provided at Exhibit 1, Tab 10, Schedule 5, Enbridge Gas believes its system will be a key contributor to Ontario's ability to achieve net-zero. Additionally, Enbridge Gas does not anticipate that large sections of its system will be retired in the foreseeable future. Enbridge Gas may reconsider the establishment of a segregated fund in the future, in

[17] Assumes a SRC liability balance of $1.5 billion, a debt/equity ratio of 64/36, ROE of 8.34% and a tax gross up on ROE of 73.5%.

conjunction with the implementation of an EPH, as more information about the potential impact of energy transition becomes available.

6. Depreciation Schedules

42. Detailed depreciation schedules for the 2019 to 2024 period by plant account and rate zone are provided at Attachment 3.

CONCENTRIC ADVISORS

October 14, 2022

Enbridge Gas Inc.
500 Consumers Road
North York, ON
M2J1P8

Attention: Danielle Dreveny
Manager, Capital FP&A

Dear Ms. Dreveny;

Pursuant to your request, we have conducted a depreciation study related to the gas transmission, distribution and storage systems and related general plant of Enbridge Gas Inc. Our report presents a description of the methods used in the estimation of depreciation and net salvage, the statistical analysis of service life and the summary and detailed tabulations of annual and accrued depreciation.

We gratefully acknowledge the assistance of Enbridge Gas personnel in the completion of the review.

Should you have any questions or concerns, please do not hesitate to contact me directly at 587.997.6489

Yours truly,

Concentric Advisors, ULC

Larry E. Kennedy
Senior Vice President

Amanda Nori
Project Manager

LEK/ta
Project: 70079

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SECTION 1

1 STUDY HIGHLIGHTS

Pursuant to Enbridge Gas Inc.'s ("EGI" or the "Company") request, Concentric Advisors, ULC ("Concentric") conducted a depreciation study related to the gas distribution, transmission, storage and general plant accounts, as of December 31, 2021. The purpose of the study is to determine the annual depreciation accrual rates and amounts applicable to the original cost of gas utility plant, as of December 31, 2021. The Curriculum Vitae for Larry Kennedy has been attached as Appendix 3 to this report.

Enbridge Gas Distribution Inc. ("EGD") amalgamated with Union Gas Limited ("Union") to form EGI since the last depreciation studies for each company were completed. In this study the assets have been combined and depreciation parameters have been developed and depreciation rates calculated on the combined asset groups. As such, depreciation parameters, methodologies, and procedures from both the Union and EGD systems have been reviewed. The recommendations within this report are viewed by Concentric to be the most appropriate recommendations to be applied to the combined asset groups. This report recommends conversion to the use of the Equal Life Group ("ELG") procedure. The ELG procedure is similar to the Generation Arrangement procedure used in the previous Union study and represents a change from the Average Life Group for the EGD assets. Additionally Concentric recommends the use of amortization accounting for a small number of general plant asset groups, which represents a change in method for the EGD general plant assets. Concentric also recommends the use of the Constant Dollar Net Salvage ("CDNS") methodology of calculating net salvage accruals, as was used in the previous EGD study, and represents a change in salvage method for the Union assets.

The depreciation rates were applied on a Remaining Life basis, based on attained ages and estimated average service life and forecasted net salvage characteristics for each depreciable group of assets. Variances between the calculated accrued depreciation and the book accumulated depreciation, as at December 31, 2021, are amortized over the composite remaining life of assets.

Concentric recommends the calculated annual depreciation accrual rates set forth herein apply specifically to gas plant in service, as of December 31, 2021, summarized in Table 1 in Section 5 of this report by account detail. Supporting data and calculations are provided as well.

Finally, this study results in an annual depreciation expense accrual related to the recovery of original cost and net salvage requirement of $786.5 million, when applied to depreciable plant study balances, as of December 31, 2021, of $21.7 billion. The study results are summarized at an aggregate functional group level as follows:

SUMMARY OF ORIGINAL COST, ACCRUAL PERCENTAGES AND AMOUNTS

Plant Group	Original Cost	Annual Accrual	
Local Storage Plant	$33,641,115	1.16%	$390,705
Underground Storage Plant	$1,297,148,055	2.91%	$37,704,129
Transmission Plant	$4,449,654,239	2.33%	$103,839,505
Distribution Plant	$14,994,747,798	3.74%	$560,985,714
General Plant	$918,099,975	9.10%	$83,536,220
TOTAL DEPRECIABLE PLANT STUDY BALANCE	**$21,693,291,183**	**3.63%**	**$786,456,273**

SECTION 2

2 BASIS OF THE UPDATE

2.1 Scope

Concentric has been retained by EGI to develop reasonable and appropriate depreciation amounts based on plant in service as of December 31, 2021 and applied specifically to plant in service as of December 31, 2021 as summarized by Table 1. This report also describes the concepts, methods and judgments which underlie the recommended annual depreciation accrual rates. The rates and amounts are based on the Straight-Line method of depreciation, incorporating the ELG procedure applied on a Remaining Life basis.

Continued monitoring and maintenance of the accumulated depreciation reserve at the account level is recommended. Concentric has determined an amortization amount to adjust the present booked accumulated depreciation variance with the calculated accrued depreciation ("theoretical reserve") over the composite remaining life of each account. This adjustment mechanism, whether determined separately as an amortization amount or incorporated in the calculation of remaining life accruals, is widely accepted throughout North America. An explanation of the monitoring of the accumulated depreciation reserve and the calculation of the true-up provision is presented on page 4-4 of this report.

The Straight-Line method, ELG procedure is a commonly used depreciation calculation procedure that has been widely accepted in jurisdictions throughout North America and is described in detail in Section 3.1. Amortization accounting is used for certain accounts because of the disproportionate plant accounting effort required to process retirements in these accounts. Many regulated utilities in North America have received approval to adopt amortization accounting for these types of accounts.

The ELG procedure was specifically developed for use by rate regulated companies. The ELG procedure was popularized in a publication of the Iowa State University entitled "Depreciation of Group Properties – Bulletin 155" by Robley Winfrey in 1942. At the time of the publication of Bulletin 155, what is currently known as the Equal Life Group Procedure was at that time published as the "Unit Summation" Procedure. Initially, the use of the ELG procedure was somewhat limited because of the extremely large number of calculations that are required when this procedure is used. However, in the 1970's and more so in the 1980's this method became more popular due to the increased use of computerized software, rendering the number of calculations to be a non-issue. At that time, many regulated telephone companies adopted the use of the ELG procedure, including virtually all of the regulated telephone companies that were regulated by the Canadian Radio and Telecommunications Commission (CRTC). In the late 1980's many other utility sectors began to adopt the use of the ELG procedure throughout North America.

The use of the ELG Procedure enhances the generational equity to all toll payers when all relevant costs are considered. Furthermore, use of the ELG Procedure provides ratepayers an enhanced matching of the depreciation expense component of the revenue requirement to the consumption of the service value of assets providing utility service. As indicated by Robley Winfrey in Bulletin 155, "the unit summation procedure of the present worth method is shown to be the only mathematically correct method".

This study calculates the annual and accrued depreciation using the Straight-Line method and ELG procedure for most accounts. For certain general plant accounts, the annual and accrued depreciation are based on amortization accounting. Both types of calculations were based on original cost, attained ages and estimates of service lives. Variances between the calculated accrued depreciation and the book accumulated depreciation are amortized over the composite remaining life of each account.

Continued monitoring and maintenance of the accumulated depreciation reserve at the account level is recommended. Concentric has determined an amortization amount to adjust the present variance with the calculated accrued depreciation (theoretical reserve) over the composite remaining life of each account.

3.2 Economic Planning Horizon and Decarbonization

3.2.1 Concept of Economic Planning Horizon

The life of long-lived assets such as those comprising EGI's system can be restricted not only by physical forces of retirement such as wear and tear and physical deterioration, but also and to a much greater extent, by economic forces of retirement. Specifically, the changing North American marketplace for natural gas demand and the rapidly emerging trend of decarbonization legislation may have a significant impact on the estimated service lives of the EGI system.

There are several factors affecting the economic viability of the EGI system. Long life assets, such as natural gas storage, transmission and distribution systems, are subject to a number of different forces of economic retirement, including changes in legislation constricting the use of carbon-based fuels.

The concept referred to with the terms "economic planning horizon", "economic life", or "truncation date" (each of which have similar meaning within depreciation literature) is one of the parameters

that can be used to set depreciation rates that accurately reflect the annual consumption in service value. Appropriate depreciation rates also help to ensure that both long term intergenerational equity among customers and a reasonable opportunity for the recovery of investment are achievable.

The pipeline system will experience both interim and final retirement activity. Interim or ongoing retirements represent those retirements described by the interim survivor curve, which is commonly referred to as the Iowa curve. Terminal or final retirements represent those retirements described by the truncation of the interim survivor curve at the truncation date (or economic life). Interim retirements include retirements related to replacements that are primarily caused by wear and tear, deterioration, and technological obsolescence, i.e. the replacement of an item of equipment with a newer item with greater functionality. Terminal retirements include retirements related to the final abandonment of major components of the system caused by the economic obsolescence of the system. Such retirements are not expected to occur all at once. Rather, it is anticipated that there will be a relatively restricted period during which these major retirements will occur. In order to readily perform the mathematical calculations of average and remaining life, the timing of the terminal and final retirements is represented by a single point, the economic planning horizon (or life span date).

3.2.2 Decarbonization

On June 8th, 2016, the Office of the Ontario Premier Kathleen Wynne released its plan for a "low-carbon future" in its "Climate Change Action Plan". The action plan outlined Ontario's plan to begin phasing out natural gas for heating by providing incentives to retrofit buildings. This plan was replaced on November 29, 2018 with the Made-in-Ontario Environment Plan released by Premier Doug Ford. The Made-in-Ontario Environment Plan commits to reducing greenhouse gas emissions to 30 percent below 2005 levels by 2030.

EGI has responded to the Made-in-Ontario-Plan with a number of low carbon strategies, including a pilot program to test the blending of hydrogen, a voluntary RNG program, and the filing of a new DSM 2022-2027 Plan. The pilot program will provide EGI with a better understanding of the future use of hydrogen within the gas distribution system. These strategies will enable EGI to better plan for a lower carbon future.

In addition to the Made-in-Ontario Environment Plan, the Canadian federal government has passed a number of acts and regulations intended to bring Canada in line with Paris Accord. Prime Minister Justin Trudeau signed the Canadian Net-Zero Emissions Accountability Act on June 30, 2021. This act sets the goal of 2030 greenhouse gas emissions being 40-45 percent below 2005 levels by 2030. Further, there is the requirement that greenhouse gas emission goals be set for 2035, 2040, and 2045 at least ten years in advance. Ultimately, the goal is for Canada to attain net-zero emissions by 2050. It is noted that both the cities of Hamilton and Toronto have made net-zero commitments independent of federal or provincial mandates.

The federal government notes that the movement to hydrogen may be an important step in order to achieve a net-zero emissions target by 2050. The federal government has created a fund intended to increase production of low-carbon fuels, including hydrogen and renewable natural gas. The use of

hydrogen and renewable natural gas may have a significant impact on the business of EGI in the foreseeable future.

3.2.3 Economic Planning Horizon Recommendations

While there is strong evidence that the future of natural gas in Ontario may be impacted by climate change legislation, it is still unknown to what extent this change will impact EGI's system. The introduction of hydrogen may have a life lengthening impact on the system if it is determined that hydrogen is a sustainable replacement fuel. The same may be true of renewable natural gas or other low carbon fuels. However, it may also be true that the move from carbon based fuels necessitates a greater electrification, in which case there may be a life shortening impact on some or all of the EGI system.

The future growth and retirement programs of the EGI system may be significantly different than the retirement patterns witnessed in the past. While future retirements that are caused by physical forces of retirement such as wear and tear and changes in technology of the assets will continue, it is reasonable to anticipate that the utilization of large groups of assets may change due to the implementation of climate change legislation. Consistent with the reduction in the utilization of the assets, it could be assumed that large scale retirement of assets may be required in the periods between now and 2050.

Common depreciation practice is to deal with the anticipated large scale retirements through the introduction of an economic planning horizon within the depreciation rate calculations. However, at this time the future impacts of the relevant climate change legislation have not been sufficiently studied, nor have specific programs been put into place that would provide indications of the changes in the utilization levels. Concentric views that additional study of the changes is required before the introduction of a Life Span date for the EGI system into the depreciation rate calculations. While such an introduction will cause a significant increase in the depreciation rate, Concentric notes that future depreciation studies of the EGI system may require the introduction of an EPH into the depreciation rate calculations. Concentric has attached Appendix 1 that shows the depreciation rate calculations using the same recommended depreciation parameters as the current study, with the introduction of a 2050 EPH. While Concentric is not recommending this move at this time, the calculations are provided as an example of what would be expected if a 2050 EPH were approved.

3.3 Estimation of Survivor Curves and Net Salvage

3.3.1 Survivor Curves

The use of an average service life for a property group implies that the various units in the group have different lives. Thus, the average life may be obtained by determining the separate lives of each of the units, or by constructing a survivor curve plotting the number of units which survive at successive ages using the retirement rate method of analysis.

The range of survivor characteristics usually experienced by utility and industrial properties is encompassed by a system of generalized survivor curves known as Iowa type curves. The Iowa curves *"...were sorted into three groups according to whether the mode was to the left, approximately coincident with, or to the right of the average-life ordinate. The curves in each of these three groups*

ENBRIDGE GAS INC.

Answer to Interrogatory from
Ontario Energy Board Staff (STAFF)

Interrogatory

Reference:

Ref 1: Exhibit 4, Tab 5, Schedule 1, pp. 3-4
Ref 2: Exhibit 4, Tab 5, Schedule 1, Attachment 1 – Depreciation Study

Question(s):

In Schedule 1 Enbridge Gas discusses depreciation methods and procedures used in the Depreciation Study.

a) Please confirm that the proposed methodology uses the ELG procedure (other than accounts that use amortization accounting), with a Remaining Life technique.

b) Please confirm that the depreciation study has generally adopted EGD's depreciation methodologies generally (straight-line method, group procedures, remaining life technique, CDNS net salvage) but with two exceptions: First, the ELG procedure rather than the Average Life Group/Average Service Life (ALG/ASL) procedure. Second, the use of amortization accounting for some groups of assets. If not confirmed, please provide a detailed explanation as to why this is not confirmed.

c) EGD previously used the ALG method, and other Ontario utilities (e.g. Ontario Power Generation in EB-2020-0290 and Hydro One Networks Inc. in EB-2021-0110) use the ALG method of depreciation. Please provide a detailed rationale for the adoption of the ELG procedure rather than the ALG procedure. Please include an explanation on whether there are circumstances specific to Enbridge Gas that renders the ALG method of depreciation less appropriate, or the ELG method more appropriate.

d) Please provide examples, if Enbridge Gas or Concentric are aware, of utilities that use the ELG method, the ALG method, or the Generation Arrangement method, in North America, specifically noting which use a Whole Life technique and which use a Remaining Life technique.

e) Please provide a version of the Concentric Depreciation Study's Table 1 (Concentric Depreciation Study page 5-2) and Section 8 for each of the following:
   i. Using the ALG procedure
   ii. Using the ELG procedure with a Whole Life technique

iii. Using the ELG Procedure with a Whole Life technique, with remaining lives calculated on the basis the ALG procedure.

Response:

The following response has been provided by Concentric Energy Advisors, Inc.:

a) Confirmed.

b) Confirmed.

c) This study incorporated the use of the Equal Life Group (also known as "Unit Summation") procedure. In this procedure, the plant account is subdivided according to the estimated remaining service lives within the account. The relative size and life expectancy of each equal life group is determined from the survivor curve for the plant account. This results in each equal life group having the same life characteristics as a single unit of plant. In the Equal Life Group (ELG) procedure, the cost of each unit of plant is theoretically fully accrued by the time of its retirement.

The ELG procedure has long been recognized as the most precise procedure by depreciation authorities, and has been advocated in various texts, periodicals and technical papers. Particularly, this procedure received favorable attention in Iowa Bulletin 155 published in 1942 stating:

> "The unit summation procedure of the present worth method is shown to be the only mathematically correct method. It is not admitted that more than one correct method exists for applying an average life ratio to property groups when estimating depreciation. Recognition is given, however, to the convenience of the average-life and probable life procedures at the sacrifice of the accuracy in the mathematical calculations."[1]

The Average Service Life (ASL) procedure was widely used through to the late 1970's, due mainly to the extensive data requirements and mathematical calculations required for ELG. With the development of computer programs to execute the ELG procedure, and as Plant Accounting systems were computerized, the complexity of the mathematical calculations and extensive data requirements became significantly less burdensome. Due to this increased ease of execution and the enhanced accuracy, several regulated companies have converted to ELG procedures since the early 1980's.

[1] Robley Winfrey; Depreciation of Group Properties; Engineering Research Institute; Iowa State University; Ames, Iowa; 1942, page 6.

The use of ELG provides a more equitable distribution of depreciation expense to the current users of the gas system because the provision for depreciation at any given time is based only on the assets in service at that time. Conversely, the ALG grouping procedures results in depreciation accruals that in later years contain an incremental component of depreciation expense to compensate for the lower levels of accruals in early years. This idiosyncrasy of ALG grouping procedures has long been recognized as a deficiency by various authorities on depreciation analysis.

Specifically in the circumstances of Enbridge Gas, the above generational equity concerns are particularly relevant given the energy policy requirements that are emerging in the natural gas utility sector. As such, the ELG calculations which more closely align the depreciation rates to the retirement dispersion patterns inherent in the Iowa curve selections, will lessen the impact to customers from any type of energy transition, thereby reducing the impact of potential future carbon-based energy policies. In contrast, the use of the ALG procedure for an electric distribution utility such as Hydro One incorporates less risk of intergenerational concerns for future customers. Overall, the introduction of fossil fuel restrictions will likely increase the demand upon electric utilities, thereby mitigating the capital expenditure impact that could be required by urban electric utilities. As such, this increased demand also mitigates the need to maintain the use of the Generation Arrangement or ELG procedures for an electric distribution utility such as Hydro One, or OPG.

With the harmonization of the legacy Enbridge Gas Distribution and Union Gas systems, a review of the appropriate depreciation procedure to be used for the combined company was conducted. Union Gas had historically used the Generation Arrangement procedure, which as noted at page 3-4 of the Concentric depreciation study report, closely aligns to the results of calculations made with the ELG procedure. Given the issues with the use of the Generation Arrangement as described at pages 3-3 and 3-4 of the Concentric depreciation study report, and that the Generation Arrangement requires retirement transactions through the entire life of the account, which was not available from legacy Enbridge Gas Distribution system the use of the Generation Arrangement procedure was not considered as a viable option. However, as the concepts inherent in the ELG procedure are closely aligned to the concepts inherent in the Generation Arrangement procedure, Concentric placed higher consideration on the ELG procedure when selecting the appropriate depreciation procedure.

Overall, Concentric views that the use of the ELG procedure for this EGI study has two significant advantages as compared to the use of the ALG procedure. Firstly, the use of the ELG procedure was the best available match to the historic procedures approved for Union Gas. Secondly, given the potential changes in use of fossil fuels and the unknown impact of such change on the Enbridge Gas system, the use of the ELG procedure best reduced the future risk of intergenerational inequity.

d) Concentric is aware of the following utilities using the ELG whole life method with variances in the accumulated depreciation trued up over the composite remaining life:

- FortisAlberta;
- ENMAX Power Corporation;
- APEX Utilities;
- ATCO Gas;
- AltaLink;
- ATCO Electric;
- City of Lethbridge;
- City of Red Deer;
- SaskEnergy;
- TransGas; and
- Yukon Electrical Company Limited.

Concentric is aware of the following utilities using the ELG remaining life method:

- Gazifere;
- IntraGaz;
- Eastward Energy; and
- NB Power.

Concentric is unable to confirm any utilities currently using the Generation Arrangement, however Concentric understands that it is widely used by Fosters & Associates in the United States.

The majority of remaining studies in Canada are completed using the ALG method with either a whole life or remaining life true up. ALG Remaining Life is also the most widely used method within the United States.

e)

i. Please see Attachment 1 for Table 1 and Attachment 2 for Section 8 using the ALG Remaining Life procedure.

ii. & iii. Please see Attachment 3 for Table 1 and Attachment 4 for Section 8 using the ELG Whole Life procedure with remaining lives calculated on the basis of the ALG remaining life procedure. Doing the depreciation calculations using the ELG procedure with only ELG Whole Life used will not include any true up for accumulated depreciation variances, and as such, be incomplete. Therefore, Concentric has provided just the ELG Whole Life results with the ALG Remaining Life procedure.

EB-2022-0200 Depreciation Positions 2024 Impact Summary

A	B	C	D	E	F	G	H
		$ millions	Cite	Islolated Impact Revised Depreciation	Cummulative Impact Revised Depreciation	Isolated Revenue Requirement Impact	Cummulative Revenue Requirement Impact
1	EGI Proposed 2024 Depreciation Provision	$892.4	Ex4/T5/S1/Att2/p.8				
2	2023 Depreciation Provision	$771.6	Ex4/T5/S1/Att2/p.8				
3	2024 vs. 2023 EGI Proposed Increase	$120.8	Calculated			$160.4	$160.4
4	Impact of Replacing ELG with ALG	-$81.7	~~Ex I.4.5 Staff 170, Att. 1~~	$810.7	$810.7	?	?
5	Impact of Emrydia + Intergroup Average Life Estimate Changes (Using ALG)	-$238.1	~~Ex I.ADR.22~~	$654.3	$572.6	?	?
6	Impact on Discounted Net Salvage of WACC (@6.03%) vs. CARF (@3.75%)	-$62.7	~~Ex I.ADR.22~~	$829.7	$509.9	?	?

Depreciation, as used in accounting, is a method of distributing fixed capital costs, less net salvage, over a period of time by allocating annual amounts to expense. Each annual amount of such depreciation expense is part of that year's total cost of providing gas utility service. Normally, the period of time over which the fixed capital cost is allocated to the cost of service is equal to the period of time over which an item renders service - that is, the item's service life. The most prevalent method of allocation is to distribute an equal amount of cost to each year of service life. This method is known as the Straight-Line method of depreciation.

The calculation of annual and accrued depreciation based on the Straight-Line method requires the estimation of survivor curves and is described in the following sections of this report. The development of the proposed depreciation rates also requires the selection of group depreciation procedures, as discussed below.

3.1.1 Study Depreciation Methods and Procedures

3.1.1.1 Group Depreciation Procedures

When more than a single item of property is under consideration, a group procedure for depreciation is appropriate because normally all of the items within a group do not have identical service lives, but have lives that are dispersed over a range of time. There are two primary group procedures, namely, Average Life Group ("ALG") and Equal Life Group ("ELG"). The Generation Arrangement, discussed below, is a lesser used procedure and is similar in nature to ELG.

3.1.1.2 Average Life Group and Equal Life Group Procedures

The difference in calculation of depreciation expense derived from ELG and ALG can best be explained with the use of a simple example.

Assume one plant account with a total cost of $2,000 is comprised of two subgroups of assets, each with an original cost of $1,000. The first group has a life of 5 years, while the second group has a life of 15 years.

Under both procedures the average life of this plant account would equal 10 years (15 + 5)/2. With the ALG procedure this average life would be used to determine the depreciation accruals for the first 5 years as follows:

($2,000 / 10 years) = $200 per year

The accrual for years 6 through 15 would be as follows:

($1,000 / 10 years) = $100 per year

Under the ELG procedure, the expense for each sub group is determined and then added together. Therefore for the first 5 years, the accrual would be as follows:

($1,000 / 5 years) + ($1,000 / 15 years) = $267 per year.

The accrual for years 6 through 15 would be as follows:

($1,000 / 15 years) = $67 per year.

The following table sets out the differences in the two methods:

Average Life Group Procedure				Equal Life Group Procedure			
Year	Accruals ($)	Retirements ($)	Acc. Deprn Balance ($)	Year	Accruals ($)	Retirements ($)	Acc. Deprn Balance ($)
1	200		200	1	267		267
2	200		400	2	267		534
3	200		600	3	267		801
4	200		800	4	267		1,068
5	200	1,000	0	5	267	1,000	335
6	100		100	6	67		402
7	100		200	7	67		469
8	100		300	8	67		536
9	100		400	9	67		603
10	100		500	10	67		670
11	100		600	11	66		736
12	100		700	12	66		802
13	100		800	13	66		868
14	100		900	14	66		934
15	100	1,000	0	15	66	1,000	0

It should be noted from the table that overall, both methods will recover the same original cost, however, there are two key differences. First, using the ALG procedure, after the first 5 years, no depreciation has been collected for the asset remaining in service. Essentially, the concept of depreciation expense matching the assets providing service is not met. With the ELG procedure, this problem is remedied and after the retirement at year 5 of the shorter life asset, an appropriate provision for the first 5 years of service on the longer living asset is accumulated ($67 X 5 years = $335). Under ELG all current users are sharing the cost of all assets in service.

Secondly, under ALG the customers using the last remaining assets are required to pick up an adjustment for the under accrual of depreciation expense during the early years of the account. This inter-generational inequity may potentially result in a situation at EGI where users in the later years of the system bear the cost of under accruals which benefited earlier users of the system.

Effectively, later users of the system would be subsiding previous users. With potential changes in the utility industry, future users of the facilities may be different from the current system users. This lack of stability may magnify the inter-generational inequity of the ALG procedure.

3.1.1.3 Generation Arrangement

The Generation Arrangement is a depreciation process that was commonly used in the telephone industry and that may be used to assist in the blending of past retirement experience with the expectations of future life characteristics. In its most pure form, the Generation Arrangement can be used with the ELG method; however, in the more typical usage, and the manner in which Union has

historically used it, the Generation Arrangement is a stand-alone depreciation method used to calculate the annual depreciation accrual rate and amount.

An excerpt from "Public Utility Depreciation Practices" as published by the Subcommittee on Depreciation of the Finance and Technology Committee of the National Association of Regulatory Utility Commissioners has been attached to this report as Appendix 2. This appendix details the calculations underlying the Generation Arrangement.

The largest difference between the Generation Arrangement and other depreciation methodologies is the role of the historical retirement transactions. ELG and ALG do not consider historical retirements in the determination of a depreciation rate, instead, historical retirements are only considered through the selection of the average service life and Iowa curve. Remaining Life ELG and Remaining Life ALG calculate depreciation on the net book amount, calculated as total plant in service less accumulated depreciation. Generation Arrangement ignores the accumulated depreciation amount and instead calculates the depreciation rate through the use of historical retirements and additions. While this should theoretically end up with a very similar outcome to Remaining Life ELG, in practice the accumulated depreciation fund is often skewed by historical true ups and other events over the long history of the account.

The necessity of actual historical experience leads to the Generation Arrangement being impractical for utilities without recorded retirements going back to the inception of the account. It is possible to simulate retirement transactions using generally accepted methods, however the resulting depreciation rate becomes closer to a whole life calculation in this circumstance. In situations where historical records are unavailable, the ELG method with the use of the remaining life procedure results in a more accurate depreciation rate.

While undergoing the selection of a depreciation methodology for this study, Concentric calculated the depreciation expense in a single EGI account using both the Generation Arrangement and ELG remaining life, in order to test the difference between ELG and Generation Arrangement. The EGD services account, with an original cost of $3.3 billion was calculated using the Iowa 55-S1. For ease of calculations, there was no net salvage used. The Generation Arrangement resulted in a depreciation amount of $61.4 million, while the ELG remaining life resulted in an amount of $63.6 million, a difference of 3.6 percent. The calculation summary of both is attached as Appendix 2.

While there is a small increase in depreciation expense when using ELG versus Generation Arrangement, the ELG calculations better match the actual historical and future experience of the plant in service. The lack of historical retirement experience for Union assets requires the Generation Arrangement to use simulated retirement data, which results in a less accurate depreciation rate than either the ALG or ELG calculations.

3.1.1.4 Recommendation of Group Procedure

The EGD depreciation studies have historically been completed using the ALG procedure, while the Union studies have used the Generation Arrangement procedure. As previous studies were completed using different procedures, it was essential to review the procedures and recommend a single best option for the combined assets. As ELG more accurately reflects the actual life of the assets used, Concentric is recommending the movement to ELG at this time.

The ELG procedure was specifically developed for use by rate regulated companies. The ELG procedure was popularized in a publication of the Iowa State University entitled "Depreciation of Group Properties – Bulletin 155" by Robley Winfrey in 1942. At the time of the publication of Bulletin 155, what is currently known as the Equal Life Group Procedure was at that time published as the "Unit Summation" Procedure. Initially, the use of the ELG procedure was somewhat limited because of the extremely large number of calculations that are required when this procedure is used. However, in the 1970's and more so in the 1980's this method became more popular due to the increased use of computerized software, rendering the number of calculations to be a non-issue. At that time, many regulated telephone companies adopted the use of the ELG procedure, including virtually all of the regulated telephone companies that were regulated by the Canadian Radio and Telecommunications Commission (CRTC). In the late 1980's many other utility sectors began to adopt the use of the ELG procedure throughout North America.

The use of the ELG Procedure enhances the generational equity to all toll payers when all relevant costs are considered. Furthermore, use of the ELG Procedure provides ratepayers an enhanced matching of the depreciation expense component of the revenue requirement to the consumption of the service value of assets providing utility service. As indicated by Robley Winfrey in Bulletin 155, "the unit summation procedure of the present worth method is shown to be the only mathematically correct method".

This study calculates the annual and accrued depreciation using the Straight-Line method and ELG procedure for most accounts. For certain general plant accounts, the annual and accrued depreciation are based on amortization accounting. Both types of calculations were based on original cost, attained ages and estimates of service lives. Variances between the calculated accrued depreciation and the book accumulated depreciation are amortized over the composite remaining life of each account.

Continued monitoring and maintenance of the accumulated depreciation reserve at the account level is recommended. Concentric has determined an amortization amount to adjust the present variance with the calculated accrued depreciation (theoretical reserve) over the composite remaining life of each account.

3.2 Economic Planning Horizon and Decarbonization

3.2.1 Concept of Economic Planning Horizon

The life of long-lived assets such as those comprising EGI's system can be restricted not only by physical forces of retirement such as wear and tear and physical deterioration, but also and to a much greater extent, by economic forces of retirement. Specifically, the changing North American marketplace for natural gas demand and the rapidly emerging trend of decarbonization legislation may have a significant impact on the estimated service lives of the EGI system.

There are several factors affecting the economic viability of the EGI system. Long life assets, such as natural gas storage, transmission and distribution systems, are subject to a number of different forces of economic retirement, including changes in legislation constricting the use of carbon-based fuels.

The concept referred to with the terms "economic planning horizon", "economic life", or "truncation date" (each of which have similar meaning within depreciation literature) is one of the parameters

ENBRIDGE GAS INC.

Answer to Interrogatory from
Industrial Gas Users Association (IGUA)

Interrogatory

Reference:

Exhibit 4, Tab 5, Schedule 1, Attachment 1, page 3-3.

Preamble:

Concentric provides an example in a table comparing the ELG and ALG procedure, and concludes: *First, using the ALG procedure, after the first 5 years, no depreciation has been collected for the asset remaining in service. Essentially, the concept of depreciation expense matching the assets providing service is not met.*

Question(s):

a) Please confirm that the example may not properly reflect the results of a mass property account where a significant portion of a vintage of assets are retired at or after the average service life, and over a relatively short period of time. For example, if 95% of the vintage of assets are retired at approximately year 50, does Concentric agree that the difference under ELG and ALG would be less significant. If not confirmed, please explain.

b) Notwithstanding the simplified example provided by Concentric, does Concentric agree that while $1,000 of accumulated depreciation is removed under the ALG example in year 5, from an accounting perspective both assets were charged $100 of depreciation per year (i.e, $500 in total up to year 5), as opposed to just one asset being charged $1,000 of depreciation expense? For example, the asset that was retired would have in theory been charged $500 of depreciation expense ($100 per year) and would have negative accumulated depreciation of $500 with the retirement of $1,000 in year 5, whereas the second asset would also have $500 of depreciation accumulated. If not confirmed, please reconcile the above with the required accounting entries to record mass property depreciation under US GAAP and best practices for regulated utilities.

c) Please confirm that the determination of depreciation under either ELG or ALG is an estimate. If not confirmed, please explain.

d) Please confirm that Concentric expects that future updates to the estimated lives of at least some of the asset classes will be required whether an ELG or ALG procedure is applied. If not confirmed, please explain.

e) Please confirm that adoption of the ELG procedure will increase the depreciation expense for EGI, all else being equal. If not confirmed, please explain.

f) Concentric has advised that EGI continues to consider the adoption of modified depreciation expense in the future to reflect an economic depreciation expense based on an economic planning horizon. Adoption of an economic planning horizon approach will truncate the lives of the assets and further increase depreciation expense as Concentric's calculations demonstrate. EGI is applying to increase depreciation expense by $193.9 million in 2024. Please quantify the portion of this increase that is related to the change from the ALG and generation arrangement procedures to ELG. Please also provide the detailed calculations in Excel showing the derivation of the change on an account-by-account basis.

Response:

The following response has been provided by Concentric:

a) Concentric agrees that the example provided in the depreciation report is a simplified example, used to explain the concept of Average Life Group versus Equal Life Group. For the impact of ALG on the Enbridge Gas depreciation study, please see response to Exhibit I.4.5-STAFF-173 part e).

b) Confirmed.

c) All depreciation parameters are an estimate, however the depreciation expense and rate that result from the estimates are based on mathematical formulas. As such, the depreciation expense and rates themselves are mathematically derived figures based on an underlying estimate.

d) Confirmed.

e) All straight line depreciation procedures accrue the same amount of depreciation expense over the life of the account. However, the immediate impact of a change to ELG for Enbridge Gas is an increase in the depreciation expense. This increase will lessen in later years, and eventually it is expected that the ELG procedure will result in lower accruals than ALG.

f) Concentric provided the depreciation expense using the ALG procedure in response at Exhibit I.4.5-STAFF-173 part e). It is expected that the change from the

Generation Arrangement results in minimal depreciation impact as the Generation Arrangement and ELG use very similar calculations. Due to the extraordinary amount of effort to perform the Generation Arrangement calculations for every account, Concentric has not included these calculations as part of this response.

Account 466

Cost of Removal Estimate	0.1
Average Age of Retirements	23.56 24
Credit Adjusted Risk Free Rate	3.75
Future Inflation Rate =	2

Age	Vintage	Original Cost	R/L	Net Salvage Requirement	Adjusted Original Cost	Adjusted Net Salvage Rate	Future Salvage Requirement	Discounted Salvage Requirement	CPI Ir	Age Adjust	Inflation Factor
51	1970	5,225,157.68		$ 522,515.77	22,043,633.96	0.02	$522,515.77	$522,515.77	6.8	1.6	4.21875
49	1972	6,694,440.19		$ 669,444.02	27,212,464.67	0.02	$669,444.02	$669,444.02	6.3	1.54	4.064935065
33	1988	3,767,639.42	3.06	$ 376,763.94	6,401,652.82	0.06	$400,300.25	$357,653.32	1.9	1.13	1.699115044
31	1990	29,064,577.31	3.76	$ 2,906,457.73	46,663,312.19	0.06	$3,131,126.81	$2,726,373.68	1.8	1.09	1.605504587
28	1993	4,270,487.16	5.16	$ 427,048.72	6,507,409.01	0.07	$472,992.56	$391,161.12	1.6	1.05	1.523809524
27	1994	6,598,676.71	5.73	$ 659,867.67	10,250,371.59	0.06	$739,155.54	$598,582.47	1.6	1.03	1.553398058
26	1995	11,074,974.21	6.35	$ 1,107,497.42	17,105,900.76	0.06	$1,255,896.40	$994,098.33	1.6	1.01	1.544554455
25	1996	41,359,020.59	7.00	$ 4,135,902.06	63,692,891.71	0.06	$4,750,851.42	$3,671,594.50	1.5	1	1.54
20	2001	2,237,627.66	10.66	$ 223,762.77	3,196,610.94	0.07	$276,353.93	$186,651.91	1.4	0.98	1.428571429
17	2004	1,108,053.64	13.14	$ 110,805.36	1,481,173.74	0.07	$143,736.49	$88,610.12	1.3	0.98	1.336734694
15	2006	6,339,908.87	14.91	$ 633,990.89	8,151,311.40	0.08	$851,748.89	$491,959.02	1.3	0.98	1.285714286
14	2007	81,039,112.91	15.82	$ 8,103,911.29	101,712,356.00	0.08	$11,085,349.64	$6,191,809.25	1.2	0.98	1.255102041
13	2008	80,181,083.22	16.75	$ 8,018,108.32	98,180,918.23	0.08	$11,171,842.29	$6,030,093.29	1.2	0.98	1.224489796
12	2009	1,978,036.78	17.69	$ 197,803.68	2,422,085.85	0.08	$280,783.38	$146,400.25	1.2	0.98	1.224489796
11	2010	5,756,021.34	18.64	$ 575,602.13	6,930,719.57	0.08	$832,586.95	$419,190.39	1.2	0.98	1.204081633
10	2011	17,185,515.58	19.60	$ 1,718,551.56	19,991,314.04	0.09	$2,533,529.31	$1,231,286.36	1.1	0.98	1.163265306
9	2012	33,368,237.21	20.58	$ 3,336,823.72	38,475,620.46	0.09	$5,015,622.00	$2,351,200.09	1.1	0.98	1.153061224
8	2013	1,949,552.75	21.55	$ 194,955.28	2,228,060.29	0.09	$298,723.02	$135,121.68	1.1	0.98	1.142857143
7	2014	6,525,504.74	22.54	$ 652,550.47	7,257,959.35	0.09	$1,019,675.49	$444,723.51	1.1	0.98	1.112244898
6	2015	203,461,376.38	23.53	$ 20,346,137.64	224,222,741.32	0.09	$32,422,314.91	$13,634,647.04	1.1	0.98	1.102040816
5	2016	153,100,505.79	24.52	$ 15,310,050.58	167,160,756.32	0.09	$24,880,140.99	$10,088,451.09	1.1	0.98	1.091836735
4	2017	235,646,157.74	25.51	$ 23,564,615.77	252,478,026.15	0.09	$39,052,671.16	$15,268,422.75	1.1	0.98	1.071428571
3	2018	2,388,189.10	26.51	$ 238,818.91	2,510,035.48	0.10	$403,700.48	$152,129.90	1	0.98	1.051020408
2	2019	620131.22	27.50	$ 62,013.12	639,114.83	0.10	$106,902.61	$38,843.24	1	0.98	1.030612245
1	2020	1,757,876.43	28.50	$ 175,787.64	1,793,751.46	0.10	$309,095.90	$108,251.08	1	0.98	1.020408163
0	2021	62,362,174.13	29.50	$ 6,236,217.41	62,362,174.13	0.10	$11,184,750.86	$3,775,523.74	1	0.98	1
		1,005,060,038.76		100,506,003.88	1,201,072,366.28		$153,811,811.06	$70,714,737.91			
				0.10	1.20		0.15	$0.07			

ENBRIDGE GAS INC.

ACCOUNT 466 - TRANSMISSION PLANT - COMPRESSOR EQUIPMENT
SUMMARY OF BOOK SALVAGE

Year	Regular Retirements	Net Salvage Amount	Net Salvage Percent	3-Year Amount	3-Year Percent	5-Year Amount	5-Year Percent	Historical Amount	Historical Percent
2010	61,532	92,837	151					92,837	0
2011	415,862	(829,015)	-199					-368,089	0
2012	3,785,219	973,053	26	78,958	6			78,958	0
2013	812,316	136,290	17	93,443	6			93,291	0
2014	2,154,337	(31,670)	-1	359,224	16	68,299	5	68,299	0
2015		0		34,873	4	49,732	3	68,299	0
2016	199,097	(682)	0	-10,784	-1	215,398	15	56,802	5
2017	537,959	0	0	-227	0	20,788	3	56,802	4
2018	1,945,218	0	0	-227	0	-6,470	-1	56,802	3
2019		(1,033,363)		-344,454	-42	-206,809	-39	-98,936	-7
2020		(1,035,041)		-689,468	-106	-413,817	-77	-215,949	-17
2021		(1,037,633)		-1,035,346	0	-621,207	-125	-307,247	-28
TOTAL	**9,911,540**	**-2,765,225**	**(27.90)**						

In order to recognize that the funds collected in current periods will not be expensed until potentially many years into the future, a discount calculation back to present day is required. In this manner, the fact that the utility has received the benefit of the funds as working capital through the inclusion of the requirement into the current period revenue requirements is recognized. Concentric discounted the future requirements by EGI's current credit adjusted risk free (CARF) rate at the time the calculation was completed of 3.78%, rounded to 3.75%. The use of a CARF is consistent with the discount rates mandated by accounting standards for Asset Retirement Obligations (ARO) for financial statement disclosure, and for estimating the discount rate in Securitization calculations. The use of a CARF rate is consistent with the evidence of interveners in the last Incentive Regulation Proceeding and applications made by Group 1 pipelines to the Canadian Energy Regulator (CER). As such Concentric included a discount rate of 3.75% in the CDNS calculations.

3.3.4 Survivor Curve and Net Salvage Judgments

The service life and net salvage estimates used in the depreciation and amortization calculations were based on informed professional judgment which incorporated a review of management's plans, policies and outlook, a general knowledge of the natural gas industry, and comparisons of the service life and net salvage estimates from Concentric's studies of other gas utilities. The use of survivor curves, to reflect the expected dispersion of retirement, provides a consistent method of estimating depreciation for gas plant. Iowa type survivor curves were used to depict the estimated survivor curves for the plant accounts not subject to amortization accounting.

The procedure for estimating service lives consisted of compiling historical data for the plant accounts or depreciable groups, analyzing this history through the use of widely accepted techniques, and forecasting the survivor characteristics for each depreciable group on the basis of interpretations of the historical data and the probable future. The forecasting of a probable future included management and operational staff interviews. The combination of the historical experience and the probable future yielded estimated survivor curves from which the average service lives were derived.

The resultant depreciation rates are summarized in Table 1 of this study (Section 5). The depreciation rates should be reviewed periodically to reflect the changes that result from plant and reserve account activity. A depreciation reserve deficiency or surplus will develop if future capital expenditures vary significantly from those anticipated in this study.

The estimates of net salvage for the mass property accounts were based in part on historical data related to actual retirement activity for the years 1983 through 2021, for most accounts. Gross salvage and cost of removal as recorded to the depreciation reserve account and related to experienced retirements were used. The estimates for net salvage for the gas plant were based on a current cost estimate of the required costs of retirement of the assets, which was inflated to the estimated end of life date of each asset group. Percentages of the cost of plant retired were calculated for each component of net salvage on an annual, three-year, five-year, and on a cumulative moving average basis.

The following discussion, dealing with a number of accounts which comprise the majority of the investment analyzed, presents an overview of the factors considered by Concentric in the determination of the average service life and net salvage estimates. The survivor curve estimates for

January 2021

IFRS® Standards
Exposure Draft ED/2021/1

Regulatory Assets and Regulatory Liabilities

Comments to be received by 30 July 2021

Comment deadline changed from 30 June 2021

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Exposure Draft

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CONTENTS

[Draft] IFRS X *Regulatory Assets and Regulatory Liabilities* is set out in paragraphs 1–85 and appendices A–D. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Terms defined in Appendix A are in *italics* the first time that they appear in the [draft] Standard. Definitions of other terms are given in the Glossary for IFRS Standards. The [draft] Standard should be read in the context of its objective and the Basis for Conclusions, the *Preface to IFRS Standards* and the *Conceptual Framework for Financial Reporting*. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Introduction

Why is the Board publishing this Exposure Draft?

Rate regulation can significantly affect the amount and timing of an entity's revenue, profit and cash flows by specifying:

(a) how much compensation an entity is entitled to charge customers ('total allowed compensation') for goods or services supplied in a period; and

(b) when the entity can include that compensation in the regulated rates charged.

In some cases, a difference in timing arises when the regulatory agreement implementing rate regulation specifies that part of the total allowed compensation for goods or services supplied in a period is included in determining the regulated rates for goods or services supplied in a different period (past or future).

Financial statements prepared applying IFRS Standards already provide users of financial statements with useful information about an entity's revenue from supplying goods or services, the cost of those goods or services, and other expenses incurred in a period. That information, however, does not give users an understanding of how those differences in timing affect the relationship between an entity's revenue and expenses.

A summary of the proposals in this Exposure Draft

The International Accounting Standards Board (Board) is proposing an accounting model to supplement the information that an entity already provides by applying IFRS Standards. The proposed model is based on the principle that an entity should reflect the total allowed compensation for goods or services supplied in a period as part of its reported financial performance for that period. To implement that principle, an entity would recognise in its statement of financial position:

(a) regulatory assets—enforceable present rights to add an amount in determining future regulated rates because part of the total allowed compensation for goods or services already supplied will be included in revenue in the future; and

(b) regulatory liabilities—enforceable present obligations to deduct an amount in determining future regulated rates 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.

As a result, an entity would recognise in its statement(s) of financial performance:

(a) regulatory income to depict a part of the total allowed compensation for goods or services supplied in the current period that was included in revenue in past periods, or will be included in revenue in future periods; and

(b) regulatory expense to depict an amount included in revenue in the current period that provides part of the total allowed compensation for goods or services that were supplied in past periods, or will be supplied in future periods.

An entity would measure regulatory assets and regulatory liabilities on a modified historical cost basis reflecting updated estimates of future cash flows that will arise from those assets and liabilities.

The information produced by implementing the Board's proposals, together with the information required by other IFRS Standards, would enable users of financial statements to understand:

(a) the relationship between an entity's revenue and expenses as completely as would have been possible if the total allowed compensation for the goods or services supplied had been fully reflected in revenue in the period in which the entity supplied those goods or services. That understanding will provide insights into the entity's prospects for future cash flows.

(b) the entity's regulatory assets and regulatory liabilities. That understanding will provide insights into how regulatory assets and regulatory liabilities will affect the amount, timing and uncertainty of the entity's future cash flows.

If finalised as a new IFRS Standard, the Board's proposals would replace IFRS 14 *Regulatory Deferral Accounts*, an interim Standard that permits a variety of accounting approaches for the effects of rate regulation to continue temporarily.

Who would be affected by the proposals?

The Board's proposals would, if implemented, affect entities subject to a regulatory agreement that is capable of creating regulatory assets and regulatory liabilities. For users of financial statements, the Board expects that application of the proposals would result in financial statements providing a clearer and more complete picture of the relationship between the revenue and expenses of those entities. Paragraphs BC214–BC251 of the Basis for Conclusions describe the likely effects of the Board's proposals.

Next step

The Board will consider comment letters and other feedback from its consultations on the Exposure Draft and will then decide whether to issue an IFRS Standard to replace IFRS 14 and whether to make any changes from the proposals in finalising such a Standard.

Invitation to comment

The Board invites comments on the proposals in the Exposure Draft, particularly on the questions set out below. Respondents need not comment on all the questions. Comments are most helpful if they:

(a) address the questions as stated;

(b) indicate the specific paragraph(s) to which they relate;

(c) contain a clear rationale;

(d) identify any wording in the proposals that is difficult to translate; and

(e) include any alternative the Board should consider, if applicable.

Questions for respondents

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?

1 A regulatory agreement is defined in the Exposure Draft as a set of enforceable rights and obligations that determine a regulated rate to be applied in contracts with customers.

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?

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?

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?

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?

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?

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?

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?

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?

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?

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?

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?

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?

Deadline

The Board will consider all written comments received by 30 July 2021. The deadline was changed from 30 June 2021.

How to comment

Please submit your comments electronically:

Online	https://www.ifrs.org/projects/open-for-comment/
By email	commentletters@ifrs.org

Your comments will be on the public record and posted on our website unless you request confidentiality and we grant your request. We do not normally grant such requests unless they are supported by a good reason, for example, commercial confidence. Please see our website for details on this policy and on how we use your personal data.

[Draft] International Financial Reporting Standard X *Regulatory Assets and Regulatory Liabilities*

Objective

1 This [draft] Standard sets out the principles for the recognition, measurement, presentation and disclosure of *regulatory assets, regulatory liabilities*, regulatory income and regulatory expense. The objective of those principles is for an entity to 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.

2 This information, together with information required by other IFRS Standards, enables users of financial statements to understand:

(a) the relationship between an entity's revenue and expenses as completely as would have been possible if the *total allowed compensation* for the goods or services supplied had been fully reflected in revenue in the period in which the entity supplied those goods or services. That understanding will provide insights into the entity's prospects for future cash flows.

(b) the entity's regulatory assets and regulatory liabilities. That understanding will provide insights into how regulatory assets and regulatory liabilities will affect the amount, timing and uncertainty of the entity's future cash flows.

Scope

3 **An entity shall apply this [draft] Standard to all its regulatory assets and all its regulatory liabilities.**

4 A regulatory asset is 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.

5 A regulatory liability is 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.

6 By definition a regulatory asset or a regulatory liability can exist only if:

(a) an entity is party to a regulatory agreement (see paragraphs 7–9);

(b) the regulatory agreement determines the regulated rate the entity charges for the goods or services it supplies to customers (see paragraphs 10–12); and

(c) 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) (see paragraphs 13–17).

Regulatory agreement

7 A regulatory agreement is a set of enforceable rights and obligations that determine a regulated rate to be applied in contracts with customers.

8 The practices for establishing regulatory agreements vary between jurisdictions and between industries. For example, a regulatory agreement may take the form of:

(a) a contractual licensing agreement between an entity and a regulator;

(b) a service concession arrangement; or

(c) a set of rights and obligations specified by statute, legislation or regulations.

9 Whether rights and obligations in a regulatory agreement are enforceable is a matter of law. Regulatory decisions or court rulings may provide evidence about the enforceability of those rights and obligations.

Regulated rates, total allowed compensation and revenue

10 A regulated rate is a price for goods or services, determined by a regulatory agreement, that an entity charges its customers in the period when it supplies those goods or services.

11 Total allowed compensation for goods or services supplied is the full amount of compensation for those goods or services that a regulatory agreement entitles an entity to charge customers through the regulated rates, in either the period when the entity supplies those goods or services or a different period.

12 The amount of revenue an entity recognises in a period applying IFRS 15 *Revenue from Contracts with Customers* depends on the regulated rates for goods or services the entity supplies in the period. That amount of revenue differs from the total allowed compensation for the goods or services supplied in that period if:

(a) differences in timing arise because the regulatory agreement includes part of that total allowed compensation in determining the regulated rates for goods or services supplied in a different period (past or future) (paragraphs 13–17); or

(b) the entity supplies goods or services in one period but, by applying IFRS 15, recognises part or all of the resulting revenue in a future period (paragraphs 18–19).

Differences in timing

13 To illustrate a difference in timing discussed in paragraph 12(a), assume that an entity's regulated rate for goods or services supplied in 20X1 was based on estimated input costs of CU100, but by the end of that year the entity recognised actual input costs in that year of CU120.[2] Assume also that the regulatory agreement gives the entity the right to add the resulting under-recovery of CU20 of those input costs in determining the regulated rate for goods or services to be supplied in 20X2; and that all amounts included in determining the regulated rates for goods or services supplied in a period are included in revenue in that same period.

14 Thus, the entity's revenue for 20X1 includes compensation of CU100 for the estimated input costs whereas the total allowed compensation for the goods or services supplied in 20X1 includes compensation of CU120 for the actual input costs. Compensation for the under-recovery of input costs of CU20 in 20X1 will be charged to customers through the regulated rates for goods or services to be supplied in 20X2, and hence will be included in revenue in 20X2. That compensation of CU20 is part of the total allowed compensation for the goods or services supplied in 20X1, not for those supplied in 20X2.[3, 4]

15 Consequently, in the circumstances discussed in paragraph 12(a) and illustrated in paragraphs 13–14, the amount of revenue recognised in a period by applying IFRS 15:

(a) does not include all of the total allowed compensation for the goods or services supplied in that period, because part of that total allowed compensation was already included in revenue in the past, or will be included in revenue in the future; or

(b) includes amounts that provide part of the total allowed compensation for goods or services supplied in a different period (past or future).

16 Applying IFRS 15 does not result in an entity providing information about the amounts described in paragraph 15(a)–(b). To supplement the information an entity provides by applying IFRS 15, this [draft] Standard adopts the principle that an entity shall reflect the total allowed compensation for goods or services supplied as part of its reported financial performance for the period in which those goods or services are supplied. To apply that principle, an entity shall recognise:

(a) regulatory income to depict a part of the total allowed compensation for goods or services supplied in the current period that was included in revenue in past periods, or will be included in revenue in future periods;

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2 Monetary amounts are denominated in 'currency units' (CU).

3 Depending on the requirements of the regulatory agreement, the total allowed compensation for goods or services might also include other components, such as *target profit*, as discussed in paragraphs B10–B20.

4 For simplicity, this example ignores regulatory interest.

(b) regulatory expense to depict an amount included in revenue in the current period that provides part of the total allowed compensation for goods or services that were supplied in past periods, or will be supplied in future periods;

(c) a regulatory asset to depict the entity's enforceable present right to add an amount in determining the 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; and

(d) a regulatory liability to depict the entity's enforceable present obligation to deduct an amount in determining the 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.

17 Paragraphs B3–B27 specify how an entity shall 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—and thus whether those components affect profit or loss in the same period or a different period.

Other differences relating to revenue recognition

18 In some instances, an entity supplies goods or services to a customer but is required not to recognise part or all of the resulting revenue until a future period. That happens when, for example:

(a) the entity does not yet account for a contract within the scope of IFRS 15 because the criteria in paragraph 9 of that Standard are not yet met; or

(b) estimates of variable consideration are constrained until related uncertainty is resolved (paragraph 56 of IFRS 15).

19 In those instances, one or both of the following consequences might arise:

(a) the total allowed compensation for goods or services already supplied has been fully charged through the regulated rates for those goods or services, but a part of that total allowed compensation will not be reflected in revenue until a future period. In that case, because the entity has no right to add that part in determining a future regulated rate, the definition of a regulatory asset is not met.

(b) an amount has been included in determining the regulated rates for goods or services already supplied, but that amount is not included in revenue already recognised. In that case, because that amount is not included in revenue already recognised, the definition of a regulatory liability is not met.

Rights and obligations that are not regulatory assets and regulatory liabilities

20 This [draft] Standard specifies only how to account for regulatory assets and regulatory liabilities. An entity shall apply other IFRS Standards in accounting for the effects of all other rights and obligations created by a regulatory agreement.

21 A regulatory asset permits an entity to increase future regulated rates only because of goods or services already supplied. A regulatory liability obliges an entity to decrease future regulated rates only because of amounts already included in revenue. A right to increase future regulated rates, or an obligation to decrease them, for any other reason, is not a regulatory asset or a regulatory liability.

22 An entity that is not subject to a regulatory agreement is typically able to increase the prices of its goods or services at any time. That ability does not create an asset similar to a regulatory asset, because that ability does not create an enforceable present right to increase the prices with the aim of recovering from current or future customers a fixed or determinable amount as a result of goods or services already supplied.

23 Similarly, an entity that is not subject to a regulatory agreement may have an economic incentive to decrease its prices. That economic incentive does not create a liability similar to a regulatory liability, because that economic incentive does not create an enforceable present obligation to decrease the prices with the aim of deducting a fixed or determinable amount in determining the prices that current or future customers will be charged in the future as a result of an amount already included in revenue.

Unit of account

24 An entity shall account for the right or obligation arising from each individual difference in timing described in paragraph 12(a) as a separate unit of account. However, if rights, obligations, or rights and obligations arising from the same regulatory agreement have similar expiry patterns and are subject to similar risks, they may be treated as arising from the same individual difference in timing.

Recognition

25 An entity shall recognise:

(a) all regulatory assets and all regulatory liabilities existing at the end of the reporting period; and

(b) all regulatory income and all regulatory expense arising during the reporting period.

26 Paragraph 78 lists the main components and causes of regulatory income and regulatory expense.

27 An entity determines whether a regulatory asset or regulatory liability exists using judgement considering all relevant facts and circumstances, including any:

(a) confirmation from the regulator of amounts to be added or deducted in determining future regulated rates;

(b) explicit requirements or guidelines in the regulatory agreement;

(c) regulatory decisions or court rulings interpreting the regulatory agreement;

(d) evidence that *allowable expenses* have been incurred;

(e) evidence that performance criteria leading to a performance incentive bonus or penalty have been met or have not been met;

(f) direct precedents—the entity's experience with the regulator's interpretation of the regulatory agreement in similar circumstances;

(g) indirect precedents—such as the experience of other entities regulated by the same regulator, the decisions of other regulators or court rulings in similar circumstances;

(h) preliminary views expressed by the regulator; or

(i) advice from qualified and experienced legal or other advisors.

28 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.

Measurement

29 An entity shall measure regulatory assets and regulatory liabilities at historical cost, modified for subsequent measurement by using updated estimates of the amount and timing of future cash flows, except that an entity shall apply the requirements in paragraph 61 to the regulatory assets and regulatory liabilities described in paragraphs 59–60.

30 When applying paragraph 29, an entity shall use a cash-flow-based measurement technique that:

(a) includes an estimate of all future cash flows arising from a regulatory asset or regulatory liability (see paragraphs 31–45); and

(b) discounts those estimated future cash flows to their present value (see paragraphs 46–54).

Estimating future cash flows

31 When applying paragraph 30(a), an entity shall include all estimated future cash flows arising from a regulatory asset or regulatory liability, and only those cash flows.

32 In estimating the cash flows when applying paragraph 30(a), the entity shall consider all reasonable and supportable information that is available without undue cost or effort about past events and about conditions existing at the end of the reporting period, as well as current expectations about future conditions other than future changes in the regulatory agreement or in legislation.

33 Cash flows arising from a regulatory asset or a regulatory liability are cash flows that are within the boundary of a regulatory agreement and will arise from charging customers a regulated rate in future periods that:

(a) recovers the regulatory asset by including part of the total allowed compensation for goods or services supplied in past periods; or

(b) fulfils the regulatory liability by deducting amounts included in revenue recognised in past periods.

34 Cash flows are within the boundary of a regulatory agreement only if:

(a) those cash flows would result from an enforceable present right or an enforceable present obligation that the entity has at the end of the reporting period to add or deduct amounts in determining a future regulated rate; and

(b) that addition or deduction would occur on or before the latest future date at which that right or obligation permits the addition or requires the deduction.

35 Paragraphs B28–B40 provide guidance on determining the boundary of the regulatory agreement.

36 Cash flows arising from a regulatory asset or regulatory liability include cash flows from regulatory interest (paragraphs B21–B27). The cash flows from regulatory interest result only from the time lag until recovery of the regulatory asset or fulfilment of the regulatory liability. That time lag does not affect the amount of any other cash flows arising from a regulatory asset or regulatory liability, but does affect their timing and may affect their uncertainty.

37 There may be uncertainty about the amount or timing of the future cash flows that will arise from a regulatory asset or a regulatory liability. If those future cash flows are uncertain, an entity shall assess whether the entity bears that uncertainty or whether customers bear it. Customers bear the uncertainty if the regulatory agreement will adjust future regulated rates so that those rates reflect the outcome of the uncertainty, including regulatory interest sufficient to compensate or charge the entity for any change in the timing of the cash flows.

38 For example, future cash flows arising from a regulatory asset may be subject to credit risk—that is, the risk that some customers will not pay the amounts charged. In such a case:

(a) if customers bear the credit risk because the regulatory agreement treats amounts uncollected as allowable in determining regulated rates for a later future period, the entity shall include in its estimates of future cash flows the cash it will collect in that later future period.

(b) if the entity bears the credit risk, the entity shall estimate future cash flows after deducting an estimate of the amounts it might not be able to collect. As a result, the estimated amounts of those credit-risk-adjusted future cash flows may be lower than the amounts the entity will charge to customers, and consequently lower than the resulting revenue, because IFRS 15 generally requires that revenue recognised is not reduced by amounts that the entity might not be able to collect from a customer.

39 An entity shall estimate uncertain future cash flows using whichever of the following two methods the entity expects to better predict the cash flows:

(a) the 'most likely amount' method—this method provides an estimate of the single most likely amount in a range of possible outcomes (that is, possible cash flow amounts). This method may better predict the uncertain cash flows if the possible outcomes are clustered around one outcome or if there are only two possible outcomes and they differ widely.

(b) the 'expected value' method—this method provides an estimate of the sum of probability-weighted amounts in a range of possible outcomes. This method may better predict the uncertain cash flows if there is a wide range of more than two possible outcomes.

40 In assessing which of the methods described in paragraph 39 better predicts the uncertain cash flows, an entity shall also assess whether a better prediction will result from considering each regulatory asset and each regulatory liability separately, or from considering any of them together with other regulatory assets or regulatory liabilities.

41 An entity shall use one of the methods described in paragraph 39 for some regulatory assets or regulatory liabilities and the other method for other regulatory assets or regulatory liabilities if the entity expects that doing so will better predict the cash flows.

42 After applying one of the methods described in paragraph 39 an entity shall continue to apply that method until it has recovered the regulatory asset or fulfilled the regulatory liability.

43 An entity's estimates of future cash flows arising from a regulatory liability shall not reflect the entity's own non-performance risk.

44 An entity shall apply IAS 10 *Events after the Reporting Period* in assessing whether an event that occurred after the end of the reporting period provides evidence of conditions that existed at that date. Consequently, estimates of future cash flows shall not reflect changes in a regulatory agreement or related legislation that occurred after the end of the reporting period because such changes do not reflect the conditions that existed at the end of the reporting period.

Foreign currency amounts

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

Discounting estimated future cash flows

46 **An entity shall measure a regulatory asset or regulatory liability by discounting to their present value the future cash flows estimated by applying paragraphs 31–45.**

47 The estimated future cash flows are discounted. Consequently, an entity shall recognise regulatory interest income or regulatory interest expense over the life of the related regulatory asset or regulatory liability (paragraphs B21–B27).

The discount rate

48 **An entity shall use the *regulatory interest rate* for a regulatory asset or regulatory liability as the discount rate for that regulatory asset or regulatory liability, unless the regulatory interest rate for a regulatory asset is insufficient. Paragraphs 50–52 prescribe how to determine whether that rate is sufficient and what discount rate to use if it is insufficient.**

49 At initial recognition of a regulatory asset or regulatory liability, if the regulatory interest rate is also the discount rate, the present value of the estimated future cash flows equals the sum of the estimated future cash flows excluding the cash flows from regulatory interest. This result also holds in the case of subsequent measurement if the regulatory interest rate is also the discount rate and, in addition, the regulatory interest is recovered or fulfilled in the same period in which it accrues.

The discount rate—assessing sufficiency

50 On initial recognition of a regulatory asset, an entity shall assess whether there is any indication that the regulatory interest rate for a regulatory asset may be insufficient to compensate the entity for the time value of money and for uncertainty in the amount and timing of the future cash flows arising from that regulatory asset. If the regulatory agreement changes the regulatory interest rate subsequently (paragraph 58), the entity shall perform that assessment again at the date of that subsequent change.

51 If there are indications that the regulatory interest rate for a regulatory asset may be insufficient to provide the compensation described in paragraph 50, an entity shall estimate the minimum interest rate sufficient to provide that compensation. In such cases, the entity shall use, as the discount rate, the higher of:

(a) the regulatory interest rate; and

(b) that minimum interest rate.

52 There may be such indications if, for example, the regulatory interest rate provided for a regulatory asset is lower than:

(a) the regulatory interest rate provided for other regulatory assets in the same currency and having a similar maturity profile and subject to similar uncertainties; or

(b) the interest rate on loans in the same currency and having a maturity profile, credit risk, and terms and conditions similar to those of the regulatory asset, after deducting any part of that interest rate intended to recover the cost of servicing the loans and any estimated credit losses already included in the estimated cash flows. Such loans could be loans that the entity itself provides or other loans for which the interest rate is readily observable.

53 This [draft] Standard does not require an entity to assess whether the regulatory interest rate for a regulatory liability is sufficient. For a regulatory liability, an entity shall use the regulatory interest rate as the discount rate in all circumstances.

The discount rate—uneven regulatory interest rate

54 Sometimes a regulatory agreement provides or charges regulatory interest unevenly by specifying at initial recognition of a regulatory asset or regulatory liability a series of different regulatory interest rates for successive periods over the life of that regulatory asset or regulatory liability. At initial recognition of the regulatory asset or regulatory liability, an entity shall translate those uneven regulatory interest rates into a single discount rate that it shall use throughout the life of the regulatory asset or regulatory liability. In determining that single discount rate, an entity shall not consider possible future changes in the regulatory interest rate.

Subsequent measurement

55 **In measuring a regulatory asset or regulatory liability after its initial recognition, an entity shall at the end of each reporting period:**

(a) update the estimated amounts and timings of future cash flows arising from the regulatory asset or regulatory liability to reflect conditions existing at that date (paragraphs 56–57); and

(b) continue to use the discount rate determined at initial recognition, except as described in paragraph 58.

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

(a) recovery of part or all of the regulatory asset or fulfilment of part or all of the regulatory liability;

(b) accrual of regulatory interest not yet reflected in the regulated rates charged to customers; and

(c) 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.

57 Changes in facts and circumstances or new information include but are not limited to:

(a) resolution of an uncertainty—for example, confirmation that the entity has met or not met performance criteria or the outcome of court rulings;

(b) examinations or other actions by a regulator—for example:

(i) the regulator's agreement or disagreement with regulatory filings made by the entity or by other entities; or

(ii) the exercise of a cancellation option or the outcome of a renewal process.

(c) changes in the regulatory interest rate as described in paragraph 58;

(d) changes in the regulatory agreement or in legislation; or

(e) a change in the boundary of the regulatory agreement.

58 In some cases, a regulatory agreement changes the regulatory interest rate at regular or irregular intervals, or in some other way specified in the regulatory agreement (for example, by a link to a benchmark interest rate). A change in the regulatory interest rate changes the cash flows arising from a regulatory asset or regulatory liability. Consequently, when the regulatory interest rate changes, an entity shall:

(a) use the new regulatory interest rate to update the future cash flows estimated by applying paragraphs 31–45; and

(b) apply paragraphs 46–54 to determine the new discount rate as:

(i) the new regulatory interest rate provided by the regulatory agreement (if necessary, translated into a single discount rate applying paragraph 54); but

(ii) the new minimum interest rate determined by applying paragraphs 50–52 to reflect conditions existing at the date of the change in the regulatory interest rate, if that new minimum interest rate is higher than the new regulatory interest rate (for a regulatory asset only).

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

59 In some cases, a regulatory asset or regulatory liability arises because a regulatory agreement treats an item of expense or income as allowable or chargeable in determining the regulated rates only once an entity pays or receives the related cash, or soon after that, instead of when the entity recognises that item as expense or income in its financial statements by applying, for example, IAS 12 *Income Taxes*, IAS 19 *Employee Benefits* or IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

60 The cash flows arising from such a regulatory asset or regulatory liability are a replica of the cash flows arising from the liability or asset relating to that item of expense or income, except for the effect of any uncertainty present in the regulatory asset or regulatory liability but not present in the related liability or related asset. Examples of uncertainties that may not be present in the related liability or related asset are demand risk and credit risk.

61 An entity shall measure the regulatory asset and regulatory liability described in paragraphs 59–60 by:

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

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

62 For example, assume that an entity recognises a provision for environmental clean-up costs and a corresponding expense by applying IAS 37, and the regulatory agreement gives the entity the right to add those costs in determining the regulated rates, but only once it pays the related cash. Applying the requirements in paragraph 61, the entity recognises a regulatory asset when it recognises the environmental clean-up provision and the related expense. The entity measures the regulatory asset using the measurement basis used for the related provision by applying IAS 37, adjusted for any uncertainty present in the regulatory asset but not present in the related provision.

63 In the cases described in paragraphs 59–60:

(a) if the related liability or related asset is measured at present value, the amount of cash paid or received includes implicitly both the underlying expense or income and a finance component for the time lag until that payment or receipt. Moreover, the regulatory agreement does not identify regulatory interest as a separate part of the cash flows arising from the regulatory asset or regulatory liability. Consequently, the regulatory interest rate is not observable from the regulatory agreement. In such cases, the measurement basis used for the regulatory asset or regulatory liability determines the split between cash flows from regulatory interest and all other cash flows arising from the regulatory asset or regulatory liability. The regulatory interest rate is implicit in that split.

(b) if the related liability or related asset is not measured at present value, the regulatory interest rate is nil.

64 When paragraph 61 applies to a regulatory asset the regulatory interest rate implicit in the measurement of the regulatory asset provides sufficient compensation for the time value of money and for uncertainty in the amount and timing of the future cash flows arising from that regulatory asset until paragraph 66 applies. This is because the same rate is implicit or explicit in the measurement of the related liability.

65 In determining the adjustment in paragraph 61(b), an entity shall consider the effects of the uncertainty both on the estimated amount and timing of the future cash flows (paragraph 39) and, if applicable, on the price for bearing the risk that the amount or timing of the future cash flows may differ from that estimate.

66 An entity shall cease applying paragraph 61 when the entity pays or receives cash to settle the related liability or recover the related asset and from that date shall measure any remaining part of the regulatory asset or regulatory liability by applying paragraphs 31–58. If an entity derecognises the related liability or related asset for any other reason, but part or all of the regulatory asset or regulatory liability still exists, the entity shall measure the remaining part by applying paragraphs 29–58.

Presentation

Statement(s) of financial performance

67 An entity shall present in its statement(s) of financial performance all regulatory income minus all regulatory expense in a separate line item immediately below revenue, except as required by paragraph 69.

68 Regulatory income includes regulatory interest income and regulatory expense includes regulatory interest expense.

69 When an entity remeasures a regulatory asset or regulatory liability applying paragraph 61, the entity shall present the resulting regulatory income or regulatory expense in other comprehensive income to the extent that the regulatory income or regulatory expense results from remeasuring the related liability or related asset through other comprehensive income.

Statement of financial position

70 An entity shall present in its statement of financial position:

(a) line items for regulatory assets and regulatory liabilities.

(b) current and non-current regulatory assets, and current and non-current regulatory liabilities, as separate classifications by applying paragraphs 66 and 69 of IAS 1 *Presentation of Financial Statements*, except when the entity presents all assets and liabilities in order of liquidity.

71 An entity is permitted to offset regulatory assets and regulatory liabilities that form separate units of account only if the entity:

(a) has a legally enforceable right to offset those regulatory assets and regulatory liabilities by including them in the same regulated rate; and

(b) expects to include the amounts resulting from the recovery or fulfilment of those regulatory assets and regulatory liabilities in the same regulated rate for goods or services supplied in the same future period.

Disclosure

72 The overall objective of the requirements in paragraphs 74–85 is for an entity to disclose in the notes information about regulatory income, regulatory expense, regulatory assets and regulatory liabilities. This information, together with all other information provided in the financial statements, shall enable users of financial statements to understand:

(a) the relationship between an entity's revenue and expenses as completely as would have been possible if the total allowed compensation for the goods or services supplied had been fully reflected in revenue in the period in which the entity supplied those goods or services. That understanding will provide insights into the entity's prospects for future cash flows.

(b) the entity's regulatory assets and regulatory liabilities at the end of the reporting period. That understanding will provide insights into how regulatory assets and regulatory liabilities will affect the amount, timing and uncertainty of the entity's future cash flows.

73 The information described in paragraph 72(a) contributes to a better understanding of the relationship between an entity's revenue and expenses. That understanding contributes to providing insights into the entity's prospects for future cash flows over many periods. In contrast, the information described in paragraph 72(b) provides insights into a narrower set of future cash flows—those that will arise from the regulatory assets and regulatory liabilities that exist at the end of the reporting period.

74 An entity shall determine the level of detail necessary to satisfy the overall disclosure objective and the specific disclosure objectives in paragraphs 77, 79 and 82. If the information disclosed applying paragraphs 75–83 is insufficient to meet the disclosure objectives, an entity shall disclose additional information to satisfy those objectives.

75 An entity shall aggregate or disaggregate disclosures in a manner that does not obscure useful information either by including a large amount of insignificant detail or by aggregating items that have substantially different characteristics. Items whose characteristics may differ substantially include:

(a) items subject to substantially different risks or uncertainties; and

(b) items relating to the different revenue categories an entity discloses by applying paragraph 114 of IFRS 15.

76 The appropriate level of aggregation or disaggregation may differ for different pieces of information, and may depend on the nature of the information and on the disclosure objective that information would contribute to meeting.

77 An entity shall disclose information that enables users of financial statements to understand how the entity's financial performance was affected because part of the total allowed compensation for the goods or services supplied in one period was (or will be) included in determining the regulated rates, and hence included in revenue, for goods or services supplied in a different period.

78 To achieve the objective in paragraph 77, an entity shall disclose in the notes the following components of regulatory income or regulatory expense included in profit or loss:

(a) the part of the total allowed compensation for goods or services supplied in the current period that will be included in revenue in future periods (creating regulatory assets during the current period).

(b) the amount included in revenue in the current period that will provide part of the total allowed compensation for goods or services to be supplied in future periods (creating regulatory liabilities during the current period).

(c) the amount included in revenue in the current period that provides part of the total allowed compensation for goods or services supplied in past periods (recovering regulatory assets during the current period).

(d) the part of the total allowed compensation for goods or services supplied in the current period that was included in revenue in past periods (fulfilling regulatory liabilities during the current period).

(e) regulatory interest income on regulatory assets and regulatory interest expense on regulatory liabilities.

(f) changes in the carrying amount of a regulatory asset or regulatory liability caused by a change in the boundary of a regulatory agreement, and the reasons for that change in the boundary.

(g) remeasurements of regulatory assets and regulatory liabilities, and the reasons for the remeasurements.

79 An entity shall disclose information that enables users of financial statements to understand the entity's regulatory assets and regulatory liabilities at the end of the reporting period. That understanding will provide insights into how regulatory assets and regulatory liabilities will affect the amount, timing and uncertainty of the entity's future cash flows.

80 To achieve the objective in paragraph 79, an entity shall disclose in the notes:

(a) quantitative information, using time bands, about when it expects to recover the regulatory assets and fulfil the regulatory liabilities.

(b) the discount rate or ranges of discount rates used in measuring regulatory assets and regulatory liabilities at the end of the reporting period.

(c) the regulatory interest rate provided by the regulatory agreement for a regulatory asset, if the entity uses the minimum interest rate as the discount rate for that regulatory asset as a result of applying paragraphs 50–53.

(d) an explanation of how risks and uncertainties affect the recovery of regulatory assets or fulfilment of regulatory liabilities.

81 In disclosing the information required by paragraph 80(a), an entity shall:

(a) specify whether the amounts disclosed in the notes are undiscounted or discounted.

(b) use judgement to determine an appropriate number of time bands. For example, an entity might determine appropriate time bands to be:

(i) not later than one year;

(ii) later than one year and not later than three years;

(iii) later than three years and not later than five years; and

(iv) later than five years.

82 **An entity shall disclose information that enables users of financial statements to understand any changes in regulatory assets and regulatory liabilities that were not a consequence of regulatory income or regulatory expense.**

83 To achieve the objective in paragraph 82, an entity shall disclose in the notes a reconciliation from the opening to the closing carrying amounts of regulatory assets and regulatory liabilities.

Regulatory assets and regulatory liabilities measured applying paragraph 61

84 In considering what information to disclose about regulatory assets and regulatory liabilities measured applying paragraph 61, and how to disclose that information, an entity shall also consider what information to disclose about the related liabilities and related assets and how to disclose the information. Considering these matters together can help an entity explain clearly that the cash flows arising from such regulatory assets and regulatory liabilities are largely a replica of the cash flows arising from the related liabilities and related assets and that the discount rates, risks and remeasurements are largely the same.

85 For example, if a regulatory asset arises from pension costs and is measured applying paragraph 61, an entity will need to consider how to disclose the information required by this [draft] Standard and the information required by IAS 19 in a manner that shows: how regulatory income or regulatory expense includes amounts that counterbalance the effects of the pension costs

recognised; how the regulatory asset counterbalances the risks in the pension liability; and, if applicable, that the discount rate is the same for the regulatory asset as for the pension liability.

Appendix A
Defined terms

This appendix is an integral part of the [draft] IFRS Standard.

allowable expense	An expense, as defined in IFRS Standards, that a **regulatory agreement** entitles an entity to recover by adding an amount in determining a **regulated rate**.
chargeable income	An item of income, as defined in IFRS Standards, that the **regulatory agreement** obliges an entity to deduct in determining a **regulated rate**.
regulated rate (for goods or services)	A price for goods or services, determined by a **regulatory agreement**, that an entity charges its customers in the period when it supplies those goods or services.
regulatory agreement	A set of enforceable rights and obligations that determine a **regulated rate** to be applied in contracts with customers.
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 of the **total allowed compensation** for goods or services already supplied will be included in revenue in the future.
regulatory interest rate	The interest rate provided by a **regulatory agreement** to compensate an entity for the time lag until recovery of a **regulatory asset** or to charge the entity for the time lag 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 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.
total allowed compensation (for goods or services)	The full amount of compensation for goods or services supplied that a **regulatory agreement** entitles an entity to charge customers through the regulated rates, in either the period when the entity supplies those goods or services or a different period.
target profit	The profit that an entity is entitled to add in determining a **regulated rate**.

Appendix B
Application guidance

This appendix is an integral part of the [draft] IFRS Standard. It describes the application of paragraphs 1–85 and has the same authority as the other parts of the [draft] IFRS Standard.

B1 This appendix provides application guidance on:

(a) total allowed compensation (see paragraphs B2–B27);

(b) the boundary of a regulatory agreement (see paragraphs B28–B40); and

(c) interaction with other IFRS Standards (see paragraphs B41–B47).

Total allowed compensation

B2 Total allowed compensation comprises:

(a) amounts that recover allowable expenses minus *chargeable income* (see paragraphs B3–B9);

(b) *target profit* (see paragraphs B10–B20); and

(c) regulatory interest income and regulatory interest expense (see paragraphs B21–B27).

Amounts that recover allowable expenses minus chargeable income

B3 An allowable expense is an expense, as defined in IFRS Standards, that a regulatory agreement entitles an entity to recover by adding an amount in determining a regulated rate.

B4 If an expense is allowable under the terms of a regulatory agreement, that fact establishes that the expense relates to the supply of goods or services in some period. In applying this [draft] Standard, an entity shall treat that allowable expense as relating to the supply of goods or services in the period when the entity recognises the expense applying IFRS Standards. Thus, the amount that recovers that allowable expense forms part of total allowed compensation for goods or services supplied in that period. For example, if raw material costs are an allowable expense, the amount that recovers that allowable expense forms part of total allowed compensation for goods or services supplied in the period when an entity consumes the raw materials and thus recognises that consumption as an expense applying IAS 2 *Inventories*.

B5 The period when an entity recognises an allowable expense as an expense applying IFRS Standards may differ from the period in which the entity adds an amount that recovers the allowable expense in determining the regulated rate. Such differences in timing give rise to regulatory assets or regulatory liabilities—that is:

(a) if an entity has recognised an allowable expense as an expense by applying IFRS Standards, but the amount that recovers that expense has not yet been included in the regulated rates and so will be included in revenue in the future, the difference in timing gives rise to a regulatory asset; and

(b) if revenue already recognised includes an amount that recovers part of an allowable expense, but that allowable expense will be recognised as an expense in the future by applying IFRS Standards, the difference in timing gives rise to a regulatory liability.

B6 If an entity consumes an asset over two or more reporting periods in which the entity supplies goods or services, and the cost of the asset is recoverable under the terms of a regulatory agreement, the entity shall allocate that cost in determining the total allowed compensation for the goods or services supplied in each of those periods. In making this allocation, an entity shall use the judgements and estimates it made in applying other IFRS Standards.

B7 For example, IAS 16 *Property, Plant and Equipment* specifies how to allocate the depreciable amount of an item of plant on a systematic basis over its useful life. If a regulatory agreement allows an entity to recover the cost of an asset through the regulated rates charged to customers, the depreciation expense recognised in a period, by applying IAS 16, is an allowable expense and the amount that recovers that depreciation expense forms part of the total allowed compensation for goods or services supplied in the same period. That is the case even if, under the terms of the regulatory agreement, the recovery of the depreciation expense occurs in a different period—for example, if the regulatory agreement uses a longer or shorter period of recovery than the asset's useful life.

B8 In the example in paragraph B7, the remaining carrying amount of the item of plant depicts the cost of the unconsumed portion of that item. Amounts that recover this unconsumed portion will form part of the total allowed compensation for goods or services in the future as the entity recognises depreciation expense to depict the consumption of this portion.

B9 Some regulatory agreements may require an entity to deduct specified income recognised by applying IFRS Standards in determining the regulated rate. This [draft] Standard refers to such income as chargeable income. For example, an entity may be required to deduct a gain on disposal of an item of plant in determining the regulated rate charged to customers in a future period. If a regulatory agreement treats income as chargeable, that fact establishes that this income relates to the supply of goods or services in some period. In applying this [draft] Standard, an entity shall treat the amount of that chargeable income as reducing the total allowed compensation for the goods or services supplied in the period in which the entity recognises the income by applying IFRS Standards.

Target profit

B10 Target profit that a regulatory agreement entitles an entity to add in determining a regulated rate for goods or services supplied in a period forms part of the total allowed compensation for goods or services supplied in the same period, unless this section specifies a different treatment (see paragraphs B12, B15 and B17).

B11 This section discusses the main components of target profit:

(a) profit margins that vary with an allowable expense (see paragraph B12);

(b) regulatory returns (see paragraphs B13–B15); and

(c) performance incentives (see paragraphs B16–B20).

Profit margins that vary with an allowable expense

B12 In some cases, a regulatory agreement entitles an entity to recover the amount of an allowable expense incurred plus a profit margin that varies with the amount of the expense—for example, a fixed percentage mark-up on the expense. This component of target profit forms part of the total allowed compensation for goods or services supplied in the period when the entity recognises the underlying allowable expense as an expense by applying IFRS Standards.

Regulatory returns

B13 A significant component of an entity's target profit often consists of regulatory returns. Regulatory agreements typically determine the regulatory return for a period by specifying a return rate and a base to which that return rate applies. Common terms for such a base are 'regulatory capital base' or 'regulatory asset base', although other terms are also used. Some regulatory agreements specify more than one base, each with its own return rate. The items for which amounts are included in such a base are not necessarily recognised as assets or liabilities applying IFRS Standards, and a regulatory agreement does not necessarily measure assets or liabilities on the same basis as IFRS Standards. For example, the regulatory capital base might measure property, plant and equipment on a basis including an allocation of administrative overheads recognised as an expense by applying IAS 16, or including an inflation adjustment not reflected in an entity's financial statements prepared by applying IFRS Standards.

B14 Applying the guidance for target profit set out in paragraph B10, if the regulatory agreement entitles an entity to add regulatory returns in determining a regulated rate for goods or services supplied in a period, those regulatory returns form part of the total allowed compensation for goods or services supplied in the same period, except as specified in paragraph B15.

B15 Sometimes a regulatory return includes an amount determined by applying a specified return rate to a base containing a balance relating to an asset not yet available for use. That balance might be a separate base or part of a larger base. The return on that balance shall not be treated as forming part of the

total allowed compensation for goods or services supplied before the asset is available for use. Once the asset is available for use, the return on that balance forms part of total allowed compensation for goods or services supplied over the remaining periods in which the entity recovers the carrying amount of the asset through the regulated rates. An entity shall use a reasonable and supportable basis in determining how to allocate the return on that balance over those remaining periods and shall apply that basis consistently.

Performance incentives

B16 A regulatory agreement may provide an entity with various performance incentives to reward it for meeting performance criteria, or to penalise it for failing to meet performance criteria. These criteria could include, for example, targeted levels of service quality, reliability, or customer satisfaction, or may relate to the entity's performance in constructing an item of property, plant or equipment.

B17 Amounts relating to a performance incentive form part of or reduce the total allowed compensation for goods or services supplied in the period in which the entity's performance gives rise to the incentive. To determine what that period is, the entity shall consider the regulatory agreement's terms relating to the performance incentive, together with other facts and circumstances.

B18 Applying the guidance in paragraph B17, if the performance criteria test only an entity's performance of construction work, the performance incentive forms part of or reduces the total allowed compensation for goods or services supplied in the period in which that performance occurs. If the performance criteria test the performance of construction work but are also fully or partly conditional on the entity's performance when it subsequently supplies goods or services to customers using the asset being constructed, the conditional part of the performance incentive forms part of or reduces the total allowed compensation for those goods or services.

B19 If the performance criteria test an entity's performance over a time frame that is not yet complete, the entity shall estimate the amount of the performance incentive and determine the portion of that estimated amount that relates to the reporting period. That portion forms part of or reduces the total allowed compensation for the goods or services supplied in the reporting period. If, for example, an entity uses the 'most likely amount' method (paragraph 39) to estimate the amount of the performance incentive, and assesses that it is most likely that the entity will meet the performance criteria, the portion of the estimated amount of the performance incentive that relates to the reporting period forms part of the total allowed compensation for the goods or services supplied in the reporting period. An entity shall use a reasonable and supportable basis in determining that portion and shall apply that basis consistently.

B20 The regulatory agreement may determine a performance incentive (that is, a bonus or penalty) in several ways. For example, a bonus or penalty may be a fixed monetary amount (such as CU100), a formula (such as 1% of the amounts charged to customers during a specified period), or an increment or decrement to the return rate (such as an additional 1%) applied by the

regulatory agreement to a base for a specified period. Regardless of how a regulatory agreement determines the bonus or penalty, an entity shall estimate its monetary amount and use that monetary amount as an input in accounting for that bonus or penalty.

Regulatory interest income and regulatory interest expense

B21 Regulatory interest compensates or charges an entity for the time lag until recovery of a regulatory asset or fulfilment of a regulatory liability:

(a) a regulatory asset arises because part of the total allowed compensation for goods or services already supplied will be added in determining regulated rates in the future. Regulatory interest income is the component of total allowed compensation that compensates the entity for the time lag until it recovers the regulatory asset.

(b) a regulatory liability arises because 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. Regulatory interest expense is the (negative) component of the total allowed compensation that charges the entity for the time lag until it fulfils the regulatory liability.

B22 The present value of the estimated future cash flows included in measuring a regulatory asset or regulatory liability changes because of the passage of time. This effect is sometimes called the 'unwinding of the discount'. As the discount unwinds, an entity shall recognise regulatory interest income on a regulatory asset and regulatory interest expense on a regulatory liability.

B23 Sometimes, a regulatory agreement treats a regulatory asset or regulatory liability as a separate base and applies a regulatory interest rate to that base to determine the regulatory interest for that item. Such an approach is often applied to short-term and medium-term regulatory assets or regulatory liabilities, such as those arising from variances in input cost prices.

B24 In other cases, a regulatory agreement does not identify a regulatory asset or regulatory liability separately. Instead, the regulatory asset or regulatory liability forms part of a larger base, such as the regulatory capital base, and the regulatory agreement applies a return rate to the whole of that larger base. In such cases, that rate is the regulatory interest rate applied to that regulatory asset or regulatory liability. The larger base can be regarded as having three components: regulatory assets, regulatory liabilities and all other components of the larger base. Accordingly, the regulatory return provided on the larger base also has three components: regulatory interest income on those regulatory assets, regulatory interest expense on those regulatory liabilities and regulatory return on the rest of the larger base.

B25 An example illustrates the analysis set out in paragraph B24. A regulatory agreement provides for each period a return rate of 8% on the outstanding balance of the regulatory capital base at the beginning of that period. That outstanding balance at the start of the current period is CU1,000 and thus the

regulatory agreement entitles the entity to add a regulatory return of CU80 in determining regulated rates for goods or services supplied to customers during the current period. The outstanding balance of CU1,000:

(a) includes overheads of CU150 that were ineligible for capitalisation applying IAS 16 and so were recognised as an expense when incurred. The entity recognises its resulting right to increase future regulated rates as a regulatory asset.

(b) was determined by the regulatory agreement without adding an amount of CU250 that was charged to customers in advance to fund construction of an item of plant. The entity recognises its resulting obligation to decrease future regulated rates as a regulatory liability.

B26 The regulatory capital base of CU1,000 can be regarded as having three components—a regulatory asset arising from the overheads of CU150, a regulatory liability arising from the advance funding from customers of CU250, and a remaining component of CU1,100. Consequently, the regulatory return of CU80 (CU1,000 × 8%) on the outstanding regulatory capital base consists of:

(a) regulatory interest income of CU12 on the regulatory asset (CU150 × 8%);

(b) regulatory interest expense of CU20 on the regulatory liability (CU250 × 8%); and

(c) regulatory return of CU88 on the rest of the regulatory capital base (CU1,100 × 8%).

B27 If an entity has measured a regulatory asset or regulatory liability by applying paragraph 61, the regulatory interest rate is implicit in the measurement of the regulatory asset or regulatory liability (paragraph 63).

Boundary of a regulatory agreement

B28 The boundary of a regulatory agreement determines which estimated future cash flows an entity includes in measuring a regulatory asset or regulatory liability (paragraphs 33–34). The boundary of a regulatory agreement is the latest future date at which an entity has:

(a) an enforceable present right to recover a regulatory asset by increasing the regulated rate to be charged to customers; or

(b) an enforceable present obligation to fulfil a regulatory liability by decreasing the regulated rate to be charged to customers.

B29 To illustrate the discussion in paragraph B28, assume that in 20X1 an entity incurred an input cost variance of CU100 that the entity cannot recover until 20X3. Assume also that the entity assessed at the end of 20X1 that it does not have an enforceable present right to increase regulated rates after the end of 20X2 to recover that variance. Thus, at the end of 20X1 the boundary of the regulatory agreement was the end of 20X2. Because the cash flows that could result from recovering that variance fall beyond the boundary of the

regulatory agreement, the entity cannot include those cash flows in the measurement of any regulatory asset at the end of 20X1.

B30 An entity's present right to increase the regulated rate at a future date is enforceable only if:

(a) the regulatory agreement gives the entity the present right to supply goods or services at that future date; and

(b) no party apart from the entity has a right to cancel the regulatory agreement before that date without arranging compensation for the entity to recover its regulatory asset.

B31 Sometimes an entity has an enforceable right to renew a regulatory agreement. Such a right can give the entity a present right to supply goods or services at a future date covered by that renewal if no other party has an enforceable right to prevent the renewal without arranging compensation for the entity to recover its regulatory asset.

B32 An entity's present obligation to decrease the regulated rate at a future date is enforceable only if:

(a) the regulatory agreement imposes upon the entity a present obligation to supply goods or services at that future date; and

(b) the entity has no right to cancel the regulatory agreement before that date without compensating another party (for example, an incoming supplier) that will fulfil the regulatory liability.

B33 The boundary of a regulatory agreement can be affected by a right to renew the regulatory agreement or a right to cancel it. In assessing whether such a right affects the boundary of the regulatory agreement, an entity shall disregard a right held by any party if there are no circumstances in which that party has the practical ability to exercise that right.

B34 The holder of a right may not have the practical ability to exercise the right if, for example:

(a) the economic consequences of exercising the right are significantly more adverse for the holder than the consequences of not exercising it;

(b) exercising a right held by an entity would lead to that entity being liquidated or ceasing to trade; or

(c) exercising a right held by a regulator would lead to major disruption in the provision of an essential public service.

Compensation for cancellation of a regulatory agreement

B35 In some cases, a regulator or an entity has a right to cancel a regulatory agreement, but the regulatory agreement requires the regulator or the entity to provide or arrange compensation for regulatory assets that have not yet been recovered or for regulatory liabilities that have not yet been fulfilled. For example, the regulator, the entity or an incoming supplier of goods or services may be required to make a balancing payment.

B36 To the extent that the amounts of receipts or payments of such compensation depend solely on the monetary amount of unrecovered regulatory assets or unfulfilled regulatory liabilities, they are cash flows within the boundary of the regulatory agreement.

B37 If the cash flows arising from unrecovered regulatory assets or unfulfilled regulatory liabilities would differ depending on whether the regulatory agreement continues or is cancelled, the cash flows are uncertain and an entity shall apply the requirements in paragraph 39. For example, assume that the probability of cancellation is 10% and a regulatory agreement specifies that on cancellation the entity would receive compensation of CU90 for a regulatory asset with a carrying amount of CU100. Applying paragraph 39, the entity would conclude that the most likely amount is CU100 and the expected value is CU99. The entity would use whichever of these two estimates better predicts the future cash flows.

B38 If a cancellation right has been exercised so that a right to receive cash or obligation to pay cash has arisen, that right or obligation is a financial asset or financial liability. In such a case, the entity shall derecognise the part of the regulatory asset or regulatory liability that no longer exists, and recognise and measure the financial asset or financial liability by applying other IFRS Standards, recognising any resulting difference in profit or loss.

Reassessment of and changes to the boundary

B39 At the end of each reporting period an entity shall reassess the boundary of a regulatory agreement, considering all changes in facts and circumstances.

B40 If this reassessment brings any additional cash inflows or cash outflows within the boundary of a regulatory agreement, the entity shall update the carrying amount of regulatory assets or regulatory liabilities accordingly. Such updates could result from recognising new regulatory assets or regulatory liabilities or from remeasuring regulatory assets or regulatory liabilities already recognised. Paragraph 78(f) requires an entity to disclose changes in the carrying amount of a regulatory asset or regulatory liability caused by a change in the boundary of a regulatory agreement, and the reasons for that change in the boundary. Paragraph 78(f) does not require an entity to specify whether the effect of that change should be viewed as the recognition of a new regulatory asset or regulatory liability, or the remeasurement of an existing regulatory asset or regulatory liability because making such a distinction would have no practical consequence.

Interaction with other IFRS Standards

IAS 12 *Income Taxes*

B41 Paragraphs B42–B46 discuss:

(a) regulatory assets or regulatory liabilities that arise when the regulated rates do not yet fully reflect current tax expense (income), or when an entity has a deferred tax liability or a deferred tax asset (paragraphs B42–B43);

(b) deferred tax liabilities or deferred tax assets resulting from a regulatory asset or regulatory liability (paragraph B44); and

(c) how income taxes affect the measurement of regulatory assets and regulatory liabilities (paragraphs B45–B46).

B42 Tax expense is typically an allowable expense and tax income is typically chargeable income. In some cases, the regulated rate for a specified period does not include all of the current and deferred tax effects of transactions occurring during that period. For example, a regulatory agreement may determine regulated rates on a basis that:

(a) includes an estimate of the current tax expense (income), with any variance between estimated and actual amounts being added or deducted when determining regulated rates in future periods; or

(b) does not include deferred tax expense (income).

B43 Applying this [draft] Standard in such cases, an entity shall recognise a regulatory asset or a regulatory liability if some or all of the current and deferred tax effects of transactions in the current period will affect the regulated rates in future periods, or affected the regulated rates in earlier periods.

B44 The tax base of a regulatory asset or regulatory liability is typically nil. Consequently, the recognition of a regulatory asset or regulatory liability typically gives rise to the recognition of a deferred tax liability or deferred tax asset in accordance with IAS 12. However, before applying IAS 12, an entity shall assess how income taxes affect the measurement of regulatory assets and regulatory liabilities (paragraphs B45–B46).

B45 In estimating the future cash flows arising from a regulatory asset or a regulatory liability, an entity shall consider the effect of amounts it is entitled to add in determining future regulated rates as a result of paying any income taxes as it recovers the regulatory asset, or that it is obliged to deduct in determining future regulated rates as a result of recovering any income taxes as it fulfils the regulatory liability.

B46 For example, assume that an entity has a regulatory asset arising because a performance incentive (bonus) of CU60 has not yet been included in determining the regulated rates, that the tax rate is 40%, and that the regulatory agreement allows all tax cash flows to be included ultimately in determining the regulated rates. In the future periods in which the bonus is

included in determining regulated rates, the entity will include an amount of CU100 which will provide the entity with a net tax cash inflow of CU60 after the income tax cash outflow of CU40 (CU100 × 40%). Consequently, in measuring its regulatory assets, the entity includes the cash flows arising from its right to recover both the bonus (CU60) and the income tax (CU40 (CU60 × 40 ÷ 60)) that will result from recovering that bonus. Thus, the measurement of the regulatory assets reflects pre-tax cash inflows of CU100. The resulting income tax cash outflows of CU40 (CU100 × 40%) are reflected in the measurement of the resulting deferred tax liability.

IFRIC 12 *Service Concession Arrangements*

B47 IFRIC 12 applies to a public-to-private service concession arrangement if the grantor controls or regulates the price at which the operator must provide services, and if other specified conditions are met. Accordingly, some arrangements within the scope of IFRIC 12 may create regulatory assets or regulatory liabilities within the scope of this [draft] Standard. An entity shall account for those regulatory assets or regulatory liabilities separately from the assets and liabilities within the scope of IFRIC 12.

Appendix C
Effective date and transition

This appendix is an integral part of the [draft] IFRS Standard.

Effective date

C1 An entity shall apply this [draft] Standard for annual reporting periods beginning on or after [18–24 months from the date of publication]. Earlier application is permitted. If an entity applies this [draft] Standard earlier, it shall disclose that fact.

Transition

C2 For the requirements in paragraphs C3–C4:

(a) the date of initial application is the beginning of the annual reporting period in which an entity first applies this [draft] Standard.

(b) the date of transition is the beginning of the earliest annual reporting period presented in the financial statements for the annual reporting period that includes the date of initial application.

(c) a past business combination is a business combination for which the acquisition date is before the date of transition.

C3 An entity shall apply this [draft] Standard retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, except as permitted in paragraph C4.

C4 An entity may elect not to apply this [draft] Standard retrospectively to a past business combination. If an entity makes this election, it shall at the date of transition:

(a) apply the election to all of its past business combinations.

(b) apply the requirements in subparagraphs (c)–(g) separately to each past business combination.

(c) recognise and measure, applying this [draft] Standard, all regulatory assets acquired, and all regulatory liabilities assumed, in a past business combination, which still exist at the date of transition.

(d) derecognise all items (such as some regulatory balances) that were recognised as assets or liabilities in that past business combination but would not have been recognised if the [draft] Standard had always been applied.

(e) recognise any deferred tax effects of the adjustments described in subparagraphs (c)–(d).

(f) adjust the carrying amount of non-controlling interests from that past business combination remaining at the date of transition for their proportionate share of the net amount of the adjustments described in subparagraphs (c)–(e), if the entity measured those non-controlling

interests at their proportionate share in the recognised amounts of the acquiree's identifiable net assets, rather than at fair value.

(g) adjust the carrying amount of goodwill still remaining from that past business combination for the net amount of the adjustments described in subparagraphs (c)–(f). If that adjustment reduces the carrying amount of goodwill to nil, the entity shall recognise any remaining amount of adjustment in retained earnings or, if appropriate, another category of equity.

Withdrawal of other IFRS Standards

C5 This [draft] Standard supersedes IFRS 14 *Regulatory Deferral Accounts*.

Appendix D
[Draft] Amendments to other IFRS Standards

This appendix sets out [draft] amendments to other IFRS Standards. An entity shall apply the amendments when it applies [draft] IFRS X.

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

Paragraph 39V is deleted. Deleted text is struck through. New text is underlined.

Effective date

...

39V [Deleted] ~~IFRS 14 *Regulatory Deferral Accounts*, issued in January 2014, amended paragraph D8B. An entity shall apply that amendment for annual periods beginning on or after 1 January 2016. Earlier application is permitted. If an entity applies IFRS 14 for an earlier period, the amendment shall be applied for that earlier period.~~

In Appendix C, paragraph C4 is amended. Deleted text is struck through. New text is underlined.

C4 If a first-time adopter does not apply IFRS 3 retrospectively to a past business combination, this has the following consequences for that business combination:

...

(c) The first-time adopter shall exclude from its opening IFRS statement of financial position any item recognised in accordance with previous GAAP that does not qualify for recognition as an asset or liability under IFRSs. The first-time adopter shall account for the resulting change as follows:

(i) the first-time adopter may have classified a past business combination as an acquisition and recognised as an intangible asset an item that does not qualify for recognition as an asset in accordance with IAS 38 *Intangible Assets*. It shall reclassify that item (and, if any, the related deferred tax and non-controlling interests) as part of goodwill (unless it deducted goodwill directly from equity in accordance with previous GAAP, see (g)(i) and (i) below). A first-time adopter shall apply the same treatment to a regulatory balance that is not a regulatory asset as defined in [draft] IFRS X *Regulatory Assets and Regulatory Liabilities* but arises if a regulatory agreement allows goodwill to be included in the regulated rates to be charged to customers in the future.

...

(g) The carrying amount of goodwill in the opening IFRS statement of financial position shall be its carrying amount in accordance with previous GAAP at the date of transition to IFRSs, after the following two adjustments:

(i) The ~~If required by (c)(i) above, the~~ first-time adopter shall increase the carrying amount of goodwill when it reclassifies the items described in (c)(i) ~~an item that it recognised as an intangible asset in accordance with previous GAAP~~. Similarly, if (f) above requires the first-time adopter to recognise an intangible asset that was subsumed in recognised goodwill in accordance with previous GAAP, the first-time adopter shall decrease the carrying amount of goodwill accordingly (and, if applicable, adjust deferred tax and non-controlling interests).

In Appendix D, paragraph D8B is amended. Deleted text is struck through. New text is underlined.

Deemed cost

...

D8B Some entities hold items of property, plant and equipment, right-of-use assets or intangible assets that are used, or were previously used, in operations subject to a regulatory agreement that is capable of creating regulatory assets or regulatory liabilities within the scope of [draft] IFRS X *Regulatory Assets and Regulatory Liabilities* ~~rate regulation~~. The carrying amount of such items might include amounts that were determined under previous GAAP but do not qualify for capitalisation in accordance with IFRSs. If this is the case, a first-time adopter may elect to use the previous GAAP carrying amount of such an item at the date of transition to IFRSs as deemed cost. If an entity applies this exemption to an item, it need not apply it to all items. At the date of transition to IFRSs, an entity shall test for impairment in accordance with IAS 36 each item for which this exemption is used. ~~For the purposes of this paragraph, operations are subject to rate regulation if they are governed by a framework for establishing the prices that can be charged to customers for goods or services and that framework is subject to oversight and/or approval by a rate regulator (as defined in IFRS 14 *Regulatory Deferral Accounts*).~~

IFRS 3 *Business Combinations*

Paragraph 28C and a heading above that paragraph are added. New text is underlined.

Exceptions to both the recognition and measurement principles

...

Regulatory assets and regulatory liabilities

28C The acquirer shall recognise and measure all regulatory assets acquired and regulatory liabilities assumed in a business combination in accordance with [draft] IFRS X *Regulatory Assets and Regulatory Liabilities*.

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

Paragraph 5 is amended. New text is underlined.

Scope

...

5 The measurement provisions of this IFRS do not apply to the following assets, which are covered by the IFRSs listed, either as individual assets or as part of a disposal group:

...

(g) regulatory assets ([draft] IFRS X *Regulatory Assets and Regulatory Liabilities*).

IAS 1 *Presentation of Financial Statements*

Paragraphs 54 and 82 are amended. New text is underlined.

Information to be presented in the statement of financial position

54 The statement of financial position shall include line items that present the following amounts:

...

(da) portfolios of contracts within the scope of IFRS 17 that are assets, disaggregated as required by paragraph 78 of IFRS 17;

(db) regulatory assets as defined in [draft] IFRS X *Regulatory Assets and Regulatory Liabilities*;

...

(ma) portfolios of contracts within the scope of IFRS 17 that are liabilities, disaggregated as required by paragraph 78 of IFRS 17;

(mb) regulatory liabilities as defined in [draft] IFRS X;

...

Information to be presented in the profit or loss section or the statement of profit or loss

82 In addition to items required by other IFRSs, the profit or loss section or the statement of profit or loss shall include line items that present the following amounts for the period:

(a) revenue, presenting separately:

(i) interest revenue calculated using the effective interest method; and

(ii) insurance revenue (see IFRS 17);

(aza) regulatory income or regulatory expense (see [draft] IFRS X);

(aa) gains and losses arising from the derecognition of financial assets measured at amortised cost;

...

IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*

The footnote to paragraph 11(b), paragraph 54G and the footnote to paragraph 54G are deleted. Deleted text is struck through. New text is underlined. The Board would also delete the related paragraphs BC38–BC40 of the Basis for Conclusions on IAS 8. These paragraphs are not reproduced here.

Selection and application of accounting policies

...

11 In making the judgement described in paragraph 10, management shall refer to, and consider the applicability of, the following sources in descending order:

...

(b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the *Conceptual Framework for Financial Reporting* (*Conceptual Framework*).*

* ~~Paragraph 54G explains how this requirement is amended for regulatory account balances.~~

...

Effective date and transition

...

54G [Deleted] ~~If an entity does not apply IFRS 14 *Regulatory Deferral Accounts*, the entity shall, in applying paragraph 11(b) to regulatory account balances, continue to refer to, and consider the applicability of, the definitions, recognition criteria, and measurement concepts in the *Framework for the Preparation and Presentation of Financial Statements** instead of those in the *Conceptual Framework*. A regulatory account balance is the balance of any expense (or income) account that is not recognised as an asset or a liability in accordance with other applicable IFRS Standards but is included, or is expected to be included, by the rate regulator in establishing the rate(s) that can be charged to customers. A rate regulator is an authorised body that is empowered by statute or regulation to establish the rate or a range of rates that bind an entity. The rate regulator may be a third-party body or a related party of the entity, including the entity's own governing board, if that body is required by statute or regulation to set rates both in the interest of the customers and to ensure the overall financial viability of the entity.~~

~~*~~ ~~The reference is to the IASC's *Framework for the Preparation and Presentation of Financial Statements* adopted by the Board in 2001.~~

IAS 36 *Impairment of Assets*

Paragraphs 2, 43 and 79 are amended. Deleted text is struck through. New text is underlined.

Scope

2 **This Standard shall be applied in accounting for the impairment of all assets, other than:**

...

(h) contracts within the scope of IFRS 17 *Insurance Contracts* that are assets and any assets for insurance acquisition cash flows as defined in IFRS 17; ~~**and**~~

(i) non-current assets (or disposal groups) classified as held for sale in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.; **and**

(j) regulatory assets (see [draft] IFRS X *Regulatory Assets and Regulatory Liabilities*).

...

Composition of estimates of future cash flows

...

43 To avoid double-counting, estimates of future cash flows do not include:

(a) cash inflows from assets that generate cash inflows that are largely independent of the cash inflows from the asset under review (for example, financial assets such as receivables, and regulatory assets); and

(b) cash outflows that relate to obligations that have been recognised as liabilities (for example, payables, pensions, ~~or~~ provisions and regulatory liabilities).

...

Recoverable amount and carrying amount of a cash-generating unit

...

79 For practical reasons, the recoverable amount of a cash-generating unit is sometimes determined after consideration of assets that are not part of the cash-generating unit (for example, receivables or other financial assets, and regulatory assets) or liabilities that have been recognised (for example, payables, pensions, ~~and~~ other provisions and regulatory liabilities). In such

cases, the carrying amount of the cash-generating unit is increased by the carrying amount of those assets and decreased by the carrying amount of those liabilities.

Approval by the Board of Exposure Draft *Regulatory Assets and Regulatory Liabilities* published in January 2021

The Exposure Draft *Regulatory Assets and Regulatory Liabilities* was approved for publication by 10 of 13 members of the International Accounting Standards Board (Board). Ms Tokar voted against its publication. Her alternative view is set out after the Basis for Conclusions. Messrs Gast and Mackenzie abstained from voting in view of their recent appointment to the Board.

Hans Hoogervorst	Chairman
Suzanne Lloyd	Vice-Chair
Nick Anderson	
Tadeu Cendon	
Martin Edelmann	
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of assets. Whether the full value of the liability reflecting presently recovered amounts is transferred to a segregated fund or that amount remains as an offset to rate base, the amount collected to date is unchanged. Therefore, all else being equal, there is no material currently apparent risk to the recoverability of salvage costs related to the future retirement of assets.

However, to increase the transparency of maintaining the status quo, I do have one recommendation. Specifically, if the status quo is maintained then I recommend the OEB direct Enbridge to begin separately tracking and reporting the annual changes in the current net salvage liability. Specifically, the existing balance in the account inclusive of any approved funding to the account and actual costs incurred should be reported as a separate requirement in future rate applications. I note that similar reporting requirements have been established by the Alberta Utilities Commission.

Additionally, during the March 27, 2023 technical conference, several parties, including IGUA, sought to obtain additional clarity on the magnitude of any future obligation related to net salvage costs (see for example, the exchange between IGUA counsel Ian Mondrow and Mr. Kennedy from pages 118 to 128 of the March 27, 2023 final transcript).

In my opinion, there would be significant benefit from Enbridge calculating and reporting the expected future net salvage cost liability based on two assumptions:

i. The applied for net salvage rates.

ii. The five-year average actual experienced net salvage costs for each account.

I consider this information to be of significant value in providing transparency to all parties on the potential magnitude of a future salvage cost obligation. This information would also be of assistance in informing the positions of all parties in relation to net salvage costs in the future. For example, the currently accumulated net salvage liability is $1.6 billion as of

the end of 2022.[118] The total average plant investment in Enbridge's assets as of the 2024 test year is forecast to be $24.9 billion.[119] While many accounts will not require significant amounts of net salvage to be recovered, and other accounts, such as buildings may be sold for positive amounts and thus not increase costs, assuming a -50% net salvage rate on this balance under the traditional method suggests the future salvage cost obligation is in the order of magnitude of $12.5 billion ($24.9 billion * 50%).

This amount is significantly greater than the currently funded amount of $1.6 billion. While the actual future costs could well be materially different than this estimate, reporting similar information over time as better information becomes known will assist all parties in future proceedings. This is particularly the case given Concentric's comments around a potential future review of an economic planning horizon due to potential impacts from an energy transition, which will impact both depreciation and net salvage.

3.2.4 Other considerations related to the collection of net salvage

Q: Do you have any further concerns with regards to Enbridge's applied for net salvage rates?

A: Yes. As set out above, I recommend a reduction to the discount rate and a potential change to the inflation rate used in the CDNS calculations. These recommendations reduce the amount of salvage costs to be recovered. This reduction is supported to some extent by the trend of over recovering net salvage costs in recent years relative to actual costs incurred,[120] as well as what I would characterize as an apparent lack of certainty from Concentric regarding the amount of salvage costs that should be recovered. This uncertainty was apparent in the exchange with Mr. Kennedy and IGUA counsel in the March 27, 2023 technical conference at page 120 lines 3 to 25:

[118] EGI IRR Exhibit I4 2024 Rebasing 2023-03-08, PDF page 1924, Exhibit I.4.5-IGUA-13 Attachment 1.
[119] EGI IRR Exhibit I4 2024 Rebasing 2023-03-08, PDF page 814, Exhibit I.4.5-STAFF-170, Attachment 1.
[120] EGI IRR Exhibit I4 2024 Rebasing 2023-03-08, PDF page 1924, Exhibit I.4.5-IGUA-13 Attachment 1.

> MR. KENNEDY: Again, it is Mr. Kennedy. As we noted, I think in this response, the actual amount of imbalance won't be money for many years out, until we actually spend the money many years out. So it is almost impossible to predict what the imbalance may be.
>
> And so I think I want to go back to the point you alluded to a bit.
>
> It is very easy when you have a band of very high net negative salvage costs in your data, and is that going to be indicative for the next 50 years, 40 years, I can't remember what the remaining life of this account is. But you know, it is a long-term outlook.
>
> It is very easy to overcook your recovery of this, if you will, and get too aggressive and then get into a yo-yo effect where you might say, well, gee, we need a minus 200 percent net negative salvage number.
>
> And so we go there, and then five years from now we go, holy smokes, the trend we saw for a few years was really just a trend for a five- or six-year period and it's slowed down.
>
> And so now we've over -- massively over-recovered. Now you've got a problem the other way. Now you've got refunds. So you get a yo-yo going on.

I agree that the amount of net salvage to be collected in the future is uncertain. However, as it is at this time unclear what judgment Concentric applied to arrive at its recommended net salvage rates as compared to the five-year averages being observed, there is likely some merit in moderating the amount being collected, which my recommendations achieve.

However, with this moderation comes some risk that the amount of net salvage costs collected will be insufficient to recover the future salvage costs incurred, and thus future significant increases in costs will be required. Accordingly, I also recommend that the OEB consider directing Enbridge to conduct a study for its 10 largest property accounts and report on the following at the time of its future rate application:

- The current approach to salvaging the assets, including the approximate unit material and labour costs to salvage assets.
- Alternative approaches available to salvage certain assets, such as abandonment in situ, and the implications such approaches may have on salvage costs.
- Enbridge's best estimate of the future costs to salvage the assets within each account, including the assumptions used to develop those estimates.

While this information will require significant judgment and thus be subject to significant uncertainty it will nevertheless provide parties with a better understanding of the potential magnitude and range of the future costs that may be incurred. The information outlined above will also provide more clarity into the best practices Enbridge may be able to employ to plan for, and perhaps mitigate or avoid a portion of, those costs. The information would also provide an additional data point to assist in developing future net salvage estimates and better inform decisions and recommendations around how current experienced levels of net salvage costs (i.e., -100%, -200%, or greater) may or may not be reflective of the future levels of expected net salvage.

Q: Does this conclude your evidence?

A: Yes.