

---

## IASB<sup>®</sup> meeting

Date	<b>September 2023</b>
Project	<b>Rate-regulated Activities</b>
Topic	<b>The direct (no direct) relationship concept—Report on findings from the survey</b>
Contacts	Siok Mun Leong ( <a href="mailto:smleong@ifrs.org">smleong@ifrs.org</a> ) Mariela Isern ( <a href="mailto:misern@ifrs.org">misern@ifrs.org</a> )

This paper has been prepared for discussion at a public meeting of the International Accounting Standards Board (IASB). This paper does not represent the views of the IASB or any individual IASB member. Any comments in the paper do not purport to set out what would be an acceptable or unacceptable application of IFRS<sup>®</sup> Accounting Standards. The IASB's technical decisions are made in public and are reported in the IASB<sup>®</sup> *Update*.

---

## Objective

1. This paper sets out:
  - (a) the staff's analysis of the responses to a survey on the direct (no direct) relationship concept; and
  - (b) the staff's recommendations on next steps.

## Staff recommendations

2. The staff recommend that the final Accounting Standard:
  - (a) includes the direct (no direct) relationship concept to help an entity to identify differences in timing arising from the regulatory compensation the entity receives on its regulatory capital base;
  - (b) specifies that if an entity is able to trace differences between the regulatory capital base and the property, plant and equipment at an asset level, this is a strong indicator that there is a direct relationship;
  - (c) specifies that in the case of service concession arrangements, an entity determines whether there is a direct (no direct) relationship between the

regulatory capital base and the intangible asset that arises from the service concession arrangement; and

- (d) includes examples to illustrate how an entity determines the direct (no direct) relationship using specific fact patterns.

## Executive summary

3. When redeliberating the proposals in the Exposure Draft [Regulatory Assets and Regulatory Liabilities](#) (Exposure Draft), the IASB tentatively decided to base some accounting requirements on whether there is a direct (no direct) relationship between an entity's regulatory capital base and its property, plant and equipment (the direct (no direct) relationship concept).
4. The final Standard will include indicators that an entity could use to determine whether there is a direct (no direct) relationship. To gather input from preparers on these indicators, the staff developed a survey (Agenda Paper 9C).
5. We received 48 completed surveys from 39 respondents in 16 jurisdictions. Most respondents reported that they were able to conclude whether their regulatory capital base had a direct (no direct) relationship with their property, plant and equipment. There was an equal split between those concluding there was a direct relationship and those concluding there was no direct relationship. There were five respondents that were unable to conclude whether there was a direct (no direct) relationship.
6. The completed surveys have shown that:
  - (a) considering the extent to which an entity's regulatory capital base and its property, plant and equipment are similar is an appropriate approach:
    - (i) for determining whether differences in timing arise from the regulatory compensation an entity receives on its regulatory capital base; and
    - (ii) that can be applied to a variety of regulatory schemes.

- (b) respondents found the features included in the background information document accompanying the survey to be generally helpful for determining the direct (no direct) relationship (Agenda Paper 9C); and
- (c) there are a few areas that may need refinement or additional guidance in the final Standard (see conclusions in paragraph 55 and staff recommendations in paragraph 2).

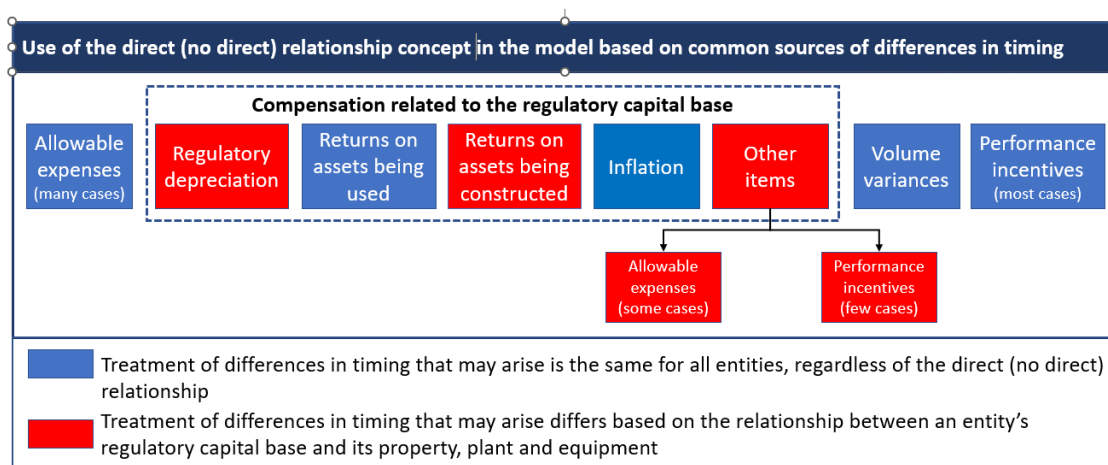
## Structure of the paper

- 7. This paper is structured as follows:
  - (a) background (paragraphs 10–15);
  - (b) feedback (paragraphs 16–53); and
  - (c) conclusions and next steps (paragraphs 54–55).
- 8. This paper includes an appendix with the profile of the respondents to the survey.
- 9. Agenda Paper 9C includes the survey and the background information document accompanying the survey. That paper is for information only. We are not asking the IASB to make decisions on that paper.

## Background

- 10. As part of its redeliberations on the proposals in the Exposure Draft, the IASB has considered the extent to which an entity's regulatory capital base and its property, plant and equipment are similar. This consideration is important for identifying differences in timing between:
  - (a) the regulatory compensation an entity receives on its regulatory capital base (for example, the regulatory depreciation of the regulatory capital base); and
  - (b) the expenses the entity incurs on its property, plant and equipment (for example, the accounting depreciation expense).

11. In particular, the IASB has used the direct (no direct) relationship concept to make tentative decisions dealing with the accounting for regulatory assets and regulatory liabilities arising from:
- (a) differences between the regulatory recovery period and the assets' useful lives;<sup>1</sup>
  - (b) regulatory returns on an asset not yet available for use when an entity capitalises borrowing costs incurred to construct that asset;<sup>2</sup> and
  - (c) items that a regulator includes in an entity's regulatory capital base (for example, allowable expenses and performance incentives).<sup>3</sup>
12. The diagram below provides an overview of the use of the direct (no direct) relationship concept in the model.<sup>4</sup>



13. At its meeting in October 2022, the IASB discussed indicators that an entity could use to determine whether its regulatory capital base has a direct (no direct) relationship with its property, plant and equipment.
14. To gather input from preparers on these indicators, the staff developed a survey (Agenda Paper 9C). The staff requested assistance from members of the Accounting

<sup>1</sup> [Agenda Paper 9B](#) discussed at the IASB October 2022 meeting.  
<sup>2</sup> [Agenda Paper 9A](#) discussed at the IASB November 2022 meeting.  
<sup>3</sup> [Agenda Paper 9C](#) discussed at the IASB December 2022 meeting.  
<sup>4</sup> [Agenda Paper 9D](#) discussed at the IASB December 2022 meeting.

Standards Advisory Forum to identify participants from their jurisdictions or regions. The staff also contacted other stakeholders, mainly members of the IASB's Consultative Group for Rate Regulation. The input will be used to develop application guidance that will form part of the final Standard.

15. We received 48 completed surveys, representing 39 respondents in 16 jurisdictions. Some respondents completed more than one survey—that is, one survey for each of their group entities subject to different regulatory schemes. The appendix to this paper includes the respondents' profiles. To better understand answers from some of the completed surveys, we contacted 15 respondents—via meetings or by email. This paper also summarises feedback from this subsequent outreach.

## Feedback

16. The survey asked respondents:
  - (a) to consider the features of their entities' regulatory capital base;
  - (b) to determine whether their entities' regulatory capital base had a direct (no direct) relationship with their property, plant and equipment based on the analysis of the features in (a) and based on the background information document (Agenda Paper 9C); and
  - (c) to share which features respondents had given the highest weight and what additional guidance respondents would require for their determination in (b).
17. This section analyses the feedback received from the completed surveys and the subsequent outreach on the direct (no direct) relationship concept. It is structured as follows:
  - (a) main outcomes from the surveys (paragraphs 19–43);
  - (b) respondents that were unable to conclude (paragraphs 44–49);
  - (c) other factors considered by respondents (paragraphs 50–52); and
  - (d) challenges identified by respondents (paragraph 53).

- 
18. During the outreach, we also gathered feedback from respondents on other tentative decisions made by the IASB using this concept. In particular, the feedback deals with the accounting for regulatory assets and regulatory liabilities arising from:
- (a) regulatory returns on assets not yet available for use that compensate for an entity's capitalised borrowing costs;
  - (b) inflation adjustments to the regulatory capital base; and
  - (c) other items that a regulator may include in the entity's regulatory capital base.

We plan to discuss this feedback at a future meeting.

### ***Main outcomes from the surveys***

19. Most respondents reported that they were able to conclude whether their entities' regulatory capital base had a direct (no direct) relationship with their property, plant and equipment.
20. A few respondents in South America and Europe concluded differently from other respondents whose regulatory capital base had similar features. We contacted these respondents. Their cases are summarised in paragraphs 33–35.
21. A few respondents in North America and Europe could not conclude. We also contacted most of these respondents. Why they were unable to conclude is summarised in paragraphs 44–49.
22. The paragraphs below summarise feedback received from respondents that concluded their entities' regulatory capital base has:
- (a) a direct relationship with their property, plant and equipment (paragraphs 23–35); or
  - (b) no direct relationship with their property, plant and equipment (paragraphs 36–38).

---

*Direct relationship*

23. In summary, when an entity's regulatory capital base has a direct relationship with its property, plant and equipment, the regulatory capital base and the property, plant and equipment are:
- (a) the same; or
  - (b) sufficiently similar for the entity to be able to reconcile any differences between the regulatory capital base and the property, plant and equipment.
24. In 21 surveys, the respondents have concluded that their entities' regulatory capital base and property, plant and equipment had a direct relationship. These entities mainly operate:
- (a) in the electricity and gas sectors in North America, Europe, Asia-Oceania and Africa. These entities are generally subject to cost-based regulatory schemes (paragraphs 25–26); and
  - (b) in the electricity and gas sectors in Brazil and the transport (motorways) sector in Europe. These entities operate through service concession arrangements within the scope of IFRIC 12 *Service Concession Arrangements* (paragraphs 27–35).

*Direct relationship—entities subject to cost-based regulatory schemes*

25. In reaching their conclusion that there is a direct relationship, respondents considered the following factors:
- (a) the regulatory capital base is derived from the property, plant and equipment—that is, the regulatory capital base and the property, plant and equipment consist of the same assets and use the same measurement basis.
  - (b) entities are able to track differences:
    - (i) when the regulatory capital base and the property, plant and equipment include different items; and

- 
- (ii) in measurement bases between the regulatory capital base and the property, plant and equipment, at the individual asset level in some cases. A common example of such differences is the inflation adjustment to the regulatory capital base, which in many cases is tracked at the individual asset level.
- (c) the recovery period of the regulatory capital base is closely aligned with the useful lives of the assets included in that base. There may be differences between when items are included in the regulatory capital base and when those items are put in operation and depreciated. However, those differences may not lead to significant differences in timing. In some cases, the regulatory capital base consists of regulatory asset classes whose recovery periods are determined based on the weighted-average of the useful lives of the assets within each regulatory asset class. In a few cases, the depreciation pace is closely aligned for the major assets but not for the other assets. For those assets whose regulatory and accounting depreciation pace differs, the differences in timing may not always be significant.
26. According to the surveys, some regulators require a reconciliation of the regulatory capital base with the property, plant and equipment, at individual asset level in some cases and at a high level in other cases. Regardless of the regulatory requirements, most respondents said they are able to perform the reconciliation at the individual asset level or the regulatory or accounting asset classes level.

*Direct relationship—Entities operating through service concession arrangements*

27. Among respondents that concluded there is a direct relationship, many entities operate through service concession arrangements that are in the scope of IFRIC 12. Most of these entities operate in the electricity and gas sectors in Brazil.
28. In some cases, the service concession arrangement gives rise to both an intangible asset and a financial asset. Consequently, the regulatory capital base consists of assets that can be reconciled with:



- 
- (a) an intangible asset, typically representing the larger portion of the cost of the assets in the regulatory capital base that an entity expects to recover through regulated rates charged to users of the public service over the concession period.
- (b) a financial asset, typically representing a smaller portion of the cost of the assets in the regulatory capital base for which the entity has a contractual right to receive cash generally at the end of the concession period.
29. For the purpose of the survey, these respondents considered whether the regulatory capital base and the intangible asset have a direct relationship. The respondents concluded that there is a direct relationship by considering the factors described in paragraph 25. The respondents also said the regulator requires a reconciliation between the items in the regulatory capital base and the items to which the intangible asset relates, at the individual item level.
30. The respondents said there are typically differences between the regulatory recovery period of the assets included in the regulatory capital base and the useful life of the intangible asset. However, a difference in timing does not always arise as explained in paragraphs 31–32.
31. An entity generally recovers the intangible asset during the concession period and the financial asset at the end of the concession. The entity typically determines the useful life of the intangible asset with reference to the service concession period. The regulator determines the annual regulatory depreciation considering the cost of the assets within the regulatory capital base and their useful lives. By doing this, in effect, the regulator is depreciating the *portion* of the cost of the assets that relate to the intangible asset over the service concession period, rather than over the individual assets' useful lives. In these cases, no difference in timing arises between the regulatory recovery period of the assets included in the regulatory capital base and the intangible asset's useful life.
32. In some cases, a difference in timing may arise. For example, for some greenfield projects in the gas sector in Brazil, the regulator may incentivise investments by accelerating the regulatory recovery period of the regulatory capital base.

- Consequently, the intangible asset is recovered through regulated rates faster than it is amortised over the service concession period. Therefore, a regulatory liability arises.
33. There are two surveys for which respondents operating under service concession arrangements concluded that the regulatory capital base and the intangible asset had no direct relationship. These respondents concluded differently from other respondents whose regulatory capital base had similar features. Paragraphs 34–35 describe these cases.
34. One of these respondents operates in the electricity distribution sector in Brazil, while the other operates in the transport sector in Europe. In concluding that there is no direct relationship, the respondents considered some or all of the following reasons:
- (a) the regulatory depreciation of individual assets included in the regulatory capital base is determined based on the assets' useful lives, while the useful life of the intangible asset is determined based on the service concession period.
  - (b) the regulatory capital base is adjusted for inflation.
  - (c) the regulatory capital base includes material items that are not included in the intangible asset. For example, the regulatory capital base includes a provision for maintenance construction that the entity accounts for applying IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.
35. We think differences in the componentisation and the measurement bases would not necessarily lead to the regulatory capital base and the intangible asset having no direct relationship. For example, the following features would indicate there is a direct relationship between the entity's regulatory capital base and its intangible asset:
- (a) the design of the regulated rate is such that the entity has a right to charge over the concession period the portion of the regulatory capital base that relates to the intangible asset. In this case, no difference in timing arises from the differences between the regulatory recovery period of individual assets included in the regulatory capital base that relate to the intangible asset and the useful life of the intangible asset (paragraph 31).

- (b) the entity is able to track a measurement adjustment in the regulatory capital base (for example, an inflation adjustment) at the individual asset level. This is the case for one of the respondents whose regulatory capital base is adjusted for inflation.
- (c) the entity is able to track an item (for example, amounts relating to a provision) separately from other items in the regulatory capital base so that the entity is able to reconcile the regulatory capital base with the intangible asset at the individual item level. This is the case for one of the respondents.

*No direct relationship*

36. In 20 surveys, the respondents concluded that their regulatory capital base and their property, plant and equipment had no direct relationship. The respondents are split between:
- (a) entities subject to regulatory schemes that use a total expenditures ('totex') approach—paragraph 37; and
  - (b) entities subject to features of regulatory schemes in a way that it would be impracticable to reconcile their regulatory capital base to their property, plant and equipment at the individual asset level—paragraph 38.
37. We received three surveys from entities operating in the electricity transmission and distribution and the water sectors in the United Kingdom. All these entities concluded that their regulatory capital base and their property, plant and equipment had no direct relationship. The main reasons provided were as follows:
- (a) the regulatory capital base is a 'lump sum' balance—that is, the regulatory capital base cannot be segregated into asset classes or individual assets. The regulatory capital base is built based on a percentage of totex and includes both operating (opex) and capital (capex) expenditures.<sup>5</sup> There is a degree of

---

<sup>5</sup> Regulators allocate totex to both slow money (that is, the regulatory capital base) and fast money (that is, the non-capitalised part of totex that an entity is entitled to recover after the regulator treats it as allowable). The percentage of totex allocated to the regulatory capital base typically does not equate to the capex-to-totex ratio.

correlation between the movements in the net book value of the entity's property, plant and equipment and the movements in the regulatory capital base. However, the regulatory capital base is better thought as a regulatory tool for determining future revenue.

- (b) the regulatory recovery period of the regulatory capital base is not aligned with the assets' useful lives. The regulator does not consider the assets' useful lives in determining the recovery period of the regulatory capital base. Instead, the regulator considers other factors, for example, the affordability of regulated rates for customers and the financial needs of entities to achieve secured long-term energy supply and net zero emissions. In addition, the regulator may change the pace of the regulatory depreciation between regulatory periods.
  - (c) the regulator determines the inflation adjustment to the entire regulatory capital base.
  - (d) there is no regulatory requirement to reconcile the regulatory capital base with the property, plant and equipment. The respondents said tracking any differences between the regulatory capital base and their property, plant and equipment would not be possible.
38. Among the rest of the respondents that concluded that their regulatory capital base and their property, plant and equipment had no direct relationship, most were entities subject to incentive-based schemes in Europe. These respondents said it would be impracticable to track differences between the regulatory capital base and the property, plant and equipment at the individual asset level. This is because:
- (a) the regulatory capital base is not a tool to recover the cost of assets in the property, plant and equipment. Instead, it is a tool to calculate an amount of allowable costs that the regulator will consider in determining regulated rates. For this purpose, the regulator uses the allowable costs arising from a

---

Regulators often allocate a higher percentage of totex to fast money than that represented by the opex-to-totex ratio. In addition, regulators typically change the percentage of totex allocated to the regulatory capital base between regulatory periods for different reasons (for example, an entity's financing needs).

particular year (often called ‘base year’) and makes lump-sum efficiency adjustments to those allowable costs.

- (b) in some cases, there are fundamental differences between the regulatory capital base and the property, plant and equipment. For example:
- (i) assets are broken down into components in the regulatory capital base that are different from those in the property, plant and equipment. Consequently, investments added to the regulatory capital base cannot be reconciled to individual assets in the property, plant and equipment.
  - (ii) the regulatory capital base may include items that are not capitalised applying IAS 16 *Property, Plant and Equipment*, for example, operating expenses, financial assets or current assets. The entity is unable to identify the amount of these items included in regulatory depreciation over time.
  - (iii) the regulatory capital base excludes costs that are capitalised applying IAS 16, for example, borrowing costs and asset retirement costs.
  - (iv) the regulatory capital base includes assets that are not yet available for use. The cost of these assets is included in regulatory depreciation, and consequently in regulated rates charged, as the assets are being constructed.
  - (v) the regulatory capital base includes both assets that are measured at replacement value or at specified regulatory value and assets that are measured at cost.
- (c) there are differences between the regulatory recovery period and the assets’ useful lives. In some cases, the asset classes in the regulatory capital base are different from the asset classes in property, plant and equipment. As a result, each regulatory asset class contains assets with different useful lives. In other cases, the regulator treats additional investments in existing assets as standalone assets. As a result, the regulatory recovery periods of these

investments are not aligned with the remaining useful lives of the existing assets.

### *Conclusions*

39. In determining whether there is a direct (no direct) relationship, the features that respondents considered were generally aligned with the features included in the background information document accompanying the survey (Agenda Paper 9C).
40. In cases when the respondents have concluded there is a direct relationship, the entity is able to perform a reconciliation of the regulatory capital base with the property, plant and equipment at the individual asset level or the regulatory or accounting asset classes level (paragraphs 26 and 29).
41. The feedback on the survey has shown that there are two different cases in which the respondents have concluded that there is no direct relationship:
  - (a) the regulatory capital base is a regulatory construct that has no relationship with an entity's property, plant and equipment (paragraph 37); and
  - (b) the regulatory capital base uses inputs from an entity's property, plant and equipment but a reconciliation at an individual asset level may be impracticable (paragraph 38).
42. A difference in measurement basis between the regulatory capital base and the property, plant and equipment is not a determinant in the direct (no direct) relationship conclusion. For example:
  - (a) respondents operating through service concessions arrangements have generally concluded that there is a direct relationship even though the regulatory capital base is adjusted for inflation. In these cases, the respondents are able to track the inflation adjustment to individual asset included in the regulatory capital base separately from other items in that base (paragraphs 25(b) and 29).
  - (b) respondents have generally concluded that there is no direct relationship in cases when the regulator determines the inflation adjustment to the entire

regulatory capital base (paragraph 37(c)) or when the regulatory capital base includes assets that are measured using different measurement bases (paragraph 38(b)). In these cases, the differences in measurement bases may cause a reconciliation of the regulatory capital base and the property, plant and equipment to be impracticable.

43. We acknowledge that in some cases the determination of whether a reconciliation would be impracticable may be judgemental. However, in many cases, the conclusion on whether there is a direct (no direct) relationship may not result in significantly different outcomes in relation to the accounting for regulatory assets and regulatory liabilities arising from differences between the regulatory recovery period and the assets' useful lives. This is because:
- (a) in many cases of direct relationship, the regulatory recovery period of the regulatory capital base and the assets' useful lives are aligned (paragraph 25(c)). Therefore, no regulatory assets and no regulatory liabilities arises or any regulatory assets and regulatory liabilities that arise may not be significant.
  - (b) in cases of no direct relationship, an entity would not account for any regulatory assets or regulatory liabilities arising from those differences. In some of these cases, the regulatory recovery period of the regulatory capital base is nonetheless aligned with the assets' useful lives.

#### ***Respondents that were unable to conclude***

44. A few respondents from North America and Europe were unable to conclude. This section deals with the main reasons provided in the survey and subsequent outreach.

#### ***Respondent from North America***

45. A respondent in the electricity and gas sectors in North America could not reach a conclusion. The respondent said that the regulatory capital base and the property, plant and equipment are very similar. However, the respondent could not conclude because there are some differences that are difficult and costly to track to individual

assets or to regulatory asset classes. For example, the regulator disallows costs that are incurred imprudently through lump-sum adjustments at the capital investment project level, not at the individual asset or regulatory asset class level. However, the respondent acknowledged that these adjustments are not significant.

46. Based on our follow-up discussion with the respondent, we think the entity's regulatory capital base may have a direct relationship with its property, plant and equipment. This is because:
- (a) the regulatory capital base and the property, plant and equipment are very similar. The differences between these two bases that cannot be tracked to individual assets are insignificant. Moreover, the entity is able to identify other items included in the regulatory capital base, for example, amounts related to working capital. The entity is also likely to be able to track when these items are included in regulated rates charged in the future.
  - (b) the regulatory capital base and the property, plant and equipment use the same measurement basis.
  - (c) the recovery period of the regulatory capital base is closely aligned with the assets' useful lives. The regulatory recovery period for each asset class is determined based on the weighted average of the useful lives of assets within that asset class.

### *Respondents from Europe*

47. Two respondents from Europe in the electricity, gas and transport infrastructure sectors with subsidiaries across different regions did not reach a conclusion on whether some of their subsidiaries had a direct (no direct) relationship between their regulatory capital base and their property, plant and equipment.
48. One of these respondents said under each regulatory scheme, some of its subsidiaries' regulatory capital base and their property, plant and equipment have some features that would indicate there is direct relationship and some others that would indicate there is no direct relationship. We acknowledge this would be the case for many



regulatory schemes, and hence, an assessment of the direct (no direct) relationship concept would require judgement to determine which features should be given a higher weight. The other respondent provided reasons similar to that of the respondent in paragraph 34. None of the respondents provided individual conclusions for each of their subsidiaries. However, based on the information provided by these respondents, we did not identify specific matters for which additional guidance would be necessary apart from those in the conclusions section of this paper (paragraph 55).

49. Two other European respondents could not conclude on whether their regulatory capital base has a direct (no direct) relationship with their property, plant and equipment. This is because their regulator determined part of the regulatory depreciation of the regulatory capital base based on benchmarks. We contacted these respondents. Their case is described in paragraph 52.

#### ***Other factors considered by respondents***

50. In determining whether there is a direct (no direct) relationship, a few respondents operating in Europe considered how the regulators use benchmarks to determine:
- (a) a sector-level regulatory capital base (paragraph 51); or
  - (b) the measurement of part of the regulatory depreciation (paragraph 52).
51. In some European regulatory schemes, the regulator determines the regulatory capital base for a group of entities within the same sector rather than for each entity individually. The compensation for each entity is determined based on the entity's market share instead of the entity's property, plant and equipment. Each entity has very limited insight into how the regulator determines the sector regulatory capital base. Moreover, there are other measurement differences between the sector regulatory capital base and individual entities' property, plant and equipment (for example, the sector regulatory capital base is adjusted by inflation). Consequently, the entities are unable to track differences between the sector regulatory capital base and their property, plant and equipment. The respondents concluded that the sector regulatory capital base has no direct relationship with their property, plant and equipment.

52. In some other European regulatory schemes, the regulator determines part of the regulatory depreciation based on the entity's depreciation expense and the remaining part based on benchmarks. The regulatory capital base of the entities subject to this regulatory scheme is substantially the same as the entities' property, plant and equipment, with a few differences that can be tracked at the individual asset level. In these cases, an entity may determine that the regulatory depreciation received during a period is compensation for the depreciation expense incurred during the same period. The fact that the regulatory compensation is measured using a different basis from that used by the entity to measure the depreciation expense neither prevents the entity from concluding that there is a direct relationship nor gives rise to a difference in timing.

### ***Challenges identified by respondents***

53. A few European respondents wondered at what level should the direct (no direct) relationship concept be applied (for example, to the entire regulatory capital base or for part of the regulatory capital base). Changes in regulatory schemes may impact an entity's determination of whether there is a direct (no direct) relationship. For example, an entity's regulatory capital base had a direct relationship with its property, plant and equipment. As a result of changes in the regulatory scheme, part of the entity's regulatory capital base preserves the direct relationship and part of that base has no direct relationship with the entity's property, plant and equipment. These respondents questioned whether an entity could bifurcate its regulatory capital base in the assessment of the direct (no direct) relationship concept.

## **Conclusions and next steps**

54. Table 1 summarises the staff's conclusions from each of the individual sub-sections within the feedback section of the paper and any necessary next steps.

**Table 1—Summary of conclusions and next steps**

Feedback section	Conclusions	Next steps
<p><b>A. Main outcomes</b> (paragraphs 19–21)</p>	<p>Most respondents that completed the survey reported that they were able to conclude on whether their regulatory capital base had a direct (no direct) relationship with their property, plant and equipment.</p> <p>The direct (no direct) relationship concept seems to be an appropriate approach for determining whether differences in timing arise from the regulatory compensation an entity receives on its regulatory capital base in a variety of regulatory schemes.</p>	<p>1. We think the final Standard could include the direct (no direct) relationship concept to help an entity to identify differences in timing arising from the regulatory compensation the entity receives on its regulatory capital base.</p>
<p><b>B. Main outcomes</b> —direct relationship and no direct relationship</p>	<p>The features included in the background information document accompanying the survey (Agenda Paper 9C) were generally helpful for respondents to determine the direct (no direct) relationship.</p> <p>The features that respondents considered for the direct (no direct) relationship determination were generally aligned</p>	<p>2. We think the final Standard could specify that if an entity is able to trace differences between the regulatory capital base and the property, plant and equipment at an asset level, this is a strong indicator that there is a direct relationship.</p>

**Table 1—Summary of conclusions and next steps**

Feedback section	Conclusions	Next steps
<p>(paragraphs 22–43)</p>	<p>with the features included in the background information document accompanying the survey.</p> <p>The conclusion on whether there is a direct (no direct) relationship may not result in significantly different outcomes in relation to the accounting for regulatory assets and regulatory liabilities arising from differences between the regulatory recovery period and the assets’ useful lives when the recovery periods and the assets’ useful lives are aligned.</p>	<p>3. Differences in measurement basis between the regulatory capital base and the property, plant and equipment may cause a reconciliation of the two bases to be impracticable. However, a difference in measurement basis is not a determinant in the direct (no direct) relationship conclusion. For example, the feedback on this survey has shown that service concessions arrangements generally have a direct relationship between the regulatory capital base and the intangible asset even if the assets within that base are adjusted by inflation. Another example is the use of benchmarks for determining part of the regulatory depreciation described in row D of this table. We think the final Standard should include examples to illustrate this point.</p>

**Table 1—Summary of conclusions and next steps**

Feedback section	Conclusions	Next steps
		<p>4. When an entity operates under a service concession arrangement, the entity should determine whether there is a direct (no direct) relationship between the regulatory capital base and the intangible asset that arises from the service concession arrangement. We think the final Standard could provide this guidance.</p>
<p><b>C. Respondents that were unable to conclude</b> (paragraphs 44–49)</p>	<p>The main reasons provided by respondents were:</p> <ul style="list-style-type: none"> <li>(a) there are differences between the regulatory capital base and the property, plant and equipment that cannot be broken down at the individual asset or regulatory asset class level (paragraph 45);</li> <li>(b) the regulatory schemes have a mix of features that makes the determination challenging (paragraph 48); and</li> </ul>	<p>5. We think including examples in the final Standard to illustrate how an entity determines the direct (no direct) relationship would be helpful.</p>

**Table 1—Summary of conclusions and next steps**

Feedback section	Conclusions	Next steps
	<p>(c) part of the regulatory depreciation of the regulatory capital base is determined based on benchmarks (paragraph 52).</p> <p>Our conclusions on the reasons provided by respondents are as follows:</p> <p>(a) differences between the regulatory capital base and property, plant and equipment that cannot be broken down at the individual asset level may lead to a conclusion that there is no direct relationship. We think this would be a matter of judgement, including how significant those differences might be.</p> <p>(b) the regulatory capital base typically has both features of a direct relationship and features of no direct relationship. We think that an entity’s ability to</p>	

**Table 1—Summary of conclusions and next steps**

Feedback section	Conclusions	Next steps
	track differences at the individual asset level is a strong indicator that there is a direct relationship.	
<b>D. Other factors considered by respondents</b> (paragraphs 50–52)	<p>The compensation an entity receives on its regulatory capital base may be determined using benchmarks.</p> <p>In cases when the regulator determines a sector-level regulatory capital base, the individual entities within the sector are unable to track differences between that base and their property, plant and equipment. In these cases, the respondents concluded that there is no direct relationship (paragraph 51).</p> <p>As mentioned in row C of this table, in cases when the regulator uses benchmarks to determine part of the regulatory depreciation, the respondents were unable to conclude whether there is a direct (no direct) relationship. It is possible that part or all of the regulatory depreciation</p>	<p>6. We think the final Standard could include examples illustrating how to determine whether there is a direct (no direct) relationship when the compensation an entity receives on its regulatory capital base is linked to benchmarks.</p>

**Table 1—Summary of conclusions and next steps**

Feedback section	Conclusions	Next steps
	is measured using a different basis from that used by an entity to measure the depreciation expense. We think this fact neither prevents the entity from concluding that there is direct relationship nor gives rise to a difference in timing (paragraph 52).	
<b>E. Challenges identified by respondents</b> (paragraph 53)	A few respondents wondered at what level should the direct (no direct) relationship concept be applied (for example, to the entire regulatory capital base or for part of the regulatory capital base). For example, as a result of changes in the regulatory scheme, part of an entity’s regulatory capital base preserves the direct relationship and part of that base has no direct relationship with the entity’s property, plant and equipment.	7. The final Standard could emphasise that for the purposes of identifying differences in timing, an entity should consider the terms of the regulatory agreement, changes to these terms and how the regulator determines the regulated rate. The IASB has already discussed this at its meeting in July 2022. <sup>6</sup>

<sup>6</sup> [Agenda Paper 9A](#) discussed at the IASB meeting in July 2022.



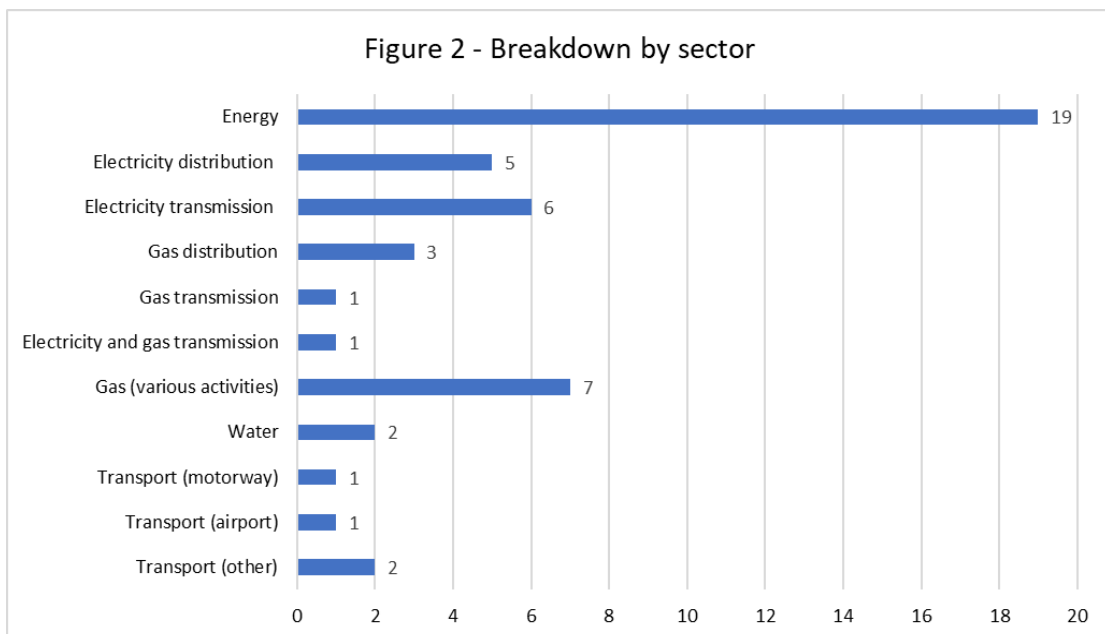
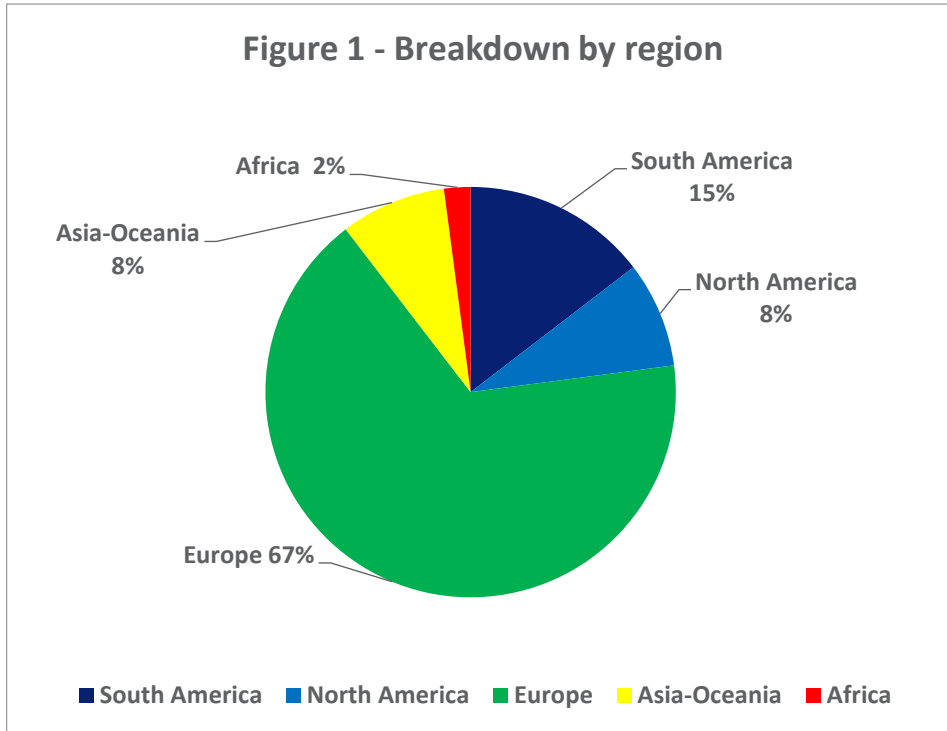
55. Based on the staff conclusions in Table 1, we recommend that the final Accounting Standard:
- (a) includes the direct (no direct) relationship concept to help an entity to identify differences in timing arising from the regulatory compensation the entity receives on its regulatory capital base (paragraph 1 in Table 1);
  - (b) specifies that if an entity is able to trace differences between the regulatory capital base and the property, plant and equipment at an asset level, this is a strong indicator that there is direct relationship (paragraph 2 in Table 1);
  - (c) specifies that in the case of service concession arrangements, an entity determines whether there is a direct (no direct) relationship between the regulatory capital base and the intangible asset that arises from the service concession arrangement (paragraph 4 in Table 1); and
  - (d) includes examples to illustrate how an entity determines the direct (no direct) relationship using specific fact patterns (paragraphs 3, 5 and 6 of Table 1).

#### Questions for the IASB

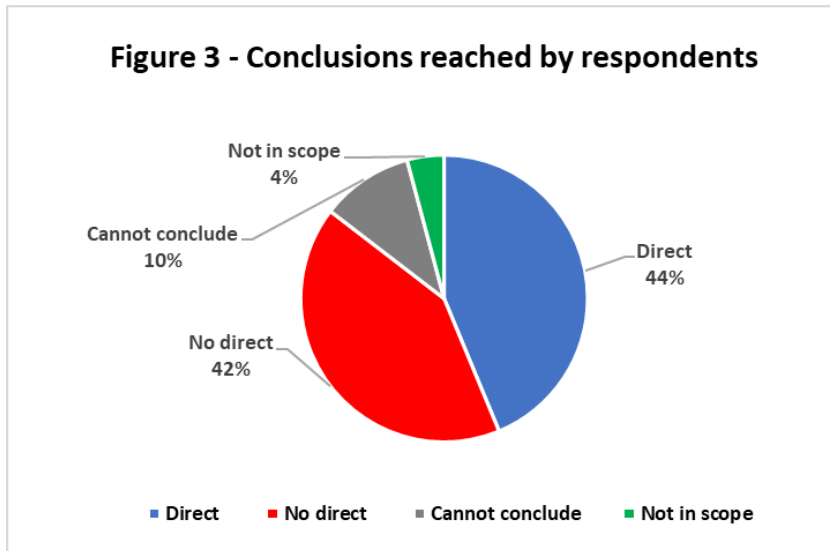
1. Does the IASB have any questions or comments on the feedback received on the direct (no direct) relationship concept?
2. Does the IASB agree with the recommendations summarised in paragraph 55?

## Appendix—Profile of respondents

A1. Figures 1 and 2 show the breakdown of the surveys received by region and sector.



A2. Figure 3 shows the breakdown of the conclusions reached by respondents. Of those able to conclude, there was an equal split between those concluding there was a direct relationship and those concluding there was no direct relationship.



A3. Figure 4 shows the breakdown of the conclusions reached by respondents by region. This figure shows that direct relationship is predominant in North and South America, with no direct relationship being predominant in Europe. We are still waiting for surveys from the electricity transmission and distribution sector in a jurisdiction in Asia-Oceania that may be subject to significantly different regulatory schemes from those of the respondents in this region. Therefore, the results for Asia-Oceania may not be representative of the actual split between direct and no direct relationship in this region.

