

HKFRS/IFRS UPDATE 2026/07

November 2026

HKICPA/IASB publishes HKFRS/IFRS 20 regulatory assets & regulatory liabilities

Background

Entities conducting rate regulated activities are required to establish prices to be charged to customers in accordance with a pricing framework that is subject to oversight and/or approval by a rate regulator, which is often a statutory body.

Rate regulation often gives rise to a difference in timing between the period when the entity supplies goods and services to customers and the period when it is entitled to charge the customers for those goods and services. In such cases, the revenue reported by the entity in its statement of financial performance and the assets and liabilities reported in its statement of financial position do not reflect the 'complete picture' of the compensation that the entity is entitled to for the goods and services supplied during that period. HKFRS/IFRS Accounting Standards did not require entities to inform investors about such differences in timing, except in the limited circumstances in which HKFRS/IFRS 14 *Regulatory Deferral Accounts* applied.

In January 2012, as an interim measure, the International Accounting Standards Board (IASB) issued IFRS 14. IFRS 14 permitted entities conducting rate regulated activities to continue to recognise and measure their regulatory deferral account balances in accordance with their previous GAAP in their first and subsequent IFRS financial statements. As IFRS 14's scope was limited to entities applying IFRS Accounting Standards for the first time, the number of entities applying it has been limited meaning that very few entities applying IFRS Accounting Standards have recognised regulatory assets and regulatory liabilities.

In January 2021, the IASB published the Exposure Draft (ED) of a new standard, *Regulatory Assets and Regulatory Liabilities* that was intended to replace IFRS 14.

After deliberating the feedback received on the ED, the IASB issued IFRS 20 *Regulatory Assets and Regulatory Liabilities* on 27 May 2026.

IFRS 20, Basis for Conclusions, illustrative examples and other supporting materials for IFRS 20 are available here on the IFRS Foundation website. The HKICPA published the equivalent standard, HKFRS 20 in July 2026.

Status

Final

Effective date

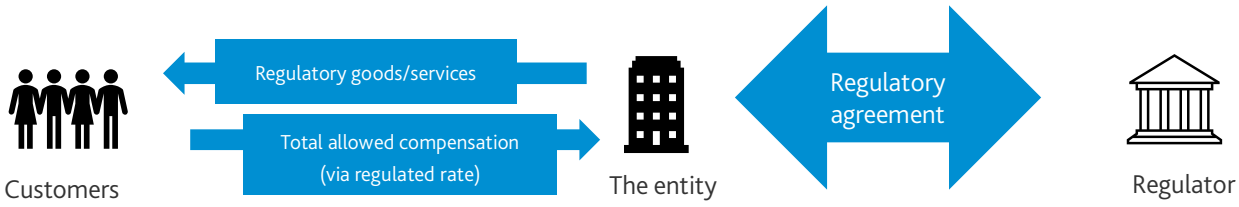
1 January 2029

Accounting impact

HKFRS/IFRS 20 requires entities subject to rate regulation to recognise regulatory assets and regulatory liabilities if certain criteria are met. The Standard may significantly affect financial reporting for entities in industries such as electricity, public transport, telecommunication.

HKFRS/IFRS 20 is expected to have a significant effect on entities in rate regulated sectors such as electricity, telecommunication, public infrastructure, public transport. For entities that are currently not accounting for regulatory deferral account balances as permitted by HKFRS/IFRS 14 in limited circumstances, HKFRS/IFRS 20 may significantly affect financial performance metrics and ratios such as EBITDA, operating profit, net income, earnings per share, return on investment and current ratio. Such entities will need to evaluate effects of these changes on their loan covenants, credit ratings and other key performance indicators.

Key concepts and terms introduced by HKFRS/IFRS 20



- A **regulator** is a body that is required by law or regulation to apply a regulatory agreement to determine a regulated rate (or a range for the regulated rate).
- A **regulatory agreement** is an agreement that creates a set of enforceable rights and enforceable obligations that prescribes how a regulator determines a regulated rate (or a range for the regulated rate).
- A **regulated rate** is a price determined by a regulator that an entity charges for goods or services supplied to customers in a period.
- **Regulatory goods or services** are goods or services supplied by an entity to comply with a regulatory agreement.
- **Total allowed compensation** is the amount of compensation to which a regulatory agreement entitles an entity for regulatory goods or services supplied in a reporting period. The amount might be charged through regulated rates in either the same period as the entity supplies the regulatory goods or services, or a different period.

When a part or all of the total allowed compensation for regulatory goods or services supplied by the entity in a reporting period is charged to customers through regulated rates in a **different period**, it creates a **difference in timing**. A **different period** may be a past period or a future period.

HKFRS/IFRS 20 addresses this difference in timing by recognising a regulatory asset or a regulatory liability.

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 or all of the total allowed compensation for regulatory goods or services already supplied has not yet been included in revenue recognised from contracts with customers applying HKFRS/IFRS 15 *Revenue from Contracts with Customers*.

Conversely, 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 part or all of the total allowed compensation for regulatory goods or services to be supplied in the future has already been included in revenue recognised from contracts with customers applying HKFRS/IFRS 15.

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

The following simplified example illustrates the issue of difference in timing and how HKFRS/IFRS 20 addresses it.

Fact pattern:

Entity A is an electricity provider is jurisdiction X and is subject to rate regulation. Entity A is entitled to recover input costs incurred in supplying electricity to end consumers. For simplicity, this example assumes no profit margin being included in the regulated rate.

The regulated rate is determined at the beginning of the year, based on estimated costs. Any under/over-recovery of costs due to a difference between the estimated and actual costs is adjusted in the regulated rate for the subsequent period.

Entity A's estimated and actual costs and amounts charged to customers through regulated rates are as below:

	Year 1	Year 2
Estimated input costs (a)	CU100	CU100
Actual input costs (b)	CU120	CU100
Amount charged to customers (c)	CU100 (based on estimated costs)	CU120 (estimated cost CU100 + under-recovery in year 1 of CU20)
(Under)/over recovery (c-b)	(CU20)	CU20

Accounting prior to HKFRS/IFRS 20 (assuming regulatory deferral account balances were not recognised):

The profit or loss recognised by Entity A, prior to HKFRS/IFRS 20, would be as below:

	Year 1	Year 2
Revenue (HKFRS/IFRS 15)	CU100	CU120
Input costs	(CU120)	(CU100)
Profit/(loss)	**(CU20)**	**CU20**

As the above accounting does not reflect the effect of differences in timing, the information provided to users about Entity A's performance for Year 1 and Year 2 may be misleading.

Accounting in accordance with HKFRS/IFRS 20:

Entity A would recognise a regulatory asset in accordance with HKFRS/IFRS 20, with resulting profit or loss as below:

	Year 1	Year 2
Revenue (HKFRS/IFRS 15)	CU100	CU120
Regulatory income/ (expense)	CU20	(CU20)
Total revenue	**CU120**	**CU100**
Input costs	(CU120)	(CU100)
Profit/(loss)	**-**	**-**

The balances of regulatory assets/ liabilities at the end of Year 1 and Year 2 would be as below:

	Year 1	Year 2
Regulatory asset	CU20	-

As a result of the recognition of regulatory assets/ liabilities, Entity A recognises the total allowed compensation for the regulatory goods or services provided in Year 1 and Year 2 in the respective years, which better reflects the performance of the entity.

Types of compensation provided

The example provided above is highly simplified and considers total allowed compensation to be equal to input costs. In practice, there may be different types of compensation provided under regulatory agreements, which include the following:

- Compensation for allowable expenses and deductions for chargeable income
- Regulatory returns, which are determined by applying a rate of return to a regulatory capital base (see below)
- Compensation or deductions for performance incentives
- Compensation for inflation provided separately from regulatory depreciation.

Scope

HKFRS/IFRS 20 applies to all regulatory assets and regulatory liabilities of an entity, with the exception of regulatory assets and regulatory liabilities that arise if premiums charged in insurance contracts within the scope of HKFRS/IFRS 17 *Insurance Contracts* are regulated.

BDO comment

It should be noted that being subject to a type of price control does not necessarily mean that the entity will be in the scope of HKFRS/IFRS 20.

For example, a government may impose a limit on price increases or the total price that an entity charges on goods or services, such as commodities. This price limit by itself would not result in the regulatory effect being in the scope of HKFRS/IFRS 20 because those types of ceilings do not result in differences in timing.

Recognition and measurement requirements

Recognition

HKFRS/IFRS 20 requires an entity to recognise:

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

b. all regulatory income and all regulatory expense arising during a reporting period.

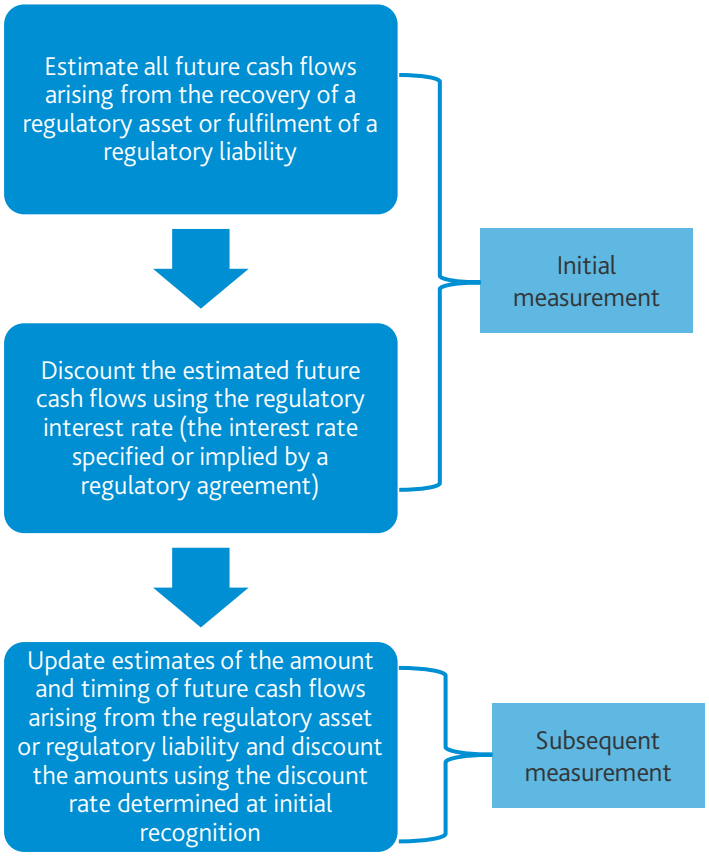
This recognition requirement results in the total allowed compensation for regulatory goods and services supplied in a particular reporting period being recognised in the same reporting period, thereby removing the differences in timing.

In case of under-recovery of compensation in the period in which the regulated goods or services are supplied, the entity would recognise a regulatory asset with the corresponding regulatory income. In case of over-recovery of compensation in the period in which the regulated goods or services are supplied, the entity would recognise a regulatory liability with the corresponding regulatory expense. Over the life of the regulatory agreement, the total allowed compensation would equal the revenue charged.

In case of uncertainties about the existence of regulatory assets or regulatory liabilities, an entity is required to assess whether the regulatory asset or regulatory liability is more likely than not to exist. The regulatory asset or regulatory liability is required to be recognised when it is more likely than not to exist.

Measurement

The measurement of regulatory assets and regulatory liabilities involves the following steps:



In case of uncertainties about the amount or timing of future cash flows, the entity is required to estimate uncertain future cash flows using either the most likely amount or the expected value. The method that better predicts the ultimate cash flows is required to be used.

Applicability of HKFRS/IFRS 15 to entities within the scope of HKFRS/IFRS 20

It should be noted that HKFRS/IFRS 15 continues to apply to entities with activities in the scope of HKFRS/IFRS 20.

The revenue recognised in a reporting period by a rate-regulated entity applying HKFRS/IFRS 15 depends on the regulated rate charged for regulatory goods or services supplied to customers in that reporting period. This amount can differ from the total allowed compensation for the regulatory goods or services supplied in that reporting period if differences in timing arise. The effects of these differences in timing are reflected in the financial statements by recognising regulatory assets and regulatory liabilities.

Simplified measurement approach for items that affect regulated rates only on payment/ receipt of cash

In some cases, a regulatory agreement provides compensation for an allowable expense or makes a deduction for chargeable income in determining the regulated rates only when an entity pays or receives the related cash, or soon after that. In such cases, HKFRS/IFRS 20 provides a simplified measurement approach.

Under this approach, the entity is required to measure the regulatory asset or regulatory liability using the carrying amount of the related liability, related asset or related loss allowance resulting from applying HKFRS/IFRS Accounting Standards. This carrying amount is required to be adjusted to reflect any differences between the related liability, related asset or related loss allowance and the regulatory asset or regulatory liability. An example of such differences would be differences resulting from uncertainties arising from estimation, credit or demand risk, which may be present in the related liability/ asset/ loss allowance, but not in the regulatory asset or regulatory liability and vice-versa.

Example of the simplified approach

Entity A enters into a regulatory agreement with a regulator. The agreement provides for compensation for pension costs in determining the regulated rates only when Entity A pays the benefits and settles its obligations under the defined benefit pension plan.

Applying the simplified measurement approach, Entity A measures the regulatory asset using the carrying amount of the related pension liability in accordance with HKAS/IAS 19 *Employee Benefits*, adjusted for any differences between the pension liability and the regulatory asset. These differences could arise if, for example, the regulatory agreement prohibits the entity from adding or deducting any differences between estimated benefit payments and actual benefit payments in determining future regulated rates.

If the simplified measurement approach had not been applicable, Entity A would have been required to estimate the cash flows for pension costs and discount them using the regulatory interest rates.

It should be noted that an entity is **required to** apply the simplified measurement approach in cases where the related items affect regulated rate only when the related cash is paid or received. This is not an accounting policy choice.

Regulatory interest rate

An entity is required to discount the estimated future cash flows arising from a regulatory asset or regulatory liability using the regulatory interest rate specified or implied by the regulatory agreement.

In specified cases, such as when the regulatory agreement specifies uneven interest rates over the life of a regulatory asset or a regulatory liability, an entity is required to derive an implied regulatory interest rate. This would be a rate that at initial recognition discounts the estimates of future cash flows arising from a regulatory asset or regulatory liability, which include regulatory interest cash flows, back to an amount that equals the sum of the estimated future cash flows, excluding regulatory interest.

For subsequent measurement of regulatory assets and regulatory liabilities, an entity is required to use discount rate determined at initial recognition for discounting estimated future cash flows. However, the regulatory interest rate may change subsequently, in case of a change in the regulatory agreement or a change in the interest rate benchmark to which the regulatory interest rate is linked. In such cases, the entity would be required to use the revised regulatory interest rate for discounting estimated future cash flows prospectively.

Interaction between HK(IFRIC)/IFRIC 12 Service Concession Arrangements and HKFRS/IFRS 20

A service concession arrangement within the scope of HK(IFRIC)/IFRIC 12 may give rise to regulatory assets or regulatory liabilities. For example, Entity X enters into a 'build-operate-transfer' arrangement with the government of jurisdiction X. Under the arrangement, Entity X is required to construct a highway and operate it for a period of ten years after the construction. The ownership of the road remains with the

government. In exchange, Entity X receives the right to charge tolls to vehicles passing on the highway for the period of ten years after the construction. The arrangement regulates the toll rate and the regulation results in differences in timing between the total allowed compensation for a particular period and the revenue recognised applying HKFRS/IFRS 15 for that period. This arrangement is within the scope of both HK(IFRIC)/IFRIC 12 and HKFRS/IFRS 20.

In such cases, the entity is required to:

- first apply the requirements in HK(IFRIC)/IFRIC 12 and other HKFRS/IFRS Accounting Standards to account for rights and obligations arising from that arrangement; and
- then apply the requirements in HKFRS/IFRS 20 to any remaining rights and obligations from that arrangement that meet the definition of a regulatory asset or a regulatory liability.

It should be noted that a service concession arrangement within the scope of HK(IFRIC)/IFRIC 12 is not necessarily within the scope of HKFRS/IFRS 20. For example, if, in the above fact pattern, the service concession arrangement had only provided for a ceiling on the toll that Entity X might charge, without any other condition that gave rise to differences in timing, the arrangement would not be within the scope of HKFRS/IFRS 20, but it would be within the scope of HK(IFRIC)/IFRIC 12.

Regulatory capital base and related concepts

Regulatory capital base (RCB) is defined as assets and other items that a regulatory agreement entitles an entity to recover by adding an amount for regulatory depreciation in determining a regulated rate to be charged to customers.

It should be noted that RCB may include items other than depreciable or amortisable assets, for example, performance incentives.

Regulatory agreements typically allow entities to recover the RCB through **regulatory depreciation**, which is a systematic allocation of the RCB by a regulator to be added in determining the regulated rate.

Regulatory capital base may be used in regulatory agreements because regulated activities often require capital intensive expenditures (e.g. the development of electrical transmission infrastructure). Regulatory depreciation permits the entity to recover their investment via the regulated rate over time.

An entity is required to recognise a regulatory asset or a regulatory liability if, and only if, the RCB has a **direct relationship** with related items. Such direct relationship can be established if the entity is able to track, by amount and reporting period, how regulatory depreciation provides compensation or makes a deduction for the amounts arising from the related items.

The following simplified example explains the concept of direct relationship of RCB with related items and differences in timing arising from it (adapted from illustrative example 1B accompanying HKFRS/IFRS 20):

Entity A has entered into a regulatory agreement with a regulator that entitles Entity A to recover the cost of depreciable assets through regulatory depreciation on a straight-line basis over the regulatory recovery period.

Entity A has two asset classes recognised in its financial statements, determined by applying HKAS/IAS 16 *Property, Plant and Equipment* (HKFRS/IFRS asset classes) – Asset Class A and Asset Class B.

The regulatory agreement provides for different regulatory classes (Regulatory asset classes) – Asset Class X and Asset Class Y.

The regulatory methodology for determining the regulatory capital base enables Entity A to identify:

- the amounts in each HKFRS/IFRS asset class that are included in each regulatory asset class; and
- the amount of depreciation expense arising from each HKFRS/IFRS asset class that is compensated through regulatory depreciation arising from each regulatory asset class.

The cost, useful lives and depreciation of property, plant and equipment (PPE) as per HKAS/IAS 16 are as below:

	Cost (CU)	Useful life (years)	Annual depreciation (straight-line) (CU)
HKFRS/IFRS Asset Class A	5,000	5	1,000
HKFRS/IFRS Asset Class B	9,000	3	3,000
Total	**14,000**		

The classification of the items of PPE as per the regulatory asset classes, the regulatory recovery period and regulatory depreciation are as below:

		Cost (CU)	Regulatory recovery period (years)	Regulatory depreciation per annum (CU)
Regulatory Asset Class X	From HKFRS/IFRS Asset Class A	5,000	4	1,250
	From HKFRS/IFRS Asset Class B	3,000	4	750
		8,000		**2,000**
Regulatory Asset Class Y	From HKFRS/IFRS Asset Class B	6,000	2	3,000
Total		**14,000**		

The differences in timing arising over years 1-5 would be as below:

(Amounts in CU)

	Year 1	Year 2	Year 3	Year 4	Year 5
HKFRS/IFRS depreciation					
HKFRS/IFRS Asset Class A	1,000	1,000	1,000	1,000	1,000
HKFRS/IFRS Asset Class B	3,000	3,000	3,000	-	-
Total HKFRS/IFRS depreciation (I)	**4,000**	**4,000**	**4,000**	**1,000**	**1,000**
Regulatory depreciation					
Regulatory Asset Class X	2,000	2,000	2,000	2,000	-
Regulatory Asset Class Y	3,000	3,000	-	-	-
Total regulatory depreciation (II)	**5,000**	**5,000**	**2,000**	**2,000**	**-**
Differences in timing (I-II)	**(1,000)**	**(1,000)**	**2,000**	**(1,000)**	**1,000**
Closing balance of regulatory asset/(liability)	**(1,000)**	**(2,000)**	**-**	**(1,000)**	**1,000**

In this example, Entity A determines that it is able to disaggregate each HKFRS/IFRS asset class into regulatory asset classes. Each disaggregated part of an HKFRS/IFRS asset class is the smallest aggregation of assets for which it is able to track, by amount and reporting period, how depreciation expense is compensated through regulatory depreciation. Therefore, Entity A determines that its RCB has a direct relationship with its property, plant and equipment in each disaggregated part of an HKFRS/IFRS asset class.

In this assessment, Entity A considers all reasonable and supportable information that is available without undue cost or effort, including:

a. the regulatory methodology underlying the determination of the regulatory capital base and regulatory depreciation; and

b. how the regulator monitors whether the regulatory depreciation provides compensation for the depreciation or amortisation expense.

In contrast to the above example, consider the following fact pattern:

> Entity B enters into a regulatory agreement with a regulator. The agreement entitles Entity B to recover the cost of the assets through regulatory depreciation on a regulatory capital base. The regulatory capital base is determined by reference to the average capital bases of five comparable public sector entities specified in the regulatory agreement. The agreement specifies which asset classes of these comparable entities need to be considered for determining the regulatory capital base of Entity B.

In this case, Entity B's RCB does not have a direct relationship with related items, i.e. the assets of Entity B. Therefore, Entity B would not be permitted to recognise regulatory assets and regulatory liabilities arising from regulatory depreciation of RCB.

It is possible for RCB to comprise parts that have a direct relationship with related items and a part that does not have such a relationship. In this case, the requirement to recognise regulatory assets and regulatory liabilities will apply to the parts of RCB that have a direct relationship with related items.

Regulatory return

Some regulatory agreements provide for a **regulatory return**, which is a return on the RCB resulting from the rate of return a regulatory agreement applies to the RCB. Such return might be only a debt return, only an equity return or both a debt and equity return.

A regulatory return forms part of the total allowed compensation for the reporting period in which the regulatory agreement applies the rate of return to the RCB. However, there is an exception to this requirement for a regulatory return on assets not yet available for use. For assets not yet available for use in certain specified situations, HKFRS/IFRS 20 specifies the periods in which the regulatory returns would be considered to be a part of the total allowed compensation.

Presentation and disclosure requirements

Presentation

Statement(s) of financial performance

An entity is required to classify all regulatory income and all regulatory expense (including regulatory interest income/expense) as revenue and present all regulatory income minus all regulatory expense as a line item in the statement of profit or loss.

There is one exception to the above requirement. When an entity includes an item of expense or income in other comprehensive income (OCI) applying other HKFRS/IFRS Accounting Standards, the entity is required to include regulatory income or regulatory expense relating to that item of expense or income in OCI. Such regulatory income or regulatory expense would be reclassified to profit or loss if, and only if, the entity reclassifies the related expense or related income to the statement of profit or loss in accordance with other HKFRS/IFRS Accounting Standards.

Statement of financial position

An entity is required to present in its statement of financial position:

a. regulatory assets and regulatory liabilities as line items; and

b. current and non-current regulatory assets, and current and non-current regulatory liabilities, as separate classifications in accordance with HKFRS/IFRS 18 *Presentation and Disclosure in Financial Statements*, except when the entity presents all assets and liabilities in order of liquidity.

Disclosure

HKFRS/IFRS 20 contains extensive disclosure requirements to enable users to understand the relationship between the entity's revenue and expenses and the effect of rate regulation.

The overall objective of the disclosure requirements is to disclose information that will provide insights into:

- the total allowed compensation for regulatory goods or services supplied by the entity in a reporting period, and hence into the entity's financial performance and prospects for future cash flows; and
- the entity's financial position at the end of a reporting period and the amount, timing and uncertainty of the entity's future cash flows.

Some of the critical disclosure requirements include:

- reconciliation from the opening to closing carrying amounts of regulatory assets and regulatory liabilities;
- quantitative information, using time bands, about when the entity expects to recover the regulatory assets and fulfil the regulatory liabilities;
- discount rate(s) used in measuring regulatory assets and regulatory liabilities;
- an explanation of how uncertainties affect the recovery of regulatory assets or fulfilment of regulatory liabilities
- nature of unrecognised regulatory assets or unrecognised regulatory liabilities and the reason they have not been recognised; and
- information that enables users of financial statements to understand the relationship between the entity's regulatory capital base and a related item or items.

Effective date and transition requirements

Effective date

HKFRS/IFRS 20 is applicable for annual reporting periods beginning on or after 1 January 2029, with earlier application permitted. In case of earlier application, the entity is required to disclose the fact.

Transition requirements

For the purposes of the transition to HKFRS/IFRS 20, the date of initial application is the beginning of the annual reporting period in which an entity first applies HKFRS/IFRS 20 and the transition date is the beginning of the annual reporting period immediately preceding the date of initial application. Therefore, if an entity applies HKFRS/IFRS 20 from an annual reporting period beginning on 1 January 2029, the date of initial application would be 1 January 2029 and the transition date would be 1 January 2028.

At the transition date, an entity is required to:

a. recognise and measure regulatory assets and regulatory liabilities as if HKFRS/IFRS 20 had always been applied;

b. derecognise all regulatory balances that the entity would not have recognised as regulatory assets or regulatory liabilities if HKFRS/IFRS 20 had always been applied;

c. recognise any deferred tax effects of the adjustments in (a)–(b); and

d. recognise the net amount of the adjustments in (a)–(c) in opening retained earnings (or other component of equity, as appropriate).

HKFRS/IFRS 20 permits two transition approaches:

- retrospective approach in accordance with HKAS/IAS 8 *Basis of Preparation of Financial Statements*; or
- modified retrospective approach.

The transition procedures explained above apply irrespective of the transition approach followed.

Further, an entity is also required to present/ disclose the following, irrespective of the transition approach:

- adjusted comparative information for the annual reporting period immediately preceding the date of initial application; and
- the quantitative information required by HKAS/IAS 8.28(f) for the annual reporting period immediately preceding the date of initial application.

The modified retrospective approach provides the following transition reliefs:	
Transition relief	**Explanation**
Election to apply the requirements for a regulatory return on assets not yet available for use in specific circumstances only to assets that are not yet available for use at the transition date	For assets not yet available for use in specific circumstances, HKFRS/IFRS 20 specifies the periods in which the regulatory returns would be considered to be a part of the total allowed compensation depending on whether the regulatory return is a debt return or both a debt or equity return. An entity may face challenges in applying these requirements if it had stopped tracking capitalised borrowing costs once assets became available for use or if it had not tracked regulatory returns included in the regulated rates charged during the periods in which the assets were not yet available for use. Therefore, this transition relief is provided. If an entity does not apply this transition relief, these requirements of HKFRS/IFRS 20 would be required to be applied for all assets that met the specified conditions which include capitalisation of borrowing costs applying HKAS/IAS 23 *Borrowing Costs* before the asset was available for use. For example, Entity X enters into a regulatory agreement which provides for a regulatory return comprising both a debt and equity return. As at the transition date of 1 January 2028, Entity X did not have any assets that were not yet available for use. However, as at 1 January 2027, it had assets not yet available for use which had a direct relationship with the RCB under the regulatory agreement. Entity X capitalised borrowing costs on these assets applying HKAS/IAS 23. If Entity X elects not to apply the transition relief, it would be required to apply HKFRS/IFRS 20.B36(b)(ii) and treat the regulatory return in excess of the capitalised borrowing cost as forming part of the total allowed compensation of the period in which the regulatory asset was not yet available for use. As a result, Entity X would recognise a regulatory asset for this item on the transition date and account for its subsequent recovery.

	If Entity X elects to apply the transition relief, it will not apply the requirements of HKFRS/IFRS 20.B35-B40 to these assets.
Election to disregard any implied regulatory interest rates that would have been derived from the terms of the regulatory agreement before the transition date, when applying the requirements for an implied regulatory interest rate	For example, Entity Y has entered into a regulatory agreement which is applicable for the period from 1 January 2011 to 31 December 2030. The agreement provided for interest rates that fluctuated from 6% to 9% per annum up to 31 December 2025. From 1 January 2026 to 31 December 2030, the interest rate was 8% per annum. Entity Y's transition date for HKFRS/IFRS 20 is 1 January 2028. If Entity Y applies this transition relief, it can disregard the uneven interest rates before 1 January 2028 to determine the implied interest rate. If Entity Y elects not to apply this transition relief, it would need to derive the implied interest rate at the inception of the agreement based on the fluctuating interest rates.
Use of hindsight at the transition date	For example, Entity Z has entered into a regulatory agreement which provides for a regulated rate to be determined at the beginning of the year based on estimated costs. Any under/over-recovery is adjusted in the regulated rate to be charged over the subsequent periods. In case of under-recovery, the regulated rate for the subsequent period(s) is increased by CU5 per unit of regulatory goods supplied. The increased rate continues until Entity Z recovers the entire amount of under-recovery. In case of over-recovery, the regulated rate for the subsequent period(s) is reduced by CU5 per unit of regulatory goods supplied. The reduced rate continues until the entire amount of over-recovery is compensated for. As at 31 December 20X7, Entity Z had an under-recovery of CU10,000 of total allowed compensation for the goods provided in the year 20X7. The date of transition to HKFRS/IFRS 20 for Entity Z is 1 January 20X8. Entity Z would need to determine the regulatory asset as at 1 January 20X8 by discounting the estimated future cash flows for recovery of the shortfall of CU10,000 using the regulated interest rate. The estimated future cash flows will depend on the estimated number of units of regulated goods to be supplied in future periods. If Entity Z does not apply this transition relief, it would have to determine the estimated number of units of regulated goods to be supplied in future periods as at 1 January 20X8 based on the facts and circumstances existing as at that date i.e. as at 1 January 20X8. For example, Entity Z determines that it would have estimated the number of units of regulated goods to be supplied in 20X8 and 20X9 as 1,200 per annum based on facts and circumstances existing as at 1 January 20X8. Therefore, it would have estimated a recovery of CU6,000 (1,200 units * CU5) in the year 20X8 and the remaining recovery of CU4,000 (800 units * CU5) in the year 20X9. It would then need to discount these amounts and determine the regulatory asset as at 1 January 20X8. If Entity Z had actually supplied 1,500 units in 20X8 and recovered CU7,500 (1,500 units * CU5) in 20X8, it cannot consider this fact in its determination of the regulatory asset as at 1 January 20X8, as that would be use of hindsight. If Entity Z applies the transition relief of use of hindsight, it can determine the regulatory asset considering the actual quantity of regulatory goods supplied in subsequent periods and discounting the actual cash flows of recovery. Therefore, it would consider a recovery of CU7,500 in 20X8 and CU2,500 in 20X9 and discount these amounts without having to estimate the amounts based on facts and circumstances as at 1 January 20X8.

An entity is permitted to elect one or more of the above transition reliefs when the modified retrospective approach is applied. An entity electing to use the modified retrospective approach is required to disclose the transition reliefs applied and describe how the transition reliefs are applied.

Effects of HKFRS/IFRS 20

The effects of HKFRS/IFRS 20 on the financial statements of entities subject to rate regulation may be significant for entities that currently do not recognise regulatory balances. For companies that currently recognise regulatory balances, the effects will depend on how they currently account for such balances.

The transition requirements of HKFRS/IFRS 20 will require entities to gather data for all reporting periods presented in the financial statements and also to evaluate estimates for all those reporting periods.

Estimating future cash flows may involve significant judgement as these are based not only on rates permitted by the rate regulation, but also on future demand for goods and services (e.g. forecasted demand for electricity). Entities will also need to evaluate disclosure requirements under HKAS/IAS 8 *Basis of Preparation of Financial Statements* for the significant judgements and sources of estimation uncertainty involved.

The following are some other complexities that may arise in the implementation and ongoing application of HKFRS/IFRS 20:

- Determining whether the activities of the entity are in the scope of HKFRS/IFRS 20
- Assessing direct relationship between the regulatory capital base and the related items
- Tracking regulatory capital base and related items
- Application of the requirements related to regulatory return on assets not yet available for use in specific circumstances
- Determination of implied interest rate
- Recognition and measurement of deferred tax on regulatory assets and regulatory liabilities
- Application of HKFRS/IFRS 20 along with HK(IFRIC)/IFRIC 12, wherever applicable
- Extensive disclosure requirements.

Implementation of HKFRS/IFRS 20 may also require changes to business processes. Therefore, affected entities should start assessing the effect of HKFRS/IFRS 20 and begin their transition work plan as soon as possible.

BDO's support and assistance on HKFRS/IFRS Accounting Standards

For any support and assistance on HKFRS/IFRS Accounting Standards, please talk to your usual BDO contact or email info@bdo.com.hk
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