

[Draft] Comment Letter

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Comments should be submitted by [28 June 2021].

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

[XX April 2021]

Dear Mr Hoogervorst,

Re: IASB Exposure Draft ED/2021/1 *Regulatory Assets and Regulatory Liabilities*

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on *Regulatory Assets and Regulatory Liabilities*, issued by the IASB on 28 January 2021 (the 'ED').

This letter is intended to contribute to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of definitive IFRS Standards in the European Union and European Economic Area.

EFRAG welcomes the ED and the IASB's efforts to address the accounting for regulatory assets and regulatory liabilities and respond to stakeholder requests for the IASB to conclude on whether rate regulation creates enforceable rights and enforceable obligations not recognised under IFRS Standards and which could qualify for recognition as assets and liabilities.

If finalised as a new IFRS Standard, the accounting model would replace IFRS 14, an interim Standard that was issued in January 2014 and permits a variety of accounting approaches for the effects of rate regulation to continue temporarily. This will enhance comparability of information for users of financial statements of entities that will be required to apply the accounting model.

EFRAG also agrees with the IASB's proposal that the accounting model for regulatory assets and regulatory liabilities will supplement the information that an entity already provides by applying IFRS Standards.

Summary of EFRAG's tentative position on the proposals

Objective and scope

EFRAG supports the IASB's overall objective to develop an accounting model for regulatory assets and regulatory liabilities. EFRAG agrees that the information provided by the proposed accounting model, together with information required by other IFRS Standards, would enable users of financial statements to understand how the financial performance and the financial position of a reporting entity is affected by its rate-regulated activities.

EFRAG supports the scope as defined in the ED. However, EFRAG is concerned about the possible impact of the scope outside the utilities sector. Therefore, EFRAG considers

that more specific guidance and examples on what constitutes a regulatory agreement would be helpful to appropriately identify activities within the scope of the proposed model.

Regulatory assets and regulatory liabilities – definitions

EFRAG supports the proposed definitions of regulatory assets and regulatory liabilities and agrees with the IASB's conclusions that regulatory assets and regulatory liabilities meet the definitions of assets and liabilities under the Conceptual Framework.

EFRAG agrees that the accounting model should focus on total allowed compensation, which includes the recovery of allowable expenses minus chargeable income, a profit component and regulatory interest to compensate or charges the entity for the time value of money.

Total allowed compensation

EFRAG supports the proposed inclusion of the three components of target profit (profit margin, regulatory returns other than those related to assets not yet in use also referred to as construction work in progress-CWIP, and performance incentives) in the total allowed compensation. However, EFRAG disagrees with the proposal that the regulatory returns for CWIP are only included in profit or loss when the asset is in use.

Recognition

EFRAG agrees that an entity should recognise all its regulatory assets and regulatory liabilities and supports the proposed recognition criteria. However, EFRAG recommends that IASB provide further guidance in the body of the future Standard regarding derecognition of regulatory assets and regulatory liabilities.

Measurement

EFRAG supports the proposed cash-flow measurement technique, including the proposal to estimate future cash flows using the most likely amount method or the expected value method, whichever the entity expects will better predict the cash flows.

EFRAG considers the requirements and guidance in the ED on the boundary of the regulatory agreement to be confusing and might result in different interpretations of what comprises the regulatory boundary.

Measurement (discounting)

EFRAG has concerns about the complexity that could arise from the discounting proposals. Should the IASB decide to require discounting, EFRAG supports using the regulatory discount rate for regulatory assets and regulatory liabilities and disagrees with the proposed application of a minimum adequate rate. We also do not support having different discounting approaches for regulatory assets and regulatory liabilities.

Measurement exception

EFRAG agrees with the ED proposals related to the measurement exception for regulatory assets and regulatory liabilities that relate to expenses or income that will be included in or deducted from the future rates when cash is paid or received. EFRAG also agrees with the proposed presentation of remeasurements of these items in Other Comprehensive Income (OCI).

Presentation

EFRAG agrees with the ED proposal to present all regulatory income minus all regulatory expense as a separate line item immediately below revenue and to include regulatory interest income and regulatory interest expense within this line item.

Disclosure

EFRAG agrees with the proposed overall disclosure objective and the specific disclosure objectives in the ED. EFRAG is of the view that these disclosure requirements will provide relevant information to users of financial statements.

However, EFRAG considers that the level of detail required to meet the specific disclosure objectives might impose a significant burden on reporting entities to generate the information. Therefore, EFRAG recommends that there will be a need to identify and prioritise from the proposed disclosures, only those that will be ascertained to be beneficial to users of financial statements and will not impose an undue burden for preparers.

Other matters (transition requirements, interaction with other standards and likely effects)

EFRAG generally supports the proposed retrospective approach transition requirements and suggests the effective date should be 24 months after the publication of the final standard to allow effective implementation.

EFRAG generally agrees with the IASB proposals addressing the interaction of the proposed Standard with other IFRS Standards. However, EFRAG suggests the need for further elaboration on interaction with IFRIC 12 and IFRS 3 requirements for past business combinations.

EFRAG agrees with the IASB's analysis of the likely effects of the proposals on the quality of financial reporting (i.e., for entities that currently recognise regulatory balances and for those that do not). On the basis of preparers' and users' overall assessment of the proposed model during the early-stage effects analysis, EFRAG expects a positive cost-benefit relationship from implementing the proposals for both users and preparers.

EFRAG's detailed comments and responses to the questions in the ED are set out in the Appendix.

If you would like to discuss our comments further, please do not hesitate to contact Isabel Batista, Ioana Kiss, Galina Borisova, or me.

Yours sincerely,

Jean-Paul Gauzès
President of the EFRAG Board

Appendix - EFRAG's responses to the questions raised in the ED

Introduction

- 1 The ED is the outcome of the IASB project on accounting for activities subject to rate-regulation. The IASB project began in 2008, to respond to stakeholder requests for the IASB to conclude on whether rate regulation creates rights and obligations not recognised under IFRS Standards and which could qualify for recognition as assets and liabilities. Since the start of the project, the IASB published an Exposure Draft Rate-regulated Activities in 2009 (which did not receive much support mainly because of its restricted scope that focused mainly on cost-of-service regulation, an interim Standard IFRS 14 Regulatory Deferral Accounts in January 2014 and a Discussion paper Reporting the Effects of Rate Regulation published in September 2014 (2014 DP).
- 2 The IASB's proposed accounting model for regulatory assets and regulatory liabilities will supplement the information that an entity already provides by applying IFRS Standards.
- 3 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.
- 4 As a result, an entity would recognise in statement(s) of financial performance regulatory expense and regulatory income to depict performance of the reporting period.
- 5 If finalised as a new IFRS Standard, the accounting model would replace IFRS 14, an interim Standard that was issued in January 2014 and permits a variety of accounting approaches for the effects of rate regulation to continue temporarily.
- 6 The ED is a follow-up of the 2014 DP which described the common features of various types of rate regulation. It grouped features that seemed most likely to give rise to rights and obligations that meet the definitions of an asset and a liability in the Conceptual Framework, and that are incremental to the assets and liabilities accounted for by applying existing IFRS Standards. The 2014 DP described the features of rate regulation that should be considered to determine whether an entity's activities should be within the scope of the DP. The DP also provided an overview of possible accounting approaches.

Question 1: Objective and scope

Notes to constituents- The IASB proposals included in the ED

Objective

- 7 *The IASB's overall objective 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.*

- 8 *The proposed model would supplement the information an entity already provides by applying IFRS Standards, including IFRS 15. This will enable users of financial statements to understand the total allowed compensation for goods or services supplied to customers in each period and the related rights and obligations. The income, expenses, assets and liabilities reported by applying the model are supplementary (incremental) to those for which an entity already accounts for by applying IFRS 15 and other IFRS Standards.*

Scope

- 9 *The ED proposes that an entity apply the proposed requirements to all its regulatory assets and all its regulatory liabilities.*
- 10 *Regulatory assets and regulatory liabilities are **created by a regulatory agreement** that determines the regulated rate in such a way that the part (some or all) of total allowed compensation for goods or services supplied in one period is charged to customers in a different period. Any other rights or obligations created by the regulatory agreement should be accounted for under other IFRS Standards.*
- 11 *The accounting model focuses on increases in future regulated rates that are **charged to customers** because of goods or services already supplied and on decreases in future regulated rates because of revenue already recognised (which includes a profit element). Therefore, recovery and settlement of total allowed compensation by parties other than the customer are not within the scope of this ED and would be accounted under existing IFRS Standards.*
- 12 *The ED proposes not to 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. The Basis for Conclusions (BC83) informs that the IASB decided not to set the scope more narrowly by focusing only on the features that were described in its 2014 DP which focused more on rate regulation present in monopolistic environments which have become less common over the years.*
- 13 *The ED proposes that a regulatory asset or regulatory liability can exist only if:*
- (a) *the entity is party to a regulatory agreement;*
 - (b) *the regulatory agreement determines the regulated rate an entity charges for the goods or services it supplies to customers; 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).*
- 14 *The IASB considers that the above features create enforceable rights and enforceable obligations that an entity should recognise as regulatory assets and regulatory liabilities. The features are explained in more detail in the Basis for Conclusions (BC30-BC35).*
- 15 *The ED does not define a regulator or specify the form of the regulatory agreement. Instead, the ED describes a regulatory agreement as a set of enforceable rights and obligations that determine a regulated rate to be applied in contracts with customers. For example, a regulatory agreement may take the form of (paragraph 8 of the ED):*
- (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 regulation.*
- 16 *The ED also does not specify whether a particular type of body, such as a regulator, must exist to enforce compliance with the regulatory agreement, and what the characteristics of that body should be. Paragraph BC86 explains that if the IASB*

were to specify characteristics that a regulator must possess, its aim would be to create a distinction that leads to entities producing the information that would be most useful to users of financial statements. This is because:

- (a) *Those characteristics vary greatly: regulators and other enforcement bodies can take diverse legal forms, can be designed with various features, can have various objectives and mandates, and can be required to meet various procedural requirements.*
 - (b) *Specifying such characteristics is unnecessary because the IASB proposes that the rights and obligations created by the regulatory agreement need to be enforceable.*
- 17 *The IASB found no reason why setting the scope of the ED more narrowly to include only regulatory agreements subject to a regulator with particular characteristics would lead to more useful information about the effects of regulatory assets and regulatory liabilities.*
- 18 *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.*
- 19 *The ED defines total allowed compensation for goods or services as being 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.*
- 20 *BC33 explains that unlike some existing accounting approaches for reporting regulatory balances, the proposed model does not involve the deferral of costs. The accounting model focuses on increases in future regulated rates because of goods or services already supplied and on decreases in future regulated rates because of revenue already recognised. The measurement of regulatory assets and regulatory liabilities is based on total allowed compensation, which typically includes not only the recovery of costs but also a profit component.*

Impact of the scope

- 21 *First, the impact will depend on the extent to which an entity's activities are subject to the type of regulation within the scope of the ED.*
- 22 *The impact will also depend on whether entities already recognise regulatory balances under local GAAP and how closely aligned are the proposals to existing regulatory requirements in the regulatory accounts.*
- 23 *The ED does not specifically state that it does not apply to self-regulation. Typically, an entity cannot have regulation with itself. However, the applicable facts and circumstances need to be assessed against the conditions outlined in the scope.*

Notes to Constituents- EFRAG Early-stage Effects Analysis findings on scope

- 24 *The findings from EFRAG’s early-stage effects analysis outreach to preparers found that most respondents were clear on who within the scope of the proposed model can be considered to be the regulator that governs rate-regulated activities within their jurisdictions. This finding could reflect that most respondents were from well-known regulated sectors (utilities, telecommunication, and energy) and not from sectors where there are activities that may be within scope but there is lack of clarity on the identity of the regulator.*
- 25 *With regards to the scope of the proposed model, many respondents were clear on the scope of the model, but some respondents highlighted activities that they were uncertain fell within scope (e.g. auction receipts that are released in future periods that result in reduced tariffs, costs recovered in future periods).*
- 26 *Most respondents were not aware of cases where there are regulatory agreements with rate-regulated enforceable rights (obligations) that are recovered (fulfilled) by third parties on behalf of customers.*
- 27 *Some respondents were aware of rate adjustments to concession arrangements where there was uncertainty on if these would fall within the scope of the proposed model instead of falling under IFRIC 12 Service Concession Arrangements. However, they did not provide elaborating comments and related fact patterns.*

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 IASB’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?

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.

- 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 IASB 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?

EFRAG's response

EFRAG supports the IASB's overall objective to develop an accounting model for regulatory assets and regulatory liabilities. EFRAG agrees that the information provided by the proposed accounting model, together with information required by other IFRS Standards, would enable users of financial statements to understand how the financial performance and the financial position of a reporting entity is affected by its rate-regulated activities.

EFRAG's initial analysis including through the feedback from the early-stage effects analysis highlights that by and large, there is clarity on scope of the model within the utilities sector. However, EFRAG is aware that there are concerns from stakeholders outside of the utilities sector on the possible impact of the scope and unintended consequences (i.e., entities unknowingly or unintendedly falling within the scope of the model). EFRAG continues to assess the impact beyond the utilities sector.

The early-stage effects analysis also highlighted that some preparers were aware of rate adjustments related to concession arrangements where there was uncertainty on if these fell within the scope of the model instead of IFRIC 12. As noted in the section of interaction with other IFRS Standards, there is a need to further evaluate the interaction of the proposed model with IFRIC 12.

EFRAG considers that more specific guidance and examples on what constitutes regulatory agreement would be helpful to appropriately identify activities within the scope of the proposed model.

EFRAG agrees that an entity should not recognise any assets or liabilities created by a regulatory agreement other than regulatory assets and regulatory liabilities.

Objective and evolution of the project

- 28 EFRAG welcomes the IASB's ED on how entities should account for rate-regulated activities. This ED is the outcome of discussions that started in 2008, and a follow-up of the Discussion paper *Reporting the Effects of Rate Regulation published in September 2014* (2014 DP) which described the common features of various types of rate regulation and provided an overview of possible accounting approaches. In its Comment Letter responding to the 2014 DP, published in January 2015, EFRAG welcomed the IASB's comprehensive project on rate-regulated activities and the publication of the 2014 DP.
- 29 EFRAG agrees that there is a need to address how entities should account for rate-regulated-activities. EFRAG supports the objective of the accounting model that

aims to improve the information about the performance and statement of financial position of entities subject to rate-regulation that creates differences in timing (i.e. between total allowed compensation for goods and services of a period and revenue recognised) that affect the relationship between an entity's revenue and expenses.

- 30 As previously noted in EFRAG's response to the 2014 DP, IFRS Standards do not generally require financial statements to contain the information that users regard as useful to understand the financial effects of rate regulation on an entity's rate-regulated activities. In the absence of specific guidance in the IFRS literature, the established practice is for rate-regulated entities not to recognise the effects of rate-regulation in the IFRS financial statements. As a result, users obtain the information they need from different sources – including local GAAP financial statements, regulatory accounts, investor presentations and public information provided by the rate regulator.
- 31 Rate-regulated entities generally need to prepare regulatory accounts in accordance with the requirements in the jurisdiction in which they operate. EFRAG understands that there are differences in reporting requirements for regulated activities across European jurisdictions results in inconsistent information being provided to users of financial statements across jurisdictions.
- 32 Previous outreach with users to support EFRAG's response to the 2014 DP, indicated that rate-regulated entities with IFRS financial statements do not provide relevant and useful information that meets users' needs about rate-regulated activities and that they prefer these effects to be recognised in the financial statements, rather than being communicated through disclosure-only requirements.
- 33 More recently, EFRAG's early-stage analysis outreach indicates that users of financial statements of rate-regulated entities currently obtain the information they use to analyse key information on regulatory requirements/laws and understand whether these have economic implications for the entity from different sources such as the financial statements, regulatory reports and other forms of sources.
- 34 Some users consider that regulatory accounts provide good disclosure of regulated assets and liabilities. However, other users indicated that there is a problem with inadequate disclosure of the links between IFRS accounts and the information reported in the regulatory accounts. The regulatory requirements vary from jurisdiction to jurisdiction and within the different industry sectors.
- 35 EFRAG observes that from an economic point of view, the entity would be required to reflect actual allowed compensation in the statement of performance in the period it had provided goods or services. This was currently not the case under IFRS reporting, including IFRS 15. Therefore, EFRAG considers that the model provides users of financial statements with useful information about the entity's real performance for the period in which the goods or services were provided. It would also enhance accountability and allow for better stewardship.
- 36 EFRAG supports the objective of the ED to give more complete information that enables users of financial statements to understand how such differences in timing affect the relationship between an entity's revenue and expenses. EFRAG agrees that the information provided by the proposed accounting model, together with information required by other IFRS Standards, would enable users of financial statements to understand that relationship in a more complete and faithfully representational manner.

Replacing IFRS 14 and supplementary accounting model

- 37 EFRAG understands that, if finalised as a new IFRS Standard, the accounting model would replace IFRS 14, an interim Standard that was issued in January 2014 and

permits a variety of accounting approaches for the effects of rate regulation to continue temporarily.

- 38 EFRAG therefore supports replacing IFRS 14 with a uniform accounting model that would be applied consistently for all entities within the scope of the ED.
- 39 The proposals in the ED would supplement information an entity already provides by applying IFRS 15 *Revenue from Contracts with Customers* to contracts with its customers and other IFRS Standards. EFRAG concurs with this approach as it will provide more transparent financial information about the impacts of rate-regulation on an entity's statement(s) of performance and financial position with the need to amend or change existing IFRS Standards.
- 40 EFRAG therefore agrees 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.

The proposed scope

- 41 The scope of the ED requires existence of an agreement that regulates rates for supplying specified goods or services and that part of the total allowed compensation for those goods or services supplied in one period is charged to customers through the regulated rates for goods or services supplied in a different period creating what the ED refers to as "timing differences".
- 42 EFRAG supports the scope as defined in the ED. EFRAG is of the view that the existence of a regulatory agreement is a sufficient and necessary criterion to define the scope.
- 43 EFRAG early-stage effects analysis shows that many preparers were clear on the scope of the model and only some preparers highlighted activities that they were uncertain fell within scope (e.g., auction receipts that are released in future periods that result in reduced tariffs, costs recovered in future periods). The early-stage analysis findings on clarity on scope shows that this could be less of an issue for stakeholders from sectors (e.g., utilities) that have been carefully monitoring the IASB development of the proposed Standard and hence are likely to be aware of consequences. However, EFRAG is aware of stakeholders outside of the utilities sectors that have questions on the potential unintended consequences.
- 44 Hence, EFRAG is still assessing which activities and industry sectors will be impacted by the scope of the ED. Most of the entities that have responded to EFRAG's outreach calls are operating in the utility sector – energy, gas and water. EFRAG has so far received limited feedback from non-utility entities.
- 45 The early-stage effects analysis also highlighted that some preparers were aware of rate adjustments related to concession arrangements where there was uncertainty on if these fell within the scope of the model instead of IFRIC 12. As noted in the section of interaction with other IFRS Standards, there is a need to further evaluate the interaction of the proposed model with IFRIC 12.

Recovery/settlement by third parties on behalf of the customer

- 46 EFRAG understands that some entities consider that the scope of the model ought to cover enforceable rights and obligations that are recovered (fulfilled) by third parties (including a regulator) on behalf of the customer. In some jurisdictions (like Italy and Spain), in service concession agreements and other regulatory agreements – when the customer could not pay the regulator (the government) would step in. Entities consider that these types of arrangements should be covered by the scope of the model as it should not make a difference whether the entity recovered the agreed allowed compensation from the customer, the government,

an insurance company or any third party. Consequently, stakeholders from these entities suggested that the model for regulatory assets and regulatory liabilities should be independent of who pays for the services or goods delivered.

- 47 Under the proposals of the ED, the accounting model focuses on increases/decreases in future regulated rates that are **charged to customers** because of goods or services already supplied to those customers. Therefore, recovery and settlement of total allowed compensation by parties other than the customer are not within the scope of this ED and would be accounted for under existing IFRS Standards. However, EFRAG observes that example 6B of the Illustrative Examples accompanying the ED describes a fact pattern where a recovery (fulfilment) of the regulatory asset (liability) by a third party might be considered within the scope of the project. In this example, it is the construction company that is pre-funding the regulated entity on behalf of the entity's customers. It suggests that the amount can be pre-funded by a party other than a customer (on behalf of the customer) and raises the question of what would be the outcome if the regulator, or another third party, that was providing the funding on behalf of the customer. Consequently, EFRAG urges the IASB to clarify the interaction between the proposals of the ED and the Illustrative Examples.
- 48 Additionally, EFRAG early-stage effects analysis shows that most preparers were not aware of cases where there were regulatory agreements with rate-regulated enforceable rights (obligations) that are recovered (fulfilled) by third parties on behalf of customers.

The regulator and the regulatory agreement

- 49 The ED does not define a regulator or specify the form of the regulatory agreement. The ED describes a regulatory agreement as a set of enforceable rights and obligations that determine a regulated rate to be applied in contracts with customers.
- 50 EFRAG considers that the definition of the regulator is important when determining whether certain activities are within the scope of the ED. In EFRAG's view, the absence of definition of a regulator could result in stakeholders raising questions on the consequences of the scope in their jurisdictions. If "regulator" was not defined, there was a risk that the scope might include activities which were not intended to be within the scope. There is the possibility of new contracts being written by entities for purposes of falling within the proposed scope. For example, a bus service where the town sets the regulated rates and oversees them. This type of agreement could be enforceable (when a user bought a ticket, that constituted a contract), although the town was not a regulator.
- 51 The ED also does not specify whether a particular type of body, such as a regulator, must exist to enforce compliance with the regulatory agreement, and what the characteristics of that body should be. EFRAG understands that the regulatory agreement is intended to be a "term" used to describe a set of enforceable present rights and obligations. However, EFRAG notes that referring to a regulatory agreement, without a clearer description and illustrative examples, may broaden the scope of the project beyond what was intended and raise questions about the types of enforceable rights and obligations that should be recognised as regulatory assets and regulatory liabilities.
- 52 Paragraph 7 of the ED describes a regulatory agreement as a set of enforceable rights and enforceable obligations that determine a regulated rate to be applied in contracts with customers. EFRAG considers the description of a regulatory agreement to be important to ensure that the scope would only include activities intended to be within the proposed accounting model.

- 53 EFRAG considers that the enforceable regulatory rights and enforceable regulatory obligations that the ED intends to cover in the scope can also arise from a regulatory framework that is enforceable by law, but where a regulatory agreement per se might not exist. EFRAG is concerned that the scope of the ED is too focused on the existence of a regulatory agreement, and this could result in situations where activities that should be within the scope of the ED are excluded.
- 54 EFRAG considers that more specific guidance and examples on what constituents a regulatory agreement would be helpful to appropriately identify activities within the scope of the accounting model proposed in the ED.

Situations that should not be subject to the scope of the ED

Self-regulation

- 55 In EFRAG's view it is not clear from the wording in the ED whether self-regulation could be included within the scope.
- 56 EFRAG notes that self-regulation is not explicitly excluded from the scope and would depend on the particular facts and circumstances whether the existence of a regulatory agreement would create regulatory assets and regulatory liabilities that meet the conditions in paragraph 6 of the ED. For example, in the case of an intercompany agreement between a parent entity and its subsidiary that creates enforceable present rights and obligations, the enforceable right or enforceable obligation might be a financial asset or a financial liability under IFRS 9 *Financial Instruments*. However, some might interpret such an agreement to be within the scope of the ED, unless the ED explicitly excludes from the scope, self-regulation and regulation from related parties or parties under common control. Similarly, an example of possible self-regulation being captured by the scope of the ED is a cooperative governed by its statutes. The members of the cooperative are usually its customers and under its statutes, the cooperative can decide to postpone collecting expenses in periods of recession and recover them in future periods.
- 57 EFRAG would be concerned if self-regulation were to be included in the scope, as this would result in entities recognising regulatory assets and regulatory liabilities that are created with itself or with entities under common control.

Alternative view on scope of the Model

- 58 Paragraphs AV7-AV9 of the Basis for Conclusions accompanying the ED explain the alternative view taken by an IASB member on the proposed scope of the proposed Standard as defined in paragraphs 3-6 of the ED.
- 59 Under the ED's proposals, regulatory assets and regulatory liabilities can only exist, if an entity is a party to a regulatory agreement which determines the regulated rate to be charged to customers when part of the total allowed compensation for goods and services supplied in one period is charged to customers in a different period.
- 60 As noted in AV8, the right to increase prices for supplying goods or services outside the scope of the proposed Standard is not recognised separately from a brand name or license, and those intangible assets are not recognised unless they were acquired.
- 61 Under the alternative view, the IASB member agreed with the ED proposal that the existence of a regulatory agreement that regulates rates for supplying specified goods or services is a necessary scope criterion, however, it was not a sufficient criterion (i.e., this criterion is not sufficient to differentiate the right that warrants recognition of an asset for future rate increases). In the IASB member's view, it was also necessary for the performance of the entity's activities to be regulated that:
- (a) competition in the sector is limited; and

- (b) the regulator is committed to support the financial viability of the entity through the rate-setting process.
- 62 EFRAG disagrees with the alternative view expressed by the IASB member regarding the definition of scope in the ED for the following reasons:
- (a) the proposed additional factors would unduly narrow the scope definition;
 - (b) limited competition was not a necessary criterion to define the scope and it would make the assessment on scope more difficult;
 - (c) financial viability criterion was already embedded in the rate-setting mechanism and uncertainty on financial viability should be incorporated into the measurement;
 - (d) the additional factors would increase complexity and subjectivity of judgement on scope;
 - (e) for incentive-based regulatory agreements which are the majority of European ones and which aim to push out inefficient actors, the proposed definition of scope in the ED was sufficient;
 - (f) there is a preference for principles-based requirements and there is a risk of introducing rules with the additional criteria.
- 63 EFRAG acknowledges the concern expressed in the alternative view that the scope does not sufficiently differentiate regulatory assets from other enforceable rights and notes the risk that, if the proposed Standard was applied by analogy, it might lead to the recognition of other enforceable rights and obligation. However, EFRAG considers that the proposed Standard is a supplementary Standard and does not modify existing IFRS Standards. Hence, there should be no grounds for overriding existing IFRS Standards for items that fall outside the scope of the proposed Standard.

Questions to Constituents

- 64 Have you identified any situations in which the proposed scope would include self-regulation? If so, please explain these situations. In your view, should such situations of self-regulation be included in the scope of the ED?
- 65 Have you identified any other situations in which the proposed scope would affect activities that you do not view as subject to rate regulation that give rise to regulatory assets and regulatory liabilities? If so, please describe the situations and why you consider they should not be within the scope.
- 66 What are your views on the alternative view that there should be additional criteria (limited competition, regulator committed to support the financial viability through the rate-setting processed) for eligibility to be within the scope of the proposed Standard?
- 67 Are you aware of examples of anomalous outcomes that could arise from the application of the scope of proposed Standard (e.g., recognition of currently excluded enforceable rights and obligations)?

Question 2: Regulatory assets and regulatory liabilities

Notes to constituents – Summary of the proposals in the Exposure Draft (ED)

- 68 *Under the ED, regulatory assets and regulatory liabilities are rights or obligations to increase or decrease future regulated rates.*
- 69 *The ED 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.'

- 70 The focus on an "enforceable present right(obligation)" is consistent with the wording in the definitions of an asset and a liability under the Conceptual Framework which focus on a present enforceable rights and present enforceable obligation.
- 71 Paragraph BC39 informs that IASB concluded that a regulatory asset meets the definition of an asset under the Conceptual Framework because:
- 72 a regulatory asset is a right. That right entitles an entity to add an amount in determining a regulated rate to be charged to customers in future periods to provide part of the total allowed compensation for goods or services already supplied.
- 73 that right has the potential to produce economic benefits. The form of those economic benefits is the addition of an amount in determining a future regulated rate. For a right to meet the definition of an asset, it does not need to be certain that the right will produce those economic benefits (paragraph 4.14 of the Conceptual Framework and paragraph BC48).
- 74 An entity controls that right because the entity has the present ability to direct the use of the right and obtain the economic benefits that may flow from it. The entity has the present ability to:
- (a) use the right, because it has the right to deploy the regulatory asset in its activities by increasing regulated rates; and
 - (b) obtain the economic benefits that may flow from the regulatory asset, because if incremental cash inflows result from the regulatory asset, they will flow to the entity rather than to any other party.
 - (c) although the mechanism for recovering a regulatory asset is by increasing regulated rates for goods or services to be supplied in future periods, the regulatory asset is a present right, and exists and is controlled by the entity because of a past event: the entity supplied goods or services, but the amounts included in the regulated rates charged to customers do not yet include part of the total allowed compensation for those goods or services.
- 75 The ED 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.'*
- 76 Paragraph BC45 informs that he IASB concluded that a regulatory liability meets the definition of a liability under the Conceptual Framework because:
- 77 the entity has an enforceable obligation to transfer economic benefits;
- 78 the form of that transfer of economic benefits is a deduction of an amount in determining a future regulated rate; and
- 79 the obligation is a present obligation that exists as a result of past events because:
- (a) the entity has already obtained economic benefits by charging customers amounts that are reflected in revenue already recognised; and
 - (b) as a consequence, the entity will have to transfer an economic resource that it would not otherwise have had to transfer, because it will have to reduce future regulated rates.

- (c) *although the mechanism for fulfilling a regulatory liability is by decreasing regulated rates in future periods, the regulatory liability is a present obligation and exists because of a past event: the entity has recognised revenue and part of that revenue will provide part of the total allowed compensation for goods or services to be supplied in the future.*

80 *The Examples 2A, 2B, 2C, Example 3, Example 6A, 6B, Examples 7A, 7B illustrate circumstances where different types of regulatory assets and regulatory liabilities might arise. Example 7C illustrates examples where neither regulatory assets nor regulatory liabilities will arise.*

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 IASB 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?

EFRAG's response

EFRAG agrees with the proposed definitions of regulatory assets and regulatory liabilities.

EFRAG agrees that the accounting model should focus on total allowed compensation, including the recovery of allowable expenses minus chargeable income, a profit component and regulatory interest which compensates or charges the entity for the time value of money.

EFRAG agrees with the IASB's conclusions that regulatory assets and regulatory liabilities meet the definitions of assets and liabilities under the *Conceptual Framework*.

EFRAG agrees with the IASB's reasoning that an entity should account for regulatory assets and regulatory liabilities separately from the rest of rights and obligations arising from the regulatory agreement. Other assets and liabilities, if any, that arise from the regulatory agreement would be recognised under existing IFRS Standards.

Proposed definitions of regulatory assets and regulatory liabilities

- 81 EFRAG agrees that rights and obligations must be enforceable to result in recognition of assets and liabilities under the *Conceptual Framework*.
- 82 EFRAG agrees that the definitions of regulatory assets and regulatory liabilities should focus on the timing differences and assess whether they meet the definitions of assets and liabilities under the *Conceptual Framework*.
- 83 EFRAG observes that the proposed model differs from some existing local GAAP accounting approaches for reporting regulatory balances. The proposed accounting model is a supplementary model (other standards apply without modification) and it focuses on increases in future regulated rates because of goods or services already supplied and on decreases in future regulated rates because of revenue already recognised.

Focus on total allowed compensation

- 84 EFRAG agrees that the accounting model should focus on total allowed compensation (see EFRAG's response to Question 3). EFRAG notes that paragraph BC23 explains that the total allowed compensation for goods or services supplied is typically included in the regulated rates charged to customers and therefore recognised in revenue under IFRS 15—in the period when those goods or services are supplied.
- 85 However, the regulator might not include the entire compensation in the same period that the goods or services were supplied to the customer. EFRAG agrees that this might result in differences in timing which might give rise to regulatory assets and regulatory liabilities. Current IFRS Standards do not reflect the economic effects of such timing differences. This results in an entity's statement of profit or loss providing an incomplete picture of the relationship between revenue and expenses, because the amount of revenue recognised under IFRS 15 in that period:
- (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).

- 86 EFRAG agrees that the definition of total allowed compensation should include a profit element, because the recognised in revenue under IFRS 15 also includes a profit component.

Definitions of assets and liabilities under the Conceptual Framework

- 87 EFRAG has considered whether the definition of a regulatory assets and regulatory liabilities as defined in paragraph 4 and 5 of the ED meets the definition of an asset and a liability under the Conceptual Framework.
- 88 Under the Conceptual Framework, it does not need to be certain that the economic benefits will be produced or that the transfer of economic resources will occur. Uncertainty is considered in the measurement of an asset or a liability.

Regulatory asset

- 89 EFRAG agrees with the IASB's conclusions that a regulatory asset meets the definition of an asset under the *Conceptual Framework* (i.e., a present economic resource controlled by an entity as a result of past events) as enumerated in Paragraphs BC 38 and BC39 of the Basis for Conclusions. Paragraph 39 states that:

- (a) a regulatory asset is a present right that an entity controls – that right entitles an entity to add an amount in determining a regulated rate to be charged to customers in future periods to provide part of the total allowed compensation for goods or services already supplied;
- (b) that right has the potential to produce economic benefits - those economic benefits represent the addition of an amount in determining a future regulated rate. For a right to meet the definition of an asset, it does not need to be certain that the right will produce those economic benefits; and
- (c) the right is a present right controlled by the entity because of a **past event** - the entity has supplied goods or services, but the amounts included in the regulated rates charged to customers do not yet include part of the total allowed compensation for those goods or services.

- 90 EFRAG considers that to meet the definition of an asset under the *Conceptual Framework*, the regulatory right must be enforceable.

Regulatory liability

- 91 EFRAG notes that a regulatory liability obliges an entity to deduct a fixed or determinable amount in determining future regulated rates because of an amount included in revenue already recognised. This obligation must be enforceable under the regulatory agreement. EFRAG agrees that an entity fulfils that liability in future periods when it deducts that amount in determining the regulated rates it charges customers for goods or services supplied in those future periods.

- 92 EFRAG agrees with the IASB's conclusions that a regulatory liability meets the definition of a liability under the Conceptual Framework (i.e., a present obligation of the entity to transfer an economic resource as a result of past events) as enumerated by Paragraph BC45 of the Basis for which states that:

- (a) the entity has an enforceable obligation to transfer economic benefits;
- (b) the form of that transfer of economic benefits is a deduction of an amount in determining a future regulated rate; and
- (c) the obligation is a present obligation that exists as a result of past events because the entity has **already obtained economic benefits** by charging customers amounts that are reflected in revenue already recognised; and as a consequence, the entity will have to transfer an economic resource that it

would not otherwise have had to transfer, because it will have to reduce future regulated rates.

- 93 Although the mechanism for fulfilling a regulatory liability is by decreasing regulated rates in future periods, the regulatory liability is a present obligation and exists because of a past event. **The past event is that the entity has recognised revenue** and part of that revenue will provide part of the total allowed compensation for goods or services to be supplied in the future.
- 94 As previously noted, EFRAG considers that to meet the definition of a liability under the Conceptual Framework, the regulatory obligation must be enforceable.
- 95 EFRAG considers that the notion of the “transfer of an economic resource” in the context of the definition of a regulatory liability in the ED, is not straight-forward. As explained in BC46 of the Basis for Conclusions, some stakeholders question whether a regulatory liability is an obligation to transfer an economic resource.
- 96 The IASB justifies a regulatory liability as an obligation that an entity fulfils by **decreasing the regulated rates for goods or services to be supplied in future periods**. This results in lower revenue and therefore a lower cash inflow, rather than a separate cash payment. In this regard, the IASB considers that lower revenue is equivalent to a transfer of an economic benefit. The IASB notes that the Conceptual Framework says that an economic resource (an asset) could produce economic benefits for an entity not only by providing it with cash inflows, but also by enabling it to avoid cash outflows. Although the Conceptual Framework makes no corresponding statement for a liability, the IASB considers that the transfer of an economic resource could take the form of a reduction in cash inflows. EFRAG agrees with this reasoning.
- 97 Overall, EFRAG agrees with the IASB’s conclusions that a regulatory liability meets the definition of a liability under the Conceptual Framework.

Separate recognition from regulatory agreement

- 98 Paragraph BC58 explains that the IASB views the cash flows that arise from a regulatory asset or regulatory liability as incremental and are largely independent of the cash flows that result from the other rights and obligations created by the regulatory agreement. Therefore, an entity can measure regulatory assets and regulatory liabilities separately by reference to estimates of the incremental cash flows. In the IASB’s view, recognising regulatory assets and regulatory liabilities separately and measuring them by reference to the incremental cash flows would provide useful information to users of financial statements. EFRAG agrees with this view.
- 99 In BC61, the IASB considers that the cash flows that result from a regulatory asset or regulatory liability are incremental and do not significantly affect cash flows from the other rights and obligations created by the regulatory agreement. Therefore, accounting separately for regulatory assets and regulatory liabilities would not diminish the value of the information provided to users of financial statements about the effects of those other rights and obligations.
- 100 EFRAG considers recognition of regulatory assets and regulatory liabilities separately from the rest of the regulatory agreement, will allow users of financial statements to have a more comprehensive understanding of an entity’s regulatory assets and regulatory liabilities and the associated cash flows, together with their respective impact on the performance statement(s). Other assets and liabilities, if any, that arise from the regulatory agreement would be recognised under existing IFRS Standards.
- 101 However, EFRAG recommends clarification of paragraph BC60 which states “Other rights and obligations created by a regulatory agreement typically generate cash

flows only in combination with other assets and liabilities, such as property, plant and equipment or recognised or unrecognised intangible assets. As a result, an entity typically does not recognise those other rights and obligations as assets and liabilities". EFRAG recommends clarification of which rights and obligations the IASB is referring to.

Question 3: Total allowed compensation

Notes to constituents – Summary of the proposals in the Exposure Draft (ED)

- 102 *Total allowed compensation is the amount that an entity is entitled to charge customers, in the same or a different period, in exchange for the goods or services supplied in a specified period, in accordance with the regulatory agreement.*
- 103 *As outline in Paragraphs B3-B27 of the ED, total allowed compensation consists of the following components which affects profit or loss at these time intervals:*
- 104 *Allowable expenses less income – 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. These are recognised when expenses/ income are incurred/ recognised under IFRS requirements.*
- (a) *Profit margins – 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. Profit margin affects the profit or loss in the period when the entity recognises the underlying allowable expense as an expense by applying IFRS Standards.*
 - (b) *Performance incentives – 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. Performance incentives are recognised in profit or loss in the period in which the entities' performance occurs.*
 - (c) *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. Regulatory returns are recognised in the profit or loss when the regulatory agreement entitles the entity to add it in determining the regulatory rate. However regulatory returns for assets under construction are only included in profit or loss when the asset is in use.*
 - (d) *Regulatory interest income/(expense) – As the discount unwinds until recovery of the regulated asset or the fulfilment of the regulatory liability.*
- 105 *Paragraphs B3–B27 of the ED 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 to customers in the current period or to goods or services supplied in a different period.*

Question 3

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 IASB’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 IASB provide any further guidance on how to apply the concept of total allowed compensation? If so, what guidance is needed and why?

EFRAG’s response

EFRAG supports the proposed inclusion of the three components of target profit (profit margin, regulatory returns other than those related to assets not yet in use also referred to as construction work in progress-CWIP, and performance incentives) in the total allowed compensation, in the period when the regulatory agreement entitles an entity to add these components in determining a regulated rate for goods or services supplied in that period.

However, EFRAG disagrees with the proposal that the regulatory returns for CWIP are only included in profit or loss when the asset is in use. EFRAG notes that, in certain cases, it is not uncommon to recognise revenue during the construction period. Hence, under such circumstances, the requirement may fail to faithfully reflect performance throughout the duration of the contract.

EFRAG also highlights the operational challenges of recognising regulatory returns related to construction work in progress only when the asset is in use. Assets are applied on a portfolio rather than individual basis to generate revenue and it is difficult to attribute revenue to a single asset. Furthermore, some entities have high volumes of initiated assets under construction and high volumes of these that become operational- and it will be challenging for these entities to apply the proposed treatment of CWIP regulatory returns.

EFRAG supports the proposal in the ED that performance incentives form part of the total allowed compensation for goods or services supplied in the period(s) over which the performance criteria are monitored and evaluated. However, EFRAG suggests improving the wording with respect to defining the performance incentives period for construction-related performance incentives as “the period to evaluate the performance of construction”.

EFRAG supports the proposed guidance in paragraphs B3–B27, outlining the components of total allowed compensation (recovery of allowable expenses, three components of target profit, and regulatory interest rate/expense for the unwind of the time lag effect).

Regulatory returns calculated by applying a return rate to a base, such as a regulatory capital base

- 106 EFRAG supports the IASB’s proposal that regulatory returns would form part of the total allowed compensation for goods or services supplied in the period in which the

regulatory agreement entitles an entity to add those returns in determining a regulated rate for goods or services supplied in that period, except for returns on assets not yet available for use. The proposal is consistent with the principle underlying the model that an entity should reflect the total allowed compensation for goods or services supplied as part of its reported financial performance for the period in which the entity supplies those goods or services.

- 107 EFRAG suggests that the definition of a target profit in Appendix A (Defined Terms) of the ED be expanded to include the application guidance in paragraph 11 of the ED which details the three main elements of the target profit, namely: profit margin on allowable expense; regulatory returns and performance incentives.

Regulatory returns on a balance relating to assets not yet available for use

- 108 EFRAG acknowledges the proposals not to recognise regulatory return before the asset is in use would:

- (a) be in line the proposed model's principle as no goods or services are being supplied using that asset before it is available for use; and
- (b) lead to comparability between entities as one approach is applied irrespective of how the regulatory returns for CWIP is structured within the regulatory agreement.

- 109 EFRAG agrees with the decision that regulatory returns on a CWIP base included in the regulated rates charged to customers during the construction period form part of total allowed compensation. However, EFRAG does not agree with the deferral and recognition of this CWIP-related regulatory return only when assets are in use for the following reasons:

- (a) EFRAG notes that the driver for recognition of regulatory returns for assets under construction is different to the accounting for performance incentives and penalties, including those related to assets under construction, which was based on performance, rather than the delivery of goods or services. EFRAG considers this to create an inconsistency on how performance is being reflected as certain milestones could be set when the asset is not yet available for use.
- (b) EFRAG considers that some entities would have a remuneration based on CWIP and others would not. EFRAG assesses that it would be difficult to compare the performance across these differing entities.
- (c) EFRAG notes that it is not uncommon to recognise revenue during the construction period as proposed in the ED. EFRAG considers the amendment in IAS 16 *Property, Plant and Equipment* where sales revenue can be recognised before an asset is ready for its intended use is inconsistent to the proposed treatment of regulatory return for CWIP.
- (d) EFRAG notes that the delivery of goods or services often involves a combination of various assets, rather than a single asset. Therefore, an entity would provide goods or services, even if one of the assets was being constructed and it is difficult to attribute revenue generated to a single asset.
- (e) Furthermore, preparers of some entities would face operational challenges of keeping track of assets under construction on a stand-alone basis rather than at a portfolio level due to their high volumes of new assets under construction and high volumes that concurrently become operational at any point in time.

- 110 Therefore, EFRAG considers that the proposed approach to defer CWIP regulatory returns and only recognising it over the period the asset is use, would not always result in relevant information on performance.

Performance incentives

- 111 EFRAG generally supports the proposal in the ED that performance incentives form part of the total allowed compensation for goods or services supplied in the period(s) over which the performance criteria are monitored and evaluated. EFRAG acknowledges that the recognition driver for performance incentives and penalties is the fact that the entity has performed or failed to perform, regardless of whether the underlying asset is under construction (CWIP), rather than being linked to the delivery for goods or services as is the case for regulatory returns on CWIP. EFRAG suggests improving the wording with respect to defining the performance incentives period for construction-related performance incentives as ‘the period to evaluate the performance of construction’.

Other components of total allowed compensation

- 112 For regulatory interest income/(expense), EFRAG agrees with the IASB’s proposal that it should affect profit or loss as the discount unwinds until recovery of the regulated asset or the fulfilment of the regulatory liability. This is because it compensates or charges an entity for the time lag until recovery of a regulatory asset or fulfilment of a regulatory liability.
- 113 For profit margins, EFRAG also supports the IASB’s proposal that it should affect profit or loss in the period when the entity recognises the underlying allowable expense as an expense by applying IFRS Standards. EFRAG notes that these profit margins vary with the allowable expense therefore, they form part of the total allowed compensation for goods or services supplied in the same period as when the entity recognises the underlying allowable expense.
- 114 Consequently, EFRAG supports how the proposed guidance on the remaining components on regulatory interest income/(expense) and profit margins above and in paragraphs B3–B27 of the ED would treat all components of total allowed compensation (recovery of allowable expenses, three components of target profit, and regulatory interest rate/expense for the unwind of the time lag effect).

Questions to Constituents

- 115 In certain regulatory agreements, the regulator may entitle the entity to recover, as part of the regulatory rate, cost relating to construction before the asset is in operation and is being used to supply goods or services. How common are these type of agreements in your jurisdiction?
- 116 Do you expect any implementation issues relating to the proposals in the ED to defer and recognise revenue from construction work in progress only in the operating phase?

Comments on Illustrative Example 3: Regulatory returns on an asset not yet available for use

- 117 Whilst reviewing the Illustrative Example relating to regulatory returns not yet available for use, EFRAG has the following additional points:
- (a) EFRAG highlights the fact that an entity has fulfilled its obligation when it is constructing an asset (as the provision of goods or services involved a combination of assets, rather than a single asset). Therefore, EFRAG questions why there is no matching in terms of recognising some of the revenue during the construction phase as opposed to deferring the recognition of revenue to the operation phase.
 - (b) EFRAG also suggests that an example demonstrating the mismatch between recognising the revenue during the construction phase and those that are not, would be helpful.

- (c) EFRAG considers it would be useful to have a table explaining the composition of the regulatory return within the example.
- (d) EFRAG found it difficult to compare the example with the boundaries of the regulation and recommends a clearer explanation of paragraph IE51(c).
- (e) EFRAG notes that in the example, the regulatory period is the same as the useful life. Therefore, EFRAG considers that clarification is needed that the reversal of regulatory return is based on the recovery period, rather than the useful life of the asset.

Question 4: Recognition

Notes to constituents – Summary of the proposals in the ED

118 Paragraph 25 of the ED proposes that 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.

119 Paragraph 26 of the ED informs that an entity determines whether a regulatory asset or regulatory liability exists using judgement considering all relevant facts and circumstances, and lists a number of factors that could help to determine existence including – confirmation from the regulator, explicit requirements or guidelines in the regulatory agreement, evidence from regulatory decisions and court rulings, and other relevant experiences and decisions that could provide evidence that regulatory assets and regulatory exist.

120 The recognition requirement in the ED is consistent with the recognition principles in the Conceptual Framework which state that an asset or a liability is recognised only if it provides useful information to users – meaning that the information about the asset or liability must be relevant and faithfully represented.

121 The Conceptual Framework adds that information might not be relevant if there is uncertainty about whether an asset or a liability exists or when the outcome is uncertain, and the probability of an inflow or outflow of economics benefits is low. For this reason, the IASB decided **that 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.**

122 Paragraph BC125 of the Basis for Conclusions informs that threshold proposed by the ED for regulatory assets and regulatory liabilities is consistent with the recognition threshold set by IAS 37 for provisions and contingent liabilities. It notes that IAS 37 sets a higher threshold for contingent assets (virtually certain) than for provisions and contingent liabilities (more likely than not). However, the IASB did agree with setting a higher recognition threshold for regulatory assets than for regulatory liabilities. In many (most) circumstances a single regulatory agreement could give rise to both regulatory assets and regulatory liabilities. Setting an asymmetric recognition threshold may result in information that could be difficult to interpret.

123 Regarding “uncertainty”, the IASB concluded that even if the probability of a flow of economic benefits is low, recognition of a regulatory asset or regulatory liability would still result in relevant information. Therefore, any uncertainty about the amount or timing of those inflows or outflows would affect the measurement of the regulatory asset or regulatory liability, as discussed in the measurement section.

124 Paragraph BC127 of the Basis for Conclusions explains that the IASB understands that if a regulatory asset or regulatory liability exists, the probability that it will give

rise to an inflow or outflow of economic benefits is generally high because of the design of the regulated rate and because of regulatory oversight of an entity applying the regulatory agreement in determining the regulated rate. Therefore, the IASB expects that entities would recognise most regulatory assets and regulatory liabilities whose existence is certain, even if the IASB were to prohibit their recognition in cases of outcome uncertainty when the probability of an inflow or outflow of economic benefits does not meet some specified minimum threshold.

- 125 In relation to faithful representation, the IASB understands that the generally fairly stable and predictable cash flows arising from regulatory assets or regulatory liabilities would typically enable entities to make reasonable estimates when measuring regulatory assets or regulatory liabilities. As a result, measurement uncertainty is unlikely to be significant.

Derecognition

- 126 The ED does not include specific derecognition criteria.
- 127 Paragraph BC129 of the Basis for Conclusions informs that when an entity recovers part or all of a regulatory asset, or fulfils part or all of a regulatory liability, by increasing or decreasing the regulated rates, the entity would derecognise that (part of the) regulatory asset or regulatory liability and recognise regulatory expense or regulatory income accordingly.
- 128 Furthermore, because the ED's measurement proposals would require entities to update their estimates of future cash flows, measurement of regulatory assets and regulatory liabilities would be zero if estimated future cash flows are zero.
- 129 For the above reasons, the IASB considers that the ED contains sufficient guidance to explain when and how regulatory assets and regulatory liabilities should be derecognised and proposes no further requirements on derecognition.

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 IASB'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?

EFRAG's response

EFRAG agrees with the proposal that an entity should recognise all its regulatory assets and regulatory liabilities.

EFRAG also agrees that 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.

EFRAG recommends that IASB provide further guidance in the body of the future Standard regarding derecognition of regulatory assets and regulatory liabilities when regulatory assets and regulatory liabilities no longer qualify for recognition under the proposed Standard including guidance for when items transition from recognition under the proposed Standard to recognition under other IFRS Standards. EFRAG considers that it would be helpful to include the guidance on derecognition included in the Basis for Conclusions in the body of the future Standard.

Recognition of all regulatory assets and regulatory liabilities

- 130 EFRAG agrees that an entity should recognise all its regulatory assets and regulatory liabilities if that results in useful information to users of financial statements. This is consistent with the general recognition principle in the *Conceptual Framework*.
- 131 EFRAG notes that in many circumstances (as explained in paragraph BC125 of the Basis for Conclusions), a single regulatory agreement would give rise to both regulatory assets and regulatory liabilities. Setting an asymmetric recognition threshold for regulatory assets and regulatory liabilities could result in information that users of financial statements will find difficult to interpret and thus decrease the relevance and understandability of the reported information.

Recognition threshold in cases of existence uncertainty

- 132 The ED proposes that, if it is uncertain whether a regulatory asset or regulatory liability exists, an entity should recognise that item if it is more likely than not that it exists.
- 133 EFRAG notes that the *Conceptual Framework* states that recognition of an asset or a liability may not always result in relevant information when: (a) it is uncertain whether an asset or liability exists; or (b) an asset or liability exists, but the outcome is uncertain, and the probability of an inflow or outflow of economic benefits is low. Therefore, in some cases of existence uncertainty, a recognition threshold would be required.
- 134 EFRAG is aware that there could be cases when the existence of a regulatory asset or a regulatory liability is uncertain. For example, negotiations with the regulator on the recovery of particular costs might take longer than expected and thus create existence uncertainty at the reporting date. In such cases of existence uncertainty, EFRAG agrees with the proposal that a 'more likely than not' recognition threshold would be helpful and consistent with the *Conceptual Framework* to ensure that the information reported by an entity is relevant to users.
- 135 EFRAG notes that the probability that a regulatory asset or a regulatory liability will give rise to an inflow or outflow of economic benefits is generally high because of the way the regulated rate is determined under the regulatory agreement and because of regulatory oversight of an entity applying the regulatory agreement in relation to the regulated rate.

Derecognition

- 136 The body of the ED does not include specific derecognition criteria.

- 137 Paragraph BC129 of the Basis for Conclusions states that when an entity recovers part or all of a regulatory asset, or fulfils part or all of a regulatory liability, by increasing or decreasing the regulated rates, the entity would derecognise that (part of the) regulatory asset or regulatory liability and recognise regulatory expense or regulatory income accordingly. EFRAG recommends that the guidance on derecognition included in the Basis for Conclusions is included in the body of the ED.
- 138 Furthermore, EFRAG considers that it might be helpful to provide guidance on how an entity would transition to the application of other IFRS Standards. For instance, in cases when regulatory assets and regulatory liabilities no longer qualify for recognition under the proposed Standard but qualify as assets and liabilities under other IFRS Standards.

Question to Constituents

- 139 Are you aware of situations where there is uncertainty regarding the existence of an enforceable right or enforceable obligation under a regulatory agreement, and if so, please describe these situations?

Question 5: Measurement

Notes to constituents – Summary of the proposals in the ED

- 140 Paragraph 29 and paragraph 30 of the ED proposes that entities should 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. Entities would use a cash-flow-based measurement technique that:
- (a) includes an estimate of all future cash flows resulting from a regulatory asset or regulatory liability that are **within the boundary of the regulatory agreement** and only those cash flows; and
 - (b) discounts those estimated future cash flows to their present value.
- 141 The IASB considers that a modified historical cost measurement would provide useful information about an entity's regulatory assets and regulatory liabilities, and about regulatory income and regulatory expense recognised as a result. As explained in paragraph BC132 of the Basis for Conclusions, in the view of the IASB information, together with information required by other IFRS Standards, would enable users of financial statements to understand the entity's regulatory assets and regulatory liabilities and understand the relationship between revenue and expenses as completely as they can when no regulatory assets or regulatory liabilities exist.
- 142 The IASB acknowledged that the proposed measurement could also be considered a current value measure, modified to use a historical discount rate. As explained in paragraph BC133 of the Basis for Conclusions, the view of the IASB is that the proposed measurement basis is more closely aligned to the cash inflows and outflows associated with regulatory assets and regulatory liabilities which are based on regulated rates (prices) which is more of a historical cost notion. Therefore, unlike a current value measure, the ED does not require an update of the discount rate unless the regulatory agreement changes the regulatory interest rate, resulting in a change in the cash flows from regulatory interest.

Estimating future cash flows

- 143 Paragraph 31 of the ED informs that when applying the measurement requirements an entity shall include all estimated future cash flows arising from a regulatory asset

or regulatory liability, and only those cash flows. To do this, an entity needs to 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. This means that an entity will need to assess the boundary of the regulatory agreement and assess whether the cash flows are within that boundary.

The boundary of the regulatory agreement

144 The cash flows included in the measurement are cash flows that are within the boundary of a regulatory agreement. In other words, the cash flows are included in the regulated rate charged to customers 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.
- (c) Paragraphs B28-B34 of the Application Guidance inform that boundary of a regulatory agreement determines which estimated future cash flows an entity includes in measuring a regulatory asset or regulatory liability. The boundary of a regulatory agreement is the latest future date at which an entity has:
 - (d) an enforceable present right to recover a regulatory asset by increasing the regulated rate to be charged to customers; or
 - (e) an enforceable present obligation to fulfil a regulatory liability by decreasing the regulated rate to be charged to customers.

145 Paragraph B29 provides the following simple example of how to interpret the boundary of a regulatory agreement:

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.

146 The ED explains that an entity only has a present enforceable right (to increase the regulated rate at a future date) and a present enforceable obligation (to decrease the regulated rate) if it stems from the regulatory agreement and no party other than the entity has a right to cancel the regulatory agreement.

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

148 Paragraph BC144 informs that in assessing whether rights to cancel or rights to renew a regulatory agreement affect the boundary of the regulatory agreement, **an entity should disregard a right held by any party if there are no circumstances in which that party has the practical ability to exercise that right.** The IASB considers that disregarding such rights is consistent with the Conceptual Framework (paragraphs 4.60-4.61 of the Conceptual Framework), the requirements in IFRS 17 Insurance Contracts and IFRS 10 Consolidated Financial Statements that address how to assess substantive rights. For example, IFRS 10 states that an investor considers only substantive rights in assessing whether it has power over an investee: for a right to be substantive, the holder must have the practical ability to exercise that right.

- 149 *The principle is that the entity can only recognise rights and obligations that are present enforceable rights and present enforceable obligations.*

Reassessing the boundary of the regulatory agreement

- 150 *An entity needs to reassess the boundary of a regulatory agreement at each reporting date. The reassessment might conclude that cash flows that were previously outside the boundary, and the entity did not recognise a regulatory asset or a regulatory liability, are now within the boundary because the entity has an enforceable present right or an enforceable present obligation that gives rise to a regulatory asset or a regulatory liability.*
- 151 *The ED proposes that any changes to the regulatory boundary need to be disclosed – see Disclosure section.*

Uncertain cash flows

- 152 *The ED proposes that an entity estimate future cash flows using the most likely amount method or the expected value method, whichever the entity expects will better predict the cash flows. That proposal is consistent with the requirements in IFRS 15 Revenue from Contracts with Customers for variable consideration and IFRIC 23 that addresses Uncertainty over Income Tax Treatments on predicting the resolution of an uncertainty over a tax treatment.*
- 153 *The ED also requires that the estimates of future cash flows arising from a regulatory asset would reflect all sources of uncertainty, **including credit risk** that is borne by the entity. This means that regulatory amounts that an entity cannot collect from customers will be considered in the measurement of the related regulatory asset.*

Updating estimated cash flows

- 154 *The ED requires entities to update their estimates of future cash flows to reflect changes in the estimated timing or amount. This would include changes in credit risk and demand risk. For this reason, no need for a separate impairment test for regulatory assets and IAS 36 Impairment of Assets is excluded from the scope of the ED.*
- 155 *Paragraph BC141 of the Basis for Conclusions informs that because cash flows arising from regulatory assets are largely independent of cash flows generated by any other assets, regulatory assets are not part of any cash-generating unit for the impairment test required by IAS 36.*

Compensation for cancellation of a regulatory agreement

- 156 *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 the entity has not yet recovered or for regulatory liabilities the entity has not yet fulfilled.*
- 157 *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.*
- 158 *The ED informs that a right or obligation to receive cash or pay cash for such compensation—when it arises—is a financial asset or financial liability, rather than a regulatory asset or regulatory 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.*

Question 5

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 IASB’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 IASB’s proposal.

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

EFRAG’s response

EFRAG supports the proposed cash-flow measurement technique because it is closely aligned to the cash inflows and outflows associated with regulatory assets and regulatory liabilities which are based on regulated rates (prices), and thus with the amounts an entity is entitled to receive or obliged to fulfil under the regulatory agreement.

EFRAG also agrees that an entity needs to consider all sources of uncertainty affecting the cash flow, including the credit risk that it bears when estimating the future cash flows arising from a regulatory asset. However, EFRAG recommends the IASB to provide guidance on how estimates of credit risk should be allocated to its individual regulatory assets.

EFRAG considers the requirements and guidance in the ED on the boundary of the regulatory agreement to be confusing and could be mixing up the entity’s licence to operate with the enforceable rights and enforceable obligations arising from the regulatory agreement. In EFRAG’s view, the boundary of the regulatory agreement should be determined based on an entity’s enforceable rights and enforceable obligations under the regulatory agreement rather than being an accounting judgement. If an entity cannot recognise a regulatory asset or a regulatory liability because the approval of the regulator is still pending, and as a result the entity does not have an enforceable right or an enforceable obligation, then EFRAG considers that the guidance on the regulatory boundary should be included in the recognition part of the ED, and not in measurement.

EFRAG supports the proposal to require an entity to estimate future cash flows arising from each regulatory asset and regulatory liability recognised, using either the most likely amount or the expected value method, depending on which approach provides more relevant information.

The proposed measurement basis

- 159 EFRAG notes that the measurement basis is more of a historical cost notion under the *Conceptual Framework* given that it *considers the cash inflows and* outflows associated with regulatory assets and regulatory liabilities which are based on regulated rates (prices). Furthermore, unlike a current value measure, the ED does not propose discount rates to be updated unless the regulatory agreement changes the regulatory interest rate.
- 160 EFRAG agrees with the IASB's view, explained in paragraph BC132 of the Basis for Conclusions, that the proposed measurement technique would provide useful information about an entity's regulatory assets and regulatory liabilities, and the respective regulatory income and regulatory expense, because it is closely aligned to the cash inflows and outflows an entity is entitled to receive or fulfil based on the agreed regulated rates (prices). That information, together with information required by other IFRS Standards, would enable users of financial statements to understand the entity's regulatory assets and regulatory liabilities and the relationship between revenue and expenses when no regulatory assets or regulatory liabilities exist.
- 161 In EFRAG's view, a fair value model, based on a market value, would not provide a faithful representation of regulatory assets and regulatory liabilities which are entity specific based on the applicable regulation and reflect what the entity is entitled to (is required to fulfil). EFRAG agrees that the proposed measurement approach is more closely aligned to the cash inflows and outflows associated with regulatory assets and regulatory liabilities which are based on regulated rates (prices), which as noted in paragraph 158 above is more of a historical cost notion.
- 162 EFRAG therefore supports the proposed measurement basis for regulatory assets and regulatory liabilities.

Cash-flow-based measurement technique

- 163 Paragraph 31 of the ED states that when applying the measurement requirements an entity shall include all estimated future cash flows arising from a regulatory asset or regulatory liability, and only those cash flows.
- 164 EFRAG agrees that for an entity to apply the measurement technique, the entity shall consider all reasonable and supportable information that is available considering past events and 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. EFRAG acknowledges that this involves a degree of judgement. However, this level of judgment should not be different to other cash-flow-measurement-based techniques already required under some current IFRS Standards.
- 165 EFRAG also agrees with the requirement in paragraph 38(b) of the ED that if an entity bears the credit risk, the entity shall reflect the effects of credit risk and the amounts it will be unable to collect from customers when estimating future cash flows. EFRAG agrees with the IASB reasoning in BC 138 of the Basis for Conclusions that such an approach keeps the model simple. However, as acknowledged by the IASB this means that 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 under IFRS 15. This is because IFRS 15 requires an entity to recognise as revenue the amount at which the entity expects to be entitled (and not the amount it receives). Any impairment of the receivable recognised under IFRS 15, is accounted for under IFRS 9 *Financial Instruments*.

The boundary of a regulatory agreement

- 166 Paragraph 33 of the ED states that 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. Paragraph 34 of the ED states that cash flows are within the boundary of a regulatory agreement only if:
- 167 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
- 168 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.
- 169 Paragraphs B28–B40 provide guidance on determining the boundary of the regulatory agreement and states that boundary of a regulatory agreement **determines which estimated future cash flows an entity includes** in measuring a regulatory asset or regulatory liability.
- 170 EFRAG agrees that only enforceable present rights and obligations should be considered in the recognition and measurement of regulatory assets and regulatory liabilities. However, EFRAG considers the requirements and guidance in the ED on the boundary of the regulatory agreement to be confusing. EFRAG has difficulties in understanding how in practice, an entity would determine the boundary of a regulatory agreement and assess whether the cash flows are within that boundary.
- 171 In EFRAG's view, the boundary of the regulatory agreement should be determined based on an entity's enforceable rights and enforceable obligations under the regulatory agreement rather than being an accounting judgment.
- 172 Furthermore, EFRAG does not agree with the analyses of the example in paragraph B29. The example explains that if the entity assesses 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, it cannot recognise that variance as regulatory asset, because it does not have an enforceable right. EFRAG understands that in many cases the negotiations with the regulator and final approval of the costs that an entity will be recover through the regulated rates can take several months, and the final approval might be after an entity's year-end. In such cases, EFRAG is unclear what an entity should do? If an entity cannot recognise a regulatory asset or a regulatory liability because the approval of the regulator is still pending, and as a result the entity does not have an enforceable right or an enforceable obligation, then EFRAG considers that the guidance on the regulatory boundary should be included in the recognition part of the ED, and not in measurement.
- 173 Furthermore, EFRAG considers that the guidance on determining the boundary was mixing the entity's licence to operate with the enforceable rights and enforceable obligations arising from the regulatory agreement.
- 174 Finally, EFRAG recommends the IASB to provide some examples, preferably when both regulatory and concession agreements are present, how to apply the guidance in B28-B34 of the Application Guidance in the ED.

Uncertain cash flows

- 175 EFRAG supports the proposal in paragraph 39 of the ED to require an entity to estimate future cash flows arising from each regulatory asset and regulatory liability recognised, using either the most likely amount or the expected value method, depending on which approach provides more relevant information. EFRAG notes that this requirement is consistent with the measurement requirements for variable consideration under IFRS 15 and with IFRIC 23 *Uncertainty over Income Tax Treatments* on predicting the resolution of an uncertainty over a tax treatment.

- 176 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.

Question to Constituents

- 177 Do you consider that the guidance in the ED on the boundary of the agreement is understood in practice and can be applied without undue cost and effort? If not please provide examples of the possible challenges on determining the boundary of the regulatory agreement and assessing which cash flows to include in the measurement of regulatory assets and regulatory liabilities.

Question 6: Discount rate

Notes to constituents – Summary of the proposals in the ED

- 178 *The ED proposes that an entity discount the estimated future cash flows to their present value in measuring regulatory assets and regulatory liabilities. Except in specified circumstances (see paragraph below), the discount rate would be the regulatory interest rate that the regulatory agreement provides.*
- 179 *Regulatory interest compensates or charges an entity for the time lag until recovery of a regulatory asset or fulfilment of a regulatory liability.*
- 180 *The IASB considered whether it should provide a practical expedient exempting entities from discounting if the effects of the time value of money and uncertainty in the amount and timing of the estimated future cash flows is not significant. However, as explained in BC165 of the Basis for Conclusions the IASB concluded that introducing such an exemption could introduce unnecessary complexity that may outweigh any incremental benefit as would still, in effect, require an entity to assess whether the time value of money and uncertainty inherent in the cash flows are significant.*
- 181 *When the regulatory interest rate provided for a regulatory asset is **insufficient**, an entity would be required to estimate the minimum interest rate and use this rate to discount the estimated future cash flows. **The ED does not propose a similar requirement for regulatory liabilities.** Therefore, regulatory liabilities are discounted using the regulatory interest rate in all circumstances. Paragraph BC166 of the Basis for Conclusions informs that any adjustments to the discount rate for regulatory liabilities would not provide useful information to users of financial statements.*

Assessing whether the discount rate is “sufficient”

- 182 *The ED (paragraph 50) requires that 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.*
- 183 *When assessing whether a discount rate is “sufficient”, paragraph BC167 of the Basis for Conclusions explains that an entity should assess whether there is any indication that the regulatory interest rate for a regulatory asset is not sufficient to compensate the entity for the time value of money and uncertainty in the amount and timing of the estimated future cash flows arising from that regulatory asset.*

- 184 *If there is an indication that the discount rate is “sufficient”, the ED proposes that an entity should estimate the ‘minimum interest rate’ that would compensate the entity for the time value of money and for that uncertainty in amount and timing.*
- 185 *If there are indications that the regulatory interest rate for a regulatory asset may be insufficient to provide the compensation, 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.*
- 186 *An indication that the regulatory interest rate is “insufficient” include for example when 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.*

Uneven regulatory interest rate

- 187 *In some cases, 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. For example, it could provide 2% for the first two years and 3% for the following three years of the regulated period.*
- 188 *The ED requires that 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. This is similar to calculating the effective interest rate as required under IFRS 9 Financial Instruments.*
- 189 *Example 5 of the Illustrative Examples that accompany the ED shows how an entity would compute a single interest rate to be applied evenly throughout the regulatory period, in cases when interest rates vary period to period.*

Updating the discount rate

- 190 *The ED proposes that an entity should continue to use the discount rate used to measure a regulatory asset or regulatory liability at initial recognition unless there is a change in the regulatory interest rate provided by the regulatory agreement. If such a change occurs, the estimated future cash flows and discount rate would be updated at the same time.*

Question 6

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 IASB’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 IASB 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 IASB’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?

EFRAG’s response

EFRAG considers that requiring discounting of regulatory assets and regulatory liabilities could result in unnecessary complexity whenever discounting of future recoveries (fulfilment) of rights (obligations) is not considered by the regulator. Should the IASB decide to require discounting, EFRAG supports using the regulatory discount rate for regulatory assets and regulatory liabilities. EFRAG recommends that the IASB to consider introducing a practical expedient to exempt entities from discounting if the effects of discounting are not significant.

EFRAG disagrees with the proposed application of a minimum adequate rate as the discount rate for regulatory assets, when the regulatory interest rate provided for a regulatory asset is insufficient.

EFRAG disagrees with the proposal for different discounting approaches for regulatory assets and regulatory liabilities. EFRAG’s considers that regulatory assets and regulatory liabilities should be discounted applying the same method and the same discount rate, which in our view should be the regulatory rate.

EFRAG agrees with the proposal that an entity should translate those rates into a single discount rate for use throughout the life of the regulatory asset or regulatory liability, in cases where the discount rates are uneven.

Finally, EFRAG understands that under some regulatory regimes, the regulatory interest rate compensates an entity for time lag as well as business risk. However, the definition of regulatory interest rate in Appendix A (Defined Terms) informs that it compensates only for time lag. Therefore, EFRAG recommends the IASB to amend the definition so that it reflects what is commonly applied in regulatory regimes.

General comments on discounting

- 191 EFRAG considers that requiring discounting of regulatory assets and regulatory liabilities will result in unnecessary complexity, particularly when discounting of future recoveries (fulfilment) of rights (obligations) is not considered by the regulator. The concept of discounting when measuring regulatory items is not very relevant to regulatory assets and regulatory liabilities as the amounts to be recovered (fulfilled) were initially negotiated with the regulator. Furthermore, some of the preparers that responded to the EFRAG early-stage effects analysis survey questionnaire highlighted concerns about costs and complexity associated with the discounting proposals.
- 192 EFRAG considers that the best approach would be to require an approach similar to IAS 12 *Income Taxes* where discounting is not required mainly because of the complexity involved.
- 193 Should the IASB decide to require discounting of regulatory assets and regulatory liabilities, EFRAG would support discounting using the regulatory interest rate, which is stipulated in the regulatory agreement to compensate or charge entities for the time lag and risk until the recovery (fulfilment) of a regulatory asset (liability).
- 194 Paragraph BC165 states that the IASB considered whether it should provide a practical expedient to exempt entities from discounting if the effects of the time value of money and uncertainty in the amount and timing of the estimated future cash flows is not significant. However, the IASB decided not to propose a practical expedient of this kind because applying such a practical expedient would still, in effect, require an entity to assess whether the time value of money and uncertainty inherent in the cash flows are significant. This could introduce unnecessary complexity that may outweigh any incremental benefit. EFRAG does not agree with this reasoning. EFRAG recommends that the IASB to consider introducing a practical expedient to exempt entities from discounting if the effects of discounting are not significant.

Estimating minimum interest rate

- 195 EFRAG disagrees with the use of a minimum adequate rate as the discount rate for regulatory assets, when the regulatory interest rate provided for a regulatory asset is insufficient.
- 196 In EFRAG's view, the regulatory agreement does not use the concept of a minimum adequate rate and introducing such a rate in the accounting model would be a highly subjective and complex exercise for preparers. As a result, EFRAG considers that it would likely be challenging in practice to apply the concepts of minimum interest rate (or insufficient or inadequate rate) and would be subject to a lot of discussion with the auditors given the level of judgement involved to make this assessment.
- 197 What matters ought to be the discount rate agreed with the regulator, as this represents the rate the entity is entitled to recover (fulfil) when measuring its regulatory assets and regulatory liabilities. Therefore, EFRAG considers that the application of a minimum adequate rate would not be relevant information for users to understand regulatory assets and regulatory liabilities.
- 198 Moreover, EFRAG is concerned that assessing whether a discount rate is sufficient will involve a high degree of subjective judgement and it will be difficult to get agreement with auditors on what constitutes a sufficient discount rate. This will likely result in undue costs that will outweigh the benefits of the proposal.
- 199 Paragraph 53 of the ED states that an entity is not required 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. Paragraph BC169 of the Basis for Conclusions explains that to avoid

introducing unnecessary cost and complexity, the IASB proposes not to require an entity to assess whether the regulatory interest rate for a regulatory liability is excessive—in other words more than is needed to charge the entity for the time value of money and uncertainty.

- 200 In EFRAG's view, the complexity to estimate the minimum interest rate for a regulatory asset is the same as for a regulatory liability. Therefore, EFRAG considers that regulatory assets and regulatory liabilities should be discounted applying the same method and the same discount rate (i.e., regulatory interest rate). Definition of regulatory interest rate in Appendix A
- 201 EFRAG notes that some preparers have highlighted that the definition of regulatory interest rate in Appendix A, which only focuses only on time lag prior to the recovery (fulfilment) of regulatory assets (liabilities) (i.e., time value of money) is inconsistent with the capital asset pricing model used in many regulatory agreements, which compensates an entity for both the time value of money as well as business risk. EFRAG recommends the IASB to amend the definition so that it reflects what is commonly applied in regulatory regimes.

The discount rate—uneven regulatory interest rate

- 202 EFRAG agrees with the proposal that an entity should translate those rates into a single discount rate for use throughout the life of the regulatory asset or regulatory liability. This approach is similar to applying an effective interest rate under IFRS 9.
- 203 Example 5 of the Illustrative Examples illustrates how an entity would compute a single interest rate, when multiple rates apply throughout the regulatory period. EFRAG agrees that this example is helpful.

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

Notes to constituents – Summary of the proposals in the ED

- 204 *An exception to the general measurement principle exists in cases where regulatory assets and regulatory liabilities that relate to expenses or income that will be included in or deducted from the future rates when cash is paid or received (for example pension costs and asset retirement obligations). In these cases, the ED proposes an entity should measure such a regulatory asset or regulatory liability using the same measurement basis used when measuring the related liability or related asset, instead of using the modified historical cost measurement basis proposed for all other regulatory assets and regulatory liabilities.*
- 205 *Paragraph BC175 of the Basis for Conclusions explains that in the view of the IASB, in these cases, measurement based on actual cash paid or received would provide users of financial statements with the most relevant, useful and understandable information because the cash flows arising from the regulatory assets or regulatory liabilities are expected to be the same amount as the cash flows arising from the related liabilities or related assets. Furthermore, the IASB considers that applying the same measurement basis as the underlying asset or liability:*
- (a) *would provide users of financial statements with the most relevant and understandable information because the cash flows arising from the regulatory assets or regulatory liabilities are a replica of the cash flows arising from the related liabilities or related assets, 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.*
 - (b) *is consistent with the Conceptual Framework, which notes that 'when assets and liabilities are related in some way, using different measurement bases for*

those assets and liabilities can create a measurement inconsistency (accounting mismatch);

- (c) *is consistent with the requirements in IFRS 3 Business Combinations for indemnification assets. IFRS 3 requires an acquirer to recognise an indemnification asset while it recognises the related indemnified item and to measure that asset on the same basis as the related indemnified item, subject to a valuation allowance for uncollectible amounts; and*
- (d) *is compatible with the requirements in IAS 37 Provisions, Contingent Assets and Contingent Liabilities that the amount recognised for a reimbursement asset should not exceed the amount of the related provision.*

206 *The ED also proposes that an entity should adjust the measurement of these regulatory assets and regulatory liabilities to reflect any uncertainty present in them but not present in the related liability or related asset.*

Question 7

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 IASB’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 IASB’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?

EFRAG’s response

EFRAG agrees with the measurement proposals for items of expense or income that affect regulated rates only when related cash is paid or received.

EFRAG also agrees with the proposals in the ED to present regulatory income or regulatory expense in OCI when the proposed measurement exception has been applied. However, EFRAG highlights the fact that some items presented in OCI (such as actuarial gains and losses) will not be recycled in profit or loss. As such, their impact on performance reported on profit or loss will never be depicted.

207 EFRAG agrees with the measurement exception proposals for regulatory assets and regulatory liabilities that relate to expenses or income that will be included in or deducted from the future rates when cash is paid or received (for example pension

costs and asset retirement obligations). In these cases, the ED proposes an entity should measure such a regulatory asset or regulatory liability using the same measurement basis used when measuring the related liability or related asset instead of the cash flow-based measurement techniques (modified historical approach) applied for other regulatory assets and regulatory liabilities.

- 208 EFRAG notes that by applying the measurement exception entities will:
- (a) avoid accounting mismatches;
 - (c) produce the same cash flows except for the effect of any uncertainty present in the regulatory asset or regulatory liability and not the underlying asset or liability; and
 - (d) align with the requirements in IFRS Standards for indemnification assets and for reimbursement assets.
- 209 EFRAG also agrees with the presentation of regulatory income or expense in OCI whenever the remeasurements of the related asset or liability are presented in OCI. Presenting such remeasurements in OCI would offset the remeasurement effects of related assets or liabilities.
- 210 However, EFRAG also highlights the fact that some items presented in OCI (such as actuarial gains and losses) will not be recycled in profit or loss. As such, their impact on performance reported on profit or loss will never be depicted.
- 211 Lastly, with regards to Illustrative Example 4, EFRAG suggests that in addition to the example provided on environmental costs, the IASB provide an additional example for decommissioning cost under IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities*.

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

Notes to constituents – Summary of the proposals in the ED

Statement(s) of financial performance

- 212 *The ED proposes that an entity present all regulatory income minus regulatory expense as a separate line item immediately below revenue, except when it is included in the other comprehensive income according to paragraph 69.*
- 213 *The IASB proposes to measure a regulatory asset or regulatory liability using the measurement basis used in measuring the related liability or related asset (paragraph 61 of the ED). When remeasurements of the related liability or related asset are presented in other comprehensive income, the IASB requires that an entity presents the regulatory income or regulatory expense resulting from remeasuring the regulatory asset or regulatory liability in other comprehensive income as well. This approach would avoid two opposite effects: one in profit or loss for the regulatory asset or regulatory liability and the other in other comprehensive income for the related liability or related asset.*
- 214 *Paragraph 68 proposes that regulatory income includes regulatory interest income and regulatory expense includes regulatory interest expense. The IASB also proposes to disclose regulatory interest income and expense in the notes separately from all other components of regulatory income or regulatory expense.*

Statement of financial position

- 215 *An entity shall present in its statement of financial position:*
- 216 *line items for regulatory assets and regulatory liabilities;*
 - 217 *current and non-current regulatory assets, and current and noncurrent 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.

- 218 An entity is permitted to offset regulatory assets and regulatory liabilities when it has:
- (a) a legally enforceable right to offset them by including in the same regulated rate; and
 - (b) expects to include the amounts from their recovery or fulfilment in the regulated rate in the same future period.

Question 8

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 IASB’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?

EFRAG’s response

EFRAG agrees with the IASB proposal to present all regulatory income minus all regulatory expense as a separate line item immediately below revenue and to include regulatory interest income and regulatory interest expense within this line item.

The proposed presentation is consistent with the objective of reflecting in the statement(s) of financial performance the compensation that the entity is entitled to for a given period regardless of when the related amounts are reflected in the regulated rate(s) charged to customers in that period.

- 219 EFRAG considers that presenting regulatory income and regulatory expenses net as a separate line item below revenue provides users with the sufficient information to distinguish the performance of the current period from the future or prior periods’ impacts due to the specific provisions of the regulatory agreement.
- 220 EFRAG agrees with the IASB proposal on including regulatory interest income and expense in the same line item as regulatory revenue and expense as they will be included in determining future regulated rates charged to the customers. EFRAG considers that it would provide relevant information about the effects on revenue of regulatory assets and regulatory liabilities and changes in them. EFRAG notes that these amounts of regulatory interest income and expense should, nevertheless, be disclosed separately in the notes to financial statements in accordance with paragraph 78(e) of the ED.
- 221 EFRAG also notes that regulatory interest revenue and expenses should meet the definition of the income/expenses from the ‘main business activities’ as defined in the IASB ED ED/2019/7 *General Presentation and Disclosures* and therefore reported within the operating category of a profit or loss and not in financing category.

- 222 EFRAG questions whether the gross presentation of the regulatory assets and liabilities on the statement of financial position would be useful for users and expresses concerns regarding the requirements of paragraph 71(b) of the ED which could make offsetting balance sheet positions more complicated.
- 223 EFRAG suggests the IASB to consider aligning the offsetting conditions with the requirements of paragraph 42 of IAS 32 *Financial Instruments: Presentation* being the existence of legally enforceable right to settle and intent to settle on net basis.

Question 9: Disclosure

Notes to constituents - Summary of the proposals in the ED

- 224 *In paragraph 72 of the ED, the IASB sets out the overall disclosure objective for regulatory income, regulatory expense, regulatory assets and regulatory liabilities to enable users of financial statements to understand:*
- 225 *the relationship between an entity's revenue and expenses which provides insights into the entity's prospects for future cash flows over many periods;*
- 226 *the entity's regulatory assets and regulatory liabilities at the end of the reporting period which provides insights into how regulatory assets and regulatory liabilities affect the amount, timing and uncertainty of the entity's future cash flows.*
- 227 *Furthermore, in paragraphs 77, 79 and 82 of the ED, the IASB lists specific disclosure objectives provide a basis for an entity to decide what information should be disclosed to satisfy the overall disclosure objective. The specific disclosure objectives are included in the following paragraphs.*
- 228 *An entity shall provide the specific disclosures below to enables users of financial statements to understand how its financial performance is affected by regulatory account balances:*
- (a) *the regulatory assets created during the current period;*
 - (b) *the regulatory liabilities created during the current period;*
 - (c) *the regulatory assets recovered during the current period;*
 - (d) *the regulatory liabilities fulfilled 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 including the reasons for that change;*
 - (g) *remeasurements of regulatory assets and regulatory liabilities, and the reasons for the remeasurements.*
- 229 *An entity shall provide the specific disclosures below to enables users of financial statements to understand how regulatory assets and regulatory liabilities at the end of the reporting period will affect the amount, timing and uncertainty of an entity's future cash flows:*
- (a) *quantitative information, using time bands, about when it expects to recover the regulatory assets and fulfil the regulatory liabilities and specify whether the disclosed amounts are undiscounted or discounted;*
 - (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;*
- (d) *an explanation of how risks and uncertainties affect the recovery of regulatory assets or fulfilment of regulatory liabilities.*

230 *Furthermore, an entity shall disclose in the notes a reconciliation between the opening and the closing carrying amounts of regulatory assets and regulatory liabilities to provide information about any changes in regulatory assets and regulatory liabilities that were not a consequence of regulatory income or regulatory expense.*

231 *For regulatory assets and regulatory liabilities measured when related cash is paid or received applying paragraph 61 of the ED, an entity shall consider what information to disclose about the related liabilities and related assets in order to clearly communicate 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.*

232 *In general, when providing disclosures, an entity shall determine the level of detail necessary to satisfy the overall disclosure objective and the specific disclosure objectives in the ED. An entity shall aggregate or disaggregate disclosures in a way that does not obscure useful information either by including large number of insignificant items or by aggregating items with substantially different characteristics (e.g. including items with substantially different risks or uncertainties; or items relating to different revenue categories).*

233 *The appropriate level of aggregation or disaggregation may differ for different pieces of information and may depend on the nature and the disclosure objective of that information.*

Notes to constituents- Early-stage effects analysis- findings on disclosure

234 *The early-stage effects analysis findings show that many of the preparer respondents considered it feasible to implement the disclosures, but some did not. Those that did not highlighted several factors that will make it difficult to implement the disclosures, for instance, due to difficulties in determining the maturities and due to the detailed nature of the disclosure requirements.*

235 *Many preparer respondents indicated that they have information (not included in IFRS financial statements) on regulatory assets and regulatory liabilities, and the information is based on local GAAP. A respondent noted that the information could be adapted for IFRS reporting. However, another respondent noted the IFRS disclosure requirements were more demanding than those of US GAAP.*

236 *On the other hand, some user respondents noted the need to have disclosures that explain main items and calculation methodology, and the rationale behind management judgment in determining regulatory assets and liabilities. One user respondent also highlighted the importance of increased transparency of IFRS financial statements due to the limitations of regulatory accounts in some jurisdictions. The user noted it would be great to have increased transparency under IFRS financial statements especially as continental European companies and regulators are less transparent, and regulatory documents (if there is disclosure) are often not in English (whereas company accounts are). But a few respondents were concerned that supplementary disclosures could further obfuscate IFRS financial statements.*

Question 9

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 IASB 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 IASB'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?

EFRAG's response

EFRAG agrees with the proposed overall disclosure objective and the specific disclosure objectives as proposed in the ED. EFRAG is of the view that these disclosure requirements will provide relevant information to users of financial statements to understand the relationship between an entity's revenue and expenses resulting from its rate-regulated activities and provide insights into its prospects for future cash flows.

However, EFRAG considers that the level of detail required to meet the specific disclosure objectives might impose a significant burden on reporting entities whenever such information is not readily available.

At the same time, the findings of the early-stage effects analysis show that users need to have disclosures that explain main items and calculation methodology, and the rationale behind management judgment in determining regulatory assets and liabilities. The early-stage effects analysis also showed that a majority of preparers considered it feasible to implement the disclosures albeit that those that did not echoed the concerns about the detailed nature of disclosures. A few users were also concerned that information from the proposed model could add to complexity and confusion of IFRS financial statements.

Therefore, after weighing the expected user benefits against preparer concerns around the detailed nature of the proposed disclosures, EFRAG considers that there will be a need to identify and prioritise from the proposed disclosures, only those that will be ascertained to be beneficial to users of financial statements and will not impose an undue burden for preparers.

- 237 EFRAG agrees with the IASB's proposed overall disclosure objective and the specific disclosure objectives as proposed in the ED. EFRAG notes that the focus of the disclosure requirements in the ED is to help entities use judgement to decide

what information would be relevant for users of financial statements to understand the economic phenomenon or other matters identified in a disclosure objective.

- 238 At the same time, EFRAG is cognisant that requiring disclosures about the nature of the regulatory agreement, the risks associated with it and the effects on an entity's financial statements could duplicate information that is already available in other sources (e.g., regulatory reports) and might create a disclosure overload for rate-regulated entities. However, EFRAG's early-stage effects analysis also showed that users need to have disclosures that explain main items and calculation methodology, and the rationale behind management judgment in determining regulatory assets and liabilities. Users also experience shortcomings with the information available in other sources (e.g., regulatory reports could be opaque and only be available in national language) and users would welcome the enhancement of IFRS disclosures.
- 239 EFRAG also notes that there are concerns the level of detail required to satisfy the overall disclosure objective. The specific disclosure requirements included in paragraphs 78, 80 and 83 of the ED, could result in entities having to disclose granular information about their regulatory account balances which may not be readily available.
- 240 Therefore, preparers might incur a significant one-time expense for redesigning their software systems as well as ongoing expenses to track the amounts necessary to be disclosed under the model (e.g., the difference between budgeted and actual amounts for regulated items).
- 241 However, EFRAG notes that Paragraphs 74 to 77 highlight that preparers have latitude to exercise judgment on the level of granularity that is relevant and fosters understandability of the disclosed information. EFRAG acknowledges that paragraphs 75 and 76 of the ED provide guidance on how to establish the appropriate level of aggregation and disaggregation of disclosed information. EFRAG considers that entities will apply the materiality principle in IFRS Standards to narrow down the disclosures required under the proposed model in the ED.
- 242 Furthermore, EFRAG's early-stage effects analysis showed that most preparer respondents expected minimal to moderate level of costs to implement the proposed model and a majority of the preparer respondents considered it feasible to implement the disclosures albeit that some preparers did not do so.
- 243 However, those that did not consider it feasible to implement the disclosures echoed the challenges arising due to the detailed nature of the disclosure requirements. One of the preparer respondents noted that the IFRS proposed disclosures are more detailed than existing disclosures under other local GAAP that they currently apply for reporting regulatory balances (e.g., US GAAP), showing that the proposals would impose incremental implementation costs.
- 244 EFRAG considers that particular disclosures required under paragraph 78(e) and 78(f) of the ED might not provide useful information to users of financial statements. EFRAG's early-stage analysis feedback showed a few users were concerned about increased complexity and potential for confusion from the additional information in IFRS financial statements.
- 245 In addition, it might be difficult for entities having several regulatory agreements to determine which agreement is more prominent in order to meet the proposed disclosure requirements in the ED.
- 246 EFRAG notes that meeting the proposed disclosure requirements might involve the following implications:
- (a) disclosure of sensitive information under the terms of the regulatory agreement;

- (b) significant judgement would be required for identifying regulatory assets and regulatory liabilities;
- (c) classifying regulatory assets and regulatory liabilities in time bands under the requirements of paragraph 81 of the ED might be difficult to provide. It would be more useful to explain the mechanism for recovery/fulfilment of regulatory assets and regulatory liabilities under the regulatory regime;
- (d) estimating the timing of recovery of regulatory assets and the fulfilment of regulatory liabilities would be subject to uncertainty;
- (e) the regulatory agreement might include different sub-agreements that formulate parts of the regulatory rate which could create additional complexities in calculating the regulatory rate;
- (f) incentive regulation is usually based on non-financial indicators whose assessment at the reporting date could lead to approximation uncertainties;
- (g) some elements of the regulatory rate are not explicitly included in the regulatory agreement and would require assessment of their impact before discussion with the regulator. In practice, the information required to be disclosed is only available after the reporting date and entities have limited time to meet the disclosure requirements.

247 Therefore, after weighing the expected user benefits against the preparer concerns around the detailed nature of the proposed disclosures, EFRAG considers that there will be a need to identify and prioritise from the proposed disclosures, only those that will be ascertained to be beneficial to users of financial statements and will not impose an undue burden for preparers.

Questions to Constituents

248 In your view, which of the proposed disclosures in the ED should be prioritised? Please explain.

Question 10: Effective date and transition

Notes to constituents – Summary of the proposals in the ED

249 *The IASB would require entities to apply the [draft] Standard for annual reporting periods beginning on or after a date 18–24 months from the date of its publication and proposes its **retrospective** application in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors except for the past business combinations as described below.*

250 *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; and
- (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.

251 The IASB considered proposing a modified retrospective approach applying from the beginning of the annual reporting period in which an entity first applies the proposed Standard (date of initial application) without restating comparative information. However, the IASB concluded that the resulting costs for users of financial statements in understanding incomparable information would outweigh the cost savings for preparers. Therefore, the IASB did not propose the modified form of retrospective application.

Question 10

Appendix C to the Exposure Draft describes the proposed transition requirements. Paragraphs BC203–BC213 of the Basis for Conclusions describe the reasoning behind the IASB’s proposals.

- a) Do you agree with these proposals?
- b) Do you have any comments you wish the IASB to consider when it sets the effective date for the Standard?

EFRAG’s response

EFRAG generally supports the proposed transition requirements and suggests the effective date should be 24 months after the publication of the final Standard to allow the entities to adjust their accounting systems and gather necessary information.

EFRAG also supports the proposed retrospective application of the proposals and the simplification option for the past business combinations proposed by the IASB.

- 252 EFRAG generally supports the proposed transition requirements and suggests the effective date should be 24 months after the publication of the final Standard to allow the entities to adjust their accounting systems and gather necessary information, especially in respect of the proposed detailed disclosure requirements.
- 253 EFRAG also supports the proposed retrospective application and the simplification option for the past business combinations proposed by the IASB, similar to an optional exemption for past business combinations made available for first-time adopters by paragraph C4(b) of IFRS 1.
- 254 EFRAG considers that the proposed simplified approach for accounting for the past business combinations addresses the most complicated issue that could arise from the retrospective application of the proposals which would otherwise require quantifying every adjustment that would result from a full reconsideration of every past business combination.

- 255 EFRAG agrees that this approach should be applied to all business combinations and separately to each one of them as this would result in increased consistency and comparability.
- 256 EFRAG questions the IASB decision to charge to goodwill and not to retain earnings all the adjustments to regulatory assets and liabilities resulting from the simplified treatment of the past business combinations.
- 257 EFRAG shares the concerns raised by the respondents to the EFRAG early-stage analysis questionnaire on implementation difficulties of the retrospective approach, such as:
- (a) The different accounting for construction work which could result in significant one-off implementation and ongoing administrative costs; and
 - (b) The retrospective calculation of discounted cash flows and the choice of an appropriate discount rate.

Question to Constituents

- 258 Do you agree with the IASB decision to charge to goodwill and not to retain earnings all the adjustments to regulatory assets and liabilities resulting from the simplified treatment of the past business combinations? If not, what do you propose?

Question 11: Other IFRS Standards

Notes to constituents – Summary of the proposals in the ED)

- 259 *The IASB estimates that the following existing IFRS Standards will be impacted by the introduction of this [draft] Standard.*

IAS 12 Income Taxes

- 260 *The IASB provides the following application guidance for the cases where the regulatory agreement includes the current or deferred tax effects.*
- 261 *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).*

- 262 *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.*

IFRIC 12 Service Concession Arrangements

- 263 *The IASB considers that some arrangements within IFRIC 12 may create regulatory assets and liabilities. Such regulatory assets and regulatory liabilities should be accounted for separately from the assets and liabilities within the scope of IFRIC 12.*

IFRS 1 First-time Adoption of International Financial Reporting Standards

- 264 *The IASB proposals do not allow the recognition of goodwill-related regulatory balances from the past business combinations by the first-time adopter, because*

this transaction is the business combination itself and not any supply of goods or services before the business combination.

265 *Therefore, the IASB proposes to amend paragraphs C4(c)(i) and C4(g)(i) of IFRS 1. The amendment would apply to a first-time adopter electing not to apply IFRS 3 retrospectively to a past business combination. These amendments would require reclassifying such balances directly to goodwill.*

266 *The IASB also proposes to retain an exemption in paragraph D8B of IFRS 1 permitting first-time adopters at the date of transition to IFRSs to use as deemed cost the previous GAAP carrying amount of an item that is used, or was previously used, in operations subject to rate regulation.*

IFRS 3 Business Combinations

267 *The IASB proposes that, as an exception to the recognition and measurement principles in IFRS 3, an entity should recognise and measure regulatory assets acquired and regulatory liabilities assumed in a business combination applying the recognition and measurement principles proposed in the ED (modified historical cost), rather than recognise and measure them at fair value.*

Summary of results of the early-stage effects analysis

268 *The early-stage effects analysis findings showed that most preparers considered that exempting acquired regulatory assets and regulatory liabilities from the scope of IFRS 3 will have unintended consequences.*

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

269 *The IASB proposes to exclude regulatory assets from the scope of the measurement requirements in IFRS 5, because it would be difficult to determine the fair value of regulatory assets because of difficulties in determining the discount rate.*

IAS 1 Presentation of Financial Statements

270 *The IASB proposes to amend paragraphs 54 and 82 of IAS 1 to require entities to present separate line items for regulatory assets and regulatory liabilities in the statement of financial position, and for regulatory income or regulatory expense in the statement(s) of financial performance.*

IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors

271 *The IASB proposes to delete paragraph 54G of IAS 8 because it provides a temporary exception that would no longer be needed when applying the proposals in the ED.*

IAS 36 Impairment of Assets

272 *The IASB proposes to specify that regulatory assets are outside the scope of IAS 36, because their measurement is based on updated estimates of future cash flows, including any estimated changes caused by, for example, demand risk or credit risk. Thus, there would be no need for a separate impairment test for regulatory assets. In addition, cash flows arising from regulatory assets are largely independent of cash flows generated by any other assets, regulatory assets are not part of any cash-generating unit for the impairment test required by IAS 36.*

Question 11

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 IASB’s proposals.

- a) Do you have any comments on these proposals? Should the IASB 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?

EFRAG’s response

EFRAG generally agrees with the IASB proposals addressing the interaction with other IFRS Standards. However, EFRAG has suggests for further clarification on the interaction with the below standards.

IAS 12 Income Taxes: EFRAG suggests the IASB specifies that these tax cash flows should form part of regulatory income and regulatory expense and should be presented in the ‘regulatory income minus regulatory expense’ line item.

IFRIC 12 Service Concession Arrangements: EFRAG suggests the IASB provides more guidance, (including illustrative examples) on the model’s interaction with IFRIC 12 requirements given the supplementary nature of the IASB model.

IFRS 1 First-time Adoption of International Financial Reporting Standards and IFRS 3 Business Combinations: EFRAG questions whether the reclassification of goodwill related regulatory balances to goodwill suggested in the proposed amendments to IFRS 1 and reclassification of measurement differences of regulatory assets and liabilities to goodwill suggested in the proposed amendments to IFRS 1; would result in the correct depiction of the entity financial performance when the goodwill-related revenues will be charged to customers but the related goodwill balances remain on the balance sheet.

IAS 36 Impairment of Assets: EFRAG suggests the IASB to provide further guidance how the interaction with a CGU that included regulatory assets would work in practice, in respect of separating the cash flows from regulatory assets from the total cash flows generated by a CGU for impairment test purposes.

IAS 12 Income Taxes

- 273 EFRAG agrees with the IASB clarifications that when tax cash flows can be included in determining the regulated rates in accordance with regulatory agreement, the entity should recognise the regulatory asset or regulatory liability to reflect such tax cash flows. EFRAG suggests that the IASB specifies that these cash flows should form part of regulatory income and regulatory expense and should be presented in the ‘regulatory income minus regulatory expense’ line item. EFRAG proposes to disclose these tax cash flows in the notes to the financial statements.

IFRIC 12 Service Concession Arrangements

- 274 EFRAG in principle agrees with the IASB proposals to account for regulatory assets and regulatory liabilities separately from the assets and liabilities within the scope of IFRIC 12 but considers that it would be necessary to have more guidance on the model’s interaction with IFRIC 12 requirements given the supplementary nature of the IASB model. The need for more guidance relates in particular to the following cases:
- (a) application of the intangible asset model under IFRIC 12 in combination with the proposed model for regulatory assets and regulatory liabilities;
 - (b) interaction with the proposed model in cases when an entity has a hybrid arrangement under IFRIC 12;

- (c) treatment of a terminal value in a concession arrangement when the regulator provides some form of terminal value guarantee.

- 275 EFRAG is aware that companies that operate concession agreements need to better understand the interaction between the proposed Standard and IFRIC 12 as it is not clear which of the two sets of requirements an entity should apply. Furthermore, the proposed requirements for accounting for regulatory assets and regulatory liabilities were different to the requirements in IFRIC 12, although in many cases the economic substance (in terms of outcome and/or intention) of the respective transactions may be similar.
- 276 The inclusion of service concession arrangements under the description of the regulatory agreement under paragraph 8 of the ED can lead to questions on, if and when, these fall under the scope of the new Standard. EFRAG therefore recommends the IASB to explain why this paragraph refers to service concession arrangements.
- 277 EFRAG suggests the IASB to include illustrative examples on how the proposed Standard would interact with IFRIC 12 requirements.

IFRS 1 First-time Adoption of International Financial Reporting Standards

- 278 EFRAG agrees with the IASB proposal to require first-time adopters to derecognise the goodwill related regulatory balances as they do not meet the recognition criteria under the model (do not arise from supply of goods or services).
- 279 EFRAG questions whether these goodwill-related balances should be reclassified to goodwill and is asking the IASB to clarify how in the future, when these amounts will be recovered from customers through the regulated rates, the related goodwill balances could be derecognised. Otherwise, this might result in the revenue being charged to customers while related goodwill remains on the balance sheet.

IFRS 3 Business Combinations

- 280 EFRAG supports the IASB tentative decision to provide an exception to the recognition and measurement principles in IFRS 3 to permit an entity to recognise and measure regulatory assets acquired and regulatory liabilities assumed in a business combination applying the recognition and measurement principles proposed in the model (modified historical cost instead of fair value at the acquisition date as required under IFRS 3).
- 281 EFRAG agrees with the IASB that measuring regulatory assets and liabilities at fair value at the date of acquisition and subsequently remeasuring them by applying the measurement principles of the model, could result in the recognition of subsequent period gains or losses that do not represent any economic event but simply reflect the change of one measurement basis to another.
- 282 However, EFRAG questions whether the resulting difference should be attributed to goodwill, provided that when these regulatory assets or liabilities will be recovered or fulfilled the respective goodwill balances will still remain on the balance sheet.
- 283 The results of the early-stage effects analysis showed that most preparers considered that exempting acquired regulatory assets and regulatory liabilities from the scope of IFRS 3 will have unintended consequences. To mitigate against these unintended consequences, EFRAG recommends that the IASB should further explore the interaction between IFRS requirements for assets, like property plant and equipment measured at fair value, as part of IFRS 3, and the recognition and measurement of regulatory assets and liabilities.

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

284 EFRAG agrees with the IASB tentative decision to exclude the regulatory assets from the scope of the measurement requirements of IFRS 5 and to measure them at modified historical cost instead of fair value. EFRAG considers that this approach removes the complexity of determining a discount rate to be used for the fair value measurement.

IAS 1 Presentation of Financial Statements

285 EFRAG agrees with the IASB tentative decision to amend IAS 1 to require presentation of regulatory assets, regulatory liabilities and regulatory income or regulatory expense as separate line items in the statement of financial position and financial performance, respectively. Regulatory interest and expense are included in the line-item regulatory income minus regulatory expense.

286 EFRAG considers that separate line items are necessary for:

- (a) regulatory assets and regulatory liabilities because their characteristics differ from those of other assets and liabilities; and
- (b) regulatory income minus regulatory expense to provide users of financial statements with a basis for understanding how the entity's financial performance was affected by the supply of goods or services in one period and the inclusion of some or all of the total allowed compensation for supplying those goods or services in the regulated rates charged to customers in a different period.

IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors

287 EFRAG agrees with the proposed deletion of the paragraph 54G of IAS 8 explaining how the requirement is amended for regulatory account balances, which will no longer be applicable when the proposals of the ED will enter into force.

IAS 36 Impairment of Assets

288 EFRAG agrees with the IASB reasoning that the cash flows that result from a regulatory asset or regulatory liability are incremental and do not significantly affect cash flows from the other rights and obligations created by the regulatory agreement. Therefore, as the measurement of regulatory assets and liabilities will be based on the estimates of the future cash flows, there would be no need for a separate impairment test for regulatory assets.

289 However, EFRAG suggest that interaction between the model and IAS 36 when regulatory assets form part of a cash generating unit (CGU) for goodwill impairment test purposes should be further clarified. To avoid unintended consequences, EFRAG suggests the IASB to provide further guidance how the interaction with a CGU that includes regulatory assets would work in practice, in respect of separating the cash flows from regulatory assets from the total cash flows generated by a CGU for impairment test purposes.

Questions to constituents

290 Are you aware of examples of service concession arrangements falling under both the proposed Standard and IFRIC 12?

291 Do you consider that it would result in the correct depiction of the entity's financial performance when the goodwill- related revenues will be charged to customers but the related goodwill balances would remain on the balance sheet?

Question 12: Likely effects of the proposals

Notes to constituents – Summary of the proposals in the ED

Likely effects of implementing the proposals on information reported in the financial statements and on the quality of financial reporting

Likely effects on the quality of financial reporting (by entities that currently do not recognise regulatory balances)

292 *In paragraphs BC230 - BC232, it is noted that the recognition of regulatory income or regulatory expense and the disclosure of their components, would produce a clearer and more complete picture of the relationship between an entity's revenue and expenses, and thus enable users of financial statements to understand the entity's financial performance better. Therefore, users of financial statements would have more complete information that provides a better basis for understanding the extent to which the fluctuations in the relationship between an entity's revenue and expenses are caused by the differences in timing.*

Likely effects on the quality of financial reporting (by entities that currently recognise regulatory balances)

293 *Financial statements of entities that currently recognise regulatory balances already provide some information about some effects of rate regulation on the relationship between revenue and expenses. Paragraphs BC234 – BC244 provides the following likely effects for such entities:*

- (a) Simpler conceptual basis for identifying and reporting regulatory assets and regulatory liabilities;*
- (b) Comparability of financial information of entities affected by the proposals;*
- (c) Focus on future cash flows;*
- (d) More complete information about the effects of regulatory assets and regulatory liabilities*
- (e) Coherent, prominent and understandable presentation*

Likely costs of implementing the proposals

294 *In paragraph BC245 – BC246, the IASB noted that although users might have to incur some initial costs to adjust their analyses and models, they will save costs of collecting and processing unaudited information. Therefore, in the long term, the IASB expects that the benefits would exceed the costs because all users could develop their analyses using financial information that provides greater insight into the relationship between revenue and expenses.*

295 *The IASB does not expect the costs of applying the proposals, both on initial application and on an ongoing basis, to be significant because to a large extent, the proposed model would use inputs an entity already needs to gather and process in determining regulated rates for the reasons provided in paragraph BC247.*

296 *For the reasons provided in paragraph BC248, the proposals in the ED expects preparers to incur some incremental costs when applying the requirements.*

297 *Consequently, the IASB's overall assessment is that the benefits of more useful information to users of financial statements would outweigh the costs to users and preparers of implementing the proposal.*

Notes to constituents – Early-stage effects analysis findings on likely effects

Preparer effects

Effects on financial statements

- 298 *The early-stage effects analysis findings show that most preparer respondents expected either a significant or moderate impact of the proposed model on the statement of financial position largely because: a) they have regulatory assets and regulatory liabilities that are not recognised in their IFRS financial statements; and b) there are differences between their respective local GAAP and proposed model requirements.*
- 299 *Most respondents expected a moderate impact on the statement of financial performance mainly because their local GAAP already requires the recognition regulatory assets and regulatory liabilities.*
- 300 *Most respondents also noted that loan covenants will not be significantly impacted by the proposed model as these covenants are normally based on local GAAP information.*
- 301 *Implementation challenges, economic consequences, and cost-benefit analysis*
- 302 *Many of the respondents considered it feasible to implement the disclosures but some did not. Those that did not highlighted several factors that will make it difficult to implement the disclosures, for instance, due to difficulties in determining the maturities and due to the detailed nature of the disclosure requirements.*
- 303 *Many respondents indicated that they have information (not included in IFRS financial statements) on regulatory assets and regulatory liabilities, and the information is based on local GAAP. A respondent noted that the information could be adapted for IFRS reporting. However, another respondent noted the IFRS disclosure requirements were more demanding than those of US GAAP.*
- 304 *Many respondents anticipated challenges with initial implementation of the proposed model. They identified some issues that may arise with the measurement requirements including assessing regulatory effects and choice of discount rate, and on determining the regulatory boundary.*
- 305 *Many respondents expected minimal to moderate level of costs to implement the proposed model, while a few expected significant costs. They enumerated at a high-level on the nature of costs (e.g., IT, systems, staff) and aspects of the model that will have cost implications (e.g., proposed model requirements for Construction work in progress, disclosures, and measurement including discounting).*
- 306 *Many respondents expected a positive cost-benefit relationship and highlighted the benefits of the proposed model including a more faithful representation of the economics of rate-regulated entities, reduced volatility of profit or loss, and enhanced comparability across local GAAP and IFRS reporting. One respondent expected a negative cost-benefit relationship due to the measurement requirements, and some respondents could not make the cost-benefit assessment as their impact assessment was still ongoing.*

User effects

- 307 *The early-stage effects analysis findings show that most user respondents indicated that recognition of regulatory assets, regulatory liabilities and related regulatory income, regulatory expense improves understanding of regulated entities, improves valuation accuracy, and leads to a more efficient allocation of capital in markets.*
- 308 *The user respondents had mixed views on the impact of the proposed model on the extent of reliance on non-GAAP measures. There was no clear-cut view on whether it would increase, decrease, or have no impact on reliance on these measures.*

- 309 *On balance, the user respondents expected benefits, and many expected no drawbacks to the recognition of regulatory assets and regulatory liabilities. However, some of the user respondents expect some drawbacks including that it may fail to reflect the regulatory complexities and could lead to confusion, and it will likely not lead to comparability with US GAAP. This finding is consistent with the feedback from past EFRAG user outreach, where most users considered it would be beneficial to recognise regulatory balances on the financial statements, but some expressed concern that it could increase complexity and reduce the understandability of financial statements of rate-regulated entities.*

Question 12

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

- a) Paragraphs BC222–BC244 provide the IASB’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 IASB’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 IASB should assess whether the likely benefits of implementing the proposals outweigh the likely costs of implementing them or on any other factors the IASB should consider in analysing the likely effects?

EFRAG’s response

EFRAG agrees with the IASB’s analysis of the likely effects of the proposals on the quality of financial reporting (i.e., for entities that currently recognise regulatory balances and for those that do not).

EFRAG only agrees to some extent with the IASB analysis of the likely costs of implementing the proposals not being significant. Based on the early-stage effects analysis, EFRAG notes that a majority of preparer respondents expect minimal to moderate costs to implement the proposal and also consider it feasible to implement the disclosures.

However, EFRAG also notes that there are concerns on the implementation of the proposals, which have been raised by some preparers including on implementing the disclosure requirements, measurement and discounting, application of the notion of regulatory boundary, and the model’s requirements for CWIP. Furthermore, although most users expected benefits, a few users were concerned about increased complexity and potential for confusion in the IFRS financial statements as a result of the proposals.

On the basis of preparers’ and users’ overall assessment of the model during the early-stage effects analysis, EFRAG expects a positive cost-benefit relationship from implementing the proposals for both users and preparers.

Likely effects of implementing the proposals on information reported in the financial statements and on the quality of financial reporting

Likely effects on the quality of financial reporting (by entities that currently do not recognise regulatory balances)

- 310 Paragraphs BC230 - BC232 notes that the recognition of regulatory income or regulatory expense and the disclosure of their components, would produce a clearer

and more complete picture of the relationship between an entity's revenue and expenses, and thus enable users of financial statements to understand the entity's financial performance better. Therefore, users of financial statements would have more complete information that provides a better basis for understanding the extent to which the fluctuations in the relationship between an entity's revenue and expenses are caused by the differences in timing.

- 311 EFRAG agrees with the noted analysis in paragraphs BC 230-BC 232. EFRAG's early-stage effects analysis findings show that most user respondents expect the proposals to improve understanding of regulated entities, improve valuation accuracy and lead to a more efficient allocation of capital in markets.
- 312 The early-stage analysis findings also show that preparer respondents expect reduced volatility in the portrayal of performance and a more faithful representation of their economic reality as a result of the proposed accounting model.

Likely effects on the quality of financial reporting (by entities that currently recognise regulatory balances)

- 313 Paragraphs BC234 – BC244 provides the following likely effects for that currently recognise regulatory balances already provide some information about some effects of rate regulation on the relationship between revenue and expenses:
- (a) Simpler conceptual basis for identifying and reporting regulatory assets and regulatory liabilities;
 - (b) Comparability of financial information of entities affected by the proposals;
 - (c) Focus on future cash flows;
 - (d) More complete information about the effects of regulatory assets and regulatory liabilities;
 - (e) Coherent, prominent and understandable presentation.
- 314 EFRAG agrees with the noted analysis in paragraphs BC 234-BC 244. EFRAG's early-stage analysis findings show that preparer respondents expect that the proposed model could improve the comparability in the reporting between IFRS and local GAAP.

Likely costs of implementing the proposals

- 315 The IASB assesses that although users might have to incur some initial costs to adjust their analyses and models, they will save costs of collecting and processing unaudited information. Therefore, in the long term, the IASB expects that the benefits would exceed the costs because all users could develop their analyses using financial information that provides greater insight into the relationship between revenue and expenses.
- 316 Concurrently, the IASB does not expect the costs of applying the proposals, both on initial application and on an ongoing basis, to be significant because to a large extent, the proposed model would use inputs an entity already needs to gather and process in determining regulated rates. Consequently, the IASB's overall assessment is that the benefits of more useful information to users of financial statements would outweigh the costs to users and preparers of implementing the proposal.
- 317 EFRAG's early-stage effects analysis shows that, on balance, the user respondents expect benefits, and many expect no drawbacks to the recognition of regulatory assets and regulatory liabilities. However, some of the user respondents expect some drawbacks including that it may fail to reflect the regulatory complexities and could lead to confusion, and it will likely not lead to comparability with US GAAP.

- 318 The overall feedback from the EFRAG early-stage effects analysis is consistent with the feedback from past EFRAG user outreach, where most users considered it would be beneficial to recognise regulatory balances on the financial statements, but some expressed concern that it could increase complexity and reduce the understandability of financial statements of rate-regulated entities.
- 319 EFRAG's early-stage effects analysis to some extent affirms the IASB's expectations that entities will already have the information to determine regulated rates. The findings show that many preparer respondents have information that could be adapted for IFRS reporting (e.g., information needed for local GAAP reporting). However, one of the respondents also noted the significant differences between the proposed disclosure requirements and the limited disclosure requirements under local GAAP (e.g., US GAAP).
- 320 A majority of preparer respondents considered it feasible to implement the disclosures, but some did not. Those that did not highlighted several factors that will make it difficult to implement the disclosures, for instance, due to difficulties in determining the maturities and due to the detailed nature of the disclosure requirements.
- 321 A majority of respondents were aware of practical challenges with initial implementation of the proposed model. They identified some issues that may arise with the measurement requirements including assessing regulatory effects and choice of discount rate, and on determining the regulatory boundary.
- 322 A majority of respondents expected minimal to moderate level of costs to implement the proposed model, while a few expected significant costs. They enumerated at a high-level on the nature of costs (e.g., IT, systems, staff) and aspects of the model that will have cost implications (e.g., proposed model requirements for Construction work in progress, disclosures, and measurement including discounting).
- 323 A majority of preparer respondents expected a positive cost-benefit relationship and highlighted the benefits of the proposed model including a more faithful representation of the economics of rate-regulated entities, reduced volatility of profit or loss, and enhanced comparability across local GAAP and IFRS reporting. However, one respondent expected a negative cost-benefit relationship due to the measurement requirements.

Question 13: Other comments

Question 13

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

- 324 EFRAG suggests that the IASB consider establishing a transition resource group (TRG) to support the rate-regulated activities project similar to TRGs set up for the implementation of IFRS 15 and IFRS 17.
- 325 EFRAG suggests that the IASB provides a detailed Illustrative Example of the disclosure requirements, especially for total allowed compensation.
- 326 EFRAG has been made aware that there are cases when a utility entity acquires another entity for synergy purposes. The regulator accepts this acquisition if an entity can demonstrate that it will generate synergies and permits an entity to recover goodwill generated from acquisition through the rates charged to customers over an agreed number of years. These goodwill balances are separately identifiable, have separate cash flows and defined useful life (the regulatory recovery period). A question has been raised on whether this fact pattern ought to be eligible to be considered within the scope of the model and regulatory assets recognised albeit that the past event is not goods or services supplied.