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## Update on Rate-regulated Activities Project Cover Note

### Objective

- 1 The objective of this session is to update the EFRAG FR Board on:
  - (a) the IASB's plans for redeliberating the proposals in its Exposure Draft *Regulatory Assets and Regulatory Liabilities* (the 'ED'); and
  - (b) the IASB's tentative decisions taken so far in its redeliberation on determining the scope of the proposed Standard.

### Background

- 2 The ED was issued in January 2021 with a comment period that ended on 30 July 2021.
- 3 The IASB has taken the following steps so far:
  - (a) discussed respondents' feedback on the ED at its October and November 2021 meetings.
  - (b) discussed and approved a plan for redeliberating the proposals at its meeting in December 2021.
  - (c) conducted targeted outreach to stakeholders in a selection of jurisdictions (e.g., the UK and Australia) where concerns were raised on the applicability of the proposals due to the type and diversity of their prevailing regulatory regimes.
  - (d) made tentative decisions on determining whether a regulatory agreement is within the scope of the proposed Standard and the role of a regulator during its meeting in February 2022.
  - (e) held a meeting with the IASB Consultative Group for Rate Regulation (Consultative Group) on 4 March 2022 to discuss the ED's proposals on the accounting for regulatory returns on capital work in progress (CWIP), which is a component of the total allowed compensation. On 28 March 2022, the IASB met again with the Consultative Group to discuss situations and implications of when the regulatory recovery period of assets differs from the IFRS depreciation- economic useful life.
  - (f) consulted ASAF members on its redeliberation plans at the 31 March 2022 ASAF meeting (the ASAF meeting paper has been included as a background paper, i.e., Agenda paper 07-02).

## **Structure of this paper**

- 4 The rest of this paper is structured as follows:
  - (a) Feedback received and IASB redeliberation plan on the ED
  - (b) IASB tentative decisions to date
  - (c) Appendix 1- Constituents' feedback to the IASB ED
  - (d) Appendix 2- Summary of EFRAG's position in its Final Comment Letter

## **Feedback received and IASB redeliberation plan on the ED**

- 5 The ED elicited 127 comment letter responses. The IASB received a summary of respondents' feedback to ED at the [October 2021 meeting](#) and [November 2021 meeting](#).
- 6 The IASB discussed and approved a plan for redeliberating the proposals at its meeting in December 2021. The IASB will redeliberate the proposals based on the following three workstreams, reflecting the feedback on topics as categorised by the IASB staff (in order of priority):
  - (a) Topics that raised significant concerns (see Appendix 1 paragraphs 19 to 22)
  - (b) Topics that were well received (see Appendix 1 paragraphs 23 to 28); and
  - (c) Other topics (see Appendix 1 paragraphs 30 to 31).
- 7 An elaboration of constituents' feedback to the ED categorised by the three workstreams is included in Appendix 1 of this paper.
- 8 In February 2022, the IASB started its redeliberation on the scope of the proposed Standard, which is one of the topics that raised significant concerns. However, the IASB has not communicated the specific timeline for its redeliberation across the three workstreams and addressing all issues arising from constituents' feedback to the ED. Hence, the EFRAG Secretariat cannot anticipate the possible timeline for the completion of the IASB redeliberation and the possible issuance of a new Standard.

## **IASB tentative decisions to date**

- 9 At its meeting in February 2022, the IASB started its redeliberation on topics that raised significant concern and made tentative decisions on determining whether a regulatory agreement is within the scope of the proposed Standard, and on the definition of a regulator. These are included in the February 2022 [IASB Update](#) and summarised below:

### *Determining whether a regulatory agreement is within the scope of the proposals*

- 10 The IASB tentatively decided:
  - (a) to require an entity to apply the Standard to all its regulatory assets and regulatory liabilities;
  - (b) that the Standard will apply to all regulatory agreements and not only to those that have a particular legal form;
  - (c) to confirm the conditions necessary for a regulatory asset or a regulatory liability to exist;
  - (d) to not explicitly specify in the Standard which regulatory schemes would be within or outside its scope;
  - (e) to clarify certain other aspects contained in the Standard that a regulatory agreement:

## *Rate-regulated Activities– Cover Note*

- (i) may include enforceable rights and enforceable obligations to adjust the regulated rate beyond the current regulatory period;
- (ii) that creates either regulatory assets or regulatory liabilities, but not both, is within its scope;
- (iii) that causes differences in timing when a specified regulatory threshold is met creates regulatory assets or regulatory liabilities;
- (iv) is not required to determine a regulated rate using an entity's specific cost for the regulatory agreement to create regulatory assets or regulatory liabilities.

### *Definition of a regulator*

11 The IASB tentatively decided to:

- (a) include the existence of a regulator as part of the conditions necessary for a regulatory asset or a regulatory liability to exist;
- (b) define a regulator as 'a body that is empowered by law or regulation to determine the regulated rate or a range of regulated rates';
- (c) include guidance to clarify that:
  - (i) self-regulation is outside the scope of the Standard;
  - (ii) a situation in which an entity or its related party determines the rates but does so in accordance with a framework that is overseen by a body empowered by law or regulation is not self-regulation for the purposes of the Standard.

### *Aspects of scope to be addressed at future meetings*

12 At future meetings, the IASB will discuss the following in relation to the scope of the proposed Standard:

- (a) Interaction with IFRS 9 and IFRS 17.
- (b) Application questions about the definition of 'regulatory agreement' and the term 'customers'.
- (c) The boundary between financial instruments and regulatory assets and regulatory liabilities.
- (d) Interaction with IFRIC 12.
- (e) Enforceability of rights and obligations to adjust future regulated rates—to be discussed when redeliberating recognition and measurement.

## **EFRAG activities**

### *TEG and CFSS members' initial reactions*

13 In preparation for the ASAF session, the EFRAG TEG-CFSS received an update on the IASB plans to redeliberate the ED's proposals and tentative decisions on the scope of the proposed Standard. The EFRAG-TEG CFSS members did not object to the IASB plans and some of them sought clarification on how the tentative decisions on scope affected self-regulation. However, questions were raised on whether some of the concerns raised by constituents were addressed – including concerns on the recognition threshold and detailed disclosures. A member also sought to know whether re-exposure would be necessary but a view was expressed that the IASB may likely focus on outreach to formulate solutions rather than to re-expose the ED.

*Next steps*

- 14 The EFRAG Secretariat intends to consult the EFRAG Rate-regulated Activities Working Group (RRAWG) in a meeting to be held at the end of April. The agenda of this meeting will be agreed upon with the RRAWG Chairman and it is likely to focus on the possible solutions to address the concerns on the total allowed compensation as well as to get the RRAWG views on the IASB tentative decisions on the scope of the proposed Standard. Once the direction of travel is clear and the IASB redeliberation of the proposals is near finalisation, EFRAG will consider undertaking impact analyses as appropriate. In the interim, as needed, EFRAG may explore outreach to European stakeholders to assess views on solutions under consideration by the IASB.

**Question for the EFRAG FR Board**

- 15 Does the EFRAG FR Board have any questions or comments about the IASB's redeliberation plans and tentative decisions on the scope of the proposed Standard in the ED or on EFRAG's intended activities on the project?

**Agenda Papers**

- 16 In addition to this cover note, agenda paper 07-02 –*ASAF Agenda Paper AP1 Rate-regulated Activities* – has been provided as background material.

## Appendix 1 – Constituents’ Feedback to the IASB ED

- 17 As noted, the IASB categorised the feedback to the ED into three categories, namely- topics that raised significant concerns, topics that were well received, and other topics as elaborated on below.

### **Topics that raised significant concerns**

- 18 The areas that raised the most concerns from respondents to the ED related to the proposed scope, total allowed compensation, and the discount rate. These areas of concern are consistent with EFRAG’s position in its Final Comment Letter. A summary of the concerns reported by respondents to the IASB is provided below.

#### *Scope*

- 19 Many respondents were uncertain about which regulatory agreements, arrangements or activities would be within the scope of the proposals. Some of these uncertainties are due to the perceived lack of clarity about:
- (a) The interaction between the proposed Standard and other Standards (mainly, IFRS 9 *Financial Instruments*, IFRS 17 *Insurance Contracts* and IFRIC 12 *Service Concession Arrangements*).
  - (b) The proposed definition of ‘regulatory agreement’ and whether a regulator is needed for regulatory assets or regulatory liabilities to exist, which should help to prevent a scope that is too broad.

#### *Total allowed compensation – regulatory return on an asset not yet available for use (CWIP)*

- 20 Most respondents including users disagreed with the ED’s proposal that an entity should reflect returns on an asset not yet available for use in the period when the asset is being used to supply goods or services to customers. According to these respondents, the proposals would:
- (a) not reflect the economic substance of the regulatory agreements;
  - (b) not result in useful information;
  - (c) be costly to implement; and
  - (d) be inconsistent with the proposed treatment for construction-related performance incentives and the US generally accepted accounting principles (GAAP).

#### *Total allowed compensation - Regulatory assets and regulatory liabilities arising from differences between assets’ regulatory recovery pace and their useful lives*

- 21 Many respondents disagreed with recognising regulatory assets or regulatory liabilities because of differences between the period that the regulatory agreements permit recovery of an asset and its IFRS economic useful life (different recovery pace). According to these respondents, the proposals would:
- (a) not reflect an entity’s rights and obligations from their regulatory agreements;
  - (b) neither meet the proposed regulatory asset and regulatory liability definitions in the ED nor the asset and liability definitions in the *Conceptual Framework*;
  - (c) not result in useful information; and
  - (d) be costly to implement

#### *Discount rate*

- 22 Most respondents including users disagreed with the proposal for an entity to use the minimum interest rate as the discount rate when the regulatory interest rate

provided for a regulatory asset is insufficient to compensate the entity for the time value of money and for uncertainty in the future cash flows arising from that regulatory asset. These respondents are concerned about the complexity of the proposals and believe that the costs of applying them would outweigh any benefits.

**Topics that were well received**

- 23 Respondents to the IASB raised less concerns with the other ED proposals. However, respondents asked for clarification and further analyses regarding the following aspects of the proposals.

*Recognition, unit of account and derecognition*

- 24 Respondents raised the following points to assess the need for:
- (a) Explore whether any changes are needed on the facts and circumstances to consider when assessing the existence of enforceable rights and enforceable obligations.
  - (b) Assess the need for a higher threshold for recognition in some circumstances.
  - (c) Explore whether to provide guidance on the derecognition of regulatory assets and regulatory liabilities.

*Measurement (estimating future cash flows)*

- 25 Respondents raised the following points:
- (a) Consider clarifications relating to the boundary of the regulatory agreement.
  - (b) Consider whether the chosen method for estimating uncertain cash flows should be applied consistently from initial recognition to recovery of a regulatory asset or fulfilment of a regulatory liability.

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

- 26 Respondents raised the following points:
- (a) Consider how income and expenses are treated as allowable or chargeable using a criterion other than a cash basis.
  - (b) Consider whether the presentation proposals in paragraph 69 of the ED should be extended to items using a criterion other than cash basis.

*Interaction with other IFRS Standards, including amendments to other Standards*

- 27 Respondents asked the IASB to address concerns and provide recommendations related to the interaction of the proposed requirements with other IFRS Standards (mainly IAS 12 *Income Taxes* and IAS 36 *Impairment of Assets*).

*Presentation*

- 28 Respondents asked the IASB to consider whether to permit entities to classify all regulatory income minus all regulatory expenses as revenue.

*Disclosure*

- 29 Respondents raised the following points:
- (a) Consider whether to develop a broader overall disclosure objective.
  - (b) Address concerns about the appropriate level of aggregation and disaggregation of the information to be disclosed and on some proposed disclosure requirements.

**Other topics**

- 30 Other topics that will be discussed in the redeliberation include transition proposals and effective date, effects analysis and due process steps.

- 31 In relation to the transition proposals, most respondents to the IASB did not support the proposed requirement to apply the Standard retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. During the redeliberation, the IASB staff plan to discuss these concerns with the IASB. These concerns are consistent with EFRAG's Final Comment Letter.

## Appendix 2 – Summary of EFRAG’s position in its Final Comment Letter

- 32 A summary of the concerns raised by EFRAG in its Final Comment Letter on the IASB proposals in the ED is provided below.
- (a) **Scope** – There are several aspects where there is a need for further clarification on entities’ scope eligibility, including:
    - (i) types of regulation where regulated rates are based on sector averages instead of an entity’s own costs;
    - (ii) specific scope exclusions (e.g., for self-regulation);
    - (iii) definition of ‘customers’ as the notion of customers (i.e., groups of customers); and
    - (iv) whether the existence of a regulator is required and better defining the characteristics of a regulator.
  - (b) **Definitions of regulatory assets and regulatory liabilities** – EFRAG noted that there are circumstances where the recognised regulatory assets and regulatory liabilities would not meet the definitions provided in the ED and instances when applying the definitions do not reflect the economic substance of the regulatory agreement.
  - (c) **Total allowed compensation (TAC)** – EFRAG disagreed with the requirement for the deferral of regulatory returns on Capital Work-in-Progress (CWIP) charged to customers during construction (paragraph B15 of the ED). EFRAG also noted that several stakeholders noted situations where the proposed requirements on TAC under paragraphs B3-B9 of the ED related to allowable expenses will not reflect the economic substance of the regulatory agreement (e.g., recoverable costs are based on regulatory accounting and not IFRS expenses). EFRAG, therefore, recommended that the IASB further examine whether the requirements of paragraphs B3-B9 can be applied across diverse regulatory regimes.
  - (d) **Recognition and measurement** – EFRAG explained that some of EFRAG’s stakeholders reported concerns with high levels of uncertainty and recommended that the IASB considers a higher recognition threshold for cases of high existence uncertainty, similar to that in IFRS 15 (constraining estimates of variable consideration). Regarding measurement, EFRAG supported the proposed cash-flow measurement technique. However, based on feedback received, EFRAG disagreed with:
    - (i) the proposed new concept of a minimum adequate rate as the discount rate for regulatory assets, when the regulatory interest rate provided is insufficient. Should the IASB decide to maintain this concept, EFRAG recommended that the IASB develop a rebuttable presumption; and
    - (ii) having different discounting approaches for regulatory assets and regulatory liabilities.
  - (e) **Presentation and Disclosure** – EFRAG agreed an entity should 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. EFRAG also generally agreed with the proposed overall disclosure objectives. However, EFRAG explained that several preparers had expressed possible operational difficulties to implement the detailed disclosure requirements and questioned whether users need such a detailed level of information. EFRAG, therefore, recommended the IASB should focus more on the usefulness of the reported information and adopt a more balanced disclosure approach by considering a

prioritisation based on cost-benefit considerations and undertaking further outreach to users.

- (f) **Transition and effective date** – EFRAG recommended a modified retrospective application with exemptions or practical expedients for assets with long useful lives and where backdated CWIP regulatory returns will need to be deferred (should the IASB decide to retain this proposal). EFRAG also recommended that the effective date should be 24-36 months after the publication of the final standard to allow effective implementation.