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Regulatory assets and regulatory liabilities

Project Update
Cover Note

Objective of this session

1 The objective of this session is to provide EFRAG FRB members with an update on the IASB's latest tentative decisions on the following aspects of total allowed compensation:

(a) Allowable expense and benchmark expenses

(b) Differences between the regulatory recovery period and the assets' useful lives

(c) Capitalised borrowing costs

(d) Inflation adjustments

Background

2 On 28 January 2021, the IASB published the Exposure Draft on the accounting for regulatory assets and regulatory liabilities (the ED) with a comment deadline of 30 July 2021.

3 EFRAG published its final comment letter on the ED on 10 September 2021 and a Feedback Statement in October 2021.

4 The IASB started to discuss respondents' feedback on the ED at its October and November 2021 meetings.

5 Appendix 1 provides a summary of the IASB tentative decisions taken so far during its re-deliberations of the proposals in the ED.

6 Appendix 2 provides a summary of the EFRAG discussions so far on the IASB tentative decisions.

7 The information presented in Appendix 1 and Appendix 2 is for information only.

The direct (indirect) concept

8 In May 2023, the EFRAG FRB discussed the direct (indirect) relationship concept between an entity's regulatory capital base and its property, plant and equipment.

9 The direct (indirect) concept was introduced by the IASB in 2022 in response to concerns about operational difficulties to apply the proposals in the ED when an entity's property, plant and equipment under local GAAP did not align with the regulatory capital base. This concept is central to the IASB's tentative decisions taken since October 2022 on total allowed compensation and more generally the accounting for regulatory assets and regulatory liabilities.

10 In a nutshell, the IASB tentatively decided that entities that operate in a regulatory environment where there is no direct relationship between its property, plant and equipment and the regulatory capital base will in many instances not recognise regulatory assets and regulatory liabilities.

11 The IASB staff is currently undertaking outreach on the direct (no direct) concept. The outcome of the outreach will be discussed with the IASB at a future meeting. Preliminary feedback shows that it is not always straight forward to assess whether an entity's property, plant and equipment has a direct or indirect relationship with its regulatory capital base. The assessment mostly depends on whether an entity can track the differences between GAAP and the regulatory accounts making an overall assessment fairly subjective and could significantly affect comparability of information.

12 A detailed explanation of the direct (indirect) concept and how it will impact the accounting model is provided in agenda paper 09-03. This paper is the same paper that was presented to the EFRAG FRB in May 2023.

Next steps

13 At the May 2023 IASB meeting, the IASB staff presented a timeline to the IASB on the project and informed that a final Standard is expected in H1 2025.

14 In 2023, the IASB has so far redeliberated the proposals on recognition (including enforceability and derecognition) and performance incentives.

15 Redeliberation of the following aspects of the model is still outstanding: (a) estimating future cash flows; (b) discount rate, including the proposed minimum interest rate; (c) items affecting regulated rates only when related cash is paid or received; (d) presentation and disclosure; (e) effective date and transition; and (f) amendments to other IFRS Accounting Standards.

16 The EFRAG Secretariat will continue to update EFRAG RRAWG, EFRAG FR TEG, EFRAG CFSS and EFRAG FRB as the project progresses.

17 The EFRAG Secretariat will also consider what level of outreach is needed to support the IASB tentative decisions so far, and if any preparatory work for endorsement advice (e.g., by commissioning an economic study on aspects of the final Standard's requirements) can be done before the issuance of a new Standard.

Agenda Papers

18 In addition to this cover note, agenda papers for this session are:

(a) Agenda paper 09-02 – Presentation on Project Update

(b) Agenda paper 09-03 – Background paper - The direct (no direct) relationship concept

Appendix 1: Summary of the IASB tentative decisions

19 The table below provides an overview of IASB discussions and tentative decisions so far. This table was prepared based on the information published in the IASB Updates.

Topic	Decisions reached	IASB meeting date
Measurement – estimating cash-flows	**Estimating uncertain future cash flows** The IASB tentatively decided that the prospective Accounting Standard would: • retain the requirement proposed in the Exposure Draft that an entity estimate uncertain future cash flows using whichever of the two methods—the 'most likely amount' method or the 'expected value' method—the entity expects would better predict the cash flows; • require an entity to reassess the method of estimating uncertain future cash flows only if there is a significant change in facts and circumstances such that the entity no longer expects the method to better predict the cash flows; • clarify that when an entity uses the 'expected value' method to estimate uncertain future cash flows the entity should consider the entire range of outcomes, including those outcomes in which a regulatory asset or a regulatory liability would not exist, or would exist but produce no future cash flows; and • retain the proposal in the Exposure Draft not to require a separate impairment test for regulatory assets.	**June 2023**
Project timeline **Timing of initial recognition**	**Project timeline** The IASB received an update on: • The status of the project, including the expected timing for completing redeliberations and issuing the prospective Standard • Issues to be redeliberated at future meetings. **Timing of initial recognition** The IASB tentatively decided that the prospective Standard would retain: • the proposal to require recognition of all regulatory assets and all regulatory liabilities existing at the end of the reporting period; and • the proposal to treat any regulatory assets or regulatory liabilities arising from regulated rates denominated in a foreign currency as monetary	**May 2023**

Topic	Decisions reached	IASB meeting date
	items when applying IAS 21 *The Effects of Changes in Foreign Exchange Rates*.	

Long-term performance incentives
 	
Derecognition
	Recognition and measurement of long-term performance incentives
	
	The IASB tentatively decided:
	
	• The IASB tentatively decided to retain the proposal to require an entity to estimate the amount of a long-term performance incentive, and to determine the portion of that estimated amount that relates to the reporting period using a reasonable and supportable basis.
	
	Derecognition of regulatory assets and regulatory liabilities.
	
	The IASB tentatively decided:
	
	• require an entity to derecognise:
	    ○ a regulatory asset as it recovers part or all of the regulatory asset by adding amounts to future regulated rates charged to customers; and
	    ○ a regulatory liability as it fulfils part or all of the regulatory liability by deducting amounts from future regulated rates charged to customers.
	
	• explain that the derecognition of regulatory assets and regulatory liabilities, as described above, is the most common way in which regulatory assets and regulatory liabilities would be derecognised. Therefore, in applying the recognition and measurement requirements at the end of each reporting period, an entity would not be required to consider explicitly when and how its regulatory assets and regulatory liabilities should be derecognised.
	
	• clarify that an entity would derecognise a regulatory asset or a regulatory liability if the asset or liability ceased to meet the 'more likely than not' recognition threshold.
	
	• include guidance on the derecognition of regulatory assets and regulatory liabilities settled by a regulator or another designated body. The guidance would also require an entity to recognise the difference between the derecognised regulatory asset or regulatory liability and any new asset or liability in profit or loss.
		April 2023

Topic	Decisions reached	IASB meeting date
	• specify that if a regulatory asset or a regulatory liability is added to or deducted from an entity's regulatory capital base and the entity's regulatory capital base has **no direct relationship with its property, plant and equipmen**t, the entity would derecognise: ○ the regulatory asset and recognise any associated regulatory expense in profit or loss; and ○ the regulatory liability and recognise any associated regulatory income in profit or loss.	
Recognition and Total allowed compensation	**The recognition threshold** The IASB tentatively decided: • to retain the proposal to require an entity to recognise a regulatory asset or a regulatory liability whose existence is uncertain if it is more likely than not that such an asset or liability exists; • not to set a recognition threshold based on the probability of a flow of economic benefits; • not to set a recognition threshold based on the level of measurement uncertainty, except for those regulatory assets and regulatory liabilities described in paragraph (e); • to retain the proposed symmetric recognition threshold for regulatory assets and regulatory liabilities; and • to require an entity to recognise a regulatory asset or regulatory liability—whose measurement depends on a regulatory benchmark determined after the financial statements are authorised for issue—when the regulator determines the benchmark. All 12 IASB members agreed with these decisions. The IASB will discuss the proposed recognition and measurement requirements for regulatory assets and regulatory liabilities arising from long-term performance incentives at a future IASB meeting. **Enforceability and recognition** The IASB tentatively decided: • to reconfirm and clarify the proposed single assessment of the existence of enforceable present rights and enforceable present	**February 2023**

Topic	Decisions reached	IASB meeting date
	obligations in the Standard, for the individual regulatory assets or regulatory liabilities. • to clarify in the Standard that rights and obligations can be enforceable even if their existence is uncertain. • to consider the principles in paragraph 35(c) of IFRS 15 *Revenue from Contracts with Customers* that relate to an entity's right to payment for performance completed to date in developing the Standard. These principles would be used to set the requirements for assessing the existence of enforceable present rights for regulatory returns on an asset not yet available for use, and for assessing the existence of enforceable present rights or enforceable present obligations for long-term performance incentives. All 12 IASB members agreed with decisions (a) and (b) and eleven of 12 IASB members agreed with decision (c). **Total allowed compensation—Performance incentives** The IASB tentatively decided to reconfirm in the Standard the proposed requirement relating to performance incentives. The requirement would be that amounts relating to performance incentives should form part of or reduce the total allowed compensation for goods or services supplied in the period in which the entity's performance gives rise to the incentive. These amounts would include those that result from an entity's performance of construction work. All 12 IASB members agreed with this decision.	
Total allowed compensation	**Inflation adjustments and accounting for allowable expenses or performance incentives included in an entity's regulatory capital base** *Inflation adjustments* The IASB tentatively decided that the Standard will specify that an entity is neither required nor permitted to recognise as a regulatory asset inflation adjustments to the regulatory capital base. All 12 IASB members agreed with this decision *Other allowable expenses or performance incentives* The IASB tentatively decided that the Standard specify that:	**December 2022**

<table>
<tr><th>Topic</th><th>Decisions reached</th><th>IASB meeting date</th></tr>
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an entity is required to recognise a regulatory asset or a regulatory liability relating to an allowable expense or performance incentive included in its regulatory capital base when:

the entity’s regulatory capital base and its property, plant and equipment have a direct relationship; and
the entity has an enforceable present right (obligation) to add (deduct) the allowable expense or performance incentive to (from) future regulated rates.

an entity is neither required nor permitted to recognise a regulatory asset or a regulatory liability relating to an allowable expense or performance incentive included in its regulatory capital base when the entity’s regulatory capital base and its property, plant and equipment have no direct relationship.

All 12 IASB members agreed with this decision.
At the December 2022 meeting, the IASB also discussed the advice from the Consultative Group for Rate Regulation on the topics discussed in the December meeting; and the use of the direct (no direct) relationship concept in the IASB’s redeliberations of the proposed model.
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<tr><td>Total allowed compensation</td><td>
Interaction between regulatory returns on an asset not yet available for use and an entity’s capitalisation of borrowing costs incurred to construct that asset.
In November 2022 the IASB discussed the interaction between the IASB’s tentative decision on regulatory returns on an asset not yet available for use and an entity’s capitalisation of borrowing costs incurred to construct that asset.
The IASB tentatively decided that when an entity’s regulatory capital base and its property, plant and equipment have a direct relationship and the entity capitalises its borrowing costs:

if the regulatory agreement provides the entity with both a debt and an equity return on an asset not yet available for use—to require the entity to reflect only those returns in excess of the entity’s capitalised borrowing costs in the statement of financial performance during the construction period; and
if the regulatory agreement provides the entity with only a debt return on such an asset—to prohibit the entity from reflecting the return in

</td><td>November 2022</td></tr>
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Topic	Decisions reached	IASB meeting date
	the statement of financial performance during the construction period. All 11 IASB members agreed with these decisions.	
Total allowed compensation	**Proposed definition of allowable expense and treatment of allowable expenses based on benchmarks** The IASB tentatively decided that the Standard: • retain the proposed definition of allowable expense; • clarify that a regulatory agreement may determine the amount that compensates an entity for an allowable expense using a basis different from the basis the entity uses to measure the expense in accordance with IFRS Accounting Standards; and • clarify the treatment of allowable expenses based on benchmarks and include examples to help entities identify differences in timing in those cases. All 11 IASB members agreed with these decisions.	**October 2022**
Total allowed compensation	**Regulatory assets and regulatory liabilities arising from differences between the regulatory recovery period and the assets' useful lives** The IASB tentatively decided that the Standard: • provide guidance to help an entity determine whether its regulatory capital base and its property, plant and equipment have a direct relationship; • retain the proposals for an entity to account for regulatory assets or regulatory liabilities arising from differences between the regulatory recovery period and the assets' useful lives if the entity has concluded that its regulatory capital base and its property, plant and equipment have a direct relationship; and • require an entity that has concluded that its regulatory capital base and its property, plant and equipment have no direct relationship to provide disclosures to enable users of financial statements to understand the reasons for its conclusion. All 11 IASB members agreed with these decisions.	**October 2022**

Topic	Decisions reached	IASB meeting date
Total allowed compensation	**Components of total allowed compensation** The IASB tentatively decided that in the Standard, the application guidance focus on: • helping entities to identify differences in timing instead of specifying the components of total allowed compensation; and • the most common differences in timing that could arise from various types of regulatory schemes. All 10 IASB members agreed with this decision.	**July 2022**
Total allowed compensation	**Regulatory returns on an asset not yet available for use** The IASB tentatively decided that the Standard will specify that when an entity has an enforceable present right to regulatory returns on an asset not yet available for use, those returns would form part of the total allowed compensation for goods or services supplied during the construction period of that asset. The Standard will provide guidance for entities to assess whether their rights to these regulatory returns are enforceable. Eight of nine IASB members agreed with this decision. One IASB member was absent.	**July 2022**
Scope **Including interaction with other IFRS Standards**	**IFRIC 12 Service Concession Arrangements.** The IASB tentatively decided that the Standard: • clarify the intended interaction between the Standard and IFRIC 12. That is, an entity would apply IFRIC 12 first and then apply the requirements of the Standard to any remaining rights and obligations to determine if the entity has regulatory assets or regulatory liabilities. • include examples to illustrate that interaction. All 11 IASB members agreed with this decision.	**September 2022**
Scope **Including interaction with other IFRS Standards**	**Scope—Customers** The IASB tentatively decided to clarify in the Standard that, for a regulatory asset or a regulatory liability to arise, it is necessary that differences in timing originate from, and reverse through, amounts included in the regulated rates that an entity accounts for as revenue in accordance with IFRS 15 *Revenue from Contracts with Customers*. This is the case even when: • an entity charges the regulated rates to its customers indirectly through another party.	**May 2022**

Topic	Decisions reached	IASB meeting date
	• the origination and reversal of differences in timing occur in different revenue streams through regulated rates charged to different groups of customers. All 10 IASB members agreed with this decision. **Scope—Financial instruments within the scope of IFRS 9** The IASB tentatively decided: • not to exclude from the scope of the Standard regulatory assets or regulatory liabilities related to financial instruments within the scope of IFRS 9. • to explain in the Basis for Conclusions on the Standard that the regulation of interest rates is typically limited to setting a cap or floor on interest rates. This type of regulation is not expected to give rise to differences in timing. All 10 IASB members agreed with this decision.	

Scope	**Determining whether a regulatory agreement is within the scope of the proposals**
	
	The IASB tentatively decided to:
	
	• reconfirm the proposals in the Exposure Draft on:
	
	  ○ requiring an entity to apply the Standard to all its regulatory assets and regulatory liabilities.
	
	  ○ requiring the Standard to apply to all regulatory agreements and not only to those that have a particular legal form.
	
	  ○ the conditions necessary for a regulatory asset or a regulatory liability to exist.
	
	11 of the 12 IASB members agreed with these decisions.
	
	• not explicitly to specify in the Standard which regulatory schemes would be within or outside its scope. All 12 IASB members agreed with this decision.
	
	• to clarify in the Standard that:
	
	  ○ a regulatory agreement may include enforceable rights and enforceable obligations to adjust the regulated rate beyond the current regulatory period.
	
	  ○ regulatory agreements that create either regulatory assets or regulatory liabilities, but not both, are within its scope.
		February 2022

Topic	Decisions reached	IASB meeting date
	○ a regulatory agreement that causes differences in timing when a specified regulatory threshold is met creates regulatory assets or regulatory liabilities. ○ a regulatory agreement is not required to determine a regulated rate using an entity's specific costs for the regulatory agreement to create regulatory assets or regulatory liabilities. All 12 IASB members agreed with these decisions. **Scope—Definition of a regulator** The IASB tentatively decided that the Standard will: • self-regulation is outside the scope of the Standard. • 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. All 12 IASB members agreed with this decision.	
Project plan	The IASB discussed and agreed on a plan for redeliberating the proposals in its Exposure Draft Regulatory Assets and Regulatory Liabilities.	**December 2021**
Feedback received on ED	At its meetings in October and November 2021, the IASB discussed the feedback received in comment letters and outreach events on its proposals in the Exposure Draft.	**October and November 2021**

Appendix 2: Summary of the EFRAG discussions so far on the IASB tentative decisions

20 The paragraphs below provide an overview of EFRAG discussions so far on the IASB tentative decisions.

EFRAG discussions

21 On 11 July 2023, the EFRAG RRAWG will discuss the IASB's tentative decisions taken in February and April 2023 on various aspects of recognition and derecognition of regulatory assets and regulatory liabilities.

22 In May 2023 the EFRAG FRB discussed the direct (indirect) concept in the forthcoming IASB's final Standard on accounting for regulatory assets and regulatory liabilities

23 In April 2023, EFRAG FR TEG discussed the IASB's tentative decisions, taken in November and December 2022 on capitalised borrowing costs and inflation adjustments.

24 In March 2023, EFRAG FR TEG and EFRAG CFSS discussed the IASB's tentative decisions, taken from September to December 2022, on scope and various aspects of total allowed compensation, in preparation for the March ASAF meeting.

25 In February 2023, the EFRAG RRAWG discussed the November and December IASB tentative decisions relating to the accounting for various aspects of total allowed compensation (including the direct/no direct concept, capitalised borrowing costs and inflation adjustments).

26 In January 2023, EFRAG FR TEG discussed the IASB tentative decisions taken in October 2022 on allowable expense and benchmark expenses and regulatory assets and regulatory liabilities arising from differences in regulatory recovery pace and assets' useful lives. EFRAG FR TEG also had an initial discussion on the direct (no direct) concept introduced by the IASB at its meeting in October 2022.

27 In December 2022, the EFRAG FRB received an update on the IASB tentative decisions from May 2022 – September 2022 (scope and aspects of the accounting for total allowed compensation).

28 In December 2022, EFRAG FR TEG received a presentation from the IASB staff on the two main regulatory regimes present in Europe and beyond – namely cost-based and incentive-based regimes.

29 On 8 November 2022, EFRAG met with the EFRAG RRAWG to discuss the IASB tentative decisions on scope and several aspects of total allowed compensation (including the topics that will be presented at the meeting today).

30 In September 2022, EFRAG FR TEG and EFRAG CFSS discussed the IASB's tentative decisions taken in May, July, and September 2022 on scope and total allowed compensation (components of the total allowed compensation and regulatory returns on assets not yet in use).

31 In July 2022, EFRAG FR TEG received an update on the IASB tentative decisions on scope and total allowed compensation. At that meeting, EFRAG FR TEG members briefly discussed the 'differences between regulatory recovery pace and assets' useful lives', and it was then agreed that an education session would be useful as a prerequisite to a detailed discussion on total allowed compensation.

32 In April 2022, EFRAG met with the EFRAG RRAWG to discuss the IASB tentative decisions on scope and the outcome of the IASB outreach to its Consultative Group in March 2022.

33 Between December 2021 and April 2022, EFRAG FR TEG, EFRAG CFSS and EFRAG FRB received updates on the IASB redeliberation plan and tentative decisions on the scope of

the final Standard. In December 2021, EFRAG FR TEG and EFRAG FRB received education sessions on the features of regulatory schemes.