EFRAG Secretariat: Isabel Batista, Juan Jose Gomez de la Calzada, Ioana Kiss and Vincent Papa

Regulatory assets and regulatory liabilities
Issues Paper

Objective

1 The purpose of this session is to seek EFRAG FR TEG/CFSS members' views on the IASB tentative decisions in Q3 and Q4 2023 on the feedback to the 2021 Exposure Draft *Regulatory Assets and Regulatory Liabilities* (the ED). This input is sought in preparation for the ASAF meeting later in March 2024. This paper relates to IASB tentative decisions related to the following five topics:

(a) **Topic 1: Credit and other risks**. This is related to the measurement of regulatory assets and regulatory liabilities. Of note, the September 2023 TEG-CFSS meeting and ASAF meeting thereafter covered other aspects of measurement (i.e., estimation of uncertain cash flows).

(b) **Topic 2: Survey feedback on the direct (no direct) relationship concept.** This concept that was not included in the ED is related to determining the total allowed compensation (TAC). The IASB redeliberations on other aspects of TAC occurred in 2022 and 2023 and have been addressed in past TEG-CFSS and ASAF meetings.

(c) **Topic 3: Items affecting regulated rates on a cash basis.** This is related to the measurement and presentation of items affecting regulated rates only when the related cash is paid or received. The measurement and presentation requirements applying to these items differ from the general measurement and presentation requirements.

(d) **Topic 4: Presentation**

(e) **Topic 5: Unit of account and offsetting**

2 Across the aforementioned five topics, the following content is provided:

(a) IASB tentative decisions

(b) Proposals in the ED

(c) Feedback to ED (or Survey) and related IASB staff analysis

(d) Feedback received on IASB tentative decisions.

3 Also included are the **Next Steps** and **Questions to EFRAG FR TEG-CFSS members** (in paragraphs 78 and 79) which are in line with the questions in the related ASAF paper (background paper – Agenda paper 05-02).

TOPIC 1: CREDIT AND OTHER RISKS

IASB tentative decision (September 2023)

4 The IASB tentatively decided:

(a) to retain the proposed requirement in the ED that an entity estimating future cash flows arising from a regulatory asset or a regulatory liability:

(i) reflects in the estimates the uncertainty about the amount or timing of future cash flows; and

(ii) assesses whether the entity or its customers bear this uncertainty in future cash flows.

(b) to specify that if an entity bears credit risk, the entity:

(i) estimates uncollectible amounts considering the net cash flows that will arise from the recovery of regulatory assets and the fulfilment of regulatory liabilities; and

(ii) allocates the estimates of uncollectible amounts to regulatory assets only.

(c) to provide no additional guidance on how an entity accounts for:

(i) credit risk if the entity is compensated for this risk; and

(ii) demand risk; and

(d) to retain the proposed requirement in the ED that an entity's estimates of future cash flows arising from a regulatory liability do not reflect the entity's own non-performance risk.

5 All IASB members present agreed with these decisions.

Proposals in the ED

6 Paragraphs 37–38 of the ED stated that:

(a) There may be uncertainty about the amount or timing of the future cash flows that will arise from a regulatory asset or a regulatory liability. If those future cash flows are uncertain, an entity shall assess whether the entity bears that uncertainty or whether customers bear it. Customers bear the uncertainty if the regulatory agreement will adjust future regulated rates so that those rates reflect the outcome of the uncertainty, including regulatory interest sufficient to compensate or charge the entity for any change in the timing of the cash flows.

(b) For example, future cash flows arising from a regulatory asset may be subject to credit risk—that is, the risk that some customers will not pay the amounts charged. In such a case:

(i) if customers bear the credit risk because the regulatory agreement treats amounts uncollected as allowable in determining regulated rates for a later future period, the entity shall include in its estimates of future cash flows the cash it will collect in that later future period.

(ii) if the entity bears the credit risk, the entity shall estimate future cash flows after deducting an estimate of the amounts it might not be able to collect. As a result, 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, because IFRS 15 generally requires that revenue recognised is not reduced by amounts that the entity might not be able to collect from a customer.

7 Paragraph 43 of the ED proposed that an entity's estimates of future cash flows arising from a regulatory liability should not reflect the entity's own non-performance risk. An entity's own non-performance risk is the risk that the entity might not fulfil a regulatory liability.

8 Paragraph 60 of the ED identified demand risk as one of the uncertainties that may be present in a regulatory asset or regulatory liability. Furthermore, the ED included two examples (Illustrative Examples 7A.2 and 7B.2) that illustrate how differences between the estimated and actual demand give rise to a regulatory asset or a regulatory liability when customers bear the demand risk.

Feedback to ED and related IASB staff analysis

9 The feedback received and IASB staff analysis and recommendations were discussed with the IASB in its September 2023 meeting (agenda paper 9A).

10 Most respondents, including EFRAG, agreed with the proposals on credit risks and other uncertainties affecting the estimates of future cash flows.

11 A few respondents suggested the IASB clarifies how the future cash flows arising from regulatory assets should be adjusted for credit risk. In their view, it was unclear:

(a) how different the credit risk determination for regulatory assets would be from the expected credit loss model in IFRS 9 for trade receivables when the entity was bearing the credit risk; and

(b) how the proposal on credit risk interacts with the expected credit loss model in IFRS 9 when the customers were bearing the credit risk.

12 A European preparer representative group said credit risk affects all future cash flows that arise from regulated rates charged to customers and it was unclear how the effect of credit risk is allocated to the individual regulatory assets. Similarly, EFRAG recommended that the IASB provide additional application guidance on how estimates of credit risk should be allocated to individual regulatory assets.

13 A few respondents suggested clarifications:

(a) on how the estimates of future cash flows should be adjusted for demand risk.

(b) that an entity's own non-performance risk does not include the case when an entity's action (for example, cost savings) leads to the regulator (partially) discharging the entity from fulfilling an obligation to decrease regulated rates in the future.

Feedback received on IASB tentative decisions

EFRAG RRAWG (November 2023)

14 Most members agreed with the IASB's tentative decisions. However, one member questioned how the allocation of the estimates of uncollectible amounts to only the regulatory assets would work in practice.

15 One member suggested the IASB should indicate that, to estimate the credit risk of regulatory assets and regulatory liabilities, an entity could consider the same basis the entity uses in calculating a loss allowance on trade receivables applying IFRS 9.

TOPIC 2: SURVEY FEEDBACK ON THE DIRECT (NO DIRECT) RELATIONSHIP CONCEPT

16 In March 2023, the IASB staff published a survey that asked questions about the features of an entity's regulatory scheme and regulatory capital base. The survey aimed to assess whether respondent entities had a direct (no direct) relationship between the regulatory capital base (RCB) and its property, plant and equipment (PPE).

IASB tentative decisions (September 2023)

17 The IASB tentatively decided that the prospective Standard would:

(a) include the direct (no direct) relationship concept to help an entity identify differences in timing arising from the regulatory compensation the entity receives on its regulatory capital base ;

(b) specify that an entity's ability to trace differences between the regulatory capital base and the property, plant and equipment at an asset level is a strong indicator that they have a direct relationship;

(c) specify that, in the case of service concession arrangements, an entity determines whether the regulatory capital base has a direct (no direct) relationship with the intangible asset that arises from the service concession arrangement; and

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

18 All 13 IASB members present agreed with these decisions. One member was absent.

IASB tentative decisions (October 2023)

19 The IASB tentatively decided that the prospective Standard should include guidance on how to account for regulatory returns on an asset not yet available for use[1] that compensate for borrowing costs an entity has capitalised. The guidance would illustrate how an entity accounts for such regulatory returns if:

(a) the entity determines the capitalised borrowing costs at a higher level of aggregation than the individual asset level; or

(b) a regulator determines the regulatory returns on a real basis.

20 Twelve of the 13 IASB members present agreed with this decision. One member was absent.

Proposals in the ED

21 The concept of a direct (no direct) relationship between an entity's RCB and its PPE was not part of the initial proposals included in the ED.

Feedback to the survey and related IASB staff analysis

22 The September 2023 IASB Staff paper 9B report on findings from the survey on direct (no direct) relationship concept can be found here.

23 Most respondents to the IASB staff survey reported that they were able to conclude whether their entities' RCB had a direct (no direct) relationship with their PPE.

[1] In November 2022, the IASB tentatively decided that when an entity's RCB and its PPE have a direct relationship and the entity capitalises its borrowing costs:

(a) 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 in the statement **reflect only those returns in excess of the entity's capitalised borrowing costs** of financial performance during the construction period; and

(b) 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 the statement of financial performance during the construction period (in this case a regulatory liability would be recognised)

24 A few respondents in South America and Europe concluded differently from other respondents whose RCB had similar features. A few respondents in North America and Europe could not conclude.

25 Other than the UK, respondents to the surveys did not disagree with the direct (no direct) relationship concept. Entities from the UK expressed concerns with the IASB's tentative decision and noted that the accounting treatment would not faithfully represent the economics of the regulatory compensation.

26 The EFRAG Secretariat further assessed the responses of the European companies that participated in the IASB staff survey (see background reading agenda paper 05-03). We <u>note that not having a direct relationship between the RCB and PPE does not mean that entities are not in the scope of the prospective Standard (i.e., entities may not have a direct relationship but would still recognise regulatory assets (liabilities) arising from volume variances, performance incentives and returns on assets being used)</u>. In total:

(a) 23 respondents from 8 EU jurisdictions participated in the survey of which 3 respondents represented multiple jurisdictions;

(b) 19 out of the 23 respondents reported that they were able to conclude whether their RCB had a direct (no direct) relationship with their PPE;

(c) 11 of the 23 respondents concluded that there was no direct relationship between their RCB and their PPE;

(d) 8 of the 23 respondents concluded that there was a direct relationship between their RCB and their PPE;

(e) 4 of the 23 respondents said that they were unable to conclude whether there was a direct (no direct) relationship and concluded that they have a mix of direct and no direct relationship between their RCB and their PPE.

27 A summary of the European entities' responses to specific questions in the survey is included below:

(a) *Reconciliation between RCB and PPE* - 13 of the 23 respondents said that a reconciliation between RCB and PPE is required

(b) *Measurement of RCB and PPE* - 19 of the 23 respondents said that there are differences between the measurement of your RCB and the measurement of an entity's PPE

(c) *Alignment between regulatory recovery period of RCB and PPE useful lives* - 16 of the 23 respondents said that the regulatory recovery period of assets included in the RCB is closely aligned with the PPE assets' useful lives

(d) *Need for additional guidance* - most respondents either did not respond to this question or said that additional guidance *to* conclude on the direct (no direct) relationship concept was not needed.

Feedback received on IASB tentative decisions

EFRAG RRAWG

28 Most EFRAG RRAWG members supported the relief provided by introducing the direct (no direct) relationship concept noting the calculations necessary to compute regulatory assets and liabilities would not be practical under some regulatory regimes faced by companies.

29 EFRAG RRAWG members noted that the gap between the regulatory treatment of RCB and IFRS accounting for PPE was wide and there was no mandatory reconciliation at the granular level required to be able to determine whether there were timing differences at

an individual asset level necessary for the recognition of regulatory assets and regulatory liabilities.

30 The observer from the UKEB shed light on concerns that are in place in the UK. Some differences in timing would be recognised as regulatory assets and regulatory liabilities by entities with a direct relationship but not by those without a direct relationship. In the UK, regulatory regimes had no direct relationship and UKEB needed to ascertain what that meant for unrecognised regulatory assets and regulatory liabilities and how material these are. There was a concern that not reflecting regulatory assets and regulatory liabilities would fail to reflect the economics and result in a lack of comparability.

31 EFRAG RRAWG members welcome the clarifications for regulatory returns on an asset not yet available for use.

EFRAG FR TEG

32 In January 2024, EFRAG FR TG discussed the findings and implications of the feedback to the IASB staff survey and specifically the responses from European companies.

33 Some members considered that the direct (no direct) concept was a pragmatic approach to solving the concerns raised on the model proposed in the ED. A member noted that the concept could be seen as a practical expedient related to minor items. Members also made the following observations:

(a) There was a need to ascertain the extent to which there could be challenges in reliably measuring the regulatory assets (liabilities) that were not being recognised. Relatedly, it was suggested that EFRAG should make its own assessment to understand why European entities that claim to have no direct regulatory agreements cannot measure regulatory assets and regulatory liabilities (i.e. whether it is a matter of reliability or it is something else) and quantify the impact. It was noted that regulation may change in the future to be closer to the Totex regulation prevailing in the US and the forthcoming IFRS Standard should stand the test of time.

(b) The assessment of whether an entity has a direct (no direct) relationship depending on the entity's ability to reconcile accounting balances with regulatory balances may result in earnings management and put some pressure on auditors.

(c) Some members questioned whether the assessment should depend on the ability to reconcile as the outcome could depend on the level at which the reconciliation was made. For example, if the reconciliation was made on a group of assets level it should be easier than at an individual asset level.

(d) One member suggested that if an entity concludes that there is no direct relationship, it should revisit its regulatory agreement to assess whether the ''unrecognised'' regulatory assets and the regulatory liabilities are enforceable assets (liabilities) when determining the regulated rate.

(e) Another member questioned whether an entity would be allowed to change from the direct to the no-direct concept or vice versa. This was important given that regulations can change over time.

(f) It was suggested that entities that have a 'no direct' relationship between their PPE and regulatory capital base could provide qualitative disclosures if it is not possible to provide quantitative disclosures.

Outreach

34 EFRAG representatives met with representatives of the German TSOs earlier this year to discuss the timing of publication of the prospective IFRS standard as well as the implications of the direct (no direct) concept.

35 Building on the findings of the IASB survey, the EFRAG project team has started to conduct outreach to companies jointly with several European national standard setters to further assess the implications of applying the direct (no direct) concept. The intended outreach entails reaching out to affected companies in different sectors along with assessing the regulatory agreements prevailing in different jurisdictions.

TOPIC 3: ITEMS AFFECTING REGULATED RATES ON A CASH BASIS

IASB tentative decisions (December 2023)

36 The IASB tentatively decided:

(a) to retain the proposed concept that differences in timing that arise from differences between regulatory and accounting criteria represent enforceable present rights or enforceable present obligations. Those rights or obligations meet the proposed definitions of regulatory assets and regulatory liabilities;

(b) to retain the measurement requirements proposed in paragraph 61 of the ED for items that affect regulated rates only when related cash is paid or received;

(c) to retain the requirements proposed in paragraph 69 of the ED to present specified regulatory income and regulatory expense in other comprehensive income;

(d) to clarify that an entity is required to reclassify regulatory income or regulatory expense presented in other comprehensive income to profit or loss if IFRS Accounting Standards require the entity to reclassify the related expense or income to profit or loss; and

(e) include no additional presentation requirements for other comprehensive income. An entity would apply the requirements in IAS 1 or the prospective PFS Standard.

37 Thirteen of 14 IASB members agreed with decision 36(a), 11 of 14 IASB members agreed with decision 36(b) and 12 of 14 IASB members agreed with decisions 36(c) – 36(e).

Proposals in the ED

38 Paragraph 59 of the ED indicated that in some cases, a regulatory asset or regulatory liability arises because a regulatory agreement treats an item of expense or income as allowable or chargeable in determining the regulated rates only once 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 by applying, for example, IAS 12 Income Taxes, IAS 19 Employee Benefits or IAS 37 Provisions, Contingent Liabilities and Contingent Assets.

39 Paragraph 61 of the ED stated that an entity shall measure this regulatory asset and regulatory liability by:

(a) using the measurement basis used in measuring the related liability or related asset by applying IFRS Accounting Standards; and

(b) adjusting the measurement of the regulatory asset or regulatory liability to reflect any uncertainty present in it but not present in the related liability or related asset.

40 Paragraph 66 of the ED proposed that an entity ceases applying paragraph 61 when the entity pays cash to settle the related liability or receives cash that recovers the related asset. From that date, the entity measures any remaining part of the regulatory asset or regulatory liability by applying the cash-flow-based measurement technique proposed for all other regulatory assets and regulatory liabilities.

41 Paragraph 69 of the ED proposed that when an entity remeasures a regulatory asset or regulatory liability applying the proposals in paragraph 61, the entity presents the resulting

regulatory income or regulatory expense in other comprehensive income to the extent that the regulatory income or regulatory expense results from remeasuring the related liability or related asset through other comprehensive income.

Feedback to ED and related IASB staff analysis

42 The feedback received and IASB staff analysis and recommendations were discussed with the IASB in its December 2023 meeting (agenda paper 9C).

Enforceable rights and obligations

43 A few respondents (an accounting firm, a preparer and a regulator in Asia-Oceania) noted that the proposals in the ED would give rise to the recognition of regulatory assets and regulatory liabilities that would represent differences in timing between the criteria used in IFRS Accounting Standards (for example, accrual basis) and those used in the regulatory agreements (for example, cash basis). These respondents disagreed that these differences in timing represent an entity's enforceable rights or enforceable obligations to adjust future regulated rates in accordance with the regulatory agreements.

44 A few respondents (accounting firms, a few preparers in Europe and a few national standard-setters in Asia-Oceania) who agreed with the proposals questioned whether an entity would have enforceable present rights or enforceable present obligations before the cash for a related liability or related asset is paid or received.

Measurement proposals

45 Most respondents, including EFRAG, agreed with the measurement proposals included in paragraph 61 of the ED. They considered that the proposals would avoid creating accounting mismatches, simplify the measurement of regulatory assets and liabilities, reflect that the cash flows arising from the regulatory asset or regulatory liability are a replica of the cash flows arising from the related liability and be consistent with requirements for indemnification assets and reimbursement assets in IFRS 3.

46 A few respondents disagreed with this exception as it would add complexity. These respondents instead supported the general measurement proposal for regulatory assets and liabilities.

47 Some respondents raised questions about the scope of the proposals. A few respondents (mainly preparers from North America) stated that a regulatory agreement may treat an item of expense or income as allowable or chargeable using a criterion other than the cash basis (for example, on an accrual basis). These respondents wondered whether entities should also be able to apply the proposed requirements when items are allowable or chargeable on an accrual basis.

Presentation proposals

48 Most respondents, including EFRAG, agreed with the presentation proposal in paragraph 69 of the ED. However, a few respondents disagreed with the proposals with many of them taking the view that all regulatory income and regulatory expense should be presented in profit or loss in order to:

(a) show the effects on revenue of regulatory assets and regulatory liabilities and changes in them. This would also better portray the total allowed compensation for the goods or services supplied to customers during the period;

(b) avoid implying that the proposal incorporates a matching concept;

(c) avoid additional complexity that may arise;

(d) avoid extending the list of items presented in OCI because no conceptual basis has been developed for what should be included in OCI.

49 A few respondents (mainly accounting firms and standard-setters in Europe), including EFRAG, asked the IASB whether and how the cumulative amount of regulatory income or regulatory expense presented in OCI should be reclassified to profit or loss. EFRAG also highlighted that some items in OCI (actuarial gains or losses) will not be reclassified to the statement of profit or loss. As such their impact on performance reported on profit or loss will never be depicted.

50 A few respondents (including EFRAG) asked for examples of the presentation of regulatory income or regulatory expense in OCI, in particular for pension costs and their income tax effects. EFRAG asked for an example of decommissioning cost under IFRIC 1 in addition to the ED's Example 4 on environmental costs.

51 A few respondents (a few preparers in North America, an accounting firm and a national standard-setter in Europe) expressed the view that the proposed presentation should not be limited to items treated by a regulatory agreement as allowable or chargeable on a cash basis but should also apply when an item is allowable or chargeable on an accrual basis. This would mean that, for such an item, an entity would present regulatory income and regulatory expense in other comprehensive income if it arises from a remeasurement of the related liability or related asset through other comprehensive income. According to these respondents, this would result in a presentation that would be more understandable to users of financial statements and would be consistent with IFRS 14 *Regulatory Deferral Accounts*.

Feedback received on IASB tentative decisions

EFRAG RRAWG

52 EFRAG RRAWG has considered the IASB's tentative decisions on this topic at its meeting on 6 March 2024. EFRAG FR TEG - CFSS will receive an oral update on the feedback provided during that meeting.

TOPIC 4: PRESENTATION

IASB tentative decisions (December 2023)

53 The IASB tentatively decided that the prospective Standard would:

(a) require an entity to classify all regulatory income minus all regulatory expense (regulatory income or regulatory expense) as revenue;

(b) require an entity to present regulatory income or regulatory expense as a separate line item in the statement(s) of financial performance;

(c) omit the proposed amendment to paragraph 82 of IAS 1 that would have required an entity to present regulatory income or regulatory expense as a separate line item immediately below revenue[2];

(d) retain the proposals to require an entity to include regulatory interest income within regulatory income and regulatory interest expense within regulatory expense;

(e) amend the prospective IFRS Standard *Presentation and Disclosure in Financial Statements* (prospective PFS Standard) to clarify that regulatory interest is classified in the operating category[3];

[2] The EFRAG Secretariat notes that under the IFRS 18 redeliberation decision, this line item can be anywhere in Revenue section, not necessarily adjacent to the main revenue in line with the useful structured summaries of the prospective PFS Standard.

[3] This contrasts with prospective PFS Standard treatment of regulatory interest expense, which is classified under Financing section on the statement of profit or loss.

(f) retain the proposal to require an entity to present in its statement of financial position:

(i) line items for regulatory assets and regulatory liabilities; and

(ii) current and non-current regulatory assets and current and non-current regulatory liabilities as separate classifications by applying paragraphs 66 and 69 of IAS 1, except when the entity presents all assets and liabilities in order of liquidity.

54 All 14 IASB members agreed with decisions53(a) 53(a) and 53(c)-53(f). Nine of 14 IASB members agreed with decision 53(b).

Proposals in the ED

55 The ED included separate proposals for statement(s) of financial performance and the statement of financial position.

Statement(s) of financial performance

56 Paragraphs 67–68 of the ED propose that:

(a) an entity present in the statement(s) of financial performance all regulatory income minus all regulatory expense in a separate line item immediately below revenue, except in limited circumstances[4]; and

(b) regulatory income includes regulatory interest income and regulatory expense includes regulatory interest expense.

Statement of financial position

57 Paragraph 70 of the ED states that an entity shall present in its statement of financial position:

(a) line items for regulatory assets and regulatory liabilities.

(b) 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.

58 The ED also proposes to amend paragraph 54 of IAS 1 by including two new separate line items for regulatory assets and regulatory liabilities.

Feedback to ED and related IASB staff analysis

59 The feedback received and IASB staff analysis and recommendations were discussed with the IASB in its December 2023 meeting (agenda paper 9B).

Statement(s) of financial performance

60 Most respondents, including EFRAG, agreed with the proposals to present regulatory income or regulatory expense, including regulatory interest, as a separate line item immediately below revenue.

61 Some respondents suggested the final Standard permit, or requires, an entity to classify regulatory income or regulatory expense as revenue.

[4] Paragraph 69 of the ED proposes that an entity present in other comprehensive income specified remeasurements of regulatory assets and regulatory liabilities..

Presentation of regulatory interest

62 Most respondents (including EFRAG) agreed with the proposal to include regulatory interest income and regulatory interest expense within the regulatory income or regulatory expense line. Some noted that regulatory interest differs from finance interest because regulatory interest is designed to meet broader regulatory objectives.

63 However, almost all respondents from Latin America and a few other respondents disagreed with the proposal as they viewed regulatory interest more as financing in nature.

Statement of financial performance

64 Respondents (including EFRAG) agreed to present separate line items for regulatory assets and regulatory liabilities in the statement of financial position.

65 Some of these respondents suggested that the final Standard provide guidance on how the proposed presentation requirements interact with the general requirements in IAS 1 on aggregation and disaggregation of line items including guidance on applying paragraph 69(d) of IAS 1 to classify a regulatory liability as current or non-current.

Feedback received on IASB tentative decisions and EFRAG Secretariat observation

66 The EFRAG RRAWG has discussed the IASB tentative decisions on presentation at its meeting on 6 March 2024. EFRAG FR TEG - CFSS will receive an oral update on the feedback provided during that meeting.

67 In respect of the tentative decision to amend the prospective IFRS Standard *Presentation and Disclosure in Financial Statements* (prospective PFS Standard) to clarify that regulatory interest is classified in the operating category; <u>the EFRAG Secretariat notes and would welcome TEG-CFSS members' views</u> on the following:

(a) under the IFRS 18 redeliberation decision, regulatory income and expense can be anywhere in the Revenue classification category, not necessarily adjacent to the main revenue in line with the useful structured summaries of the prospective PFS Standard;

(b) the prospective PFS standard requires interest on liabilities to be presented under the Financing category in the statement of profit or loss.

TOPIC 5: UNIT OF ACCOUNT AND OFFSETTING

IASB tentative decisions (December 2023)

68 The IASB tentatively decided the following:

(a) to clarify that the unit of account is the right or obligation arising from a difference in timing or from a group of differences in timing. The differences in timing included in that group would:

(i) be created by the same regulatory agreement;

(ii) have similar expiry patterns; and

(iii) be subject to similar risks[5].

(b) to omit the proposal in paragraph 71 of the ED that would have permitted an entity to offset regulatory assets and regulatory liabilities in the statement of financial position.

69 All 14 IASB members agreed with these decisions.

[5] The EFRAG Secretariat notes that this criterion is similar to the portfolio requirements in IFRS 17.

Proposals in the ED

70 The IASB initial proposal on unit of account states:

'An entity shall account for the right or obligation arising from each individual difference in timing described in paragraph 12(a) as a separate unit of account. However, if rights, obligations, or rights and obligations arising from the same regulatory agreement have similar expiry patterns and are subject to similar risks, they may be treated as arising from the same individual difference in timing.'

71 The ED's proposed definition for the unit of account has not changed. It will be further clarified in the forthcoming RRA Standard.

72 With respect to offsetting, paragraph 71 of the ED included a proposal on offsetting regulatory assets and regulatory liabilities. The proposal would have permitted an entity to offset regulatory assets and regulatory liabilities that form separate units of account only if the entity:

(a) has a legally enforceable right to offset those regulatory assets and regulatory liabilities by including them in the same regulated rate; and

(b) expects to include the amounts resulting from the recovery or fulfilment of those regulatory assets and regulatory liabilities in the same regulated rate for goods or services supplied in the same future period.

Feedback to ED and related IASB staff analysis

73 The feedback received and IASB staff analysis and recommendations were discussed with the IASB in its December 2023 meeting (link).

74 Following the consultation on its ED, the IASB received the following feedback:

(a) Unit of account - a few respondents (mainly preparers and national standard-setters):

(i) asked how paragraph 24 of the ED would be applied to some regulatory accounts that include items that are subject to different risks, however, are netted and recovered over the same period;

(ii) asked for more guidance on applying the proposal on the unit of account. In particular, how the unit of account proposal interacts with the proposal in paragraph 40 of the ED (which considers whether a better prediction of the cash flows would result from considering units of account separately or from considering any of them together). In their view, the fact that an entity may consider a group of regulatory assets or regulatory liabilities as the unit of account for measurement purposes appears to contradict the requirement in the unit of account proposal (account for the right or obligation arising from each individual difference in timing as a separate unit of account);

(iii) expressed concerns about the interaction between the proposed unit of account and other proposals in the ED - such as regulatory returns on an asset not yet available for use and the accounting for regulatory assets and regulatory liabilities arising from differences between the regulatory recovery period and the assets' useful lives. In their view, the IASB's proposal may be onerous to apply in practice because an entity may need more granular information than that currently used in setting regulated rates;

(iv) EFRAG FCL position - in its comment letter on the IASB ED, EFRAG also recommended the IASB should clarify the unit of account for disclosure purposes. EFRAG noted that it might be difficult for entities having several regulatory agreements to determine which agreement is more prominent to meet the proposed disclosure requirements. Specifically, whether the disclosures should be presented per regulation or in aggregate for several operations or subsidiaries and whether it is meaningful to provide disclosures on a stand-alone basis.

(b) Offsetting - regarding the proposal on offsetting regulatory assets and regulatory liabilities (paragraph 71 of the ED), a national standard-setter commented that it was unclear how the proposed conditions for offsetting would interact with the proposal on the unit of account. Some other respondents suggested to:

(i) permit offsetting based on only the first proposed condition (that is, an entity has a legally enforceable right to offset regulatory assets and regulatory liabilities by including them in the same regulated rate); or

(ii) permit offsetting based on conditions similar to those specified in IAS 12 *Income Taxes* or IAS 32 *Financial Instruments: Presentation*;

(iii) EFRAG FCL position – in its comment letter, EFRAG supported the offsetting of regulatory assets and regulatory liabilities in the statement of financial position. However, expressed concerns that the requirements of paragraph 71(b) of the ED could make offsetting balance sheet positions more complicated. EFRAG suggested the IASB to consider:

- aligning the offsetting conditions with the requirements of paragraph 42 of IAS 32 (being the existence of legally enforceable right to settle and intent to settle on a net basis) or the requirements of IAS 12 for deferred tax assets and liabilities where expected simultaneous settlement in the future is not a requirement;
- explaining in the *Basis for Conclusions* the reasons for permitting instead of requiring offsetting (like in IAS 32 and IAS 12) of regulatory assets and regulatory liabilities in paragraph 71 of the ED.

Feedback received on IASB tentative decisions

EFRAG RRAWG

75 EFRAG RRAWG has considered the IASB's tentative decisions on this topic at its meeting on 6 March 2024. EFRAG FR TEG - CFSS will receive a verbal update on the feedback provided during that meeting.

NEXT STEPS

76 At its February 2024 meeting, the IASB redeliberated the proposals on:

(a) Boundary of a regulatory agreement;

(b) Amendments to IAS 36; and

(c) Disclosure.

77 The outstanding topics still to be redeliberated by the IASB are:

(a) Discount rate, including the proposals on minimum interest rate;

(b) Items affecting regulated rates only when related cash is paid or received - whether to extend the measurement and presentation proposals for these items to other situations (e.g. for accruals);

(c) Interaction between the model and IFRS 17 *Insurance Contracts*;

(d) Amendments to other IFRS Accounting Standards;

(e) Effective date and transition; and

(f) Expected effects of the prospective Accounting Standard.

QUESTIONS FOR EFRAG FR TEG-CFSS MEMBERS

78 Do the IASB tentative decisions on the following topics help address feedback from stakeholders in your jurisdiction:

(a) credit and other risks (paragraphs 4 to 15)

(b) survey on the direct (no direct) relationship concept (paragraphs 16 to 35)

(c) items affecting regulated rates on a cash basis (paragraphs 36 to 52)

(d) presentation (paragraphs 53 to 67) including the amendments made to the prospective PFS Standard

(e) unit of account and offsetting (paragraphs 68 to 75)

79 Do you have any other comments on either the progress so far or the next steps?