

EFRAG Comment Letter

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

9 September 2021

Dear Mr Barckow,

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 the 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 *Regulatory Deferral Accounts*, an interim Standard issued in January 2014 but not endorsed in the EU, which permits a variety of accounting approaches for the effects of rate regulation to continue temporarily. The new Standard will enhance comparability of information for users of financial statements of affected entities and enable the faithful representation of performance by these entities.

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 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. However, we note a number of concerns with the proposals which we recommend the IASB consider before finalising the proposed Standard.

EFRAG considers that there is clarity on the scope of the proposed Standard within the utilities sector. However, EFRAG acknowledges that there may be some entities outside of the utilities sector that may unknowingly fall within the proposed scope, but this situation is likely to be rare. There are several aspects where there is a need for further clarification on entities' scope eligibility. For example, in cases where allowed income in the regulatory agreement is based on sector/industry average costs rather than an entity's individual costs- a situation that imposes high uncertainty related to the enforceability of present rights and obligations.

EFRAG also considers that it will be helpful for the IASB to set specific scope exclusions (e.g., for self-regulation) and to provide a definition of ‘customers’ as the notion of customers (i.e., groups of customers) under the ED differs from the notion of the customer under IFRS 15 *Revenue from Contracts with Customers*.

EFRAG recommends specific guidance and examples on what constitutes a regulatory agreement and application guidance on how an entity should assess whether rights and obligations created by the regulatory agreement are enforceable. EFRAG encourages the IASB to be explicit whether the existence of a regulator is required and considers that having guidance on who the regulator is would be helpful but not necessary to define the scope of the project. EFRAG suggests consideration of the following characteristics of a regulator: an independent third-party that is empowered by statute or contract, in presence of a legal framework that empowers the counterparty that regulates the rates. EFRAG agrees that an entity should not recognise any assets or liabilities created by a regulatory agreement other than regulatory assets and regulatory liabilities.

Regulatory assets and regulatory liabilities

EFRAG generally supports the proposed definitions of regulatory assets and regulatory liabilities and generally agrees that these meet the definitions of assets and liabilities under the IASB’s Conceptual Framework.

However, as explained in our response to Question 3(b), there are circumstances where the recognised regulatory assets and regulatory liabilities would not meet the definitions provided in the ED. For example, when regulatory liabilities are recognised during the construction of an asset that is not yet in use. Furthermore, there are instances when the proposed requirements do not reflect the economic substance of the regulatory agreement. For example, when the assets useful life differs from the recovery period under the regulatory agreement.

Total allowed compensation

EFRAG in general 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). However, EFRAG disagrees with the proposal under paragraph B15 to defer the inclusion in total allowed compensation of the regulatory returns related to construction work in progress (CWIP) that have been charged to customers during construction (i.e., deferral of these regulatory returns to when the asset is in use). This proposed requirement is not appropriate for the diverse regulatory regimes across jurisdictions and where in some instances, the return could be equivalent to an investment subsidy or compensation for building infrastructure. EFRAG recommends that the accounting for these returns should depend on the economic substance of the regulatory agreement. EFRAG considers that notion of goods or services supplied when referring to total allowed compensation needs to be considered more broadly than is the case in the ED (e.g., to consider that investing in infrastructure could be a service).

EFRAG is also aware of situations where the proposed requirements on total allowed compensation under paragraphs B3-B9 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). And where these requirements would result in regulatory assets and regulatory liabilities that are inconsistent with the IASB definitions of these terms (e.g., where regulatory recovery period differs from the economic useful life and where a regulatory liability is recognised on deferral of regulatory returns).

Therefore, EFRAG recommends that the IASB further analyses whether the requirements of paragraphs B3-B9 of the ED relating to allowable expenses can be applied across diverse regulatory regimes including those where costs are based on sectoral averages and where recoverable costs under the regulatory agreement are based on regulatory

accounting and not IFRS expenses. And to thereafter clarify if and when these regulatory agreements are in scope.

Recognition

EFRAG agrees that an entity should recognise all its regulatory assets and regulatory liabilities and generally supports the proposed recognition criteria.

However, EFRAG notes that some of EFRAG's stakeholders have reported that recognising regulatory assets and regulatory liabilities in instances where there is high existence and measurement uncertainty, would provide information that is not useful to users of financial statements. These stakeholders have 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).

EFRAG recommends that IASB provide further guidance in the body of the future Standard regarding the derecognition of regulatory assets and regulatory liabilities.

Measurement

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. EFRAG, therefore, recommends the IASB to clarify how the boundary of the regulatory agreement should be determined (current price control period versus the period of the licence which typically is a much longer period). EFRAG also 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 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 recommends that the IASB considers consistency in the respective treatment of credit risk in the estimated cash flows and the regulatory discount rate.

Measurement (discounting)

EFRAG supports discounting of regulatory assets and regulatory liabilities using the regulatory discount rate for both regulatory assets and regulatory liabilities. However, like in IFRS 15, EFRAG recommends that the IASB 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 also disagrees with the proposal for different discounting approaches for regulatory assets and regulatory liabilities.

However, should the IASB decide to retain the concept of a minimum interest rate (requirements in paragraphs 50-53 of the ED), EFRAG recommends the IASB to redraft the requirements as a rebuttable presumption. In this case, an entity applies the regulatory interest rate for both regulatory assets and regulatory liabilities unless there is evidence that the regulatory interest rate does meet the objective described in paragraph 103 of the ED.

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.

Measurement exception (items affecting regulatory rates when cash is paid or received)

EFRAG agrees with the ED measurement exception proposals regarding 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, or soon thereafter,

instead of when the entity recognises that item as expense or income in its financial statements.

EFRAG agrees with the proposals for measuring any resulting regulatory asset or regulatory liability (i.e., using the measurement basis as the related liability or related asset, and adjusting for uncertainty present in it but not for the related liability or related asset). EFRAG also agrees with the proposed presentation of regulatory income or regulatory expenses resulting from the remeasurement of a regulatory asset or regulatory liability in Other Comprehensive Income ('OCI') whenever these arise from the remeasurement of related liability or related asset through OCI. EFRAG recommends the IASB provide an illustrative example of this requirement.

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. However, EFRAG recommends that the IASB refines the wording within these objectives in a manner that further emphasises a focus on the usefulness of information (e.g., by describing the type of assessment of information that is expected within the specific objectives).

EFRAG acknowledges there is support for the proposed disclosures from users but that there are also a range of concerns from preparers about the burdens of the proposed disclosures. EFRAG recommends a more balanced disclosure approach by considering a prioritisation based on a cost-benefit consideration and undertaking further outreach with users of financial statements to establish an appropriate level of detail required to fulfil the disclosure objectives. Furthermore, EFRAG suggests that, in finalising the proposed disclosures, the IASB consider insights obtained from the development of the Disclosure Initiative project.

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

To better address practical difficulties identified by constituents, EFRAG recommends 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. EFRAG recommends that the effective date should be at least 24-36 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 *Service Concession Arrangements*.

EFRAG questions whether the reclassification of goodwill related regulatory balances to goodwill suggested in the proposed amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards* would result in the correct depiction of the entity's financial performance.

Likely effects

EFRAG expects a positive cost-benefit relationship from implementing the proposed Standard. The benefits arise from the reduced volatility and more faithful presentation of performance and more consistent reporting of regulatory assets and regulatory liabilities. However, as highlighted by some of the EFRAG effects-analysis preparer respondents, there can be significant costs for some entities that will lessen the overall expected positive cost-benefit relationship.

Other comments

EFRAG recommends the formation of a transition resource group to help preparers with the implementation of the proposed Standard.

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, Galina Borisova, or me.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'JP Gauzès', written in a cursive style.

Jean-Paul Gauzès
President of the EFRAG Board

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

Question 1: Objective and scope

Question 1

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?
- 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?

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.

EFRAG's response

EFRAG supports the IASB's overall objective to develop an accounting model for regulatory assets and regulatory liabilities. However, as noted in our responses to the various questions in this Appendix, we note a number of concerns with the proposals which we recommend the IASB to consider before finalising the proposed Standard.

EFRAG considers that there is clarity on the scope of the proposed Standard within the utilities sector. However, as a result of the broad and principles-based definition of scope, some entities outside of the utilities sector might unknowingly fall within scope but this is likely to be rare. Furthermore, in a few regulatory regimes, there is uncertainty related to the enforceability of present rights and obligations of whether some utility entities are within the scope of the proposed Standard. EFRAG considers that such situations (e.g., arising from demand risk or where allowable income in the regulatory agreement is based on sector average costs) should fall within the scope of the proposed Standard and any measurement uncertainty should be reflected when recognising regulatory assets and regulatory liabilities.

EFRAG considers that it will be helpful to set specific scope exclusions (e.g., for insurance companies, self-regulation) and provide a definition of 'customers' to help scope the project. EFRAG recommends the definition of scope should explicitly state that regulatory assets and regulatory liabilities reflect future adjustments to the revenue amounts reported under IFRS 15 as this would lessen the uncertainty on scope eligibility.

The feedback also indicates various situations that need clarification on scope eligibility. For example, when allowable income under the regulatory agreement is based on sector/industry average costs rather than an entity's individual costs.

EFRAG recommends that the IASB provides specific guidance and examples on what constitutes a regulatory agreement and application guidance on how an entity should assess whether rights and obligations created by the regulatory agreement are enforceable.

EFRAG encourages the IASB to be explicit on whether the existence of a regulator is required and considers that having guidance on who the regulator is would be helpful but not necessary to define the scope of the project. EFRAG suggests consideration of the following characteristics of a regulator: an independent third-party that is empowered by statute or contract, in presence of a legal framework that empowers the counterparty that regulates the rates.

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

Do you agree with the objective of the Exposure Draft? Why or why not?

- 1 EFRAG welcomes the objective of the IASB's ED on how entities should account for rate-regulated activities. However, as noted in our responses to the various questions in this Appendix (i.e., total allowed compensation allowable expenses and regulatory returns on construction work in progress, and discounting), we note a number of concerns with the proposals which we recommend the IASB to consider before finalising the proposed Standard.
- 2 EFRAG agrees that there is a need to address how entities subject to rate regulation should account for their operations. 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.

- 3 Overall, 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. EFRAG's recent and past outreach to users including through the effects analysis survey shows support for the objective of the ED.

Supplementary accounting model

- 4 The proposals in the ED would supplement information an entity already provides by applying IFRS 15 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.
- 5 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.

Do you agree with the proposed scope of the Exposure Draft? Why or why not? If not, what scope do you suggest and why?

- 6 The scope of the ED requires the 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, both current and future customers, through the regulated rates for goods or services supplied in a different period creating what the ED refers to as 'differences in timing'.
- 7 EFRAG considers that the proposed definition of scope in paragraph 6 of the ED can be further developed to explicitly state that regulatory assets and regulatory liabilities reflect future adjustments to the revenue amounts an entity will charge its customers by applying the requirements in IFRS 15. Consequently, all other adjustments to revenue recognised by applying other IFRS Standards will not be captured in the scope.
- 8 It may also be useful to consider having a definition of 'customers' in the proposed Standard because the concept of 'customers' in the ED refers to a wider and collective category which is different from the definition of a customer in IFRS 15. Providing a definition of 'customers' will help entities in applying the proposed accounting model and resolve the scope question of whether the recovery/settlement from third parties is within the scope of the proposed Standard.

Entities outside the utility sector

- 9 Overall, EFRAG received limited feedback from entities outside the utility sector. However, the feedback received from outreach with companies (within one jurisdiction) operating in the European railways and European telecom sector indicated that they would not be affected by the scope of the ED as the regulatory regime in which they operated would not create regulatory assets and regulatory liabilities as defined in the ED.
- 10 In addition, EFRAG discussed the scope proposals of the ED with the EFRAG Financial Instruments Working Group and the EFRAG Insurance Accounting Working Group to assess the impact of the ED for financial institutions including the

insurance sector. Feedback from the insurance industry indicated that it will be helpful if the proposed Standard sets specific scope exceptions and be clear on what activities are not in scope. For example, given the introduction of IFRS 17 *Insurance Contracts*, to explicitly scope out insurance contracts from the proposed Standard. EFRAG notes that this particular problem would be resolved if the IASB decides to limit the scope of the ED to reflect future adjustments to the revenue under IFRS 15 as suggested in paragraph 7.

- 11 Based on the feedback received, EFRAG does not have evidence that the proposed Standard will affect entities outside rate-regulated sectors (the utility sector being the most affected). However, as detailed further below, there are various circumstances where EFRAG recommends that the IASB provides clarification on scope-related considerations.

Regulated rates based on sector averages, rather than an entity's own costs

- 12 In some jurisdictions, operators in the electricity distribution sector assessed that they had no enforceable present right or obligation to add or deduct an amount in determining a regulated rate to be charged to customers in future periods because the regulated rates were determined by the regulator based on the average sector costs (based on the performance of all operators together and on the volume estimations by the regulator – which may be made public after the date of preparation of the financial reports) rather than on the entity's costs. EFRAG understands that these operators have concluded they were out of the scope of the proposed Standard. However, EFRAG considers that such situations should fall within the scope of the proposed Standard and any measurement uncertainty should be reflected when recognising regulatory assets and regulatory liabilities. EFRAG suggests that the IASB clearly addresses and distinguishes uncertainty relating to scope (i.e., uncertainty on the enforceability of present rights and obligation) and uncertainty related to the recognition and measurement of regulatory assets and regulatory liabilities.

Low demand risk

- 13 In another jurisdiction, it was expected that mainly entities that are subject to a low demand risk would be eligible to be within the scope of the proposed Standard because:
- (a) the proposed measurement requirements mitigated any concerns about measurement uncertainty for regulatory assets and regulatory liabilities; and
 - (b) it was unlikely that enforceable rights and obligations would exist if there was significant demand risk (i.e., no guaranteed demand for goods or services by customers).
- 14 EFRAG notes that the scope of the proposed Standard is not restricted to entities subject to low demand risk. This is a major development of the model that may have broadened the scope compared to the proposals included in the IASB's discussion paper *Reporting the Financial Effects of Rate Regulation* published in 2014 that focused on defined-rate regulation.

Recovery/settlement by third parties on behalf of the customer

- 15 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.

- 16 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.
- 17 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 was providing the funding on behalf of the customer.
- 18 While understanding that the model focuses on rates that are charged to the customers, some stakeholders have questioned whether situations where the recovery is from a third party even though the rates are charged to customers, would fall within scope. This shows that interpretation issues could arise especially in the transportation sector (e.g., railway) as stakeholders might not readily distinguish between rates being charged to customers and the responsibility for payment. Consequently, EFRAG urges the IASB to clarify and explicitly state that situations of amounts charged to customers and settled by third parties can be in scope because the focus of the model is on rates charged to customers.

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?

- 19 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 that a clear and more detailed description of a regulatory agreement is important to ensure that the scope would only include activities intended to be within the proposed accounting model.
- 20 EFRAG understands that the enforceable present rights and enforceable present 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. The final amendments should clarify such circumstances.
- 21 EFRAG considers that more specific guidance and more structured examples on what constitutes a regulatory agreement would be helpful to appropriately identify activities within the scope of the accounting model proposed in the ED, because there is a wide variety of regulatory agreements which characteristics may vary greatly and have to be assessed against a broad array of national legal frameworks, with differing levels of maturity.
- 22 This is especially important in situations where significant demand risk and measurement uncertainty may cause certain regulations to fall outside the scope of the model. EFRAG considers that such regulations should be captured by the scope of the ED but as noted in responses to Questions 4 and 5, recognition should consider the high existence and measurement uncertainty of these items.

- 23 In Appendix A, the regulatory agreement is defined as “a set of enforceable rights and obligations that determine a regulated rate to be applied in contracts with customers.” While regulated rate is defined as “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”. EFRAG recommends that the IASB further clarifies these definitions of regulatory agreement and regulated rate as they refer to each other in a circular manner.

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?

- 24 The ED does not define a regulator or specify the form of the regulatory agreement. 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.
- 25 EFRAG notes that the principles-based definition does not necessitate the definition of a regulator. EFRAG observes that having clarity on who the regulator is would be helpful to determine whether certain activities are within the scope of the proposed Standard and would help limit unintended consequences such as broader application than intended. However, EFRAG considers that having a regulator is not a prerequisite for being within the scope of the proposed Standard.
- 26 EFRAG encourages the IASB to be explicit on whether the existence of a regulator is required to be within the scope of the proposed Standard. EFRAG suggests consideration of the following characteristics of a regulator: an independent third-party that is empowered by statute or contract, in presence of a legal framework that empowers the counterparty that regulates the rates.
- 27 EFRAG notes that the ED also does not define a ‘regulator’ and the basis for conclusions do not explain why the IASB decided to not retain the IFRS 14 definition. EFRAG recommends that the IASB examines how the IFRS 14 definition of a “regulator” has been applied in the jurisdictions that decided to adopt IFRS 14 and explain why it decided not to retain that definition in its proposals.

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.

Self-regulation

- 28 In EFRAG’s view, it is not clear from the wording in the ED whether self-regulation could be included within the scope.
- 29 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. The ED should make it clear that statutes mean jurisdictional laws and not articles of incorporation. Otherwise, stakeholders could interpret that an example of possible self-regulation within the scope of the proposed Standard could be 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.

- 30 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.
- 31 EFRAG understands that the focus on enforceable rights and obligations is likely to exclude self-regulation from the scope of the proposed Standard. However, EFRAG questions whether the current wording of the ED might present opportunities for structuring such that entities could set up related parties to be the “regulator” for purposes of being eligible to apply the proposed Standard.
- 32 Therefore, EFRAG recommends the IASB should explicitly state that self-regulation is not in the scope of the proposed Standard.

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?

- 33 EFRAG agrees that an entity should not recognise any assets or liabilities created by a regulatory agreement other than regulatory assets and regulatory liabilities. However, as pointed out in our response to the definition of regulatory assets and regulatory liabilities in Question 2 and total allowed compensation in Question 3, some items (e.g., regulatory liability for CWIP regulatory returns that is recognised when an asset is under construction) may end up being classified as regulatory assets and regulatory liabilities due to the mechanics of the proposed model- even though they do not arise from and are not enforceable on the basis of the regulatory agreement.

Additional criteria

- 34 EFRAG observes that the two additional criteria suggested in the alternative view (i.e., competition in the sector is limited and the regulator is committed to supporting the financial viability of the entity through the rate-setting process) might be helpful indicators when assessing whether an entity is within the scope of the proposed Standard. In addition, the customer having no ability to avoid price increases could be another useful indicator.
- 35 However, EFRAG notes the following reasons favour the definition of scope as stated in the ED:
- (a) the proposed additional factors would unduly narrow the scope definition;
 - (b) there being 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 is 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 is sufficient; and
 - (f) there is a preference for principles-based requirements and there is a risk of introducing rules with the additional criteria.
- 36 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 obligations. However, EFRAG considers that the proposed Standard is a supplementary Standard and does not modify existing IFRS Standards. Hence, there ought to be no grounds for overriding existing IFRS Standards for items that fall outside the scope of the proposed Standard.

- 37 Hence, EFRAG recommends the IASB not to consider additional scoping criteria in the proposed Standard because such criteria would be difficult to assess and may result in inconsistent application of the proposed scope requirements and sector-specific requirements.

Question 2: Regulatory assets and regulatory liabilities

Question 2

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 encourages the IASB to further examine rate-regulation in jurisdictions where the TAC is not determined based on the entity's individual cost base, but on the average cost base of the sector and entities have limited insight regarding the amounts they will be entitled to recover (obliged to settled) in future periods. It is not clear whether this sector-average type of rate-regulation gives rise to enforceable rights and enforceable obligations that meet the definitions of regulatory assets and regulatory liabilities. EFRAG has been told that this type of rate-regulation is present in a few European countries and aims at creating greater efficiency among utility service providers.

EFRAG agrees with the IASB's conclusions that regulatory assets and regulatory liabilities meet the definitions of assets and liabilities under the *Conceptual Framework*. However, as explained in our response to Question 3(b), some of EFRAG's stakeholders note that there is no arising enforceable obligation on a regulatory liability that is recognised for CWIP regulatory returns. Therefore, this recognised regulatory liability does not meet the ED's definition of a regulatory liability. For similar reasons, one could argue that a regulatory liability that is recognised when the recovery period of an asset is shorter than the asset's useful life, does not meet the definition of a regulatory liability.

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.

EFRAG has identified some situations in which the proposed definitions would result in regulatory assets and regulatory liabilities being recognised when their recognition would not provide useful information to users of financial statements.

Do you agree with the proposed definitions? Why or why not? If not, what changes do you suggest and why?

- 38 EFRAG agrees with the proposed definitions and that the enforceable present right (regulatory asset) or enforceable present obligation (regulatory obligation) reflects the difference in timing of when an entity can charge customers for the compensation through the regulated rate as determined by the regulatory agreement and when the entity has provided the goods or services to the customers.
- 39 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*.
- 40 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.

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?

- 41 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.
- 42 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.
- 43 EFRAG also agrees that the definition of total allowed compensation should include a profit element as that is consistent with revenue recognition under IFRS 15 that also includes a profit component.

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?

- 44 EFRAG has considered whether the definition of regulatory assets and regulatory liabilities as defined in paragraphs 4 and 5 of the ED meets the definition of an asset and a liability under the *Conceptual Framework*.
- 45 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

- 46 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 of the ED 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.

Regulatory liability

- 47 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.
- 48 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.

- 49 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.
- 50 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 straightforward. As explained in paragraph BC46 of the Basis for Conclusions, some stakeholders question whether a regulatory liability is an obligation to transfer an economic resource – this is because a regulatory liability, as defined in the ED, results in a reduction in a future cash flow, rather than a separate cash flow.
- 51 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 as explained in BC46 of the Basis for Conclusions.
- 52 As noted in EFRAG’s response to Question 3(b), EFRAG disagrees with the proposals in paragraph B15 of the ED that would require the recognition of a regulatory liability. Some of EFRAG’s stakeholders have noted that there is no arising enforceable obligation on this regulatory liability that is recognised when deferring CWIP regulatory returns. Therefore, this recognised regulatory liability does not meet the ED’s definition of a regulatory liability.
- 53 For similar reasons as the above paragraph, one could argue that a regulatory liability that is recognised when the recovery period of an asset is shorter than the asset’s useful life, does not meet the definition of a liability. This is because the entity’s present right to recover the asset is not dependent on the timing of recognition of the related IFRS depreciation expense, and thus the entity has no further obligation.

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?

- 54 EFRAG agrees with the principle to separately account for regulatory assets and liabilities as their cash flows are incremental and independent from those of other rights and obligations created by the regulatory agreement.

- 55 EFRAG considers the separate recognition of regulatory assets and regulatory liabilities 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.
- 56 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 are being referred to.

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?

- 57 Some of EFRAG's stakeholders have reported that recognising regulatory assets and regulatory liabilities in the following situations would not provide useful information to users of financial statements:
- (a) Recognising a regulatory liability for CWIP regulatory returns in the absence of a legal or regulatory-agreement-based obligation to reduce future rates. For similar reasons, one could argue that a regulatory liability that is recognised when the recovery period of an asset is shorter than the asset's useful life, does not meet the definition of a liability and might provide information that is not useful to users of financial statements.
 - (b) As noted in earlier responses, there are jurisdictions where the regulatory rates are based on the sectoral average costs, rather than an entity's own costs. In these jurisdictions, there is a high level of uncertainty regarding the amounts the entity was entitled to recover (settle).

Question 3: Total allowed compensation

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

As noted in response to Question 2, EFRAG broadly supports the elements of the total allowed compensation and suggests the definition of target profit in Appendix A (Defined Terms) should be consistent with paragraph 11 of the ED.

However, EFRAG disagrees with the proposal to defer the inclusion in total allowed compensation of regulatory returns related to CWIP that are charged to customers during the construction (i.e., deferred recognition of regulatory returns to only when an asset is in use). EFRAG's disagreement is based on conceptual reasons, and information usefulness and operational and cost-benefit considerations. EFRAG considers there are situations where recognising regulatory returns for CWIP during construction would be the most faithful representation of the economics of the transaction (e.g. when the return is an investment subsidy or compensation for developing infrastructure). The proposed requirements to defer recognition of regulatory returns are not appropriate for the diverse regulatory regimes across jurisdictions. EFRAG recommends that the accounting for CWIP regulatory returns should depend on the economic substance of the regulatory agreement. EFRAG considers that notion of goods or services supplied when referring to total allowed compensation needs to be considered more broadly than is the case in the ED (e.g., to consider that investing in infrastructure could be a service).

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 an improvement in the wording related to defining the performance incentives period for construction-related performance incentives as 'the period to evaluate the performance of construction'.

EFRAG in general 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). However, EFRAG is also aware of situations where the proposed guidance on total allowed compensation will not reflect the economic substance of the regulatory agreement (e.g., recoverable costs are based on regulatory accounting and not IFRS expenses). EFRAG is also concerned about situations where recognised regulatory assets and regulatory liabilities would be inconsistent with the IASB definitions of these terms (e.g., where regulatory recovery period differs from the economic useful life of an asset or where CWIP regulatory returns result in a regulatory liability).

EFRAG recommends that the IASB further analyse whether the requirements of paragraphs B3-B9 can be applied across diverse regulatory regimes including those where costs are based on sectoral averages or where recoverable costs are based on regulatory agreement and not IFRS expenses. And to thereafter clarify if and when these regulatory agreements are in scope.

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)?

- 58 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.
- 59 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.

(ii) Regulatory returns on a balance relating to assets not yet available for use (paragraphs B15 and BC96–BC100)?

- 60 Based on the feedback received from constituents, EFRAG disagrees with the IASB proposal to defer the inclusion of regulatory returns charged to customers during construction of the asset in determining total allowed compensation to only when the asset is in use.
- 61 EFRAG disagrees with the proposal due to conceptual reasons, and after taking account of the usefulness of information and operationality/cost-benefit considerations as explained further below:
- (a) Conceptual reasons:
- (i) CWIP regulatory returns that are charged to customers during construction may be compensating for other goods or services that may not be related to the supply of goods or services to customers but maybe compensation for fulfilling other performance obligations (e.g., rendering of public services).
- (ii) Related to the above paragraph, EFRAG’s effects analysis showed the following:
- some companies are granted regulatory returns while the asset is under construction relating to performance obligations other than the delivery of goods or services to customers; and
 - some users indicated that they consider these regulatory returns to be compensation for entities’ construction risk and creating additional capacity.
- (iii) As noted, in our response to Question 2, the regulatory liability, recognised as a result of applying paragraph B15 of the ED is inconsistent with the ED’s definition of a regulatory liability as there is no legal or economic obligation arising from the regulatory agreement for the entity to reduce future tariffs charged to customers. The liability is a by-product of the mechanics of the proposed accounting model (i.e., the balancing credit entry when deferring the regulatory returns is called a ‘regulatory liability’).
- (iv) Although the proposed requirement matches the timing of recognition of the regulatory return to that of the allowable expense (depreciation of the asset when it is in use), this proposal would be inconsistent with the economic rights and obligations arising from the regulatory agreement.

- (v) Seeking comparability across different types of arrangements should not take precedence over the relevance of information, especially in comparisons between different sectors or different jurisdictions.
 - (vi) Performance incentives can be recognised when the asset is not yet in use. As such, there is an inconsistency between the accounting for regulatory returns versus performance incentives for CWIP.
- (b) Usefulness-of-information considerations:
- (i) Deferral of regulatory returns on CWIP would result in information that does not faithfully reflect the effects of rate regulation and be misleading for investors. As shown by the EFRAG effects analysis, some users would have to adjust their analytical models to appropriately reflect the compensation during construction. They considered that under the proposed requirements, cash flows would differ from profit or loss and there would be an understatement of the profitability of the project.
 - (ii) Moreover, the preparer effects analysis has shown that for some entities, CWIP regulatory returns can be material (i.e., a significant proportion of revenue or total allowed compensation). Therefore, the proposed requirements could materially impact both the portrayed financial performance and financial position for some entities.
- (c) Operability/cost-benefit considerations:
- (i) The proposal would result in high implementation and operational costs since the regulatory return would need to be allocated to single assets without having the technical systems and databases to comply with the proposed guidance.
 - (ii) A full retrospective application that will defer already recognised regulatory returns would impose significant data-gathering challenges. Preparer respondents to the EFRAG effects analysis indicated they would have to go far back in time to ensure the correct allocation of regulatory returns on CWIP to the respective long-term assets under construction.
- 62 Overall, EFRAG considers that with the diversity of regulatory agreements across jurisdictions, there are situations where recognising regulatory returns for CWIP during construction would be the most faithful representation of the economics of the transaction. For example, when it is established that the regulatory return is compensating the entity for a service other than for its supply of goods and services to the customer, as evidenced by the fact that in some jurisdictions, the regulatory agreement does not oblige the entity to refund the regulatory return received if the investment project is not completed. Therefore, the regulatory return granted could be seen as an investment subsidy. EFRAG recommends that the accounting for CWIP regulatory returns should depend on the economic substance of the regulatory agreement.
- 63 EFRAG recommends that the IASB clarify that when an entity identifies its performance obligations based on the regulatory agreement (e.g., during construction of assets), the performance obligation does not necessarily mean supply of goods or services to customers.

(iii) Performance incentives (paragraphs B16–B20 and BC101–BC110)?

- 64 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, rather than being linked to the delivery for goods or services as is the case for regulatory returns on CWIP. EFRAG suggests improvements in the wording related to defining the performance incentives period for construction-related performance incentives as “the period to evaluate the performance of construction”.

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?

Other components of total allowed compensation

- 65 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.
- 66 EFRAG also agrees with the IASB proposal on the profit margin component of target profit. Namely, 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.
- 67 EFRAG broadly supports the notion of total allowed compensation and its proposed overall guidance with three components (i.e., recovery of allowable expenses; the three components of target profit- margin on expenses, regulatory returns, and performance incentives; and regulatory interest rate/expense for the unwind of the time lag effect).
- 68 However, in addition to disagreeing with the proposals for CWIP regulatory returns, EFRAG notes that some constituents have concerns with the proposals for the allowable expense (paragraphs B3 to B9) as elaborated in the below paragraphs that would need either clarifying guidance or further analysis of the allowable expense proposals to make them workable across diverse regulatory regimes.

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?

- 69 Some constituents have noted limitations arising from the proposed determination of the allowable expense component of total allowed compensation (paragraphs B3 to B9) in the context of it not seeming applicable to certain regulatory regimes. For example, parts of the guidance would lead to timing differences that are misaligned to the local regulatory regime:
- (a) For example, when rates charged to the customer are based on expenses from regulatory accounting and not IFRS-based expenses.
 - (b) The outcome of the proposed approach is not consistent with the regulatory agreement, and this could arise from the following situations:
 - (i) Situations, where variances in quantities lead to enforceable rights (i.e., situations where the rate that is allowed by regulatory agreement to be charged to customers in one period is not charged as a result of deviations in quantities delivered but is allowed to be charged to customers in the future periods to cover the allowed expense and thus leading to enforceable rights); and

- (ii) Situations where the application of paragraphs B3-B9 could result in the recognition of regulatory assets and regulatory liability that are a by-product of the mechanics of the proposed accounting model rather than reflecting enforceable economic rights or obligations arising from the regulatory agreement. For example, when these regulatory assets and regulatory liabilities arise due to differences between the 'recovery period of the asset according to the regulatory' and 'the asset useful life'. This concern is similar to that of recognising regulatory liabilities when deferring the recognition of CWIP regulatory returns (i.e., for regulatory returns that have been charged to customers).
 - (c) regulatory assets and regulatory liabilities that are a by-product of the accounting mechanics and neither meet the ED's definition of these terms and the Conceptual Framework definition of assets and liabilities do not provide useful information for users of financial statements.
- 70 In summary, the notion of total allowed compensation is a key building block of the proposed Standard (i.e., timing differences that determine the recognition of regulatory assets and regulatory liabilities are based on total allowed compensation) and the applicability of all its components across diverse regulatory regimes is a yardstick for the effective working of the proposed accounting model. Therefore, EFRAG recommends that the IASB further analyse whether the requirements of paragraphs B3-B9 can be applied across diverse regulatory regimes including those where costs are based on sectoral averages.
- 71 The proposed further analysis of paragraphs B3 to B9 should also ensure that it does not lead to recognition of regulatory assets and regulatory liabilities that are inconsistent with the ED's proposed definitions of regulatory assets and regulatory liabilities. (i.e., those that do not represent economic enforceable rights and obligations but are a by-product of the accounting model's mechanics).
- 72 Finally, EFRAG recommends that the IASB provides clarifying guidance on the following aspects of total allowed compensation highlighted by constituents:
 - (a) cases where the components of total allowed compensation could be overlapping (i.e., when it is not clear whether inflation adjustments are allowable expense or regulatory returns on the asset);
 - (b) cases allowable expense was based on sectoral-average expenses for the period (in total or partially) and clarify whether these situations are in scope of the proposed Standard;
 - (c) when sectoral-average expense comprises elements of allowable expense and incentive component (i.e., there is a seeming overlap between the allowable expense and performance incentive component);
 - (d) cases where the allowable recoverable expenses that affect regulated rates as specified in the regulatory agreement, are not based on IFRS expenses (so-called permanent differences);
 - (e) cases where incentives and penalties are added to the regulatory asset base and therefore recovered through regulatory returns on that base (e.g., seeming overlap between regulatory returns or a carved out separate components recovered through rates).

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

- 73 After reviewing the Illustrative Example relating to regulatory returns not yet available for use, EFRAG has the following additional points, should the IASB retain its proposals on the regulatory returns on CWIP:

- (a) EFRAG suggests that an example demonstrating the mismatch between recognising the revenue during the construction phase and those that are not, would be helpful.
- (b) EFRAG considers it would be useful to have a table explaining the composition of the regulatory return within the example.
- (c) EFRAG found it difficult to compare the example with the boundaries of the regulation and recommends a clearer explanation of paragraph IE51(c).
- (d) 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

Question 4

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 generally agrees with the proposal that an entity should recognise all its regulatory assets and regulatory liabilities. However as explained in the above paragraph 57, some of EFRAG’s stakeholders have reported that recognising regulatory assets and regulatory liabilities in some situations would not provide useful information to users of financial statements.

EFRAG considers it necessary for paragraph 25 of the ED to explain at which point an entity would initially recognise a regulatory asset and a regulatory liability. In EFRAG view, it is not sufficient to state, as noted in paragraph 25, that all regulatory assets and regulatory liabilities shall be recognised at the end of the reporting period.

EFRAG generally 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. However, some of EFRAG’s stakeholders do not agree that the proposed recognition threshold is appropriate in all cases, given that the levels of existence and measurement uncertainty depend on the type of rate-regulation in place, which differs across jurisdictions in Europe and outside of Europe. Some of EFRAG’s constituents

have recommended that the IASB consider a higher recognition threshold for cases of high existence and measurement uncertainty, similar to that in IFRS 15 (constraining estimates of variable consideration).

EFRAG also considers that it would be useful for the IASB to provide application guidance on how to implement the various circumstances outlined in paragraph 27 of the ED about how an entity would determine whether a regulatory asset or a regulatory liability 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.

Do you agree that an entity should recognise all its regulatory assets and regulatory liabilities? Why or why not?

- 74 EFRAG generally agrees that an entity should recognise all its regulatory assets and regulatory liabilities if that results in useful information to users of financial statements. However as explained in paragraph 73 above, some of EFRAG's constituents have reported that recognising regulatory assets and regulatory liabilities in some situations would not provide useful information to users of financial statements. These situations can arise when:
- (a) an entity recognises a regulatory liability in order to defer regulatory returns on assets not yet in use; and
 - (b) as noted in response to Questions 1, 2 and 3, in jurisdictions where the regulated rates and recoverable expenses under the regulatory agreement are based on sectoral average costs, rather than an entity's own costs, resulting in high levels of uncertainty regarding the amounts the entity was entitled to recover (settle).
- 75 Furthermore, 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.
- 76 EFRAG considers it necessary to clarify paragraph 25 of the ED and explain at which point an entity would initially recognise a regulatory asset and a regulatory liability. In EFRAG's view, it is not sufficient to state, as noted in paragraph 25, that all regulatory assets and regulatory liabilities shall be recognised at the end of the reporting period. EFRAG notes that there is nothing specific in the ED about the initial recognition of regulatory assets and regulatory liabilities—i.e., when an entity should first recognise them in the financial statements. In EFRAG's view, the lack of clarity would have wide implications (such as how to apply IAS 21 *The Effects of Changes in Exchange Rates*).

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?

- 77 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.
- 78 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.
- 79 EFRAG acknowledges that the proposed recognition threshold focuses on existence uncertainty and that any measurement uncertainty should be addressed in measurement. EFRAG notes that this may create an inconsistency with the *Conceptual Framework* that discusses relevance of information when the outcome is uncertain, which is more linked to measurement rather than recognition. EFRAG recommends the IASB to explain in the basis for conclusions why it only considered existence uncertainty in the recognition threshold.
- 80 Some of EFRAG's stakeholders have noted cases when the existence of a regulatory asset or a regulatory liability is significantly uncertain. For example, negotiations with the regulator on the recovery of particular costs and their respective amounts and instances when entities do not have sufficient insight on the amounts to be recognised as they are linked to sector averages. These stakeholders consider that a higher recognition threshold is required for cases where existence uncertainty is significant in their regulatory regime and may be complex to assess whether it is "more likely than not" that a regulatory asset or a regulatory liability exists. These stakeholders recommend that the IASB considers adopting a threshold similar to the "highly probable" threshold in IFRS 15, that constrains the estimates (amounts recognised) for variable consideration. EFRAG notes that the existence of different recognition thresholds is one of the topics the IASB has to consider when looking at the interaction of the proposed Standard with other IFRS Standards (i.e. IFRS 15).
- 81 EFRAG understands 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 (at least in some regulatory regimes) 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. In this regard, EFRAG also considers that it would be useful for the IASB to provide application guidance on how to implement the various facts and circumstances outlined in paragraph 27 of the ED about how an entity would determine whether a regulatory asset or a regulatory liability exists.

Derecognition

- 82 EFRAG notes that the body of the ED does not include specific derecognition criteria.
- 83 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.
- 84 Furthermore, EFRAG considers that it might be helpful for the IASB 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 5: Measurement

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. 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. EFRAG recommends that the IASB considers consistency in the respective treatment of credit risk in the estimated cash flows and the regulatory discount rate.

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. EFRAG considers the guidance on the boundary of the regulatory agreement 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. 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 boundary of a regulatory agreement

- 85 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:
- (a) 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
 - (b) 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.
- 86 Paragraphs B28–B40 provide guidance on determining the boundary of the regulatory agreement and states that the boundary of a regulatory agreement **determines which estimated future cash flows an entity includes** in measuring a regulatory asset or regulatory liability.
- 87 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.
- 88 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.
- 89 However, EFRAG understands that in many cases the negotiations with the regulator and final approval of the costs that an entity will 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.
- 90 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.
- 91 Furthermore, EFRAG considers that the guidance on determining the boundary would be interpreted as mixing the entity’s licence to operate with the enforceable rights and enforceable obligations arising from the regulatory agreement. This is because some might interpret the boundary of the regulatory agreements as being the end date of a current price-control period (which in Europe typically covers a period of between 3-5 years), instead of being the licence period, which typically has an indefinite life.
- 92 EFRAG considers that a regulator generally does not have a practical ability to exercise their right to cancel an entity’s regulatory agreements, despite them having the legal authority to do so since there would likely be major disruptions to an essential public service. In EFRAG’s view, an entity should apply the principle in paragraph B34(c) of the ED and look beyond the current price-control period when assessing its regulatory assets and liabilities. The IASB should clarify if this is how an entity should interpret the guidance on the boundary and include examples that clearly illustrate the guidance in B28-B34 about how an entity should determine the regulatory boundary.

Do you agree with the proposed cash-flow-based measurement technique? Why or why not? If not, what technique do you suggest and why?

- 93 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.
- 94 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.
- 95 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 either entitled to or 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 the above paragraph 93 is more of a historical cost notion.
- 96 EFRAG, therefore, supports the proposed measurement basis for regulatory assets and regulatory liabilities.

Do you agree with the proposed cash-flow-based measurement technique? Why or why not? If not, what technique do you suggest and why?

- 97 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.
- 98 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 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.
- 99 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 aims to keep the model simple. However, EFRAG notes that allocating credit risk to the estimates of cash flows is not always straightforward and the ED is not clear whether credit-risk allocation should be done on the individual timing differences or a simpler method, such as a pro-rata approach would be used. Accordingly, EFRAG recommends that the IASB provide additional application guidance on how estimates of credit risk should be allocated to individual regulatory assets.

100 Furthermore, EFRAG recommends that the IASB considers consistency in the respective treatment of credit risk in the estimated cash flows and the regulatory discount rate.

Do you agree with the proposal for estimating cashflows that are uncertain? Why or why not? If not, what approach do you suggest and why?

101 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 uncertainty over a tax treatment.

Question 6: Discount rate

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 supports the proposal to require an entity to discount the estimated future cash flows to their present value in measuring regulatory assets and regulatory liabilities. In EFRAG’s view, the concept of discounting is a fundamental part of general IFRS requirements where the effects of the time value of money are significant.

However, like in IFRS 15, EFRAG recommends that the IASB consider introducing a practical expedient to exempt entities from discounting if the effects of discounting are not significant.

EFRAG supports the application of the regulatory interest rate to discount for both regulatory assets and regulatory liabilities. 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. The regulatory interest rate is considered objective by users and, in EFRAG's view, the regulatory interest rate should be used to discount regulatory assets and regulatory liabilities in all circumstances. EFRAG disagrees with the proposal for different discounting approaches for regulatory assets (i.e., higher of minimum rate or regulatory interest rate) and regulatory liabilities (i.e., regulatory interest rate).

However, should the IASB decide to retain the concept of a minimum interest rate, EFRAG recommends the IASB to redraft the requirements as a rebuttable presumption. In this case, an entity applies the regulatory interest rate for both regulatory assets and regulatory liabilities unless there is evidence that the regulatory interest rate does meet the objective described in paragraph 103 of the ED.

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. However, EFRAG recommends the IASB to clarify that Example 5 illustrates only one of the possible ways to comply with the requirements of paragraph 54. Furthermore, EFRAG recommends that the IASB provide additional illustrative examples, or application guidance, to cover more complex scenarios of determining a single interest rate when rates are uneven.

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

Do you agree with these proposals? Why or why not? If not, what approach do you suggest and why?

- 102 EFRAG supports the proposal to require an entity to discount the estimated future cash flows to their present value in measuring regulatory assets and regulatory liabilities. In EFRAG's view, the concept of discounting is a fundamental part of general IFRS requirements where the effects of the time value of money are significant.
- 103 EFRAG considers that the regulatory discount rate should be used to discount both regulatory assets and regulatory liabilities.
- 104 However, like in IFRS 15, EFRAG recommends that the IASB consider introducing a practical expedient to exempt entities from discounting if the effects of discounting are not significant. 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 are insignificant. 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. EFRAG acknowledges the

IASB's observation that this could introduce unnecessary complexity that may outweigh any incremental benefit. However, EFRAG does not agree with this reasoning that an exemption from discounting would introduce complexity.

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

105 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. Considering the complexity of the proposal and the fact that according to the feedback obtained the instances where the regulatory interest rate is not considered to sufficiently compensate the entity are rare, EFRAG considers that an entity should use the regulatory interest rate in all circumstances.

Estimating minimum interest rate

106 EFRAG does not support the proposal requiring the use of the minimum interest rate for regulator assets. The regulatory interest rate is considered objective by users, while the notion of minimum interest rate is not defined and its estimate would be discretionary. EFRAG has also heard from users that the regulatory interest rate should be used to discount regulatory assets and regulatory liabilities. Users did not support the concept of applying a minimum interest rate as proposed by the IASB in the ED. Users informed EFRAG that using a different WACC determined by each individual company when determining a minimum discount rate will not facilitate comparability and will be confusing.

107 Furthermore, EFRAG considers that the IASB is introducing yet another concept for discounting under IFRS literature by requiring an entity to use a minimum interest rate.

108 However, should the IASB decide to retain the concept of applying a minimum interest rate (the requirements in paragraphs 50-53 of the ED), EFRAG recommends the IASB to redraft the requirements as a rebuttable presumption whereby an entity applies the regulatory interest rate for both regulatory assets and regulatory liabilities unless there is evidence that the regulatory interest rate does meet the objective described in paragraph 103 of the ED.

(a) In EFRAG's view, redrafting this proposal as a rebuttable would reduce the burden on preparers of assessing the sufficiency of the discount rate at each reporting period except in rare cases where specific circumstances indicate that this is not appropriate.

(b) In developing a rebuttable presumption, EFRAG recommends the IASB to first consider the instances where the regulatory interest rate is not considered to sufficiently compensate the entity, and how common these instances are. If the IASB identifies such instances, EFRAG recommends that these are provided as examples when finalising the proposed Standard.

Different discounting approaches for regulatory assets and regulatory liabilities

109 EFRAG disagrees with the proposal to apply 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.

110 EFRAG considers there is a lack of clarity about the rationale for assessing whether the regulatory interest for regulatory liabilities is insufficient. In our view, it is unusual that the regulatory interest rate will be considered for insufficiency to discount an asset, however not considered for excessiveness when discounting a regulatory liability.

111 Paragraph BC169, explains that the reason for not adjusting an excessive discount rate on a regulatory liability is "an excessive regulatory interest rate on a regulatory

liability may merely offset an excessive regulatory interest rate on a larger regulatory asset”. However, it is not clear why the opposite argument does not hold for a regulatory asset.

- 112 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 might be a 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.
- 113 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.
- 114 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 come to an 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.

Definition of regulatory interest rate in Appendix A

- 115 EFRAG notes that during the outreach events some stakeholders 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 (WACC). Furthermore, EFRAG has been informed that the regulatory interest rates for operating expenses and capex can be different. For CAPEX, the regulatory interest rate is typically based on WACC. EFRAG recommends the IASB to amend the definition so that it reflects what is commonly applied in regulatory regimes.

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

- 116 As explained in paragraph 108, should the IASB decide to retain the concept of applying a minimum interest rate, EFRAG recommends the IASB to develop a rebuttable presumption that the regulatory interest rate is an appropriate discount rate unless the indicators set out in paragraph 52 of the ED are present.

Uneven regulatory interest rate - Do you agree with the proposal? Why or why not? If not, what do you recommend and why?

- 117 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 *Financial Instruments*.
- 118 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.
- (a) However, EFRAG recommends the IASB to clarify that Example 5 illustrates only one of the possible ways to comply with the requirements of paragraph 54. Paragraph 54 requires an entity to translate uneven regulatory interest rates into a single rate, at initial recognition, and use that rate throughout the life of the regulatory asset or regulatory liability. Paragraph 54 adds that in

determining that single rate, an entity shall not consider possible future changes in the regulatory interest rate.

- (b) Furthermore, EFRAG recommends that the IASB provides additional illustrative examples, or application guidance, to cover more complex scenarios of determining a single interest rate when rates are uneven.

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

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 exception proposals related to items of expense or income that affect regulated rates only when related cash is paid or received, or soon thereafter, instead of when the entity recognises that item as expense or income in its financial statements. EFRAG agrees with the proposals for measuring any resulting regulatory asset or regulatory liability (i.e., using the measurement basis as the related liability or related asset, and adjusting for uncertainty present in it but not for the related liability or related asset).

EFRAG also agrees with the proposals in the ED that when an entity remeasures the regulatory asset or regulatory liability, the resulting regulatory income or regulatory expense should be presented in OCI when these arise from remeasuring the related liability or related asset through OCI. However, EFRAG highlights the fact that some items presented in OCI (such as actuarial gains and losses) will not be recycled to profit or loss. As such, their impact on the performance reported in profit or loss will never be depicted.

EFRAG recommends that the IASB provides clarifying guidance and a comprehensive example on the presentation in OCI of certain items that affect

regulated only when related cash is paid or received (e.g., actuarial gains or losses from pension benefits remeasurements).

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?

- 119 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, or soon thereafter, instead of when the entity recognises that item as expense or income in its financial statements (for example pension costs and asset retirement obligations).
- 120 For these items, the ED proposes an entity should measure such a regulatory asset or regulatory liability by:
- (a) 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; 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.
- 121 EFRAG notes that by applying the measurement exception entities will:
- (a) avoid accounting mismatches;
 - (b) 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
 - (c) align with the requirements in IFRS Standards for indemnification assets and reimbursement assets.

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?

- 122 EFRAG also agrees with the presentation in OCI of regulatory income or expense resulting from the remeasurements of regulatory assets or regulatory liabilities whenever these arise from remeasurements of the related asset or liability that are presented in OCI. Presenting such remeasurements in OCI would offset the remeasurement effects of related assets or liabilities.
- 123 However, EFRAG also highlights 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.
- 124 EFRAG recommends the IASB to provide clarifying guidance and a comprehensive example on the presentation in OCI of certain items that affect regulated only when related cash is paid or received (e.g., actuarial gains or losses from pension benefits remeasurements).
- 125 Lastly, with regards to Illustrative Example 4, EFRAG suggests that in addition to the example provided on environmental costs, the IASB should 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

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.

EFRAG supports the offsetting of the regulatory assets and liabilities on the statement of financial position and is concerned that the requirements of paragraph 71(b) of the ED could make offsetting balance sheet positions more complicated. EFRAG also notes a significant judgement required to present separately current and non-current regulatory assets and liabilities as required by paragraph 70(b).

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?

126 EFRAG considers that presenting regulatory income and regulatory expenses net as a separate line item below revenue provides users with 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.

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?

127 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.

- 128 EFRAG also notes that regulatory interest income 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.
- 129 EFRAG supports the offsetting of the regulatory assets and liabilities on the statement of financial position and is concerned that the requirements of paragraph 71(b) of the ED could make offsetting balance sheet positions more complicated.
- 130 EFRAG suggests the IASB considers 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 a net basis or the requirements of IAS 12 *Income Taxes* for deferred tax assets and liabilities where expected simultaneous settlement in the future is not a requirement.
- 131 EFRAG notes a significant judgement required to present separately current and non-current regulatory assets and liabilities as required by paragraph 70(b) of the ED. EFRAG also suggests that the IASB should include in the BC the reasons for permitting instead of requiring offsetting (like in IAS 32 and IAS 12) of regulatory assets and liabilities in paragraph 71 of the ED.

Question 9: Disclosure

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. 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 rate regulation and provide insights into its prospects for future cash flows. However, EFRAG recommends that the IASB refines the wording within these objectives in a manner that further emphasises a focus on the usefulness of information (e.g., by describing the type of assessment of information that is expected within the specific objectives).

EFRAG acknowledges there is support for the proposed disclosures from users but that there are also a range of concerns from preparers about the burdens of the proposed disclosures. EFRAG recommends a prioritisation of the proposed disclosures requirements to ensure an undue burden is not imposed on preparers without necessarily providing the intended benefits for users. EFRAG recommends a more balanced disclosure approach by considering a prioritisation based on cost-benefit considerations and undertaking further outreach with users of financial statements to establish an appropriate level of detail required to fulfil the disclosure objectives.

Based on feedback including user feedback, EFRAG proposes how to streamline and/or prioritise the specific sub-paragraphs. Furthermore, EFRAG recommends that, in finalising the proposed disclosures, the IASB considers insights obtained from the development of the Disclosure Initiative project.

Finally, EFRAG recommends the IASB to clarify the unit of account for disclosure purposes.

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? Do you have any other comments on the proposed overall disclosure objective?

132 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. As noted in the below paragraph 141, EFRAG recommends that the IASB considers updating the objectives with wording that further emphasises a focus on the usefulness of information.

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?

133 EFRAG acknowledges there is support for the proposed disclosures from users but that there are also a range of concerns from preparers about the burdens of the proposed disclosures including due to the current unavailability of underlying quantitative information and lack of IT systems to prepare the disclosures. EFRAG note that in addition to the disclosure requirements, some constituents are concerned that ED proposals for total allowed compensation (CWIP regulatory returns) may result in the need for the reporting of alternative performance measures. There is also a concern about burdens associated with interim reporting.

- 134 EFRAG recommends a prioritisation of the proposed disclosure requirements to ensure an undue burden is not imposed on preparers without necessarily providing the intended benefits for users.
- 135 Users² have indicated that providing a breakdown of regulatory income and regulatory expense and a roll-forward reconciliation of regulatory assets and liabilities is very important. Furthermore, some users indicated that the following disclosures are already provided information in the regulatory reporting of some jurisdictions and thus should not impose a disclosure burden:
- (a) a breakdown of regulatory interest income on regulatory assets and regulatory liabilities;
 - (b) a maturity breakdown of relevant balances;
 - (c) reconciliation of regulatory assets and regulatory liabilities in the balance sheet;
 - (d) information about rewards and penalties giving rise to regulatory assets and regulatory liabilities.
- 136 At the same time, preparers have indicated a range of constraints they face in providing the proposed disclosure information. Preparers may 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). The EFRAG effects analysis also showed that some preparers do not have or only have part of the information required to provide the proposed disclosures.
- 137 Furthermore, EFRAG notes that meeting the proposed disclosure requirements may involve the following implications:
- (a) disclosure of sensitive information under the terms of the regulatory agreement;
 - (b) 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;
 - (c) 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;
 - (d) incentive regulation is usually based on non-financial indicators whose assessment at the reporting date could lead to approximation uncertainties;
 - (e) 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; and
 - (f) the misalignment between the total allowed compensation concept as applied in the ED and the requirements in local regulatory regimes may necessitate the reporting of alternative performance measures to explain the effects of the proposed Standard.

² User feedback from both the EFRAG effects analysis and outreach showed that providing a breakdown of regulatory income and regulatory expense and roll-forward reconciliation of regulatory assets and liabilities are very important.

- 138 Therefore, EFRAG recommends the IASB to weigh the expected user benefits against the potential burden on preparers from the proposed requirements. EFRAG suggests that the proposed disclosures are more balanced by considering a prioritisation based on a cost-benefit consideration and undertaking further outreach with users of financial statements to establish an appropriate level of detail required to fulfil the disclosure objectives.
- 139 EFRAG notes the suggestion made by some constituents in respect of paragraph 78 of the ED that disclosure requirements could focus on the recognised regulatory assets and regulatory liabilities at year-end with only the main movements being disclosed and explained. However, the EFRAG effects analysis and user outreach showed that the breakdown of regulatory income and reconciliation of balances were considered by the users that provided feedback as more important categories of disclosures than those on discount rates and maturity analysis. Furthermore, EFRAG suggests that, in finalising the proposed disclosures, the IASB considers the insights obtained from the development of the Disclosure Initiative project.
- 140 To allow the prioritisation of disclosures and a focus on only providing useful disclosures, EFRAG recommends the following to the IASB:
- (a) to aggregate some of the information required under paragraph 78 of the ED or provide a combination of 'high-level' qualitative and quantitative information that helps users to understand how a regulatory agreement may have affected an entity's performance.
 - (b) based on users' feedback, to consider the disclosures related to maturity analysis (paragraphs 80-a and 81 of the ED) and those related to discounting (paragraphs 80-b and c of the ED) to be of relatively lower importance to the users that provided feedback than the rest of the disclosures.

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?

- 141 EFRAG supports the overall and specific objectives but recommends that the IASB refines the wording within these objectives in a manner that further emphasises a focus on the usefulness of information (e.g., by describing the type of assessment of information that is expected within the specific objectives).
- 142 EFRAG recommends the IASB clarify the specific disclosure objective for paragraph 82 of the ED (i.e., to disclose information to understand any changes in regulatory assets and regulatory liabilities that were not a consequence of regulatory income or regulatory expense). The ED (Appendix A) does not define regulatory income and regulatory expense and our understanding is that regulatory income and regulatory expenses only arise from changes in regulatory assets and regulatory liabilities. Other than from acquisitions and foreign currency translations, it is difficult to envision how changes in regulatory assets and regulatory liabilities would be unrelated to regulatory income and regulatory expenses. Therefore, an illustrative example of what the IASB intends to be reflected in the proposed reconciliation will be helpful for constituents.
- 143 Finally, EFRAG notes that 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. EFRAG recommends that the IASB clarifies the unit of account for disclosure purposes. 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.

Question 10: Effective date and transition

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 notes there are significant implementation efforts required to apply the proposed standard (tailoring or changing IT systems, training staff, etc) and recommends an effective date that is at least 24-36 months after the publication of the final Standard to allow the entities to adjust their accounting systems and gather necessary information and with early application permitted.

Given the feedback from respondents about the complexities of the full retrospective approach, EFRAG proposes to consider, depending on the final decisions made for the accounting for CWIP regulatory returns, the use of a modified retrospective application with exemptions or practical expedients for assets with long useful lives and CWIP regulatory returns to better address practical difficulties identified by constituents.

EFRAG agrees with the simplification option for the past business combinations proposed by the IASB, but questions how it interacts with paragraph 50 of IFRS 3 *Business Combination* which states that ‘after the measurement period [of a business combination] ends, the acquirer shall revise the accounting for a business combination only to correct an error in accordance with IAS 8’ and to clarify the meaning of regulatory assets and liabilities ‘which still exist at the date of transition’ referred to in paragraph C4(c). EFRAG also 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.

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

- 144 EFRAG notes there are significant implementation efforts required to apply the proposed standard (tailoring or changing IT systems, training staff, etc) and recommends the effective date that is at least 24-36 months after the publication of the final Standard to allow the entities to adjust their accounting systems and gather necessary information for implementation of the requirements and with early application permitted.
- 145 Although EFRAG notes that the proposed retrospective application would provide comparable information between the reporting periods, given the feedback from respondents about the complexities of the full retrospective approach, should the IASB retain its current proposed approach to CWIP, EFRAG proposes to consider the use of a modified retrospective application with exemptions or practical expedients for assets with long useful lives and CWIP regulatory returns to better address the practical difficulties that have been identified by constituents.
- 146 The following concerns were raised by constituents in their feedback on the full retrospective application (see also paragraph 185), which they consider will be very

complex and burdensome for many entities and could lead to undue cost and efforts for the following reasons:

- (a) There will be a need to go back to the beginning of the regulatory regime to identify the historical cost of the regulatory asset, with adjustments that may have taken place multiple times in situations with a time lag and increase in prices.
- (b) Administrative burden related to the adjustments for CWIP regulatory returns. The requirements for CWIP could result in significant one-off implementation and ongoing administrative costs. Due to the large time horizon of useful lives of assets, a full retrospective application would require the recalculation of regulatory assets and liabilities concerning a huge amount of assets and the linking of regulatory assets and liabilities to allowable (IFRS) expenses deviating from local regulatory rules as proposed in paragraphs B3-B9 of the ED (which require complex recalculations over the full lifetime of the long-lived regulated assets).
- (c) For groups with several foreign operations within the scope of the ED.

147 Therefore, EFRAG suggests that, depending on the final decisions made for the accounting for CWIP regulatory returns, the IASB should consider providing some practical expedients in respect of transition requirements. For example, to require a modified retrospective approach with exemptions (for example for assets with long useful lives, and to avoid retrospective deferral of already recognised CWIP regulatory returns for past periods) or retrospective application which would only apply to assets that are made available for use on or after the beginning of the earliest period presented. The IASB could also consider a choice regarding the timeframe to go back for a “modified retrospective transition”, which could be based on local regulatory rules considering for example one regulatory period.

148 EFRAG agrees with 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.

149 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.

150 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.

151 However, EFRAG is seeking clarification in respect of the relief provided in respect of its interaction with paragraph 50 of IFRS 3. This paragraph specifies that ‘*after the measurement period [of a business combination] ends, the acquirer shall revise the accounting for a business combination **only** to correct an error in accordance with IAS 8’ (emphasis added)*. Hence, no adjustments to the past business combination would be required.

152 EFRAG also recommends that the IASB clarifies what is meant by regulatory assets and liabilities “*which still exist at the date of transition*” referred to in paragraph C4(c). Does it refer to:

- (a) the residual amounts of the regulatory assets existing at the date of the past business combination that have not been fully derecognised at the date of transition (or to the residual amounts of the regulatory liabilities existing at the date of the past business combination that have not been fulfilled at the date of transition)? or

- (b) the mechanisms included in a regulation that enable, at a point in time, the recognition of regulatory assets and regulatory liabilities (whatever the amounts at stake)?

Question 11: Other IFRS Standards

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 asks for further clarification on the interaction with the Standards noted below.

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. A separate illustrative example on this topic can be helpful to avoid confusion around the tax treatment.

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*: EFRAG questions whether the reclassification of goodwill-related regulatory balances 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 provides further guidance on 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 16 *Property, Plant and Equipment* - IFRS 3 revaluation model: EFRAG recommends the IASB provides additional guidance on how the differences between regulatory asset values and IFRS values should be accounted for (for example if the amount of PPE for regulatory purposes differs from IFRS amounts) and to provide examples illustrating these situations.

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? Do you have any comments on the proposed amendments to other IFRS Standards?

IAS 12 Income Taxes

- 153 EFRAG agrees with the IASB clarifications that when tax cash flows can be included in determining the regulated rates in accordance with the 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.
- 154 EFRAG also suggests the IASB refines the wording in paragraphs B45 and B46 to avoid the impression that paragraph B45 implies that the measurement of the regulatory asset is based on after-tax cash flows whereas the example in paragraph B46 concludes that it should be presented on a gross basis based on the pre-tax cash flows with the tax effect reflected as a deferred tax liability. A separate illustrative example on this topic can be helpful to avoid confusion.

IFRIC 12 Service Concession Arrangements

- 155 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 supplement paragraph B47 of the ED with more guidance on the model's interaction with IFRIC 12 requirements given the supplementary nature of the proposed model. Specifically, the need for more guidance relates 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; and
 - (c) treatment of a terminal value in a concession arrangement when the regulator provides some form of terminal value guarantee.
- 156 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.
- 157 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.
- 158 EFRAG suggests the IASB includes illustrative examples of how the proposed Standard would interact with IFRIC 12 requirements.

IFRS 1 First-time Adoption of International Financial Reporting Standards

- 159 EFRAG questions 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 the supply of goods or services).

- 160 It could be argued that these balances have a finite useful life which is equal to the duration of the regulatory agreement, are separately identifiable and recoverable and it would not reflect the economic reality if these balances stay within goodwill indefinitely. EFRAG suggests that these would be more suited for recognition as a special subset of regulatory-related assets which then would be amortised.
- 161 When users value a business, they would like to see the fair value of acquired assets and the return which is consistent with acquired net regulatory assets. EFRAG considers that reclassifying these balances to goodwill which is not amortised would distort this return.
- 162 Taking into account the above, EFRAG questions whether the goodwill-related regulatory balances should be reclassified to goodwill. EFRAG suggests the IASB should clarify how the related goodwill balances could be derecognised when these amounts will be recovered from customers through the regulated rates in the future. Otherwise, this might result in the revenue being charged to customers while related goodwill remains on the balance sheet.

IFRS 3 Business Combinations

- 163 EFRAG agrees with the IASB decision to provide an exception to the recognition and measurement principles in IFRS 3 and 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).
- 164 In reaching its position EFRAG considered the IASB's arguments 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.
- 165 EFRAG also notes that, as highlighted in paragraph BC 260, IFRS 3 has a different recognition threshold than that of the proposed Standard (more likely than not) and, as such, may fail to recognise some acquired regulatory assets (or liabilities).
- 166 There could also be significant costs associated with discounting (such as the need to determine an appropriate discount rate and tracking separately regulated assets and liabilities measured at fair value, etc) as noted in paragraph BC 260.
- 167 In addition, EFRAG considered existing exceptions for IAS 12 *Income Taxes* and IAS 19 *Employee Benefits*, avoiding the recognition of post-combination gains or losses by using the measurement and recognition principles of these standards as well as an exception for items included in/deducted from the future rates when cash is paid/received, required under the proposed model, and decided that it would be consistent to provide the same exception for all the regulatory assets and liabilities.
- 168 Agreeing with this exception would also be consistent with EFRAG position on the proposed exclusion of regulatory assets and liabilities from the scope of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* (discussed below).
- 169 Notwithstanding its support for the IFRS 3 exception, EFRAG notes that the carrying amount of acquired regulatory assets and assumed regulatory liabilities in a business combination and the extent to which these amounts would differ from the fair value will depend on the outcome of the IASB deliberations and decision on the use of either the regulatory interest rate or minimum interest rate as a discount rate. The carrying amount can also be influenced by the different recognition thresholds of the proposed Standard and IFRS 3. Applying the proposed model, an entity would recognise regulatory assets or regulatory liabilities if it is "more likely than not" that

they exist, whereas, under IFRS 3, an entity might not recognise them if it is uncertain that they exist.

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

170 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

171 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.

172 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

173 EFRAG agrees with the proposed deletion of 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

174 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.

175 However, EFRAG suggests 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, especially in the light of the proposed amendments to paragraphs 43 and 79 of IAS 36 in Appendix D of the ED. To avoid unintended consequences, EFRAG suggests the IASB provides further guidance on 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.

IAS 16 revaluation model and IFRS 3 purchase price allocation (PPA)

176 EFRAG heard concerns about the interaction of the measurement of, for example, property plant and equipment (PPE) at fair value (either under IAS 16 – revaluation model or as a result of a PPA under IFRS 3) with the recognition of regulatory assets and liabilities. It is unclear whether the value of timing difference will be affected by the eventual revaluation of the PPE from amortised cost to fair value and whether any double counting would arise.

177 Therefore, EFRAG recommends the IASB to provide additional guidance on how differences between regulatory asset values and IFRS values should be accounted for (for example if the amount of PPE for regulatory purposes differs from IFRS amounts) and to provide examples illustrating these situations.

IFRS 15

178 EFRAG recommends the IASB to consider the interaction of the proposed Standard with IFRS 15, in particular as it is a supplementary standard to IFRS 15. In addition, EFRAG suggests that the IASB explicitly explains in the BC, the reasons for retaining a recognition threshold for uncertainty that differs from the “highly probable” recognition threshold for variable consideration in IFRS 15.

Question 12: Likely effects of the proposals

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 a two-stage effects analysis that EFRAG conducted, EFRAG notes that some preparer respondents expect significant implementation costs (e.g., due to tracking regulatory returns related to individual assets under construction in applying the CWIP proposals; disclosure requirements; and the retrospective transition requirements).

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.

Overall, EFRAG expects a positive cost-benefit relationship from implementing the proposed Standard. The benefits arise from the reduced volatility and more faithful presentation of performance, and more consistent reporting of regulatory assets and regulatory liabilities. However, as highlighted by some of the effects-analysis preparer respondents, there can be significant costs for some entities that will lessen the overall expected positive cost-benefit relationship.

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?

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

179 EFRAG agrees with the noted analysis in paragraphs BC 230-BC 232. EFRAG conducted a two-stage effects analysis before and after the issuance of the ED (herein referred to as 'aggregated effects analysis'). The aggregated 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.

180 The aggregated effects 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)

181 EFRAG agrees with the noted analysis in paragraphs BC 234-BC 244. The aggregated effects analysis findings show that preparer respondents expect that the proposed model could improve the comparability in the reporting between IFRS and local GAAP. Users also expected that:

- (a) the model would make it easier to understand these entities;
- (b) the model would help to reduce volatility in the profit or loss; and
- (c) the model would lead to more transparent financial statements.

182 The aggregated 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.

183 The feedback from the aggregated effects analysis is consistent with the feedback from past and recent EFRAG user outreaches, where users generally considered it would be beneficial to recognise regulatory balances on the financial statements.

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?

184 Moreover, the effects analysis findings show that many preparer respondents have some information that could be adapted for IFRS reporting (e.g., the information needed for local GAAP reporting). However, one of the preparer respondents also noted the significant differences between the proposed disclosure requirements and the limited disclosure requirements under local GAAP (e.g., US GAAP).

185 EFRAG notes that some preparers expect significant implementation costs due to:

- (a) not having the necessary processes and systems in place to implement the proposed Standard;
- (b) the needed information not being readily available (e.g., information to track individual assets under construction while implementing the proposals on CWIP regulatory returns).
- (c) one-off costs and ongoing costs for required tools and processes (e.g. to track individual assets under construction) could be significant,

- (d) significant costs due to the proposed disclosure requirements and the retrospective transition requirements; and
- (e) significant implementation costs due to the need for change in accounting and reporting processes as the required information is mostly available only on an annual basis, but the proposed requirements will also have to be applied for interim quarterly and half-yearly reports.

186 Based on its aggregated effects analysis, EFRAG expects a positive cost-benefit relationship. The effects-analysis findings show that a majority of preparer respondents expected a positive cost-benefit relationship from implementing the proposed model as they expected it would result in a more faithful representation of the economics of rate-regulated entities, reduce the volatility of profit or loss, and enhance comparability across local GAAP and IFRS reporting. For those that did not expect a positive cost-benefit, it was due to them expecting significant implementation costs for their companies as noted earlier, or due to concerns about aspects of the proposal (e.g., the proposed requirements for CWIP regulatory returns in paragraph B15).

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?

- 187 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.
- 188 EFRAG suggest that the IASB provides a detailed Illustrative Example of the disclosure requirements, especially one that reflects all the components of the total allowed compensation.
- 189 EFRAG suggests that the future Standard would benefit from the inclusion of real-world-based Illustrative Examples on the different aspects of the proposals.
- 190 EFRAG also recommends the IASB explains in the BC how it concluded that regulatory assets and regulatory liabilities were monetary items when applying IAS 21 *The Effects of Changes in Foreign Exchange Rates*.