EFRAG extended early-stage effects analysis for preparers on rate-regulated activities

General information

In January 2021, the IASB published the Exposure Draft *Regulatory Assets and Regulatory Liabilities* (the ED). The ED`s objective is that entities in the scope of the ED should provide relevant information to financial statement users 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. An overview of the ED's proposals can be found through this link.

From October 2020 to January 2021, EFRAG conducted an early-stage effects analysis of the IASB (then tentative)- proposals based on questionnaire responses from preparers and users [preparer report accessible here]. The present questionnaire for entities subject to rate-regulation is the continuation of the early-stage analysis and is intended to help EFRAG and its constituents understand the potential impact of certain topics of the ED in practice.

The survey, targeted at preparers, includes 37 questions on the potential impact including the expected costs and benefits of the proposed ED`s guidance. The findings will be reflected in EFRAG's final comment letter.

The survey should take approximately 30-45 minutes to complete and can be completed with breaks being taken.

1) Please provide the following information:

Title: ____

Name and surname*: ____

Role / Function*: ____

Your email*: ____

2) In which sector are you?

( ) Utilities

( ) Transport

( ) Other, please describe shortly: ____*

3) In which region/s do you operate?

[ ] European Economic Area and the UK

[ ] North America

[ ] Asia-Pacific

[ ] Other markets (South and Central America, Middle East/Africa)

4) Please specify whether your financial reporting is in accordance with IFRS Standards:

( ) Yes

( ) No, please describe shortly: ____

( ) Apply both IFRS and other GAAP's, please describe shortly:

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5) What is the amount of your total consolidated assets as per the latest reporting period?

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6) Please describe the type of regulatory agreement(s) you have in place (hybrid, cost of service, incentives, etc.).

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7) May we contact you if we have questions about your response?*

( ) Yes

( ) No

Questions regarding "Scope"

The ED proposes to apply the requirements to all regulatory assets and regulatory liabilities, which are created by a regulatory agreement. The scope is not restricted to regulatory agreements with a particular legal form or only to those enforced by a regulator with particular attributes.

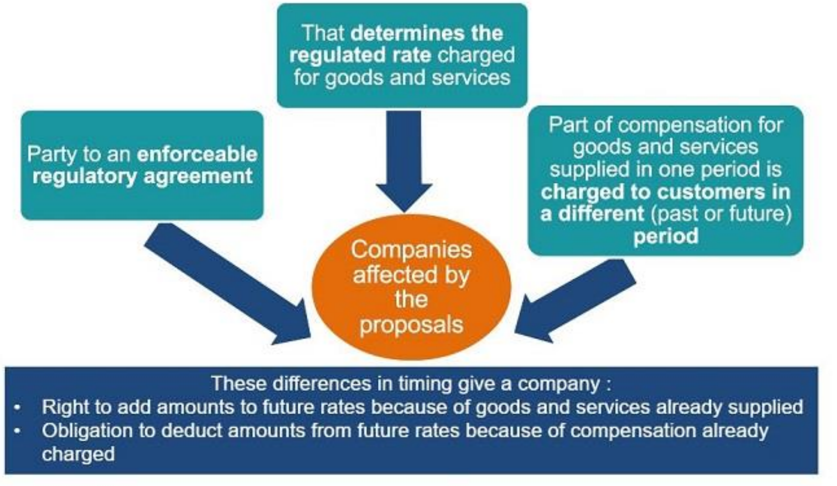
The ED sets out when a regulatory asset or a regulatory liability can exist. Regulatory assets and regulatory liabilities are created by a regulatory agreement that determines the regulated rate the entity charges for goods or services it supplies to customers in such a way that the part (some or all) of total allowed compensation for goods or services supplied in one period is charged to customers in a different period (past or future) referred to in the ED as differences in timing. More specifically:

1. A regulatory asset is 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.
2. A regulatory liability is 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.

The ED describes a regulatory agreement as a set of enforceable rights and obligations that determine a regulated rate to be applied in contracts with customers. For example, a regulatory agreement may take the form of:

1. a contractual licensing agreement between an entity and a regulator;
2. a service concession arrangement; or
3. a set of rights and obligations specified by statute, legislation, or regulations.

The ED 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.



Source: EFRAG presentation

8) Have you identified any other situation/s in which the proposed scope would affect entities that you do not view as subject to rate regulation that gives rise to regulatory assets and regulatory liabilities?

( ) Yes

( ) No

If yes, please describe the situation/s and why you consider these should not be within the scope.

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9) Are the ED`s proposals on scope clear enough to enable an entity to determine whether a regulatory agreement gives rise to regulatory assets and regulatory liabilities?

( ) Yes

( ) No

If no, please describe what aspects of the scope need to be further clarified.

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10) Are you aware of situation/s where rate adjustments related to service concession arrangements under IFRIC 12 *Service Concession Arrangements* result in enforceable rights and obligations but do not fall within the scope of IFRIC 12 and could be within the scope of the proposed model?

( ) Yes

( ) No

If yes, please describe the situation/s.

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11) Are you aware of situation/s that are not within the scope of the proposed model but in your view should be?

( ) Yes

( ) No

If yes, please describe the situation/s.

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12) Have you identified any situation/s in which the proposed scope would include self-regulation?

( ) Yes

( ) No

If yes, please describe the situation/s.

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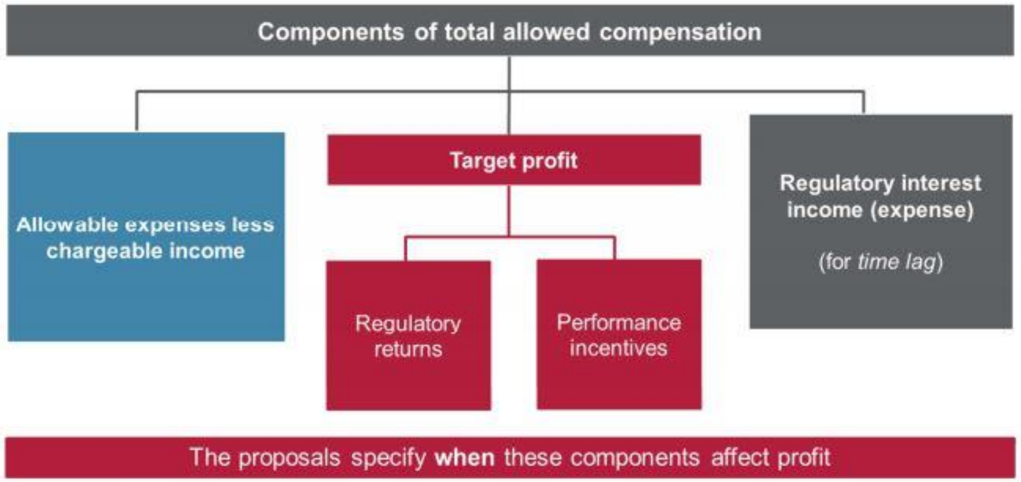
Total allowed compensation

The ED uses the term total allowed compensation for the full amount of compensation for goods or services supplied that a regulatory agreement entitles a company to charge customers through the regulated rates – in either the period when the company supplies those goods or services or in a different period.

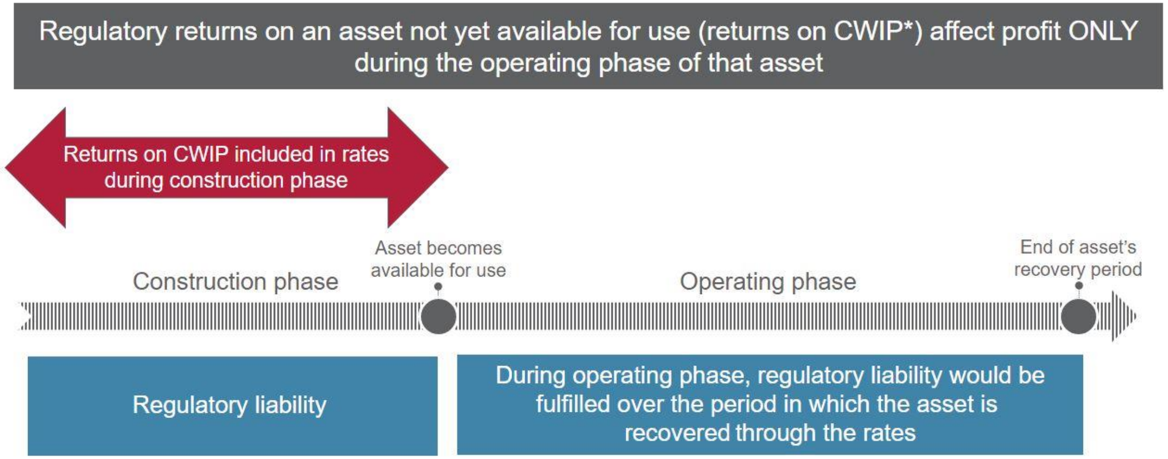
Regulatory assets and regulatory liabilities arise when some or all of the total allowed compensation under enforceable regulatory agreements for goods or services delivered in a particular period are reflected in the rates that are charged to customers in a different reporting period.



Source: IASB CMAC presentation March 2021

As depicted in the above diagram, the ED identifies the components of total allowed compensation, namely:

- Recovery of allowable expenses less chargeable income.
- Target profit, which in turn consists of the following sub-components:
  - Regulatory returns that are allowed on a regulatory asset base.
  - Performance incentives- financial rewards or penalties for achieving specified performance criteria to be incorporated while setting regulated rates.
- Regulatory interest rate for time lag effects.



Source: IASB presentation

For assets not yet in use or construction work in progress* (CWIP), and where the regulatory agreement allows regulatory returns to be charged to customers while an asset is under construction; the ED proposes that these regulatory returns should be included in total allowed compensation when the asset is in use and over the regulatory recovery period of the asset through the regulated rates.

Correspondingly, a regulatory liability is recognised during the construction period and regulatory income recognised when the asset is in use.

In effect, the regulatory returns on CWIP during construction will only be reflected in the entity's reported performance (profit or loss) when the asset is in use. Once the asset is available for use, the proposed guidance requires regulatory returns to be allocated over the remaining periods in which the entity recovers the carrying amount of the asset through the regulated rates. The ED proposes that an entity use a reasonable and supportable basis in determining how to allocate the return.

13) In your jurisdiction and/or company, how does the regulator compensate for regulatory returns for CWIP when determining the total allowed compensation? (Multiple answers possible)

[ ] Includes regulatory returns in total allowed compensation during the CWIP phase

[ ] Includes regulatory returns in total allowed compensation when the asset is available for use

[ ] Depends on the type of regulatory arrangement (if different types exist)

[ ] Regulatory returns on CWIP are not compensated and therefore are excluded from the total allowed compensation

14) In the event that the CWIP is not completed, does the regulator oblige the entity to either compensate the customer or refund the regulatory return charged to customers during construction?

( ) Yes

( ) No

If yes, please explain and describe situations where this occurs.

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15) If readily available and applicable, please provide the following information related to assets where regulatory returns are granted and charged to customers when the asset is not yet in use. Please fill in period in months or years.

( ) Typical timeline to complete assets under construction:

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( ) Typical period of recovery of carrying value of assets allowed by the regulatory agreements:

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( ) Typical economic useful life of assets:

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( ) Not applicable

16) Within your company, do you link the delivery of goods or services to being compensated for regulatory returns on CWIP?

( ) Yes

( ) No

( ) Not applicable

If no, please explain what service the regulatory return is compensating.

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17) For the latest reporting period, what is the regulatory return charged to customers for CWIP as a proportion of either total allowed compensation or revenue?

( ) Insignificant

( ) Moderate

( ) Significant

( ) Not applicable

If readily determinable, please state the proportion (regulatory return charged to customers/revenue) in percentage terms for the latest reporting period.____

18) Do you foresee any implementation challenges in identifying regulatory returns related to a regulatory asset base that includes CWIP and/or in revenue from regulatory returns to particular assets?

( ) Yes

( ) No

If yes, please explain.

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19) Have you identified any particular challenges in using a reasonable and supportable basis to determine how to allocate the return over the remaining periods in a consistent manner?

( ) Yes

( ) No

If yes, please explain.

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20) Would your company face any other implementation issues not addressed above in applying the ED's proposed requirements for determining the total allowed compensation?

( ) Yes

( ) No

If yes, please explain.

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Measurement - discounting and discount rate

The ED proposes that an entity discounts the estimated future cash flows to their present value used in measuring regulatory assets and liabilities. The discount rate would be the regulatory interest rate that the regulatory agreement provides, except for regulatory assets where the regulatory interest rate is insufficient to compensate the entity.

For regulatory liabilities, the discount rate would be the regulatory interest rate that the regulatory agreement provides. In case of a series of different regulatory interest rates for successive periods (uneven interest rates) over the life of the regulatory asset or regulatory liability, the ED requires an entity to translate those uneven interest rates into a single discount rate that the entity should use throughout the life of the regulatory asset or regulatory liability.

	Future cash flows	Discount rate
Initial measurement	**Estimate all future cash flows (including cash flows from regulatory interest)** Using 'most likely amount' method or 'expected value' method	**Discount the estimated future cash flows** Using the **regulatory interest rate** **unless** this rate for a regulatory asset is **insufficient***
Subsequent measurement	**Update estimates of future cash flows** • to reflect recovery of the regulatory asset or fulfilment of the regulatory liability • for changes in estimates	**Continue to use the discount rate** determined at initial recognition, **unless** the regulatory agreement **changes** the regulatory interest rate

Source: IASB CMAC presentation March 2021

21) In your jurisdiction, what does the regulatory interest rate compensate for?

( ) Time value of money

( ) Business risk

( ) Both time value of money and business risk

( ) Other factors/additional factors

If the regulatory interest rate compensates for other factors, please explain what these are.

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22) For your company, and based on the applicable regulation, will discounting cash flows by applying a minimum interest rate for regulatory assets result in:

( ) A loss in profit or loss

( ) A gain in profit or loss

23) Would your company face any implementation issues with the ED`s proposed requirements for discounting and specifically with estimating the minimum interest rate for regulatory assets when the regulatory rate is deemed to be insufficient?

( ) Yes

( ) No

If yes, please explain.

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24) For your company, and based on the applicable regulation, do you foresee any implementation challenges to determine a single discount rate when the regulatory interest rate is uneven?

( ) Yes

( ) No

If yes, please explain and please suggest what alternatives you would suggest.

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25) Do you think that a practical expedient not to discount regulatory assets and regulatory liabilities, if the effects of time and risks were not significant, should be incorporated in the proposed Standard?

( ) Yes

( ) No

Interaction with other IFRS Standards

Exception to IFRS 3 *Business Combinations*

The ED proposes to exempt regulatory assets and liabilities from the recognition and measurement principles in IFRS 3 *Business Combinations*. Instead, an entity should recognise and measure regulatory assets acquired and regulatory liabilities assumed in a business combination applying the recognition and measurement principles proposed in the ED (modified historical cost, instead of fair value measurement). The IASB proposes to book the resulting differences in valuation of regulatory assets and liabilities to goodwill.

26) What do you expect will be the impact of the proposed guidance on goodwill/ gain on acquisition arising on the business combination which includes regulatory assets and regulatory liabilities?

( ) Increase amount of recognised goodwill

( ) Decrease amount of recognised goodwill

( ) Results in a bargain purchase

( ) None

( ) Do not know

Goodwill-related regulatory balances

The ED does not allow the recognition of goodwill-related regulatory balances from the past business combinations by the first-time adopter of IFRS, because this transaction is the business combination itself and not any supply of goods or services before the business combination. The ED proposes to amend IFRS 1 *First-time Adoption of International Financial Reporting Standards* to derecognise such balances and to recognise the resulting difference directly to goodwill. The amendment would apply to a first-time adopter electing not to apply IFRS 3 retrospectively to a past business combination.

27) If you are a first-time adopter, will the proposed accounting treatment of goodwill-related regulatory balances from past business combinations have a significant impact on the balance sheet position of your company?

( ) Yes

( ) No

( ) Do not know

( ) Not applicable

If yes, please explain.

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IFRIC 12 *Service Concession Arrangements*

Service concession arrangements within the scope of IFRIC 12 *Service Concessions Arrangements* are subject to some form of rate regulation because the grantor regulates the price to be charged for the services. A service concession arrangement may be the form that a regulatory agreement takes. Service concession arrangements may create regulatory assets and regulatory liabilities.

28) Are there any aspects of the interaction of the proposed model with IFRIC 12 that you find problematic for practical application purposes?

( ) Yes

( ) No

If yes, please explain.

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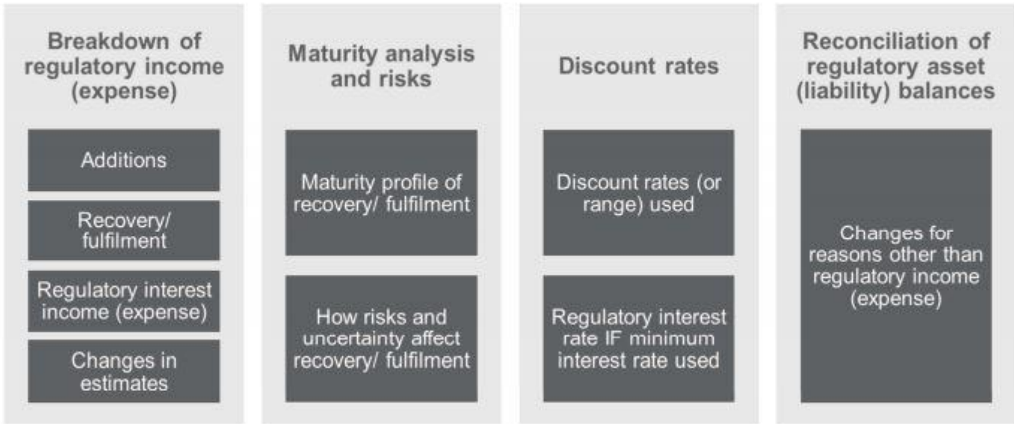
Disclosures

The ED sets out the overall disclosure objective for regulatory income, regulatory expense, regulatory assets and regulatory liabilities to enable users of financial statements to understand the following:

1. the relationship between an entity's revenue/s and expense/s which provides insights into the entity's prospects for future cash flows over many periods;
2. the entity's regulatory assets and regulatory liabilities at the end of the reporting period which provides insights into how regulatory assets and regulatory liabilities affect the amount, timing and uncertainty of the entity's future cash flows.

The diagram below depicts the different categories of disclosures that will be required.



Source: IASB CMAC presentation March 2021

29) For preparing the proposed disclosures, do you have all information readily available?

( ) Yes

( ) Partly available

( ) No

If not all of the information is readily available, please elaborate on the missing information?

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30) Are there any other constraints to providing the proposed disclosures (i.e., operational difficulties or regulatory restrictions)?

( ) Yes

( ) No

If yes, please explain.

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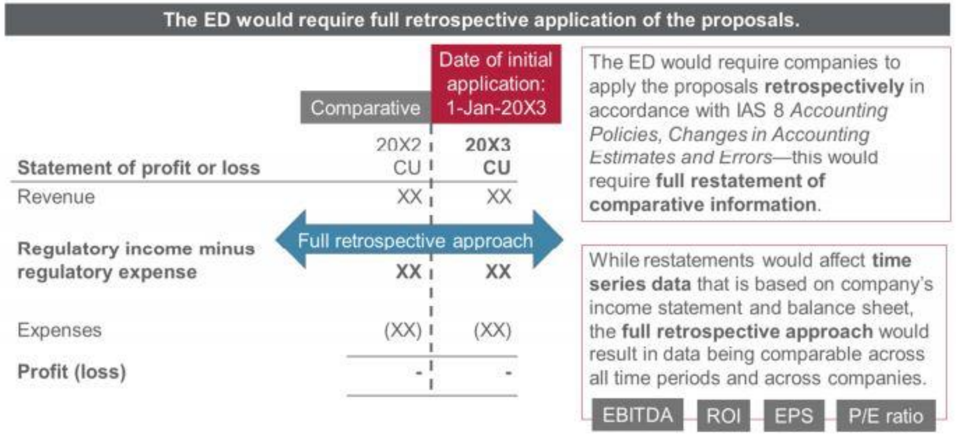
Transition



Source: IASB CMAC presentation March 2021

31) Are there any implementation challenges arising from the ED`s transition requirements?

( ) Yes

( ) No

( ) Do not know

If yes, please explain.

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Likely effects on financial statements

EFRAG would like to ask for insights on the likely effects of the proposed accounting on the balance sheet and financial performance on the 2020 financial statements.

32) What do you anticipate will be the impact of the proposed model on the 2020 balance sheet (i.e. incremental amount of regulatory assets and regulatory liabilities recognised as at latest year-end)?

( ) Significant

( ) Moderate

( ) Minimal

( ) None

Please elaborate on your selection in the question above of the anticipated impact.

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33) What do you anticipate will be the impact of the proposed model on your companies 2020 profit or loss and performance (i.e., incremental impact of regulatory income and expenses on the net income (loss))?

( ) Significant

( ) Moderate

( ) Minimal

( ) None

Please elaborate on your selection for the question above of the anticipated impact.

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Cost-benefit analysis

34) What do you anticipate will be the level of costs (either one-off or ongoing) that you expect to incur to implement the proposed model for accounting for regulatory assets and regulatory liabilities?

( ) Significant

( ) Moderate

( ) Minimal

( ) None

Please elaborate on your response and, if any, highlight the specific aspects of the model that will result in greater costs.

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35) If you responded to the first questionnaire of the early-stage effects analysis, have you changed your view on the anticipated level of costs?

( ) The anticipated level of costs has increased

( ) The anticipated level of costs has decreased

( ) No change in assessment

( ) Did not participate

36) To what extent do you agree/disagree with the following statements related to the ED?

(1 = Strongly disagree, 2 = disagree; 3 = partially agree; 4 = agree; 5 = strongly agree)

	1	2	3	4	5
The ED supports preparers' efforts to provide users of financial statements with relevant information	( )	( )	( )	( )	( )
The ED appropriately reflects the complexity of existing rate-regulation regimes	( )	( )	( )	( )	( )
The information needed to implement the ED requirements is readily available	( )	( )	( )	( )	( )

Please elaborate on your view.

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37) What is your assessment of the overall cost-benefit (i.e., incremental costs versus expected improvements in information for users of financial statements) resulting from your company's application of the proposed model?

( ) Positive cost-benefit relationship

( ) Negative cost-benefit relationship

( ) Hard to determine

Please elaborate on your choice.

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Thank You!

Thank you for taking our survey. Your response is very important to us.