EFRAG extended early-stage effects analysis for users of financial statements of rate-regulated entities

General information

Page description:

The IASB published the Exposure Draft *Regulatory Assets and Regulatory Liabilities* (the ED) in January 2021. The ED proposes a new accounting model to give users of financial statements better information about a company's incremental rights (i.e., regulatory assets) and obligations (i.e., regulatory liabilities) arising from the rate regulation under which an entity operates and specifically the relevant enforceable regulatory agreement between an entity and the rate regulator. The ED`s objective is that entities in the scope of the proposed Standard 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. A high-level summary of the ED proposals can be found here.

From October 2020 to January 2021, EFRAG conducted an early-stage effects analysis to assess the impact of the proposals for both users and preparers. [related user report accessible here]. This survey is an extension of the early-stage effects analysis with a focus on a selection of topics. The survey, targeted at financial statement users, includes 15 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 15-20 minutes to complete and can be completed with breaks being taken.

1. Please provide the following information:

Title

Name and surname *

Your email *

2. Type of user

- Sell-side analyst
- Buy-side analyst
- Portfolio manager
- Private / retail investor
- Rating agency analyst
- Other, please describe shortly

3. What sector/s with rate regulated entities do you cover?

- ☐ Utilities
- ☐ Transport
- ☐ Other, please describe shortly

4. On which asset classes do you focus?

- ☐ Bonds
- ☐ Equities
- ☐ Other, please describe shortly

5. In which regions do you cover companies?

- ☐ Europe
- ☐ North America
- ☐ Asia-Pacific
- ☐ Global
- ☐ Other markets (South and Central America, Middle East/Africa)

6. Please specify whether the companies you cover apply IFRS

- Yes
- No

7. Can your contact information be shared with the IASB for their outreach activities? *

- Yes
- No

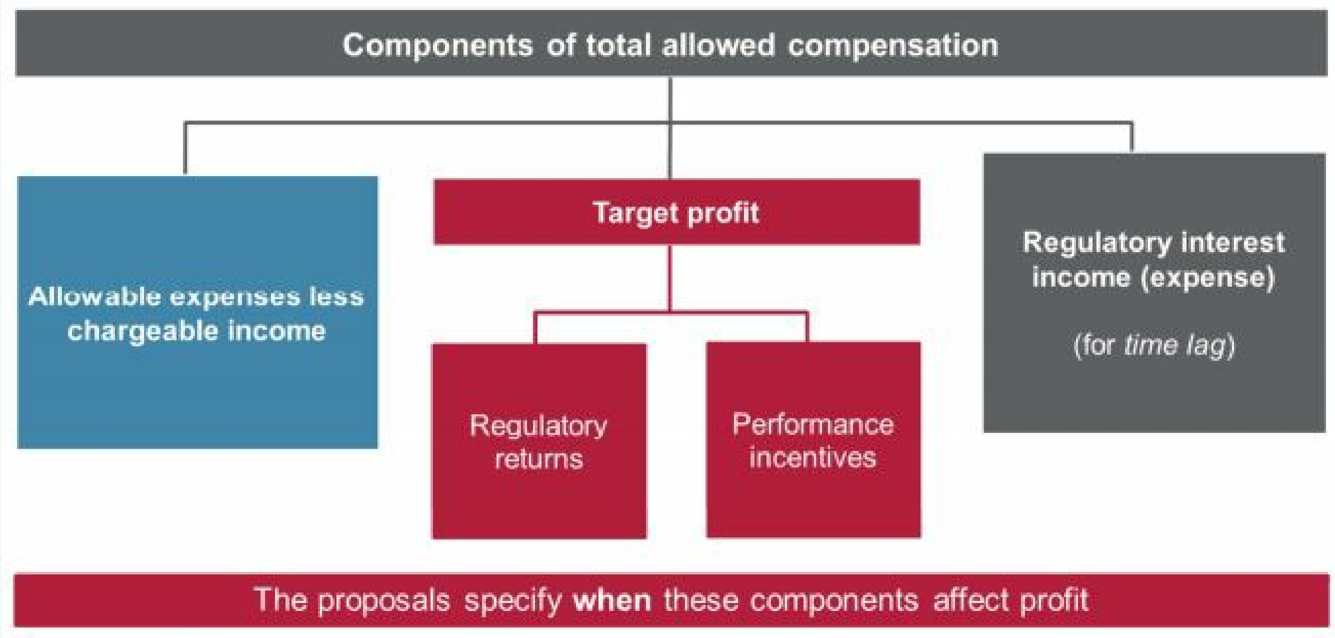
8. May we contact you if we have questions about your response? *

- Yes
- No

Analysis of rate-regulated entities under the current financial reporting regime

Page description:

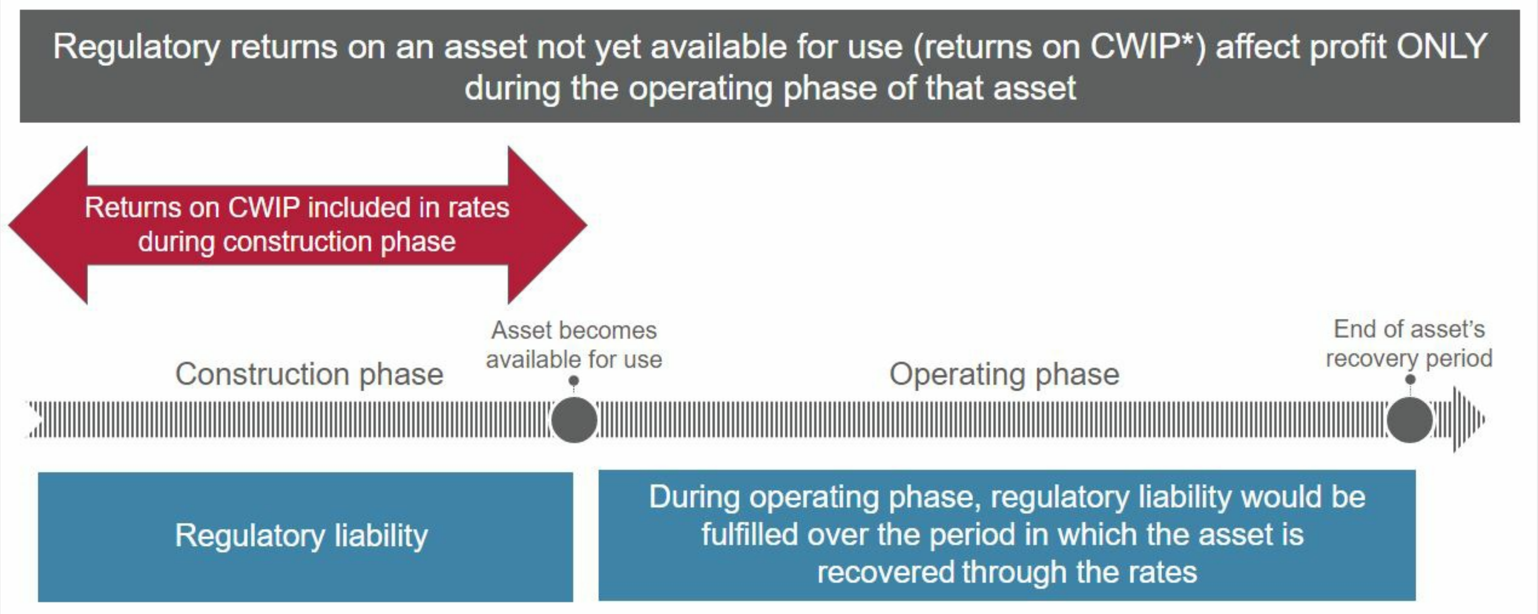
The ED uses the term total allowed compensation for the full amount of compensation for goods or services supplied that a regulatory agreement entitles a company to charge customers through the regulated rates – in either the period when the company supplies those goods or services or in a different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

9. Will there be a need for you to make analytical adjustments for the proposed accounting treatment for CWIP regulatory returns?

- ○ Yes
- ○ No

If yes, please elaborate.

10. Are there particular business models to which the proposed accounting treatment for CWIP regulatory returns will affect how you assess the reporting entities?

- Yes
- No

If yes, please elaborate.

11. Do you expect that the proposed requirements for CWIP regulatory returns will have a material impact on the financial statement and non-GAAP metrics that you apply when analysing rate-regulated entities?

- Yes
- No
- Do not know

If yes, please elaborate.

Discounting

Page description:

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

	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

12. When assessing regulatory assets and regulatory liabilities, do you consider the present value of the regulatory cash flows?

- ○ Yes
- ○ No

If yes, please describe what discount rate you apply.

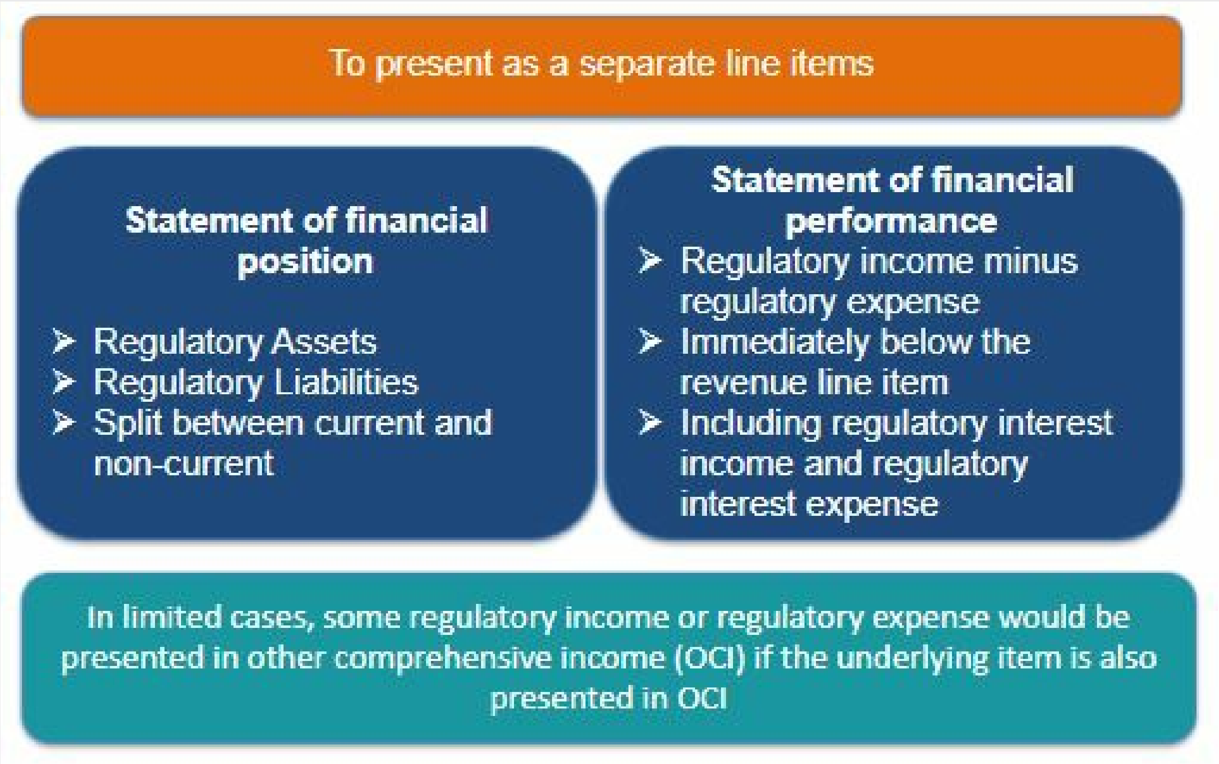
13. Do you consider the ED’s proposals for discounting will enhance the analysis of the financial performance and financial position of a rate-regulated entity?

- Yes
- No
- No opinion

Please elaborate.

Presentation

Page description:
The ED proposes the following presentation requirements:



Source: EFRAG presentation

14. The presentation of regulatory income minus regulatory expense (including regulatory interest income and regulatory interest expense) immediately below the revenue line item in the statement of financial performance will enhance analysis of entities?

- Yes
- No

If no, please elaborate.

Disclosures

Page description:

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 revenues and expenses 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

15. Please evaluate the extent to which you agree/disagree that each of the following categories of disclosures will enhance the analysis of rate-regulated reporting entities.
(1 = Strongly disagree, 2 = disagree; 3 = partially agree; 4 = agree; 5 = strongly agree)

	1	2	3	4	5
Breakdown of regulatory income (expense)	○	○	○	○	○
Maturity analysis and risks	○	○	○	○	○
Discount rates	○	○	○	○	○
Reconciliation of regulatory asset (liability) balances	○	○	○	○	○

Please elaborate on your response to the previous question.

Thank You!

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