This paper provides the technical advice from EFRAG TEG to the EFRAG Board, following EFRAG TEG's public discussion. The paper does not represent the official views of EFRAG or any individual member of the EFRAG Board. This paper is made available to enable the public to follow the EFRAG's due process. Tentative decisions are reported in EFRAG Update. EFRAG positions as approved by the EFRAG Board are published as comment letters, discussion or position papers or in any other form considered appropriate in the circumstances.

Accounting for regulatory assets and regulatory liabilities Cover Note

Objective

1 An IASB exposure draft on the accounting for regulatory assets and regulatory liabilities ('the proposed accounting model') is expected at the end of January 2021, with a 150-day comment period. The purpose of this session is to update the EFRAG Board on EFRAG TEG's preliminary views on the IASB's tentative decisions on the accounting model.

2 On the assumption that the exposure draft is published by the end of January/early February 2021, the EFRAG Secretariat plan to ask the EFRAG Board to approve the EFRAG draft comment letter at its meeting in March/April 2021.

Background on the IASB project

3 The IASB project focuses on the accounting for regulatory assets and regulatory liabilities. Since IFRS adoption in 2005, many companies operating in a rate-regulated environment have raised the question about whether rights and obligations arising from rate regulation would qualify for recognition under the *Conceptual Framework* Some EU companies recognised (and still recognise) regulatory balances using different accounting methods and others do not.

4 The IASB has concluded that regulatory assets and regulatory liabilities meet the definitions of assets and liabilities under the *Conceptual Framework* and provide useful information to users of companies that have regulatory balances.

5 The model, when finalised as an IFRS Standard, will replace IFRS 14 *Regulatory Deferral Accounts*, an interim Standard permitting different accounting approaches for rate regulation.

6 The EFRAG Board received a presentation from an IASB Board member on the accounting model at its meeting in February 2020. The EFRAG Board was not asked to take any decisions. Some EFRAG Board members considered that, based on their current understanding, the scope of the model would not affect many companies in Europe.

7 The expert views from the EFRAG Rate-regulated Activities Working Group (EFRAG RRAWG) discussed in previous meetings were presented to EFRAG TEG to assist EFRAG TEG in developing their preliminary views.

8 The EFRAG Secretariat notes that as the IASB finalises and improves the drafting of the expected proposals, the wording in the forthcoming exposure draft might be different to the IASB tentative decisions included in this paper, which have been the primary source for discussions so far.

9 Once the exposure draft is published, any differences to the tentative proposals will be discussed with EFRAG RRAWG, EFRAG TEG and potentially EFRAG CFSS to enhance and further develop the EFRAG draft comment letter.

10 The EFRAG Secretariat is currently undertaking outreach with preparers and users of financial statements as part of an early-stage analysis (ESA) of the anticipated effects of the proposed accounting model. The ESA is targeted at users and preparers. The outreach to preparers includes an assessment of the implications of the scope of the model and financial statement effects. The outcome of this work will be considered in developing the EFRAG draft comment letter.

What is the problem the IASB project tries to address?

11 A rate-regulated company provides goods or services to customers at rates (prices) that are determined by a regulatory agreement (regulatory framework). The amount of revenue that a rate-regulated company is therefore entitled to charge its customers is determined by the regulated rates.

12 The rates for goods or services supplied in a period are set in such a way that part of the compensation for goods or services supplied in one period is included in the rates charged to customers in a different period. This creates a timing difference that **makes the information reported in the financial statements incomplete**.

13 Without the information about the differences in timing investors would not understand how they affect the company's financial performance and the relationship between the company's revenue and its expenses, financial position and expected future cashflows.

14 To address this timing problem, the forthcoming exposure draft will propose that a company should reflect the compensation for goods or services supplied as part of its reported financial performance for the period in which those goods or services are supplied or rendered. This is the key underlying principle in the accounting model.

15 The objective of the IASB project is to address either the lack of or incomplete information in the financial statements and provide users of financial statements with relevant information regarding the company's performance and financial position. The forthcoming exposure draft proposes that a company that falls within its scope, should provide information about its regulatory income, regulatory expense, regulatory assets and regulatory liabilities. That information would supplement the information that companies already provide by applying IFRS 15 and other IFRS Standards.

Agenda Papers

16 In addition to this cover note, the following papers have been prepared for the session:

(a) Agenda paper 09-02 – Issues paper on EFRAG TEG's preliminary views on the IASB tentative decisions on the accounting model.

(b) Agenda paper 09-03 – IASB presentation of the accounting model prepared for the December 2020 ASAF meeting (*background only*).