

Report of the EFRAG RRAWG Chairman – EFRAG RRAWG meeting held on 19 June 2020

Agenda of the EFRAG RRAWG

- 1 The following topics were discussed at the meeting:
 - (a) Update from IASB observer on the project
 - (b) Key messages - EFRAG draft comment letter on the forthcoming IASB ED on accounting model for regulatory assets and regulatory liabilities
 - (c) IASB March 2020 meeting - treatment of 'target profit' in the accounting model for regulatory assets and regulatory liabilities
 - (i) Regulatory returns on CWIP base
 - (ii) Performance incentives
 - (d) Next steps – Effect analysis on the impact of the accounting model for regulatory assets and regulatory liabilities.

Update from IASB observer on the project

- 2 The IASB Staff provided an update on the project which included the most up to date tentative decisions made by the IASB to date. The IASB Staff noted that, given the effects of covid-19 and the ongoing uncertainty, they would ask the IASB at its meeting in July 2020 to extend the initial proposed comment period from 120 days to 180 days. EFRAG RRAWG members supported an extended comment period of 180 days.

Key messages - EFRAG draft comment letter on the forthcoming IASB ED on accounting model for regulatory assets and regulatory liabilities

Objective of the IASB project on accounting for regulatory assets and regulatory liabilities

- 3 RRAWG generally agreed with the objectives stated. RRAWG members thought that further guidance was needed on the application of some of the proposals on recognition, measurement, interaction with other IFRS Standards and transition requirements. RRAWG members also noted that some of the proposals were highly subjective and did not reflect the concepts typically used in regulatory agreements and the general objectives of the regulatory environment relevant to entities that are expected to apply the model.

Scope

- 4 Overall, EFRAG RRAWG thought the scope was clear. However, they observed the following:
 - (a) Some RRAWG members informed that they were still investigating whether and what extent the transport industry, such as railways, public transport etc. would be impacted. Another key concern cited by several RRAWG members that represent companies that operate concession agreements was the interaction with IFRIC 12 *Service Concession Arrangements*. These RRAWG members were of the view that it was not always clear which of the two sets of requirements an entity should apply and furthermore the proposed

requirements for accounting for regulatory assets and regulatory liabilities were different to the requirements in IFRIC 12. However, in many cases the economic outcome/intention of the respective transactions were very similar.

- (b) Some RRAWG members suggested 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. They raised the question whether in this situation also the regulator/government would be part of the definition of customer. In their view, this was common practice in some jurisdictions (like Italy and Spain) for service concession agreements and regulatory agreements – when the customer could not pay (for whatever reason) the regulator (the government) would step in. In their view, 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 and/or government/regulator. Therefore, the definition of the customer should be broadened to avoid scoping out activities that should be included in the scope.
- (c) Some EFRAG RRAWG members considered that it was not always easy to determine who is the customer. For example, in case of a bus service where the town sets the tariffs and oversees them. These agreements were enforceable, although the town was not a regulator. There was a question about whether the user of a bus service was the customer, or whether it was the town where the bus service operated. When a user bought a ticket, that constituted a contract. This illustrated that it is not always easy to determine who the customer might be.

Definition of regulatory assets and regulatory liabilities

- 5 RRAWG members observed that from an economic point of view the entity would be required to reflect actual allowed compensation (performance) in the period it had provided goods or services. This was currently not the case under IFRS reporting. Some EFRAG RRAWG considered that the model would enhance accountability and allow for better stewardship.
- 6 RRAWG considered that the examples presented in the paper, for a regulatory asset and a regulatory liability, met the definitions of an asset and a liability (respectively) under the IASB Conceptual Framework. One EFRAG RRAWG noted that, for a regulatory liability, it was confusing, in some cases, to link it to the provision of goods or services. One example could be a pre-funding arrangement where an entity does not provide the goods or services during the pre-funding period, but rather in a future period.

Recognition of regulatory assets and regulatory liabilities

- 7 EFRAG RRAWG members confirmed the views previously expressed. In the previous meeting:
 - (a) RRAWG members had mixed views on whether there was a need for a recognition threshold if an entity had enforceable rights and obligations that arose from the regulatory agreement and had assessed it was in the scope of the model. RRAWG members confirmed that there was no need for a recognition threshold. However, when there was uncertainty in the recovery/fulfilment of the regulatory asset/liability, it might be useful.
 - (b) RRAWG members had noted difficulties with understanding how in practice an entity would determine the boundary of a regulatory agreement and why it was important to make this assessment, given the nature of the regulatory environment to which the model will apply. In their view boundary should be determined based on the.

- (c) Some RRAWG members had previously observed that the tentative guidance on determining the boundary was mixing the entity's licence to operate with a specific tariff period, however that also beyond the tariff period enforceable rights and obligations would exist based on the license or legal framework.

Measurement

- 8 EFRAG RRAWG members generally agreed with the proposed modified historical cost measurement approach in the model for regulatory assets and regulatory liabilities.
- 9 The Chairman noted that it was quite far-fetched to call this modified historical cost, considering that updates are made for changes in "regulatory return" as well as cash flow estimates. He noted that practically, one may as well use simple a current value approach (not FV), based on NPV of future cash flows discounted at higher of regulatory return and minimum interest rate.
- 10 Some EFRAG RRAWG members suggested that further guidance was needed with respect to the proposed measurement exception (i.e. not apply modified historical cost) for regulatory assets and regulatory liabilities that relate to expenses or income included in the regulatory rate when cash is paid or received, and are measured at the same measurement basis that the entity used when measuring the related liability or asset (e.g. IAS 12 *Income Taxes* or IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*).
- 11 Some of EFRAG RRAWG members disagreed with discounting estimated future cash flows. Some EFRAG RRAWG members commented that the concept of discounting when measuring regulatory items was not very relevant to those items as the amounts to be recognised as regulatory assets and regulatory liabilities were initially negotiated with the regulator, as this negotiation factored in discounting. Some EFRAG RRAWG members added that discounting would be complex because, like with IAS 12, an entity would need to track the timing differences and the periods in which they originate (reverse).
- 12 Many EFRAG RRAWG members disagreed with the IASB tentative decision that when the regulatory interest rate is inadequate to compensate the entity for the time value of money and uncertainty inherent in the cash flows, the entity should determine a minimum adequate rate to use as the discount rate when measuring regulatory assets. The EFRAG RRAWG members explained that:
 - (a) the regulatory agreement does not use the concept of a minimum adequate rate and introducing such a rate in the model would be a highly subjective and complex exercise for preparers; and
 - (b) the usage of a minimum adequate rate as a concept would not give information value to users of financial statements to understand regulatory assets and regulatory liabilities.
- 13 When a minimum adequate rate concept would be applied, most EFRAG RRAWG members were of the opinion that such minimum rate should be very clearly defined to limit discussions between preparers and auditors.
- 14 EFRAG RRAWG members that supported discounting said that it should be based on the regulatory discount rate.

Presentation

- 15 EFRAG RRAWG members supported the presentation requirements under the model for regulatory assets and regulatory liabilities.
- 16 Members, however, expressed split views as to whether regulatory interest income and regulatory interest expense should be included within the regulatory income or

regulatory expense line item immediately below the revenue line item. Some members supported the IASB presentation approach as it gives clearer performance of regulatory assets and regulatory liabilities, and the revenue line items also include the “regulatory interest income and expense” as included in the rates being charged to customers. Other members were of the view that regulatory interest expense and regulatory interest income belong to the financing category and should be presented as such. Some EFRAG RRAWG members questioned whether the IASB proposals were in line with the IASB proposals in its primary financial statements project.

Amendments to and interaction with IFRS Standards

- 17 EFRAG RRAWG members reiterated that the IASB needed to further consider the interaction between the model and IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* and IAS 36 *Impairment of Assets*, particularly when regulatory assets form part of a CGU. It was not clear how the interaction with a CGU that included regulatory assets would work in practice and there was a risk of unintended consequences unless clear guidance was provided. A similar point was made for assets that had been acquired in a business combination and were used to provide regulatory goods or services.
- 18 EFRAG RRAWG members reiterated that it would be necessary to have guidance on the model’s interaction with IFRIC 12 given the ‘overlay’/ supplementary nature of the model. It was not clear how to apply the intangible asset model under IFRIC 12 in combination with the model for regulatory assets and regulatory liabilities. A question was also raised on the interaction of the model for cases when an entity has a hybrid model/arrangement under IFRIC 12. One EFRAG RRAWG asked how an entity would treat a terminal value in a concession arrangement when the regulator provides some form of terminal value guarantee.
- 19 Similar to previous views expressed, EFRAG RRAWG members agreed with the proposed exception to the recognition and measurement principles in IFRS 3 *Business Combinations*, that 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 model. However, the interaction between measuring assets, like PP&E at FV, as part of IFRS 3 and the recognition and measurement of regulatory assets and liability should be further explored.

Disclosure

- 20 Many EFRAG RRAWG members expressed concerns with the level of detailed disclosure requirements and considered that entities might not readily have available the level of granular information required under the proposals.
- 21 EFRAG RRAWG members generally agreed that the materiality principle will need to be applied to narrow down the disclosure requirements under the model. A suggestion was made that the focus of disclosures should be on what is recognised in the financial statements of the reporting entity as well as on the rights and obligations that did not meet the definitions of regulatory asset and regulatory liability and were not recognised as such.

Transition requirements

- 22 The EFRAG RRAWG members generally supported the transition requirements of the model for regulatory assets and regulatory liabilities. However, members agreed that the IASB should also consider certain practical expedients alongside a modified retrospective approach to avoid full retrospective restatement and to simplify the transition requirements similar to the approach in IFRS 15. The EFRAG RRAWG members noted that the transition requirements will have an impact on the

impairment test of the CGU under IAS 36 *Impairment of Assets*, therefore additional guidance was required.

- 23 Some EFRAG RRAWG members questioned why goodwill-related regulatory assets should be derecognised and allocated to goodwill under the model and not allocated to other assets instead.

IASB March 2020 meeting - treatment of 'target profit' in the accounting model for regulatory assets and regulatory liabilities

Regulatory returns on CWIP base

- 24 EFRAG RRAWG members had mixed views regarding the IASB's tentative decision that regulatory returns on a construction work-in-progress (CWIP) base included in the regulated rates charged to customers during the construction period form part of total allowed compensation only during the period when the asset is in operation and is being used to supply goods or services.
- 25 Some EFRAG RRAWG members noted that it is not uncommon to recognise revenue during the construction period. Those that did have the view referred to the amendment in IAS 16 *Property, Plant and Equipment* where sales revenue can be recognised before an asset is ready for its intended use. However, some RRAWG members noted that tracking any regulatory returns in respect of CWIP will be very burdensome, as this was not necessarily tracked in such detail for regulatory purposes. Other RRAWG members questioned whether this proposal was aligned with the requirements for CWIP under IFRIC 12.

Performance incentives

- 26 The EFRAG RRAWG discussed when performance incentives, whether construction-related or non-construction-related, form part of the total allowed compensation for goods and services delivered during the period.
- 27 The EFRAG RRAWG members generally supported the IASB tentative decision 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. A suggestion was made to improve the wording with respect to defining the performance incentives period for construction-related performance incentives as 'the period to evaluate the performance of construction'.

Next steps – Effect analysis on the impact of the accounting model for regulatory assets and regulatory liabilities [This section was only discussed for a few minutes due to running out of time]

- 28 EFRAG RRAWG members generally agreed that the effect analysis could be conducted using a questionnaire and would cover both scope and application issues. This work could be undertaken jointly (partly) with the outreach/ field-test work. EFRAG RRAWG agreed to send examples to the EFRAG project team to illustrate some of the difficulties observed with applying the model, as discussed during the meeting today and the previous meeting.

Question for EFRAG TEG

- 29 Does EFRAG TEG have any comments on this report?