

This paper has been prepared by the EFRAG Secretariat for discussion at a public meeting of EFRAG FR TEG-CFSS. The paper forms part of an early stage of the development of a potential EFRAG position. Consequently, the paper does not represent the official views of EFRAG or any individual member of the EFRAG FR Board or EFRAG FR TEG-CFSS. The paper is made available to enable the public to follow the discussions in the meeting. Tentative decisions are made in public and reported in the EFRAG Update. EFRAG positions, as approved by the EFRAG FR Board, are published as comment letters, discussion or position papers, or in any other form considered appropriate in the circumstances.

Rate-regulated Activities Cover Note

Objective

- 1 The objective of this session is to obtain EFRAG FR TEG/CFSS views on:
 - (a) the IASB's plans for redeliberating the proposals in its Exposure Draft *Regulatory Assets and Regulatory Liabilities* (the 'ED'); and
 - (b) the IASB's tentative decisions taken so far on determining the scope of the future standard including the role of the regulator.
- 2 A summary of the ED's proposals is provided in the appendix of agenda paper 08-02 (ASAF paper provided for background only).

Background

- 3 The ED was issued in January 2021 with a comment period that ended on 30 July 2021.
- 4 The IASB has taken the following steps so far:
 - (a) discussed the respondents' feedback on the ED at its October and November 2021 meetings
 - (b) discussed and approved a plan for redeliberating the proposals at its meeting in December 2021
 - (c) made tentative decisions on determining whether a regulatory agreement is within the scope of the proposals and the role of a regulator during its meeting in February 2022.

Structure of this paper

- 5 This paper is structured as follows:
 - (a) EFRAG's position in its Final Comment Letter
 - (b) Feedback received by the IASB on the ED
 - (c) IASB deliberations
 - (d) IASB tentative decisions to date
 - (e) EFRAG's staff analysis
 - (f) Questions to EFRAG TEG/CFSS members

EFRAG's position in its Final Comment Letter

- 6 EFRAG published its [final comment letter](#) on the ED on 10 September 2021 and a [Feedback Statement](#) in October 2021.
- 7 EFRAG supported the overall objective to develop an accounting model for regulatory assets and regulatory liabilities but expressed concerns on several aspects of the proposals and asked for clarification on some of the proposals. A summary of EFRAG's views is provided in the Appendix.

Feedback received by the IASB on the ED

- 8 A detailed summary of the feedback received is provided in agenda papers 9 (and related papers) of the IASB [October 2021 meeting](#) and the IASB [November 2021 meeting](#). The feedback received is categorised into three buckets: topics that raised significant concerns; topics that were well received; and other topics. The IASB plans to redeliberate the proposals based on this structure and order of priority.

Topics that raised significant concerns

- 9 The areas that raised most concerns from respondents to the ED related to the proposed scope, total allowed compensation and the discount rate. These areas are consistent with EFRAG's position in its Final Comment Letter. A summary of the concerns reported by respondents to the IASB is provided below.

Scope

- 10 Many respondents were uncertain about which regulatory agreements, arrangements or activities would be within the scope of the proposals. Some of these uncertainties are due to the perceived lack of clarity about:
 - (a) The interaction between the proposals and other Standards (mainly, IFRS 9 *Financial Instruments*, IFRS 17 *Insurance Contracts* and IFRIC 12 *Service Concession Arrangements*). Respondents asked the IASB to develop detailed guidance and illustrative examples on how an entity would account for regulatory assets and regulatory liabilities applying the financial asset, the intangible asset or a hybrid model in IFRIC 12.
 - (b) The proposed definition of 'regulatory agreement' and whether a regulator is needed for regulatory assets or regulatory liabilities to exist. According to these respondents, both the broad proposed definition of 'regulatory agreement' and the lack of definition of 'regulator' may capture a wide range of activities and arrangements that should not be included in the scope and may make consistent application of the final requirements difficult.

Total allowed compensation – return on an asset not yet available for use (CWIP)

- 11 Most respondents disagreed that an entity should reflect returns on an asset not yet available for use in the period when the asset is being used to supply goods or services to customers. According to these respondents, the proposals would:
 - (a) not reflect the economic substance of the regulatory agreements;
 - (b) not result in useful information;
 - (c) be costly to implement; and
 - (d) be inconsistent with the proposed treatment for construction related performance incentives and US generally accepted accounting principles (GAAP).
- 12 Most users that provided feedback to the IASB during the comment period of the ED also disagreed with the proposals on CWIP.

Total allowed compensation - Regulatory assets and regulatory liabilities arising from differences between assets' regulatory recovery pace and their useful lives

- 13 Many respondents disagreed with recognising regulatory assets or regulatory liabilities because of differences between the period that the regulatory agreements permit an entity to recover an asset (the regulatory recovery pace) and the asset's useful life. According to these respondents, the proposals would:
- (a) not reflect an entity's rights and obligations from their regulatory agreements;
 - (b) neither meet the proposed regulatory asset and regulatory liability definitions in the ED nor the asset and liability definitions in the *Conceptual Framework*;
 - (c) not result in useful information; and
 - (d) be costly to implement

Discount rate

- 14 Most respondents disagreed with the proposal for an entity to use the minimum interest rate as the discount rate when the regulatory interest rate provided for a regulatory asset is insufficient to compensate the entity for the time value of money and for uncertainty in the future cash flows arising from that regulatory asset. These respondents are concerned about the complexity of the proposals and believe that the costs of applying them would outweigh any benefits. Most of the users commenting to the IASB (through outreach and other ways) on the minimum interest rate did not agree with the proposal.

Topics that were generally well received

- 15 Respondents to the IASB raised less concerns with the other ED proposals. However, respondents asked for clarification and further analyses regarding the following aspects of the proposals.

Recognition, unit of account and derecognition

- 16 Respondents raised the following points:
- (a) Explore whether any changes are needed on the facts and circumstances to consider when assessing the existence of enforceable rights and enforceable obligations.
 - (b) Assess the need for a higher threshold for recognition in some circumstances.
 - (c) Explore whether to provide guidance on derecognition of regulatory assets and regulatory liabilities.

Measurement (estimating future cash flows)

- 17 Respondents raised the following points:
- (a) Consider clarifications relating to the boundary of the regulatory agreement.
 - (b) Consider whether the chosen method for estimating uncertain cash flows should be applied consistently from initial recognition to recovery of a regulatory asset or fulfilment of a regulatory liability.

Items affecting regulated rates only when cash is paid or received

- 18 Respondents raised the following points:
- (a) Consider how income and expenses are treated as allowable or chargeable using a criterion other than cash basis.
 - (b) Consider whether presentation proposed in paragraph 69 of the ED should be extended to items using a criterion other than cash basis.

Interaction with other IFRS Standards, including amendments to other Standards

- 19 Respondents asked to address concerns and provide recommendations related to the interaction of the proposed requirements with other IFRS Standards (mainly IAS 12 *Income Taxes* and IAS 36 *Impairment of Assets*).

Presentation

- 20 Respondents asked to consider whether to permit entities to classify all regulatory income minus all regulatory expense as revenue.

Disclosure

- 21 Respondents raised the following points:
- (a) Consider whether to develop a broader overall disclosure objective.
 - (b) Address concerns about appropriate level of aggregation and disaggregation of the information to be disclosed and on some proposed disclosure requirements.

Other topics

- 22 Other topics that will be discussed in the redeliberations include transition proposals and effective date, effects analysis and due process steps.
- 23 In relation to the transition proposals, most respondents to the IASB did not support the proposed requirement to apply the Standard retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. During the redeliberations, the IASB staff plan to discuss these concerns with the IASB. The EFRAG staff notes that these concerns are consistent with EFRAG's Final Comment Letter where EFRAG recommended the IASB 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 also recommended 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.

IASB redeliberation plans

- 24 IASB discussed and approved a plan for redeliberating the proposals at its meeting in December 2021. Based on the feedback received, the IASB will redeliberate the proposals based on the following workstreams (in order of priority):
- (a) Topics that raised significant concerns (see paragraphs 9 to 14)
 - (b) Topics that were well received (see paragraphs 15 to 21); and
 - (c) Other topics. These include transition proposals and effective date, effects analysis and due process steps.
- 25 Appendix B of the [IASB agenda paper 9](#) of its December 2021 meeting provides an outline of the main matters that the IASB will need to consider and/or addressed during its redeliberations for each of the workstreams mentioned above.
- 26 The IASB started deliberations at its meeting in February 2022.
- 27 The IASB also discussed with its Consultative Group for Rate Regulation (IASB Consultative Group) on 4 March 2022 the concerns reported on CWIP and possible courses of action the IASB may consider addressing the concerns. The IASB staff plan to discuss scope, discount rate and disclosure with the Consultative Group at future meetings. The IASB will meet again with the Consultative Group on 28 March 2022. For information purposes, a summary of the outcome of the 4 March Consultative Group meeting is provided below.

IASB Consultative Group meeting on 4 March 2022

- 28 The IASB staff presented an example comprising two different fictional jurisdictions where regulatory returns on CWIP could and could not be considered in the amounts charged to customer in the period the construction took place. Based on the analysis for both jurisdictions the following 5 courses of action (options) were presented:
- (a) expand the scope of the Standard to include rights and obligations that are not regulatory assets and regulatory liabilities;
 - (b) broaden ‘goods or services supplied’ to include satisfying service requirements specified by a regulatory agreement;
 - (c) remove paragraph B15¹ of the ED;
 - (d) confirm the proposal; and
 - (e) narrow the scope paragraph of B15 to long term projects.
- 29 Most members of the IASB Consultative Group supported either the option to remove B15 of the ED or to broaden the meaning of ‘goods or services supplied’ to include satisfying requirements set out in the regulatory agreement. One member (user) noted that it did not make sense to recognise a liability (as per the proposal) and considered that an entity should recognise a regulatory return when it has earned it. Some members also supported to expand the scope of the standard to include rights and obligations on CWIP while others expressed the need for a closer examination of this option to prevent unintended consequences.
- 30 Members generally noted that a key issue is what is the ‘right’ the entity has that entitles it to a regulatory return during the construction phase and whether that right meets the definition of an asset under the *Conceptual Framework*. It was also important to understand what were the ‘goods or services’ the entity provided that were linked to that right. The ED referred to the ‘goods or services’ provided to customers when the asset under construction is being used. However, many members considered that the **goods or services supplied by a rate-regulated entity should be viewed broadly** to include, in addition to goods or services supplied to customers, the service of making an infrastructure available for an uninterrupted supply of goods or services to existing and future customers. Based on the broader notion of goods or services supplied, an entity’s right to accrue regulatory returns on CWIP during the construction period could be argued as arising from providing the service of making an infrastructure available.
- 31 Some members considered that the proposals focused on an individual asset. However, entities had many assets and it would be extremely complex to apply the proposal in ‘real-life’ cases.

IASB tentative decisions to date

- 32 At its meeting in February 2022, the IASB started its redeliberations and made tentative decisions on determining whether a regulatory agreement is within the scope of the proposals ([Agenda Paper 9B](#)) and the definition of a regulator ([Agenda Paper 9C](#)). These are included in the February 2022 [IASB Update](#) and summarised below:

Determining whether a regulatory agreement is within the scope of the proposals

- 33 The IASB tentatively decided:
- (a) to require an entity to apply the Standard to all its regulatory assets and regulatory liabilities;

¹ B15 proposes to defer the inclusion in total allowed compensation of the regulatory returns related to CWIP.

- (b) that the Standard will apply to all regulatory agreements and not only to those that have a particular legal form;
- (c) to confirm the conditions necessary for a regulatory asset or a regulatory liability to exist;
- (d) to not explicitly specify in the Standard which regulatory schemes would be within or outside its scope;
- (e) to clarify in the Standard that a regulatory agreement:
 - (i) may include enforceable rights and enforceable obligations to adjust the regulated rate beyond the current regulatory period;
 - (ii) that creates either regulatory assets or regulatory liabilities, but not both, is within its scope;
 - (iii) that causes differences in timing when a specified regulatory threshold is met creates regulatory assets or regulatory liabilities;
 - (iv) is not required to determine a regulated rate using an entity's specific cost for the regulatory agreement to create regulatory assets or regulatory liabilities.

Definition of a regulator

34 The IASB tentatively decided to:

- (a) include the existence of a regulator as part of the conditions necessary for a regulatory asset or a regulatory liability to exist;
- (b) define a regulator as 'a body that is empowered by law or regulation to determine the regulated rate or a range of regulated rates';
- (c) include guidance to clarify that:
 - (i) self-regulation is outside the scope of the Standard;
 - (ii) a situation in which an entity or its related party determines the rates, but does so in accordance with a framework that is overseen by a body empowered by law or regulation, is not self regulation for the purposes of the Standard.

Next steps

35 In its next steps the IASB will discuss:

- (a) Interaction with IFRS 9 and IFRS 17.
- (b) Application questions about the definition of 'regulatory agreement' and the term 'customers'.
- (c) Boundary between financial instruments and regulatory assets and regulatory liabilities.
- (d) Interaction with IFRIC 12.
- (e) Enforceability of rights and obligations to adjust future regulated rates—to be discussed when redeliberating recognition and measurement.

EFRAG staff analysis

IASB redeliberation process

36 The EFRAG staff agrees with the IASB redeliberation plan and order of priority of the issues to be discussed noted in paragraphs 24 - 27 of this paper. We note that the issues on the proposals, identified by the IASB respondents as being the most significant (see paragraphs 9 to 14), are consistent with the main concerns reported by EFRAG in its Final Comment Letter (see Appendix). We also think that making

clear in the Standard that a regulatory agreement that creates either regulatory assets or regulatory liabilities, but not both, is within its scope will be a useful clarification for jurisdictions with regulatory agreements that create asymmetric rights and obligations - for example, a regulatory agreement that gives rise to only regulatory liabilities- are within the scope of the requirements. However, we consider that the wording " but not both" can be interpreted by some to mean that a regulatory agreement cannot create both regulatory assets and regulatory liabilities (instead of either or) and recommend the drafting be made clearer.

- 37 We also agree that it will be useful for the IASB to discuss the feedback with its Consultative Group and obtain insight on how to proceed on the more significant issues. The Chair of the EFRAG RRAWG is an observer of the IASB's Consultative Group and participated in the IASB meeting on 22 March 2022.
- 38 However, we note that some EFRAG respondents raised concerns in the application of the notion of total allowed compensation and the misalignment between the model and regulatory accounting in EU jurisdictions. We encourage the IASB to also undertake outreach with preparers, users and regulators in these jurisdictions and have an open and transparent discussion to give affected stakeholders the opportunity to present their views on a problem that is important for the application of the total allowed compensation concept. The EFRAG staff will consider whether these matters should be discussed with the EFRAG RRAWG, with the IASB project staff and perhaps a IASB Board member present, to benefit from additional feedback from an EU perspective on how to address the concerns raised.

IASB tentative decisions so far

- 39 The EFRAG staff supports the IASB tentative decisions summarised in paragraphs 33 and 34. In our view, the additional guidance will help to resolve some of the key issues on scope reported by respondents, including EFRAG.
- 40 The EFRAG staff supports including the existence of a regulator as part of the conditions necessary for a regulatory asset or a regulatory liability to exist and defining a regulator as tentatively agreed by the IASB and clarifying when self-regulation might be within or outside the scope. This is consistent with EFRAG's recommendation in its Final Comment Letter.
- 41 However, as noted by some IASB members during the IASB discussion in February 2022, the EFRAG staff consider that it is important not to introduce too many scope qualifiers when developing the final standard (when something is in or out of scope) but rather clearly describe what is required to be in the scope of the final standard.

Questions for EFRAG FR TEG/CFSS

- 42 Do you have any questions or comments about the IASB's proposed approach to redeliberations?
- 43 Do you agree the IASB should prioritise the redeliberation of proposals relating to scope and total allowed compensation?
- 44 Given the IASB's discussions on the scope so far, do you have any suggestions in approaching the next IASB discussions for this topic?
- 45 Do you have other comments/suggestions?

Agenda Papers

- 46 In addition to this cover note, agenda paper 08-02 –*ASAF Agenda Paper AP1 Rate-regulated Activities* – has been provided for the session as background material.

Appendix – Summary of EFRAG’s position in its Final Comment Letter

- 1 A summary of the concerns raised by EFRAG in its Final Comment Letter on the IASB proposals in the ED is provided below.
- (a) **Scope** – There are several aspects where there is a need for further clarification on entities’ scope eligibility, including:
 - (i) types of regulation where regulated rates are based on sector averages instead of an entity’s own costs;
 - (ii) specific scope exclusions (e.g., for self-regulation);
 - (iii) definition of ‘customers’ as the notion of customers (i.e., groups of customers); and
 - (iv) whether the existence of a regulator is required and better defining the characteristics of a regulator.
 - (b) **Definitions of regulatory assets and regulatory liabilities** – EFRAG noted that there are circumstances where the recognised regulatory assets and regulatory liabilities would not meet the definitions provided in the ED and instances when applying the definitions do not reflect the economic substance of the regulatory agreement.
 - (c) **Total allowed compensation (TAC)** – EFRAG disagreed with the requirement for the deferral of regulatory returns on Capital Work-in-Progress (CWIP) charged to customers during construction (paragraph B15 of the ED). EFRAG also noted that, several stakeholders noted situations where the proposed requirements on TAC under paragraphs B3-B9 of the ED 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). EFRAG therefore recommended that the IASB further examine whether the requirements of paragraphs B3-B9 can be applied across diverse regulatory regimes.
 - (d) **Recognition and measurement** – EFRAG explained that some of EFRAG’s stakeholders reported concerns with high levels of uncertainty and 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). Regarding measurement, EFRAG supported the proposed cash-flow measurement technique. However, based on feedback received, EFRAG disagreed with:
 - (i) the proposed new concept of a minimum adequate rate as the discount rate for regulatory assets, when the regulatory interest rate provided is insufficient. Should the IASB decide to maintain this concept, EFRAG recommended that the IASB develop a rebuttable presumption; and
 - (ii) having different discounting approaches for regulatory assets and regulatory liabilities.
 - (e) **Presentation and Disclosure** – EFRAG agreed an entity should 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. EFRAG also generally agreed with the proposed overall disclosure objectives. However, EFRAG explained that several preparers had expressed possible operational difficulties to implement the detailed disclosure requirements and questioned whether users need such level of information. EFRAG therefore recommended the IASB to focus more on the usefulness of information provided and adopt a

more balanced disclosure approach by considering a prioritisation based on cost-benefit considerations and undertaking further outreach to users.

- (f) **Transition and effective date** – EFRAG recommended 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 (should the IASB decide to retain this proposal). EFRAG also recommended that the effective date should be 24-36 months after the publication of the final standard to allow effective implementation.