

This paper has been prepared by the EFRAG Secretariat for discussion at a public meeting of EFRAG FR TEG. 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 FRB or EFRAG FR TEG. 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 FRB, are published as comment letters, discussion or position papers, or in any other form considered appropriate in the circumstances.

IASB project - Regulatory Assets and Regulatory Liabilities Cover Note

Introduction

- 1 On 28 January 2021, the IASB published Exposure Draft ED/2021/1 *Regulatory Assets and Regulatory Liabilities* (the ED) with a comment period of 180 days and a comment deadline of 30 July 2021.
- 2 EFRAG published its [final comment letter](#) on the ED on 10 September 2021 and a [Feedback Statement](#) in October 2021.

Objective

- 3 The objective of this session is to discuss the IASB tentative decisions regarding total allowed compensation made during its redeliberations in October 2022 following the feedback to the ED on:
 - (a) Allowable expense and benchmark expenses (Agenda paper 10-02)
 - (b) Regulatory assets and regulatory liabilities arising from differences in regulatory recovery pace and assets' useful lives (Agenda paper 10-03).

- 4 Agenda papers 10-02 and 10-03 respectively are unchanged from Agenda papers 06-03 and 06-04 for the EFRAG FR TEG meeting held on 1 December 2022. The discussion on these papers was postponed to the January 2023 TEG meeting.
- 5 In December 2022, EFRAG FR TEG received a presentation from the IASB staff on the two main regulatory regimes present in Europe and beyond – namely cost-based and incentive-based regimes. The differences in these regimes are a key driver to the IASB's tentative decisions on total allowed compensation and whether an entity's regulatory capital base has a direct (no direct) relationship with its property, plant and equipment. This is further explained in more detail in Agenda paper 10-04 provided as background information.

Agenda Papers

- 6 In addition to this cover note, agenda papers for this session are:
 - (a) Agenda paper 10-02 – Allowable expense and benchmark expenses
 - (b) Agenda paper 10-03 – Regulatory assets and regulatory liabilities arising from differences in regulatory recovery pace and assets' useful lives.
 - (c) Agenda paper 10-04 – Background reading only – Use of the direct relationship concept – Overview (IASB agenda paper December 2022 AP9D)

Background

IASB discussions and tentative decisions so far

- 7 The IASB started to discuss respondents' feedback on the ED at its October and November 2021 meetings.
- 8 The 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 (proposed scope, total allowed compensation, and the discount rate);
 - (b) Topics that were well received (recognition, measurement, presentation and disclosure); and
 - (c) Other topics. These include transition and effective date, effects analysis and due process steps.
- 9 So far, the IASB has made tentative decisions in relation to scope and different aspects of total allowed compensation. The **appendix provides a summary of the IASB's tentative decisions** to date.
- 10 During 2022, the IASB staff has conducted targeted outreach to stakeholders in a selection of jurisdictions (e.g., the UK and Australia) where concerns were raised on the applicability of the proposals due to the type and diversity of their prevailing regulatory regimes.
- 11 The IASB has met with its Consultative Group for Rate Regulation (Consultative Group) on three occasions in 2022:
 - (a) 4 March 2022 – discussed discuss the ED's proposals on the accounting for regulatory returns on capital work in progress (CWIP), which is a component of the total allowed compensation
 - (b) 28 March 2022 - discussed possible courses of action related to when regulatory assets and regulatory liabilities arise due to differences between the regulatory pace of recovery and assets' useful lives
 - (c) 4 October 2022 – discussed the interaction between the IASB's tentative decision on regulatory returns on an asset not yet available for use and an entity's capitalisation of its borrowing costs and proposed accounting for inflation when a regulatory agreement adjusts the regulatory capital base for inflation.
- 12 The IASB has consulted with ASAF members on its redeliberation plans and tentative decisions at the following meetings:
 - (a) 31 March 2022 ASAF meeting – Scope of the final Standard
 - (b) 28 September 2022 ASAF meeting – Scope of the final Standard, and aspects of total allowed compensation (namely, components of total allowed compensation and regulatory returns on an asset not yet available for use).

EFRAG discussions

- 13 Between December 2021 and April 2022, EFRAG FR TEG, EFRAG CFSS and EFRAG FRB received updates on the IASB redeliberation plan and tentative decisions on the scope of the final Standard.
- 14 In April 2022, EFRAG met with its Rate-regulated Activities Working Group (RRAWG) to discuss the IASB tentative decisions on scope and the outcome of the IASB outreach to its Consultative Group in March 2022 (see paragraph 11).
- 15 In July 2022, EFRAG FR TEG received an update on the IASB tentative decisions on scope and total allowed compensation. At that meeting, EFRAG FR TEG

members briefly discussed the ‘differences between regulatory recovery pace and assets’ useful lives’, and it was then agreed that an education session would be useful as a prerequisite to a detailed discussion on total allowed compensation.

- 16 In September 2022, EFRAG FR TEG and EFRAG CFSS discussed the IASB’s tentative decisions taken in May, July, and September 2022 on scope and total allowed compensation (components of total allowed compensation and regulatory returns on assets not yet in use).
- 17 On 8 November 2022, EFRAG met with the RRAWG to discuss the IASB tentative decisions on scope and several aspects of total allowed compensation (including the topics that will be presented at the meeting today).
- 18 In December 2022, EFRAG FR TEG received a presentation from the IASB staff on the two main regulatory regimes present in Europe and beyond – namely cost-based and incentive-based regimes.
- 19 In December 2022, the EFRAG FRB received an update on the IASB tentative decisions from May 2022 – September 2022 (scope and aspects of the accounting for total allowed compensation).

Next steps

IASB

- 20 On 5 January 2023, the IASB staff sent a request to ASAF seeking input from preparers on the indicators that an entity could use to determine whether its regulatory capital base has a direct (no direct) relationship with its property, plant and equipment. The input will be used to develop application guidance that will form part of the final Standard on regulatory assets and regulatory liabilities. In the request, the IASB staff informed that to gather that input, they are developing a survey and would appreciate ASAF members’ assistance in identifying entities in their jurisdiction or region that would be interested in participating in the survey. The EFRAG Secretariat will discuss with the IASB staff how EFRAG could help facilitate and contribute to the outreach through interaction with EFRAG CFSS, EFRAG RRAWG members and other European stakeholders that have engaged with EFRAG on this project. The EFRAG Secretariat consider that it would be useful for EFRAG to be able to leverage on the feedback and results of the outreach for European companies.
- 21 So far, the IASB has redeliberated and made tentative decisions on most aspects of scope and total allowed compensation. The remaining topic for deliberation on scope is the interaction with IFRS 17 *Insurance Contracts*. As explained in the paragraph above, the IASB staff is currently undertaking outreach on direct (no direct) relationship. The IASB will redeliberate the remaining proposals on recognition, measurement, presentation and disclosure in 2023.

EFRAG

- 22 In Q1 2023, we expect to meet with the EFRAG RRAWG to discuss the IASB tentative decisions made since November 2022 (borrowing costs, inflation adjustments and performance incentives) and obtain further insight on the direct (no direct) relationship between regulatory capital base and property, plant and equipment.
- 23 The EFRAG Secretariat note that the concept of direct (no direct) relationship is a fundamental concept underpinning the IASB tentative decisions on total allowed compensation, which was not included in the ED. Based on our understanding introducing this concept in the accounting model is likely to result in less regulatory assets (liabilities) being recognised. The concept was introduced to help address application concerns noted during the IASB deliberation process. If EFRAG FR TEG

consider it useful, we could further explore this concept during the February 2023 EFRAG FR TEG meeting.

- 24 In March 2023, we expect to update EFRAG FR TEG on the IASB tentative decisions taken in November and December 2022 (borrowing costs, inflation adjustments and performance incentives) and the feedback from the EFRAG RRAWG on these tentative decisions.
- 25 The EFRAG Secretariat will continue to update the EFRAG FR TEG and EFRAG FRB as the project progresses.

Questions for EFRAG FR TEG members

- 26 Do EFRAG FR TEG members have any comments on the IASB discussions so far and the next steps by the IASB and EFRAG?

Appendix - Summary of the IASB tentative decisions

- 1 The table below provides an overview of IASB discussions and tentative decisions so far. This table was prepared based on the information published in the IASB Updates.

Topic	Decisions reached	Meeting Date
Feedback received on DP	At its meetings in October and November 2021, the IASB discussed the feedback received in comment letters and outreach events on its proposals in the ED.	October and November 2021
Project plan	The IASB discussed and agreed on a plan for redeliberating the proposals in its Exposure Draft Regulatory Assets and Regulatory Liabilities.	December 2021
Scope Including interaction with other IFRS Standards	<p>Determining whether a regulatory agreement is within the scope of the proposals</p> <p>The IASB tentatively decided to:</p> <ul style="list-style-type: none"> • reconfirm the proposals in the Exposure Draft on: <ul style="list-style-type: none"> ○ requiring an entity to apply the Standard to all its regulatory assets and regulatory liabilities. ○ requiring the Standard to apply to all regulatory agreements and not only to those that have a particular legal form. ○ the conditions necessary for a regulatory asset or a regulatory liability to exist. <p>Eleven of 12 IASB members agreed with these decisions</p> <ul style="list-style-type: none"> • not explicitly to specify in the Standard which regulatory schemes would be within or outside its scope. All 12 IASB members agreed with this decision. • to clarify in the Standard that: <ul style="list-style-type: none"> ○ a regulatory agreement may include enforceable rights and enforceable obligations to adjust the regulated rate beyond the current regulatory period. ○ regulatory agreements that create either regulatory assets or regulatory liabilities, but not both, are within its scope. ○ a regulatory agreement that causes differences in timing when a specified regulatory threshold is met creates regulatory assets or regulatory liabilities. ○ a regulatory agreement is not required to determine a regulated rate using an entity's specific costs for the regulatory agreement to create regulatory assets or regulatory liabilities. <p>All 12 IASB members agreed with these decisions</p> <p>Scope—Definition of a regulator</p> <p>The IASB tentatively decided that the Standard will:</p> <ul style="list-style-type: none"> ○ self-regulation is outside the scope of the Standard. 	February 2022

Regulatory assets and regulatory liabilities – Cover Note

<p>Total allowed compensation</p>	<p>Regulatory returns on an asset not yet available for use</p> <p>The IASB tentatively decided that the Standard specify that when an entity has an enforceable present right to regulatory returns on an asset not yet available for use, those returns would form part of the total allowed compensation for goods or services supplied during the construction period of that asset. The Standard will provide guidance for entities to assess whether their rights to these regulatory returns are enforceable.</p> <p>Eight of nine IASB members agreed with this decision. One IASB member was absent.</p>	<p>July 2022</p>
<p>Total allowed compensation</p>	<p>Proposed definition of allowable expense and treatment of allowable expenses based on benchmarks</p> <p>The IASB tentatively decided that the Standard:</p> <ul style="list-style-type: none"> • retain the proposed definition of allowable expense; • clarify that a regulatory agreement may determine the amount that compensates an entity for an allowable expense using a basis different from the basis the entity uses to measure the expense in accordance with IFRS Accounting Standards; and • clarify the treatment of allowable expenses based on benchmarks and include examples to help entities identify differences in timing in those cases. <p>All 11 IASB members agreed with these decisions.</p>	<p>October 2022</p>
<p>Total allowed compensation</p>	<p>Regulatory assets and regulatory liabilities arising from differences between the regulatory recovery period and the assets' useful lives</p> <p>The IASB tentatively decided that the Standard:</p> <ul style="list-style-type: none"> • provide guidance to help an entity determine whether its regulatory capital base and its property, plant and equipment have a direct relationship; • retain the proposals for an entity to account for regulatory assets or regulatory liabilities arising from differences between the regulatory recovery period and the assets' useful lives if the entity has concluded that its regulatory capital base and its property, plant and equipment have a direct relationship; and • require an entity that has concluded that its regulatory capital base and its property, plant and equipment have no direct relationship to provide disclosures to enable users of financial statements to understand the reasons for its conclusion. <p>All 11 IASB members agreed with these decisions.</p>	<p>October 2022</p>
<p>Total allowed compensation</p>	<p>Interaction between regulatory returns on an asset not yet available for use and an entity's capitalisation of borrowing costs incurred to construct that asset.</p> <p>In November 2022 the IASB discussed the interaction between the IASB's tentative decision on regulatory returns on an asset not yet available for use and an entity's capitalisation of borrowing costs incurred to construct that asset.</p>	<p>November 2022</p>

Regulatory assets and regulatory liabilities – Cover Note

	<p>The IASB tentatively decided that when an entity’s regulatory capital base and its property, plant and equipment have a direct relationship and the entity capitalises its borrowing costs:</p> <ul style="list-style-type: none"> • if the regulatory agreement provides the entity with both a debt and an equity return on an asset not yet available for use—to require the entity to reflect only those returns in excess of the entity’s capitalised borrowing costs in the statement of financial performance during the construction period; and • if the regulatory agreement provides the entity with only a debt return on such an asset—to prohibit the entity from reflecting the return in the statement of financial performance during the construction period. <p>All 11 IASB members agreed with these decisions.</p>	
<p><i>Total allowed compensation</i></p>	<p><i>Inflation adjustments and accounting for allowable expenses or performance incentives included in an entity’s regulatory capital base</i></p> <p><u>Inflation adjustments</u></p> <p>The IASB tentatively decided that the Standard specify that an entity is neither required nor permitted to recognise as a regulatory asset inflation adjustments to the regulatory capital base.</p> <p>All 12 IASB members agreed with this decision</p> <p><u>Other allowable expenses or performance incentives</u></p> <p>The IASB tentatively decided that the Standard specify that:</p> <ul style="list-style-type: none"> • an entity is required to recognise a regulatory asset or a regulatory liability relating to an allowable expense or performance incentive included in its regulatory capital base when: <ul style="list-style-type: none"> ○ the entity’s regulatory capital base and its property, plant and equipment have a direct relationship; and ○ the entity has an enforceable present right (obligation) to add (deduct) the allowable expense or performance incentive to (from) future regulated rates. • an entity is neither required nor permitted to recognise a regulatory asset or a regulatory liability relating to an allowable expense or performance incentive included in its regulatory capital base when the entity’s regulatory capital base and its property, plant and equipment have no direct relationship. <p>All 12 IASB members agreed with this decision.</p> <p>At the December 2022 meeting, the IASB also discussed the advice from the Consultative Group for Rate Regulation on the topics discussed in the December meeting; and the use of the direct (no direct) relationship concept in the IASB’s redeliberations of the proposed model</p>	<p>December 2022</p>