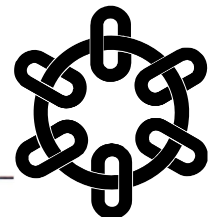
Norsk RegnskapsStiftelse



International Accounting Standards Board
Email: commentletters@ifrs.org

Cc: EFRAG

20 July 2021

Dear Sir/Madam

Comment letter to ED 2021/1 Regulatory Assets and Liabilities

Norsk Regnskapsstiftelse (the Norwegian Accounting Standards Board, NASB) welcomes the opportunity to submit its views on ED 2021/1: Regulatory Assets and Regulatory Liabilities.

In general, we support the proposals in the ED. The existence of a regulatory agreement gives rise to rights and obligations that in our opinion should be reflected in the financial statements.

The scope of the standard must be very clear, as the recognition and measurement rules are different from other standards. In this regard IASB should reassess whether there is a need for a definition of who might be a regulator. We are concerned of unintended consequences of entities being within scope that should not be or vice versa.

We have some concerns about how the regulation should be put into practice for cost recoveries where there is a time lag between when the cost is expensed and when it affects the regulated cost base and thereby the allowed rate. Also, we encourage IASB to look into situations where there is a "standard cost" or "benchmark cost" that replaces the actual cost for some of the operations. We provide more details in the enclosed comments and appendix to this letter.

We are concerned about the suggested retrospective implementation method. We believe this would not be feasible in practice and expect that some reliefs or modified transition methods are introduced in the final standard.

Lastly, in order to meet user needs and support a smooth implementation and consistent application, it would be helpful if IASB provides examples that are more realistic and not as simple as those currently included.

We stand ready to discuss further the issues raised in this paper.

Yours faithfully,

Bjørn Einar Strandberg
Chair of the Technical Committee on IFRS

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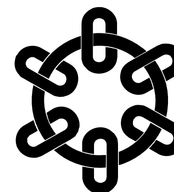


Question 1—Objective and scope
Paragraph 1 of the Exposure Draft sets out the proposed objective: an entity should provide relevant information that faithfully represents how regulatory income and regulatory expense affect the entity's financial performance, and how regulatory assets and regulatory liabilities affect its financial position.

Paragraph 3 of the Exposure Draft proposes that an entity apply the [draft] Standard to all its regulatory assets and all its regulatory liabilities. Regulatory assets and regulatory liabilities are created by a regulatory agreement that determines the regulated rate in such a way that part of the total allowed compensation for goods or services supplied in one period is charged to customers through the regulated rates for goods or services supplied in a different period (past or future).1 The [draft] Standard would not apply to any other rights or obligations created by the regulatory agreement—an entity would continue to apply other IFRS Standards in accounting for the effects of those other rights or obligations.

Paragraphs BC78–BC86 of the Basis for Conclusions describe the reasoning behind the Board's proposals. They also explain why the Exposure Draft does not restrict the scope of the proposed requirements to apply only to regulatory agreements with a particular legal form or only to those enforced by a regulator with particular attributes.

(a) Do you agree with the objective of the Exposure Draft? Why or why not?

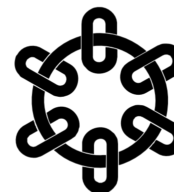
Yes. We believe the draft will improve the measurement of performance when there is a different timing of revenue in accordance with IFRS 15 and total allowed compensation. We agree that when the entity has an enforceable right or liability to increase or deduct an amount in the future rates towards its customers based on past transactions, this should affect the measurement of income in the same period as the services are delivered.

(b) Do you agree with the proposed scope of the Exposure Draft? Why or why not? If not, what scope do you suggest and why?

In general, we are supportive of how the scope has been set. We are satisfied that the features of the DP in BC83 has been abandoned as a scoping criterion. However, we are of the opinion that it would be beneficial to also define who may be a 'regulator'. We sense that the 'regulator' should have some attributes of a governmental body or an entity with delegated authority. Rights and obligations from contracts between private entities should not in general qualify.

Our analysis has focused on the only major industry in Norway that seem to be affected, namely operators of the Norwegian electric grid. We would expect these operators to be within the scope of the [draft] Standard, but have come across some issues that we want to bring to your attention:

ED 6 (b) states that the regulatory agreement <u>determines the regulated rate</u>. We understand this description to be interpreted widely, by setting a clear overall allowed



income to be charged to the customers. The operator may still be free to set the rates per unit for each individual period, but need to over time be within the allowed income

(c) Do you agree that the proposals in the Exposure Draft are clear enough to enable an entity to determine whether a regulatory agreement gives rise to regulatory assets and regulatory liabilities? If not, what additional requirements do you recommend and why?

In general, we believe the proposals are clear enough. But when explaining how the ED works, we believe that the example used in para 13 is so simple that it would not be seen in practice. But the example illustrates the main principles and we assume that due to the complexities of various regulated regimes around the world, this principle needs to be adapted and interpreted. When interpreting the standard, we note that the objective is to provide useful information about the effect on financial performance and not only its financial position. We believe that some of the interpretation issues may be more easily solved by looking at the financial performance for the period.

(d) Do you agree that the requirements proposed in the Exposure Draft should apply to all regulatory agreements and not only to those that have a particular legal form or those enforced by a regulator with particular attributes? Why or why not? If not, how and why should the Board specify what form a regulatory agreement should have, and how and why should it define a regulator?

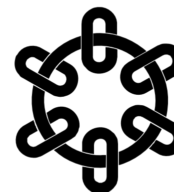
See our response to 1 (b).

(e) Have you identified any situations in which the proposed requirements would affect activities that you do not view as subject to rate regulation? If so, please describe the situations, state whether you have any concerns about those effects and explain what your concerns are.

None identified or observed at the current time.

(f) Do you agree that an entity should not recognise any assets or liabilities created by a regulatory agreement other than regulatory assets and regulatory liabilities and other assets and liabilities, if any, that are already required or permitted to be recognised by IFRS Standards?

Yes, we agree. No other assets and liabilities apart from the regulatory assets and liabilities should be recognised due to the ED.



Question 2—Regulatory assets and regulatory liabilities

The Exposure Draft defines a regulatory asset as an enforceable present right, created by a regulatory agreement, to add an amount in determining a regulated rate to be charged to customers in future periods because part of the total allowed compensation for goods or services already supplied will be included in revenue in the future.

The Exposure Draft defines a regulatory liability as an enforceable present obligation, created by a regulatory agreement, to deduct an amount in determining a regulated rate to be charged to customers in future periods because the revenue already recognised includes an amount that will provide part of the total allowed compensation for goods or services to be supplied in the future.

Paragraphs BC36–BC62 of the Basis for Conclusions discuss what regulatory assets and regulatory liabilities are and why the Board proposes that an entity account for them separately.

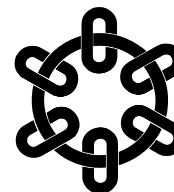
(a) Do you agree with the proposed definitions? Why or why not? If not, what changes do you suggest and why?

Yes, we believe definitions are workable.

We have an example from the Norwegian grid that illustrates a situation that may fall outside the definition. If two grid operators merge, the new total allowed compensation will be lower than the sum of the total allowed compensation for the two before the merger. This is due to a more demanding benchmark for larger operators than for small. The regulator compensates for this disadvantage by giving the merged company a right to charge the net present value of the difference for the first 30 years. This amount is not segregated from other underbilling and accrues interest and may be included in the rates when the operator chooses to.

As this 'merge compensation' does not arise from the delivery of core goods or services, but of the merger itself, it seems to fall outside the definition of a regulatory asset.

(b) The proposed definitions refer to total allowed compensation for goods or services. Total allowed compensation would include the recovery of allowable expenses and a profit component (paragraphs BC87–BC113 of the Basis for Conclusions). This concept differs from the concepts underlying some current accounting approaches for the effects of rate regulation, which focus on cost deferral and may not involve a profit component (paragraphs BC224 and BC233–BC244 of the Basis for Conclusions). Do you agree with the focus on total allowed compensation, including both the recovery of allowable expenses and a profit component? Why or why not?



Yes, we agree that the focus should be on total allowed compensation. Over time the total allowed compensation and the amount billed to customers should be equal.

We have some concerns relating to the practical determination of the total allowed compensation for the period and refer to our response to question 3 (b) below.

(c) Do you agree that regulatory assets and regulatory liabilities meet the definitions of assets and liabilities within the Conceptual Framework for Financial Reporting (paragraphs BC37–BC47)? Why or why not?

While there may be different views with regard to whether regulatory assets and liabilities qualifies as assets and liabilities under the Conceptual Framework, we support the Boards work to clarify the basis for recognising these items as assets and liabilities through standard setting

(d) Do you agree that an entity should account for regulatory assets and regulatory liabilities separately from the rest of the regulatory agreement (paragraphs BC58–BC62)? Why or why not?

Yes, we agree. In theory, the concession or licence to operate are the real economic value in the long for a regulated business. Such concessions may be recognised in the accounts if the entity has been acquired in a business combination. This asset should not be mixed with more short-term regulatory balances.

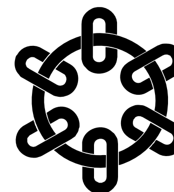
(e) Have you identified any situations in which the proposed definitions would result in regulatory assets or regulatory liabilities being recognised when their recognition would provide information that is not useful to users of financial statements?

None identified as of today.

Question 3—Total allowed compensation

Paragraphs B3–B27 of the Exposure Draft set out how an entity would determine whether components of total allowed compensation included in determining the regulated rates charged to customers in a period, and hence included in the revenue recognised in the period, relate to goods or services supplied in the same period, or to goods or services supplied in a different period. Paragraphs BC87–BC113 of the Basis for Conclusions explain the reasoning behind the Board’s proposals.

(a) Do you agree with the proposed guidance on how an entity would determine total allowed compensation for goods or services supplied in a period if a regulatory agreement provides:



(i) regulatory returns calculated by applying a return rate to a base, such as a regulatory capital base (paragraphs B13–B14 and BC92–BC95)?

(ii) regulatory returns on a balance relating to assets not yet available for use (paragraphs B15 and BC96–BC100)?

(iii) performance incentives (paragraphs B16–B20 and BC101–BC110)?

Yes, we agree that B3-B27 are quite clear, for these three components.

We have identified that there may be different return rates for various timing differences, some are adjusted for inflation and some with a floating reference rate plus a margin. The practical application of the standard may therefore necessitate some simplifications or the use of a blended rate.

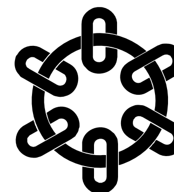
(b) Do you agree with how the proposed guidance in paragraphs B3–B27 would treat all components of total allowed compensation not listed in question 3(a)? Why or why not? If not, what approach do you recommend and why?

We agree with the guidance as proposed and find it to be well articulated and useful for target profit, including both performance incentives and regulatory returns.

The guidance for cost recovery is more difficult to use in practice. We like to draw your attention to the two following scenarios drawn from the Norwegian grid:

- *The cost recovery is regulated by the regulator using the costs of year 1 to set the allowed compensation for year 3. If there is a general increase in cost over time (due to inflation etc.) there will always be a deferred asset element in the balance sheet. It will only be recovered if the cost base comes back to the level at the first year of the regulatory regime. (This also provides a difficulty in the implementation of the standard when using it retrospectively.) We understand that the measurement rules will probably restrict the asset from being presented in the balance sheet when using a DCF-model. (See appendix example 2).*

- *In our national grid only 40% of the allowable costs are recovered by affecting the regulated allowed income two years later. The remaining cost compensation is based on benchmark numbers from a peer group (where the operator may be one of those, or even a large operator of that group). In this situation it is difficult to establish which costs that may be recovered, and whether other operator's costs for the period should have effect on the total allowable compensation. (See appendix example 1)*



- *When the expenses of a peer-group for the period affects the regulated income for the same period, the estimation of the amount of expenses incurred by other entities in the peer group may be challenging as that information typically will not be available.*

(c) Should the Board provide any further guidance on how to apply the concept of total allowed compensation? If so, what guidance is needed and why?

Yes, we think that an example of a time lag and for a situation where some of the costs to be recovered are based on a benchmark, as described for our national grid would be welcomed as this may be a quite typical scenario.

Question 4—Recognition

Paragraphs 25–28 of the Exposure Draft propose that:

• an entity recognises all its regulatory assets and regulatory liabilities; and

• if it is uncertain whether a regulatory asset or regulatory liability exists, an entity should recognise that regulatory asset or regulatory liability if it is more likely than not that it exists. It could be certain that a regulatory asset or regulatory liability exists even if it is uncertain whether that asset or liability will ultimately generate any inflows or outflows of cash. Uncertainty of outcome would be addressed in measurement (Question 5).

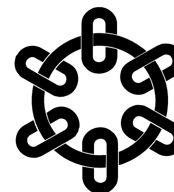
Paragraphs BC122–BC129 of the Basis for Conclusions describe the reasoning behind the Board's proposals.

(a) Do you agree that an entity should recognise all its regulatory assets and regulatory liabilities? Why or why not?

Yes.

(b) Do you agree that a 'more likely than not' recognition threshold should apply when it is uncertain whether a regulatory asset or regulatory liability exists? Why or why not? If not, what recognition threshold do you suggest and why?

Yes, we support using the same likelihood for whether a regulatory asset or a regulatory liability should be recognised (similar to uncertain tax positions in IFRIC 23, and different from the general asymmetrical requirements in IAS 37).



Question 5—Measurement

Paragraph 29 of the Exposure Draft specifies the measurement basis. Paragraphs 29–45 of the Exposure Draft propose that an entity measure regulatory assets and regulatory liabilities at historical cost, modified by using updated estimates of future cash flows. An entity would implement that measurement basis by applying a cash-flow-based measurement technique. That technique would involve estimating future cash flows — including future cash flows arising from regulatory interest — and updating those estimates at the end of each reporting period to reflect conditions existing at that date.
The future cash flows would be discounted (in most cases at the regulatory interest rate — see Question 6). Paragraphs BC130–BC158 of the Basis for Conclusions describe the reasoning behind the Board's proposals.

(a) Do you agree with the proposed measurement basis? Why or why not? If not, what basis do you suggest and why?

Yes, we agree with the measurement basis.

However, we think the description in para 29 may be clarified. There is no explicit reference to initial recognition, but it seems to be historical cost, as the DCF model is the subsequent modification. We cannot see that any difference between the initial and subsequent measurement is warranted.

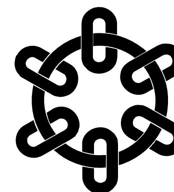
As we have described above (and in the example in Appendix 2), a time-lag in recovery of costs in an inflation scenario will lead to parts of the expenses never to be recovered, and it seems as this need to be taken into consideration on the initial measurement when using discounted cash flows. To defer the write-down to the subsequent measurement would be inappropriate.

(b) Do you agree with the proposed cash-flow-based measurement technique? Why or why not? If not, what technique do you suggest and why?

We generally support the use of a cash-flow-based measurement technique that reflect any uncertainty relating to the cash flow.

Some of our members would argue that a higher threshold for uncertain assets might we warranted, similar to variable consideration under IFRS 15. For the coherence of the standards, it is difficult to argue that an uncertain variable future income arising from a regulation is recognised at a higher amount than one stemming from a contract with a customer.

In some jurisdictions, the uncertainty connected to regulatory approval for certain items of expenses may be high (but less than 50 %), and the prudence of IFRS 15 may be warranted.



A different example may be incentive payments with duration over several periods. Using the more likely than not recognition criteria and a neutral cash-flow-based technique may lead to assets that have a significant risk of a material negative adjustment.

If cash flows arising from a regulatory asset or regulatory liability are uncertain, the Exposure Draft proposes that an entity estimate those cash flows applying whichever of two methods—the ‘most likely amount’ method or ‘expected value’ method—better predicts the cash flows. The entity should apply the chosen method consistently from initial recognition to recovery or fulfilment. Paragraphs BC136–BC139 of the Basis for Conclusions describe the reasoning behind the Board’s proposal.

(c) Do you agree with this proposal? Why or why not? If not, what approach do you suggest and why?

Yes, we agree.

Question 6—Discount rate

Paragraphs 46–49 of the Exposure Draft propose that an entity discount the estimated future cash flows used in measuring regulatory assets and regulatory liabilities. Except in specified circumstances, the discount rate would be the regulatory interest rate that the regulatory agreement provides. Paragraphs BC159–BC166 of the Basis for Conclusions describe the reasoning behind the Board’s proposals.

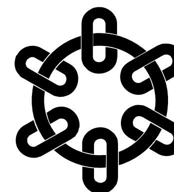
(a) Do you agree with these proposals? Why or why not? If not, what approach do you suggest and why?

Yes, regulatory rate and the discount rate should as the main rule be equal. As for our national grid, the regulatory rate aims at reflecting a normal WACC for such an operator.

Paragraphs 50–53 of the Exposure Draft set out proposed requirements for an entity to estimate the minimum interest rate and to use this rate to discount the estimated future cash flows if the regulatory interest rate provided for a regulatory asset is insufficient to compensate the entity. The Board is proposing no similar requirement for regulatory liabilities. For a regulatory liability, an entity would use the regulatory interest rate as the discount rate in all circumstances. Paragraphs BC167–BC170 of the Basis for Conclusions describe the reasoning behind the Board’s proposals.

(b) Do you agree with these proposed requirements for cases when the regulatory interest rate provided for a regulatory asset is insufficient? Why or why not?

Yes, even if this might complicate the use of the standard.



(c) Have you identified any other situations in which it would be appropriate to use a discount rate that is not the regulatory interest rate? If so, please describe the situations, state what discount rate you recommend and explain why it would be a more appropriate discount rate than the regulatory interest rate.

We have not identified such situations.

Paragraph 54 of the Exposure Draft addresses cases when a regulatory agreement provides regulatory interest unevenly by applying a series of different regulatory interest rates in successive periods. It proposes that an entity should translate those rates into a single discount rate for use throughout the life of the regulatory asset or regulatory liability.

(d) Do you agree with the proposal? Why or why not? If not, what do you recommend and why?

We have no comment to this, as we have not yet recognised any situations where this is applicable in our jurisdiction.

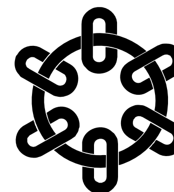
Question 7—Items affecting regulated rates only when related cash is paid or Received

In some cases, a regulatory agreement includes an item of expense or income in determining the regulated rates in the period only when an entity pays or receives the related cash, or soon after that, instead of when the entity recognises that item as expense or income in its financial statements. Paragraphs 59–66 of the Exposure Draft propose that in such cases, an entity would measure any resulting regulatory asset or regulatory liability using the measurement basis that the entity would use in measuring the related liability or related asset by applying IFRS Standards. An entity would adjust that measurement to reflect any uncertainty that is present in the regulatory asset or regulatory liability but not present in the related liability or related asset. Paragraphs BC174–BC177 of the Basis for Conclusions describe the reasoning behind the Board’s proposals.

(a) Do you agree with the measurement proposals when items of expense or income affect regulated rates only when related cash is paid or received? Why or why not? If not, what approach do you suggest for such items and why?

Yes.

When these measurement proposals apply and result in regulatory income or regulatory expense arising from remeasuring the related liability or related asset through other comprehensive income, paragraph 69 of the Exposure Draft proposes



that an entity would also present the resulting regulatory income or regulatory expense in other comprehensive income. Paragraphs BC183–BC186 of the Basis for Conclusions describe the reasoning behind the Board's proposal.

(b) Do you agree with the proposal to present regulatory income or regulatory expense in other comprehensive income in this case? Why or why not? If not, what approach do you suggest and why?

Yes, we agree that it should follow the classification of the underlying expense.

Question 8—Presentation in the statement(s) of financial performance

Paragraph 67 of the Exposure Draft proposes that an entity present all regulatory income minus all regulatory expense as a separate line item immediately below revenue. Paragraph 68 proposes that regulatory income includes regulatory interest income and regulatory expense includes regulatory interest expense. Paragraphs BC178–BC182 of the Basis for Conclusions describe the reasoning behind the Board's proposals.

(a) Do you agree that an entity should present all regulatory income minus all regulatory expense as a separate line item immediately below revenue (except in the case described in Question 7(b))? Why or why not? If not, what approach do you suggest and why?

Yes, we agree. While these items are not revenue in itself, its major function is to adjust the revenue recognised according to IFRS 15 for timing differences.

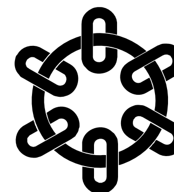
(b) Do you agree with the proposed inclusion of regulatory interest income and regulatory interest expense within the line item immediately below revenue? Why or why not? If not, what approach do you suggest and why?

Yes, we agree in order to simplify the accounting. In theory we are less supportive.

Question 9—Disclosure

Paragraph 72 of the Exposure Draft describes the proposed overall objective of the disclosure requirements. That objective focuses on information about an entity's regulatory income, regulatory expense, regulatory assets and regulatory liabilities, for reasons explained in paragraphs BC187–BC202 of the Basis for Conclusions. The Board does not propose a broader objective of providing users of financial statements with information about the nature of the regulatory agreement, the risks associated with it and its effects on the entity's financial performance, financial position or cash flows.

(a) Do you agree that the overall disclosure objective should focus on information about an entity's regulatory income, regulatory expense, regulatory assets and



regulatory liabilities? Why or why not? If not, what focus do you suggest and why?

Yes. If the risks associated with the regulatory agreement is significant, IAS 1 and general disclosure requirements may warrant a more extensive package of information. There is no need to duplicate such requirements in the ED.

(b) Do you have any other comments on the proposed overall disclosure objective? Paragraphs 77–83 of the Exposure Draft set out the Board's proposals for specific disclosure objectives and disclosure requirements.

We question whether the requirements in the notes shall be disclosed per regulation or in aggregate for several operations or subsidiaries. What if all operations, while keeping separate records vis-à-vis the regulator, are under the same regulatory framework? Should the amounts be presented net or gross in the notes? This is a question of the unit of account for disclosure purposes.

Further, we note the details required in paragraph 78 (a)-(d) and cannot see that all four components may be applicable for one unit of account simultaneously. For one period there can only be a reduction in the regulatory asset and only the creation of a regulatory liability if the current year's difference is larger than the opening regulatory asset and vice versa.

(c) Do you have any comments on these proposals? Should any other disclosures be required? If so, how would requiring those other disclosures help an entity better meet the proposed disclosure objectives?

No.

(d) Are the proposed overall and specific disclosure objectives and disclosure requirements worded in a way that would make it possible for preparers, auditors, regulators and enforcement bodies to assess whether information disclosed is sufficient to meet those objectives?

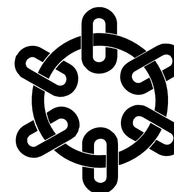
See our comments above.

Question 10—Effective date and transition

Appendix C to the Exposure Draft describes the proposed transition requirements. Paragraphs BC203–BC213 of the Basis for Conclusions describe the reasoning behind the Board's proposals.

(a) Do you agree with these proposals?

(b) Do you have any comments you wish the Board to consider when it sets the effective date for the Standard?



We believe that a full retrospective implementation is too complex and burdensome for most entities. As described above and in appendix 2, in situations with a time-lag and increase in prices, to identify the historical cost of the regulatory asset there is a need to go back to the beginning of the regulatory regime, with adjustments in the regulatory regime that may have taken place multiple times. A practical expedient to measure the regulatory assets and liabilities at the opening balance of the comparative period at the DCF amount would be welcomed.
Due to the complexity of the standard, the effective dates should be set providing a longer period than normal to prepare for the implementation.

Question 11—Other IFRS Standards

Paragraphs B41–B47 of the Exposure Draft propose guidance on how the proposed requirements would interact with the requirements of other IFRS Standards. Appendix D to the Exposure Draft proposes amendments to other IFRS Standards. Paragraphs BC252–BC266 of the Basis for Conclusions describe the reasoning behind the Board's proposals.

(a) Do you have any comments on these proposals? Should the Board provide any further guidance on how the requirements proposed in the Exposure Draft would interact with any other IFRS Standards? If yes, what is needed and why?

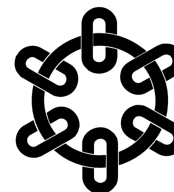
We note that in explaining the effects of tax expense on the regulated income or expense for the period, the wording uses an initial estimate of the tax expense, with variations to actual tax expense as giving rise to a regulatory asset or liability for the period. Based on the general reading of the ED, this is different from the way cost recovery is described. This may cause some confusion. If all income taxes are recoverable, we cannot see that this is different than any other costs, meaning that the IFRS expense for the period determines the amount of the total allowed compensation, and thereby the regulatory asset or liability for the period.

Without doing a detailed analysis, we question whether there may be an iterative process in arriving at the amount recognised, as the regulatory asset itself typically creates a temporary difference that affects the tax expense?

As for B45-B46 we are not satisfied with the line of reasoning. In B45 it states clearly that the measurement of the regulatory asset is based on cash flows after tax. The example in B46 continues this line of reasoning, but concludes (surprisingly in the context of the preceding text) that this should be presented gross based on the pre-tax cash flows with the tax effect as a deferred tax liability. We think these two paragraphs may confuse readers.

(b) Do you have any comments on the proposed amendments to other IFRS Standards?

We have no comments.



Question 12—Likely effects of the proposals

Paragraphs BC214–BC251 of the Basis for Conclusions set out the Board's analysis of the likely effects of implementing the Board's proposals.

(a) Paragraphs BC222–BC244 provide the Board's analysis of the likely effects of implementing the proposals on information reported in the financial statements and on the quality of financial reporting. Do you agree with this analysis? Why or why not? If not, with which aspects of the analysis do you disagree and why?

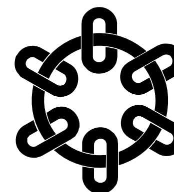
We have no comments.

(b) Paragraphs BC245–BC250 provide the Board's analysis of the likely costs of implementing the proposals. Do you agree with this analysis? Why or why not? If not, with which aspects of the analysis do you disagree and why?

We think that the initial adoption of the ED may be quite costly for entities as specifics of the regulatory agreements and the particular workings of how the total allowed compensation is arrived at may be complex. There is also current costs of maintaining the regulatory accounts in the financial statements that may be significant. While the Norwegian regulation seem to be quite predictable, other countries may have short concession period, uncertainties in the regulatory regime, higher political risk and uncertainties around the final determination of the allowed compensation. The cost may therefore differ from jurisdiction to jurisdiction and entity to entity.

(c) Do you have any other comments on how the Board should assess whether the likely benefits of implementing the proposals outweigh the likely costs of implementing them or on any other factors the Board should consider in analysing the likely effects?

On balance we believe that the benefits outweigh the cost of presenting the information.



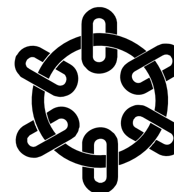
Question 13—Other comments

Do you have any other comments on the proposals in the Exposure Draft or on the Illustrative Examples accompanying the Exposure Draft?

As described above, we believe that there should be given more examples that reflects some of the complexities arising in practice.

We also notice that the ED does not intend to regulate the recognition and measurement of allowable expenses. A large part of a regional operator's cost base is the payment to the national grid. The income of the national grid will be within the scope of the ED, while the cost for the regional operators that this income represents will only be measured following the general recognition criteria (being the tariff applicable for the volume delivered in a period).

We agree not to include similar standard setting for the expense side as this would make the ED too complex, and only lead to grossing up numbers in the accounts. We note that this asymmetry may create a problem for national statistics though.



Appendix

The Norwegian regulation of operators of the electric network uses an incentive-based model that is more complex than the regulation presented in the examples of the ED and the accompanied Illustrative Examples. In the Norwegian model the recoverable expenses are calculated based on a formula of 40% cost recovery and 60% cost norm resulting from benchmarking models. There is a two-year lag in most of the cost data, but the model also uses data from the year under regulation for some costs.

We illustrate two of these issues in isolation.

1. **Expenses recovered through benchmarking analysis**

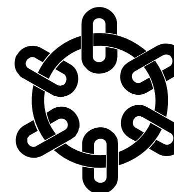
According to the regulatory agreement an entity's recoverable expenses will be compensated based on a formula of 40% cost recovery and 60% based on a cost norm derived from benchmarking models:

	Total expenses	Percentage recoverable	Allowed compensation
Entity's own expenses	100	40 %	40
Benchmark norm expenses	90	60 %	54
Total allowed compensation according to regulatory agreement			94

The ED is silent on how recovery of expenses based on benchmark figures should be treated. It may be a combination of performance incentives regulated by B17 and a recovery of allowable expenses regulated by B4. The use of a benchmark figure works as an incentive to be more efficient than its peers.

Should the actual expenses of its peers for the year in question be estimated and included in the estimate for the total allowed compensation for the year? Are other entities transactions a basis for identifying a regulatory asset, or should the entity wait until the regulator in fact approves a higher benchmark norm based on reported expenses for the period (which may be a year or two later)?

In fact, the entity itself is usually one of the members of the benchmark group, and as such a portion of the benchmark expenses may be derived from the entity's actual costs.



2. **Allowable expenses determine allowed compensation with a time lag**

ED13 and ED14 provides an example where the under-recovery of input costs in year 1 is added to the regulated rate for year 2. This means that the entity will receive full recovery of input costs over time.

However, in this example the regulatory allowable compensation for a single year is set by the regulator based on the actual costs of the year before. There is no true up for the year if actual costs deviate from the assumptions inherent in the allowable compensation set by the regulator, but the next period's allowable compensation will be based on this period's actual expenses. Over time actual expenses will be recovered, but with a time lag, but with the deviation between the costs of the first year in the regime and the current year never to be recovered if nominal prices increase.

	yr0	**yr1**	**yr2**	**yr3**
Actual expenses for the year	100	105	110	115
Allowed compensation set by regulator		100	105	110
Total allowed compensation as per the ED		105	110	115
Billed		100	105	110
Underbilling/overbilling recognised by regulator		0	0	0
Regulatory asset according to ED (at 'cost')		5	10	15
Subsequent measurement of regulatory asset (at DCF)		~0	~0	~0

We believe that there is a basis for recognising a regulatory asset in this case, as any cost deviation in the current period will affect future rates.

However, as can be seen from the table, in a situation with general price increase in the society, the regulatory asset created each year will just accumulate over time, and never be recovered unless prices and cost levels decline back to year 0. Based on the measurement using the DCF-model, this component will therefore likely be measured at zero.