IEAF International Energy Accounting Forum

International Accounting Standards Board (IASB)
Andreas Barckow, Chair
Columbus Building
7 Westferry Circus, Canary Wharf
London E14 4HD
United Kingdom

Brussels, August 3, 2021

IASB's Exposure Draft Regulatory Assets and Regulatory Liabilities (ED)

Dear Mr Barckow,

The International Energy Accounting Forum (hereafter "IEAF") thank you for the opportunity to respond to the ***Exposure Draft Regulatory Assets and Regulatory Liabilities (ED/2021/1)***.

The IEAF consists of the major European energy companies (see our members' list in **Appendix 1**). The goal of the IEAF is to discuss and formulate best practices, to reduce areas of difference in accounting in the sector, to advocate the energy industry's point of view and to make specialist energy industry knowledge available to the International Accounting Standards Board and other Standard setters.

Our members unanimously welcome the ED and acknowledge the efforts made by the staff and the Board for this long-term project, that the IEAF has followed as early as the 1st ED of 2009; quasi all members are impacted and most have contributed to preparing this comment letter – for which I warmly thank them.

Since regulations differ across our jurisdictions (and even within the same jurisdiction), our members have different attention points (highlighted in their own comment letters for some): however, there are many issues on which we have reached a consensus and that are explained in detail in Appendix 2 of this letter.

Our key recommendation is that IFRS financial statements should reflect the true economics of the underlying regulatory agreements as well as the performance of the entities recognising regulatory assets and regulatory liabilities.

This has led us to the main following views:

- we agree with the total allowed compensation including a profit component, even though a minority of our members believe that an alternative cost deferral approach could have been chosen, in line with FASB Accounting Standards Codification® Regulated Operations (topic 980). However, when this profit component includes regulatory returns on assets not yet available for use, which are granted by the regulator during the construction phase, we do not agree with the guidance proposed in the ED to defer the returns to the operational period of said assets. Neither do we agree with that proposed in case of misalignment between the regulatory recovery period and the asset's useful life according to IAS 16.

- we agree (except a minority view) that the proposed measurement technique would provide useful information about an entity's regulatory assets and regulatory liabilities, and the respective regulatory income and regulatory expense. Some essential aspects of the proposed cash-flow-based measurement technique rely on the notion of enforceability and boundary, which the assessment could be challenging.

- Regarding discount rate, albeit we believe the principle of discounting future cash flows would provide more comparable and understandable information to users of financial statements, we are concerned by the potential complexity of its determination as proposed in specified circumstances: we would thus recommend the Board to give up the exception to the use of the regulatory interest rate and provide clarification for situations where the regulatory interest rate is not set for the full term of forecast cash flows.

Regarding disclosures, even if the ED states that '*an entity shall determine the level of detail necessary to satisfy the overall disclosure objective and the specific disclosure objectives […]*', we fear that the detailed information required in the ED, could be interpreted as checklists.

Finally, we wish to highlight the complexity of the full retrospective method to be applied on first application and that relating to the application of the proposals, especially for interim financial reporting. We thus consider that the effective date should be set between 24 months at the earliest to 36 months after the future Standard is issued, with early application still being permitted.

We thank you to consider these comments as well as our other observations and suggestions in Appendix 2 and hope you will find them useful.

If you require any clarification or information, please do not hesitate to contact us at isabelle.nuss@engie.com.

Yours sincerely,

On behalf of the International Energy Accounting Forum,
Jonathan Susin
Tel: +32 2 518 65 87 / Email: jonathan.susin@engie.com

Appendix 1: Members of the International Energy Accounting Forum

– Alpiq	www.alpiq.de
– Axpo	www.axpo.ch
– EDF	www.edf.com
– EnBW	www.enbw.com
– Energie Steiermark AG	www.e-steiermark.com
– Engie	www.engie.com
– EWE	www.ewe.de
– Fortum	www.fortum.com
– Gas Natural	www.gasnatural.com
– Gazprom Marketing & Trading	www.gazprom-mt.com
– Iberdrola	www.iberdrola.es
– Innogy SE	www.innogy.com
– OMV	www.omv.com
– Ørsted	www.orsted.com
– Royal Dutch Shell	www.shell.com
– RWE	www.rwe.com
– Scottish Power	www.scottishpower.com
– Solvay Energy Services	www.solvay-energy.com
– TenneT	www.tennet.eu
– Unesa	www.unesa.es
– Vattenfall	www.vattenfall.com
– Verbund	www.verbund.com
– Veolia	www.veolia.com

This comment letter has also been endorsed by 50Hertz (www.50herz.com), E.ON (www.eon.com), National Grid (www.nationalgrid.com) and Suez (www.suez.com).

Appendix 2 to comment letter on Exposure Draft Regulatory Assets and Regulatory Liabilities (ED/2021/1)

Note: we have only kept the questions for which we have made comments, which explains why Questions 1, 4 and 8 are not shown in the contents below.

Contents

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?

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?

1. We agree with the focus on total allowed compensation, including in particular a profit component.

2. However, a minority of our members believe that an alternative cost deferral approach could have been chosen, in line with FASB Accounting Standards Codification® Regulated Operations (topic 980). This alternative approach would also treat the timing differences and allow the recognition of relevant regulatory assets and regulatory liabilities. Regulatory assets would represent probable future revenues associated with currently incurred costs that are expected to be recovered in the future from customers through the rate-making process; regulatory liabilities would represent probable future reductions in revenues associated with amounts that are to be refunded to customers through the rate-making process.

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?

3. We agree that regulatory assets and regulatory liabilities meet the definitions of assets and liabilities under the *Conceptual Framework for Financial Reporting*.

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?

4. We agree that an entity should account for them separately from the rest of rights and obligations arising from the regulatory agreement.

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?

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)?

5. We do not agree with the guidance proposed in the ED regarding the treatment of regulatory returns on assets not yet available for use.

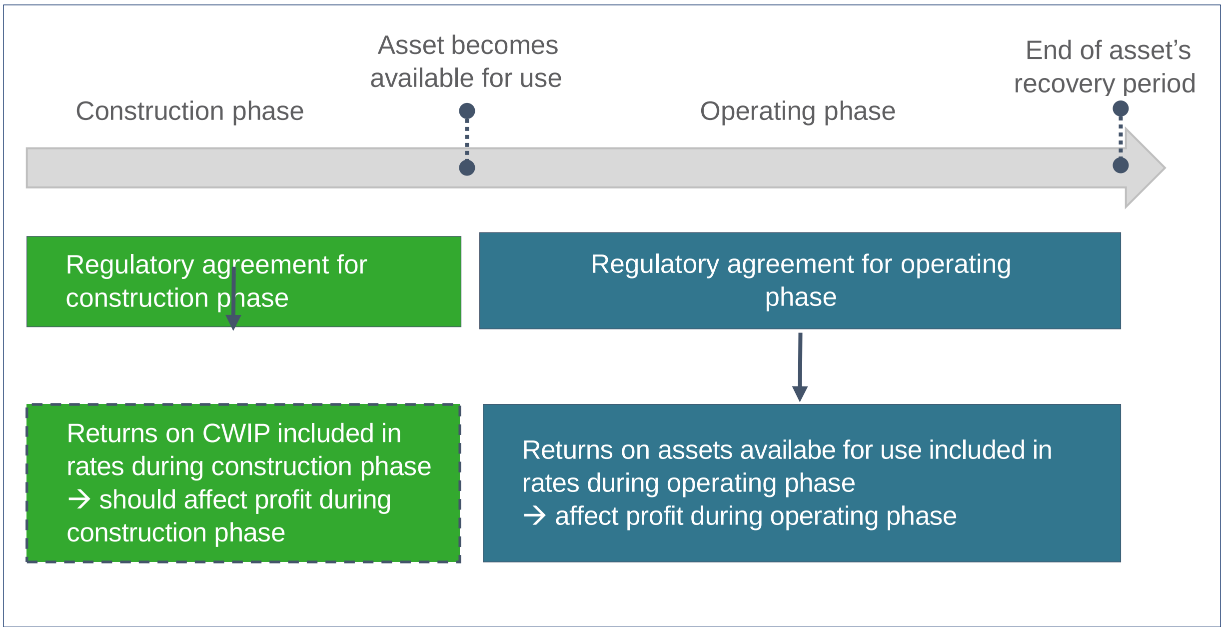
6. There are explicit regulatory agreements in some of our members' jurisdictions that provide for regulatory returns during the construction phase (see below paragraph 9 and following) and create enforceable rights: we thus consider it more in line with the ED's objective to recognise said returns during the construction phase.

7. In our view, the guidance proposed in the ED for these assets (hereafter referred to as CWIP or construction work in progress) is not in line with the proposed objective of the future Standard that is '*to 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 1 of the ED) (see below paragraph 15 and following).

8. Further, we believe that this guidance is not in line with the ED's definition of a regulatory liability (see below paragraph 18 and following), given the deferral of the revenue would not result in an adjustment to rates charged to customers in a future period. This proposed treatment therefore takes you further away from underlying regulatory agreements and the overall cost-benefit consideration of applying this proposal would be negative (see below paragraph 21 and following).

Regulatory agreements giving rise to regulatory returns during construction phase

9. As illustrated in the graph below, in some jurisdictions, there are separate regulatory agreements that apply to the construction phase and those that apply to the operational phase of an asset. During the construction phase, the regulatory agreement allows regulatory returns on invested capital and these returns are already included in the rates charged to customers during this phase. However, for the operational phase, once the asset is completed, a different regulatory agreement applies that allows for regulatory returns in relation to the assets in use.



10. For CWIP and where the regulatory agreement allows regulatory returns to be charged to customers while an asset is under construction, we strongly believe – contrary to the proposal in the ED – that these regulatory returns should be included in the total allowed compensation **during the construction phase of the asset**.

11. In several jurisdictions, for example Germany and The Netherlands, rate-regulated companies operating in the energy sector are entitled by law to get a regulatory return during construction phase of the asset. Within this explicit regulatory framework for certain investments[1], a regulatory return covering, amongst other things, interest on equity in connection to the invested capital and interest on borrowing costs can be claimed without time-lag. The regulatory returns relating to the construction phase do not cover any reimbursements on anticipated depreciation. According to the regulatory agreement for the construction phase of the asset, the regulatory return is granted e.g. for the grid expansion, which is a part of a transmission system operator's performance obligation. For this regulatory return, it is irrelevant whether goods or services are

[1] e.g. the regulatory mechanism is called 'investment measure' in Germany and 'RCR-projects' in the Netherlands.

supplied to the customer using the completed asset. Once the asset is available for use, there is **another** regulatory agreement applicable covering the returns on assets available for use and is included in the rates charged during the operating phase.

12. Whilst we take note of the Board's considerations described in paragraph BC98, we do not share that view. In our opinion, it would not contradict the model's principles in paragraph BC30 if the regulatory returns on CWIP would be part of the total allowed compensation for goods or services supplied when the asset is not yet available for use. From a regulatory perspective (as described above), the construction as such and the provision of capital by the regulated company are already the relevant services supplied to the customer.

13. Further, we believe that comparability reasons do not justify the reduction of the relevance of information resulting from the guidance of the Board in paragraphs B15 and BC96-BC100.

14. An asymmetry is also noted whereby paragraph B18 of the ED allows recognition of performance incentives as construction takes place but not regulatory returns, despite underlying regulatory agreements entitling an entity to both elements during the construction phase.

Not in line with the ED's objective and relevance of information

15. As a result of not reflecting the regulatory returns on CWIP granted by a regulatory agreement during the construction phase in the entity's reported performance (profit or loss), we think that the guidance in paragraphs B15 and BC96-BC100 of the ED would lead to financial statements not providing the most relevant information. As the cash flows resulting from the regulatory returns on CWIP are already received during construction phase, the current guidance on CWIP proposed in the ED would not give better insights or an understanding of how regulatory assets and regulatory liabilities will affect the amount, timing and uncertainty of the entity's future cash flows. Moreover, the recognition of a regulatory liability as described in paragraph BC99 would even imply that there will be a cash outflow in future periods which actually will never happen.

16. The usefulness of information for users would also be limited due to distorting effects of the proposal on the balance sheet as well as profit and loss. A true and fair presentation of all financial effects resulting from regulated business activities and providing the most relevant information is crucial for the users of financial statements, especially to attract new investors to access additional financing for facilitating and enabling the energy transition, and in light of the dynamic development of the energy sector in the near future. The proposed treatment would result in a regulatory liability being recognised on the balance sheet over the total investment period, being released over the period in which the entity recovers the carrying amount of the asset through the regulated rates, without having any underlying regulatory obligation to include the revenues the regulated company is entitled to during the construction phase as a reduction in future tariffs. Furthermore, the proposal would lead to a time shift of the

company's financial performance with regard to returns on CWIP being allocated to the operating phase of an asset, for which a different regulatory agreement is applicable.

17. In consequence, we believe that the guidance is not in line with the future Standard's objective.

Definition of a regulatory liability is not met

18. According to paragraph 5 of the ED, '*a regulatory liability is an enforceable present obligation […] to deduct an amount in determining a regulated rate to be charged to customers in future periods […]*'. As already described above, there is no present legal or economic obligation arising from a regulatory agreement for the rate-regulated company to reduce future tariffs when the regulatory return for CWIP is received. In some jurisdictions there is even no obligation for the rate-regulated company to consider this revenue in future tariffs even if the asset would never be completed.

19. Besides that, we would recommend another rationale on when the goods and services related to CWIP is being supplied. Contrary to paragraph BC98 and the definition of a regulatory liability mentioned above, it is our view that the goods and services being supplied relate to the construction activity itself, as explicitly stated by the regulatory agreement. The regulatory agreement granting regulatory returns during the construction phase includes no connection to goods and services that will only be supplied with the use of the asset in the future as another regulatory agreement is applicable for this operation phase.

20. Therefore, we consider that this proposal does not meet the Board's own definition of a regulatory liability as suggested in paragraph BC99.

Cost-benefit consideration

21. The application of the guidance in paragraphs B15 and BC96-BC100 would lead to high implementation and operational costs since the rate-regulated company would need to allocate, at a single asset level, the corresponding revenue which has been received during the construction phase in order to recognise a related regulatory liability. The development and implementation of a technical system or a database would be necessary to comply with the proposed guidance. The necessary information is not readily available per single asset and a full retrospective application would increase the challenges of gathering the data even further, given the long useful lives that often apply to assets in the utilities sector (see Question 10). The complexity of gathering that information is also mentioned in paragraph BC100 and should not be underestimated, especially considering a huge investment program ahead leading to a multiplied asset base in the energy sector.

22. As we believe that the relevance of financial information for users will decrease by applying the proposed guidance and at the same time, preparers will face high implementation and operational costs, the cost-benefit ratio in this respect is therefore negative.

23. **All in all and based on our arguments above, we would strongly suggest reconsidering the guidance in paragraphs B15 and BC96-BC100, allowing the recognition of regulatory returns on CWIP during the construction phase.**

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

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?

24. Paragraph B7 of the ED states that where '*a regulatory agreement allows an entity to recover the cost of an asset through the regulated rates charged to customers, the depreciation expense recognised in a period, by applying IAS 16, is an allowable expense and the amount that recovers that depreciation expense forms part of the total allowed compensation for goods or services supplied in the same period*'.

25. Paragraphs B5(a) and B5(b) of the ED explain that:

    (a) where allowable expenses already recognised have not yet been included in the regulated rates but will be included in revenue in the future; or

    (b) where revenue already recognised includes an amount that recovers part of an allowable expense, but that allowable expense will be recognised as an expense in the future by applying IFRS Standards,

    then, the difference in timing gives rise to a regulatory asset or regulatory liability respectively.

26. The above requirements would therefore result in entities having to recognise regulatory liabilities for both:

    - the cost recoveries that occur before the asset is put into use (paragraph B15 of the ED), and
    - the shorter time period of asset recovery versus IAS 16 useful life.

27. As already stated under Question 3 a) (ii) above, paragraph 5 of the ED defines a regulatory liability as '*an enforceable present obligation […] to deduct an amount in determining a regulated rate to be charged to customers in future periods […]*".

28. Conversely, where the time period of asset recovery is longer than IAS 16 useful life, a regulatory asset would be recognised. Paragraph 4 of the ED defines a regulatory asset as '*an enforceable present right […] to add an amount in determining a regulated rate to be charged to customers in future periods […]*'.

29. Misalignment between the regulatory recovery period and an asset's useful life does not result in any such adjustment under any known regulatory framework. Thus, this proposal does not meet the Board's own definition of what a regulatory asset or regulatory liability is.

30. The outcome of the proposals is an alignment between income and related expenditure (as stated in paragraph BC235 of the ED). However, this ignores the economic reality of certain

underlying regulatory agreements. Namely, entities are allowed to recover the costs of building an asset as they incur the expenditure and over a shorter or longer recovery period than the estimated useful economic life of the asset. There are no other requirements underpinning this right to recovery and the revenue that has been charged to customers is correct. Seeking to link the revenue to a future supply of goods or services thus distorts the economic reality.

31. We therefore do not believe the current proposals provide more useful information to users of the financial statements and we believe that investors would need further education via increased use of alternative performance measures (see our comments under Question 9 c)). This further impedes comparability between different entities, particularly those that will not be required to apply the future Standard.

32. We would urge the Board to reconsider their proposals to align certain items of regulatory income and IFRS expenditure**, so that IFRS financial statements do not stray away from reflecting the true economics of the pervasive underlying regulatory agreements**, which are configured on an allowance-based model, not a cost-based model. Thus, the focus ought to be on recognising the revenue actually allowed by an underlying regulatory agreement for a given financial year, not when related costs according to IFRS were incurred.

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?

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?

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?

33. We agree that the proposed measurement technique would provide useful information about an entity's regulatory assets and regulatory liabilities, and the respective regulatory income and regulatory expense, because it is directly linked to the cash inflows and outflows an entity has an enforceable right or enforceable obligation to receive or fulfil based on the agreed regulated rates.

34. Having said that, we believe there is a couple of issues that should be considered.

Boundary

35. Paragraphs 33-35 of the ED, together with paragraphs B28-B40, introduces the notion of boundary, beyond which estimated future cash flows are deemed to be scoped out from the measurement requirements.

36. The boundary of a regulatory agreement thus determines which estimated future cash flows an entity includes in measuring regulatory assets or regulatory liabilities. Paragraph B28 defines the boundary as '*the latest future date at which an entity has*:

   a) an enforceable present right to recover a regulatory asset by increasing the regulated rate to be charged to customers; or

   b) an enforceable present obligation to fulfil a regulatory liability by decreasing the regulated rate to be charged to customers'.

37. Accordingly, some essential aspects of the proposed cash-flow-based measurement technique rely on the **notion of enforceability, which assessment of could be challenging**:

a.1 Regulated activities for which the set of rights and obligations derive from a bundle of contracts or agreements.

38. A regulator may grant an entity with the present right to operate an activity in the context of a long-term supply agreement (e.g. an 'evergreen' operating licence) and a right for compensation for the goods or services supplied without any renewal or cancellation options.

39. However, the regulated rate is agreed between the parties for shorter periods (price periods). The long-term supply agreement encompasses thus unlimited successive price periods, the terms of which are agreed in advance before each price period.

40. Under these circumstances, what is the regulatory agreement that creates enforceable rights and obligations?

    - Is it the long-term supply agreement, indicating as a principle the right to be compensated for goods or services provided (applicable without any predictable time limit as there is no renewal or cancellation options); or

    - the price periods, corresponding to the arrangements specifying in detail the regulated rates agreed for shorter periods?

a.2 Cases when the exception to the cash-flow based measurement technique applies.

41. For example, a regulatory asset arises because the regulatory agreement treats an item of expense as allowable in determining the regulated rate once the entity pays the related cash, instead of when the entity recognises that item as expense in its financial statement applying for example IAS 19 - *Employee benefits* (as described in paragraph 59-66 of the ED).

42. That applies to a number of European regulations providing that **the regulated rate charged to customers in year N includes the cash paid for pensions in N** (except that it's not the actual

expense disbursed including insurance paid to externalize the commitment but an estimated amount of it).

43. The estimation is made for the period over which the regulated rate is agreed (for example 4 years). The difference between the actual amount disbursed and the estimated expense is, in fine, a gain or a loss for the regulated entity.

44. Under these circumstances, some questions arise to apply the ED regarding:

- When could the related cash flows be considered to be enforceable? As mentioned above, is it based on the regulatory agreement specifying that the costs are allowable or based on the price periods?
  - Applying the first alternative would lead to consider the timing difference on the total amount of the pension liability whereas, under the second alternative, the cash flows taken into account would be those covered over the 4 years of the price period.
- Is it necessary to take into account what would happen to such regulatory asset if the licence were withdrawn and the business transferred to another operator? In other words, has the entity an enforceable right for all outstanding cash flows arising from regulatory assets relating to pension liability either because:
  - if employees are transferred to a new operator, the pension liability is transferred and so is the regulatory asset (so there is no effect in the price the outgoing operator would receive); or
  - if employees are retained, the outgoing operator would receive a higher price that compensates for the retained pension liability while the related regulatory asset would be transferred to the new operator.

45. Accordingly, we would suggest the Board:

- **develop additional application guidance in relation to assessing whether rights and obligations are enforceable in the context of assessing the boundary of a regulatory agreement; and**
- **clarify the interaction between 'enforceability' and the recognition requirements in paragraphs 25–28 of the ED.**

<u>**Uncertainty about the timing and amount of the future cash flows**</u>

46. Paragraphs 37-38 of the ED provides some guidance based on which party bears the uncertainty, either the entity or the customers.

47. In the example of future cash flows arising from a regulatory asset that are subject to credit risk, paragraph 38 (b) addresses the case when the entity bears said credit risk: the entity is

then expected 'to estimate future cash flows after deducting an estimate of the amounts it might not be able to collect'.

48. The credit risk pertains to cash flows received from customers when they pay (or do not pay) whatever amount is set by the rates applicable ('downstream side'). Allocating this credit risk to the estimates of cash flows used to compute the compensation granted to the operator is not straightforward since those cash flows, on the 'upstream side', differ from those flowing from customers to the operator. For example, should an entity expect a credit risk on the payments due by some customers amounting to 100, to which regulatory assets would it allocate this amount it might not be able to collect? Would it be on a prorated basis to the estimated cash flows of the assets which recovery periods are longer than their useful lives (for example 10 allocated to 10 assets) or to only one of these assets (for example 100)?

49. **Accordingly, we would suggest the Board provide additional application guidance on how estimates of credit risk should be allocated to individual regulatory assets.**

<u>**Alternative proposed cash-flow-based measurement technique**</u>

50. A minority of our members believe that an alternative cash-flow-based measurement technique could have been chosen since the proposed one would create significant operational complexities in the US regulated businesses (see paragraph 2 above).

51. Albeit understanding the theoretical basis for adopting a discounted cash flow measurement, they highlight that financial instruments are measured under this basis while most other assets and liabilities are not. Given that paragraph BC52 of the ED states that regulatory assets and liabilities are not financial instruments, then, they do not believe it is appropriate to adopt a discounted cash flow approach.

52. As an illustration to the complexities mentioned above, US regulated entities often hold thousands of individual regulatory assets and regulatory liabilities.

53. Corporate and regional overheads are allocated to PP&E components but are not capital expenditures under IAS 16. They generate many individual regulatory assets (i.e. paragraphs B13 and B25 of the ED).

54. Regulatory time lags exist between:

- Allowable operating expenses incurred (including allocated overheads) and,
- The reflection of these allowable costs in rates.

55. There are **recurring situations**, whereby regulatory assets take between 6 months and 2 years until they are included in the rates.

56. To use CWIP as an example again, here is a diagram illustrating the regulatory time lag mentioned in paragraph 54 above:

57. The entity already holds enforceable rights at the end of 2020 and 2021, to get tariff increases based on precedents and explicit regulation guidelines. When applying the proposals, the entity would:

   - First, measure in 2020 the regulatory asset based on estimates of the effective regulatory interest rate, timing and amount of future cash flows, in compliance with paragraph 54 and Illustrative Example no. 5 of the ED on uneven regulatory interest rates;
   - Second, update the computations when the regulator determines the actual return;
   - Third, regularly re-measure the regulatory assets or regulatory liabilities over their long lives, because the regulator often changes the return rate.

58. Moreover, the regulators in the USA do not take into account any discounting since regulatory assets and liabilities are measured by using a cost deferral approach under ASC 980 for regulated entities applying U.S. GAAP. The application of effective regulatory interest rates would create recurring misalignments between the IFRS accounting, regulator accounting and rate making processes, including additional deferred taxes.

59. There would be a need for two sets of forecasts and accounts. Significant investments would be required to upgrade IT systems, and to establish additional processes and controls.

60. **These members believe this approach would be preferable to the cash-flow-based measurement technique for both conceptual and practical reasons, that, in effect, an alternative cost deferral method would be less complex to implement and would provide a fair representation of the intentions of both the entity and the regulator in the rate-making processes.**

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?

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?

61. Though a minority of our members think otherwise (see the comments under Question 5 b) above), we agree with the principles of what is proposed and believe the principle of discounting future cash flows would provide more comparable and understandable information to users of financial statements, even if discounting implies significant complexity to the measurement of regulatory assets and regulatory liabilities.

62. To mitigate this complexity, we would **suggest the Board:**

- **incorporate a practical expedient similar to that under paragraph 63 of IFRS 15 on significant financing component, possibly extending the period set under said paragraph (to 2 years as an example), and**
- **give up the exception, in specified circumstances, to the use of the regulatory interest rate** so that, as said above, IFRS financial statements do not stray away from reflecting the true economics of the pervasive underlying regulatory agreements.

63. Finally, we **recommend clarification is provided for situations where the regulatory interest rate is not set for the full term of forecast cash flows**. See the response to Question 6 d) for further detail on possible practical implications of applying the proposals, specifically in instances where a wider capital base does not have a constant (or observable) rate of return.

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?

64. We find it unusual that the regulatory interest rate will be considered for insufficiency to discount an asset, however not considered for excessiveness when discounting a regulatory liability.

65. If an argument for not adjusting an excessive discount rate on a regulatory liability is '*an excessive regulatory interest rate on a regulatory liability may merely offset an excessive regulatory interest rate on a larger regulatory asset*' (see BC169 of the ED), then it is not clear why the opposite argument does not hold than an insufficient regulatory interest rate on a regulatory asset may merely offset an insufficient regulatory interest rate on a larger regulatory liability.

66. **We recommend that the need to assess the regulated interest rate on a regulated asset is removed** to ensure consistency with considerations for regulated liabilities. We expect this will remove possible costs of implementing requirements.

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.

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?

67. One of our members brought forward an issue in certain cases where a regulatory liability is fulfilled over a term that is longer than a regulatory capital base considered by a regulatory agreement, questioning the combination of the following requirements of the ED:

- paragraphs 48-49, stating that the discount rate for a regulatory liability (and an asset where not insufficient) should equal the regulatory interest rate and the present value of the estimated future cash flows will equal the sum of the estimated future cash flows excluding the cash flows from regulatory interest;
- paragraph 54 requires an uneven regulatory interest rate to be translated into a single discount rate;
- paragraphs B24-B26 require the return rate applied to a larger capital base, to be considered the regulatory interest rate for regulatory assets and regulatory liabilities contained within it.

68. Whilst we recognise illustrative example 2C[2] illustrates a scenario where the IFRS useful economic life of an asset is one year longer than the period over which the asset's cost is recovered via rates, it is not clear how the regulatory liability should be measured if a regulatory agreement did not indicate the regulatory return that would be available for the duration of a regulatory liability[3].

[2] IE38 and following of the ED: Recovery period shorter (4 years) than an asset's useful life (5 years).
[3] Which is not the case in example 2C providing for a regulatory return of 8% from Year 1 to Year 5.

69. As an example, we typically observe that regulatory agreements across the continent set regulatory rates of return for set periods (approx. 3-5 years) that are significantly shorter than the useful economic lives of assets as determined by IFRS. Therefore, we consider the guidance of paragraph 58 of the ED would require the current rate of return to apply throughout a license term and for cash flows to be subsequently adjusted if the regulatory rate is adjusted. However, it is not clear whether it is appropriate to rebut the interest rate being unobservable and uncertain.

70. In an extension of the consideration above, it is also unclear how to treat a scenario where a regulatory liability is expected to be fulfilled beyond the current maximum term of recovery of a regulatory capital base. Our understanding is again to infer from paragraph 58 of the ED that the regulatory interest rate at the time of recognising the regulatory balance, should be assumed to apply until the liability is fulfilled, and future changes to the discount rate would be considered in accordance with said paragraph. However, it is uncertain whether:

    - uncertainty should be considered in the future cash flows, or
    - whether the future rate should be assumed nil given current facts would not support a regulatory return being observable at the time of settling the balance.

71. To drive consistent application of the proposals, **we therefore recommend providing an illustrative example, or application guidance**, to cover these issues.

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?

72. We agree with the measurement proposals related to items of expense or income that affect regulated rates only when related cash is paid or received.

73. However, we would **welcome guidance on the application of these proposals to pensions, in particular regarding the boundary as developed above under paragraph 41 and following**.

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?

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?

74. We agree with the proposed overall disclosure objective focusing on the financial effects of the proposals.

b) Do you have any other comments on the proposed overall disclosure objective?

75. Some of our members have suggested it might be helpful to enlarge the overall disclosure objective by giving additional information regarding the regulatory system(s).

76. However, others which are involved in different activities generating regulatory assets and regulatory liabilities, either in the same jurisdiction or in several jurisdictions, fear that this may prove to be burdensome and eventually not adapted to users' needs.

77. The latter are thus in line with the position of the Board as stated in paragraph BC192 (a) of the ED and with the reference made to paragraph 1.6 of the *Conceptual Framework for Financial Reporting*.

Paragraphs 77–83 of the Exposure Draft set out the Board's proposals for specific disclosure objectives and disclosure requirements.

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?

78. Most of our members have serious concerns regarding the disclosure requirements in paragraphs 77-83 of the ED as the information required seems to be far too granular. Although

paragraph 74 states that '*an entity shall determine the level of detail necessary to satisfy the overall disclosure objective and the specific disclosure objectives […]*', we fear that the requirements in these paragraphs could be interpreted and applied as checklists.

79. Their concerns regarding the disclosure requirements mainly derive from the application of the total allowed compensation model that leads to the application of a 3rd GAAP due to the deviations between IFRS principles and local regulatory rules.

80. To achieve the disclosure objectives, a sophisticated IT-system to determine the total allowed compensation is required as the total allowed compensation differs from local regulatory rules (→ there will be a strong need to tailor IT systems).

81. For example, if the useful lives of assets differ between IFRS and local regulatory rules, these differences have to be monitored and shown according to IFRS rules. The time horizon for such calculation and monitoring can be quite long, with app. 30 – 50 years leading to a complex determination and monitoring per asset over the total period.

82. Furthermore, sometimes there might be multifactor variances (i.e. deviations between planned and actual quantities and/or costs, change in interest rates, etc.). This leads to the necessity of complex deviation analyses. Additional differences between local regulatory regulations and IFRS regulations further complicate the whole process (lack of information).

83. Due to the deviation between the rules of the proposed IFRS total allowed compensation model and local regulatory rules, the information needed is not readily at hand. Therefore, an individual tracking process must be implemented for each regulatory asset / liability to be able to fulfil the proposed rules of the ED. As there are thousands of assets with useful lives of periods of some 30 – 50 years, the process to collect, monitor, revalue and update the necessary data is very complex and will cause high operational costs.

84. Finally, the application of the total allowed compensation model impacts the relevant key performance indicators of an entity and may cause need for alternative performance measures to explain the effects of the future Standard and its deviation from the local regulatory regime. In cases when the IFRS rate-regulated accounting model does not reflect the economic impact of local rate-regulation adequately, preparers and users will have to fall back on non-GAAP disclosures for reconciliation purposes. Regarding esp. the realized returns for CWIP, entities would feel the necessity to explain the effects of such corrections to users.

85. Furthermore, due to the application of the total allowed compensation model, local regulatory costs have to be recognised in accordance with the future Standard. This does not show the actual regulatory impacts. Therefore, there would be a need for additional explanations and hence lead to additional disclosures.

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?

86. In general, we believe the objectives and requirements are worded appropriately.

87. Nevertheless, we are concerned that users might not fully understand that the disclosures reflect only the IASB total allowed compensation model rather than the underlying national regulatory system. This might give a wrong impression whenever total allowed compensation model and national regulatory system are not in line; or in other words, it requires deep knowledge of the future Standard to clearly see possible differences between total allowed compensation model and national regulatory model (e.g. disclosed future cash-flows might differ).

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?

88. We do not fully agree with the proposals regarding the transition requirements.

89. Our members are concerned that a complete full retrospective first-time application might be extremely difficult to implement, leading to undue cost or effort. This would especially, but not only, concern the requirements regarding CWIP. Due to the large time horizon of useful lives of assets, a full retrospective application would make it necessary to recalculate regulatory assets and liabilities concerning a huge amount of assets and the proposed linking of regulatory assets and liabilities to allowable (IFRS) expenses deviating from local regulatory rules as proposed in paragraphs B3-B9 of the ED (which require complex recalculations over the full lifetime of the long-lived regulated assets).

90. In line with the proposed election regarding past business combinations (see our comments under paragraph 93 below), we would recommend allowing a prospective approach, especially for the requirements regarding CWIP.

91. Furthermore, the transition provisions could offer a choice for a modified transition rule (avoiding a fully retrospective research work back to history). A choice regarding the timeframe to go back for a "modified retrospective transition" could be based on local regulatory rules considering for example one regulatory period.

92. **We would therefore recommend providing a modified retrospective approach with exemptions (for example for assets with a long useful life) or a prospective approach.**

93. We welcome the specific transition requirements applying to past business combinations provided by paragraph C4 of the ED.

94. However, we would appreciate a clarification on the transition requirements described in paragraph C4 (c):

- '(c) *recognise and measure, applying this [draft] Standard, all regulatory assets acquired, and all regulatory liabilities assumed, in a past business combination, which still exist at the date of transition*'.

95. Indeed, we wonder what is targeted by the terminology '*which still exist at the date of transition*'. Does it refer to:

- the residual amounts of the regulatory assets existing at the date of the past business combination that have not been fully derecognised at the date of transition (or to the residual amounts of the regulatory liabilities existing at the date of the past business combination that have not been fulfilled at the date of transition)? or
- the mechanisms included in a regulation that enable, at a point in time, the recognition of regulatory assets and regulatory liabilities (whatever the amounts at stake)?

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

96. Due to the expected high operational burden (e.g. gathering of the data necessary to meet the requirements of the future Standard, training staff, tailoring of maybe even totally new IT systems, etc.), the first-time application of the Standard should not be too ambitious. We would recommend adopting the same timeline as that for IFRS 15, published in 2014 and applicable as from 2018 with an earlier application possible. Indeed, depending on the future Standard's impacts on their financial statements and difficulties to implement it, some IEAF members would need **an application not earlier than 36 months after the future Standard is issued.** Others could however be ready earlier and agree with the 24-month period proposed in the ED. In any case, we trust this would not be detrimental to entities that currently recognise regulatory balances since they could elect to early apply the future Standard as provided by paragraph C1 of the ED.

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?

97. BC141 of the ED states that '*cash flows arising from regulatory assets are largely independent of cash flows generated by any other assets*' and that '*regulatory assets are not part of any cash-generating unit for the impairment test required by IAS 36*'.

98. Appendix D of the ED proposes to amend paragraph 43 of IAS 36, whereby cash flows arising from regulatory assets should **not be included** in the measurement of the recoverable amount of the cash-generating unit.

99. Appendix D proposes to amend paragraph 79 of IAS 36 whereby '*for practical reasons, the recoverable amount of cash-generating unit is sometimes determined* ***after consideration of assets*** *that are not part of the cash-generating unit (for example, […] regulatory assets*)**, or**

***liabilities** that have been recognized (for example, […] regulatory liabilities). In such cases, the carrying amount of the cash-generating unit is increased by the carrying amount of those assets and decreased by the carrying amount of those liabilities*.'

100. The recognition of regulatory assets and regulatory liabilities should not mechanically lead to a risk of impairment. However, we would **recommend that the IASB provide further clarification** on how the regulatory assets, regulatory liabilities and the related CGU would interact in practice when the impairment test is made.

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

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?

101. We have some reservations on 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, especially for interim financial periods (see our comments under Question 12 b) below). As an example, there are cases where users of financial statements may not have better insights into the entity's prospects for future cash flows, due to the seasonality of some activities.

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?

102. As per paragraph BC247 of the ED, the assumption taken by the Board is that an entity that currently does not recognise regulatory balances '*already needs to gather and process in determining regulated rates*', which would make the costs of applying the proposals not significant. We do not support this analysis for the following reasons:

Interim financial reporting

103. Regulations are usually based on the civil year, even though the application date of regulated rates may vary and either coincide with the beginning of the civil year or be set at the beginning of the 1st quarter or 2nd quarter. For those regulations, there is no interim review made by the regulator within said year. This means that everything works on a 12-month basis. Recognising, measuring and disclosing any data in between (half-year financial reporting or quarter) would have to be specifically implemented.

104. Some data is expected to be problematic due to the seasonality of the activity (not relevant to estimate amounts on a straight-line basis) and the assumptions to use:

- for the average weather / climate correction, as an example,
- or the amounts of LNG subscriptions depending on the contracts signed with customers as another example.

105. Applying IAS 34 *Interim Financial Reporting* is thus expected to be difficult, as well as the limited review conducted by the auditors.

106. Therefore, we **would recommend, at least, an exemption related to the annual reporting period when an entity first applies the future Standard.**

Year-end reporting

107. Even for year-end reporting, the inputs necessary in order to abide by the requirements of the proposals will need to be either customised for that reporting period or newly implemented to satisfy the requirements of the future Standard (an example would be the return on CWIP granted during the construction phase). Furthermore, applying the future Standard will require to adapt processes in order to respect the timing of consolidation accounts' closing procedures. Some information required by the proposed model exists but is built and analysed under a different timing, adapted mainly within the regulation process.

108. Applying the future Standard will require both a solid knowledge of:

- the mechanisms of regulations in all the countries where Groups are involved in a regulated environment, or even in the same jurisdiction as the provisions of the regulation differ from one entity to another; and
- the future Standard on regulatory assets and regulatory liabilities.

109. The regulations are often complex, mastered by a limited number of persons in our Groups. The work that its implementation represents will add to an already heavy workload, implying to deploy a real project organization: training / impact study / implementation of tools to collect and process information, etc.

110. Accordingly, we would **suggest the Board:**

- **allow at least three years for implementing the future Standard (i.e. the maximum period as stated under Question 10 b)),**
- **simplify as much as possible requirements, whenever possible: discount rate, transition requirements, etc.**

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?

111. We reiterate our comments regarding reconsideration of the future Standard's focus on aligning the timing of recognition of allowable expenses recorded under IFRS with the related revenue recovery under the regulatory agreement.

112. We anticipate significant costs to implement these proposals and question whether the benefits of such a focus outweigh the anticipated costs when such accounting would not be representative of the underlying economics of certain regulatory agreements in place across Europe.

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?

Unit of account

113. As stated in paragraph 24 of the ED, the principle is that '*an entity shall account for the right or obligation arising from each individual difference in timing […] as a separate unit of account*'. However, the same paragraph also provides for the possibility to group some rights and/or obligations:

- arising from the same regulatory agreement and provided that:
  - they have similar expiry patterns, and
  - in addition, are subject to similar risks.

114. This is based on the understanding from the Board that '*entities typically track separately the effects of each of the individual differences in timing*' (see BC116 of the ED).

115. Within some regulations, there are cases for which this assumption does not apply:

- As an example, in some French and British regulations, the specific return granted on CWIP is computed on their annual average amount (means computed on the amounts at the beginning of the reporting annual period and those at the end of same period). There is no specific regulatory need to track the return on each of these CWIP.

116. Conversely, when this assumption applies, we question whether the exception to the principle stated by paragraph 24 would apply:

- As an example, various items are taken into account in a claw back account, such as:
  - all or part of the differences between actual expenses and income, and forecast expenses and income for predetermined items,
  - the financial outcome of performance incentives,
  - capital gains on asset disposal and
  - stranded costs once they are validated by the regulator.

- The balance of this account is calculated as at the end of a given financial year and can be recovered over the following financial period(s) according to mechanisms specific to the regulations concerned.
- In said cases, the various items encompassing the claw back account are not subject to similar risks and we wonder whether paragraph 24 mentioned above would apply.

117. Based on paragraph BC118 of the ED, we would tend to assess that this paragraph would apply in the case described since all of the items encompassing the claw back account ultimately have ‘*similar implications for the entity’s prospects for future cash flows*’.

118. We would thus recommend the Board to **clarify its approach for the unit of account** as stated in paragraph 24 of the ED.