Mrs Isabel Batista
Mr Vincent Papa
On behalf of Mr Jean-Paul Gauzes,
Chairman
European Financial Reporting Advisory
Group (EFRAG)
35 Square de Meeûs
Brussels

Object **Exposure Draft ED/2021/1 Regulatory Assets and Regulatory Liabilities**

Paris, August 27th, 2021

Dear Isabel, Dear Vincent,

I am writing to you to express our views on the above-mentioned Exposure Draft (ED). The content of this comment letter is the same as submitted to the IASB end of July.

The recognition of regulatory assets and regulatory liabilities has been subject to long-standing discussions since the IFRS Interpretations Committee first considered this matter in 2004. Accordingly, we welcome the publication of the ED which, in our view, will eventually allow to give a more accurate view of the year-on-year financial performance of entities having regulatory agreements, which is our case in the EDF Group.

We think the new standard would result in an improvement to financial reporting and would fill a gap in existing IFRS Standards. We also agree with the model underpinning the Board's proposal, meaning a model that supplements the information that an entity already provides by applying IFRS Standards, in particular IFRS 15 *Revenue from Contracts with Customers*.

We are fully aligned with the objective of the ED and are generally supportive of the different Board's proposals in this ED. Consequently, we will mention in this letter the

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few points on which we have a disagreement or on which we would like to insist or draw the attention of the Board.

Scope

Concerning the scope, we think the Board should clarify or develop further application guidance in relation to:

- *whether the existence of a regulator is required to assess whether regulatory assets and obligations exist* : the ED is referring to regulatory assets and regulatory liabilities under a regulatory agreement, but does not establish if there is a need for a regulator, which would be part of the regulatory agreement. A regulatory asset (liability) permits (obliges) an entity to increase (deduct) future regulated rates by a fixed or determinable amount because of goods or services already supplied (because of an amount included in revenue already recognised). From an economic perspective, the right to increase the rate (or the obligation to decrease it) reflects contracts of a specific nature. We understand that right may exist without any regulator. However, in practice, it would be useful to provide further clarifications on the need of a regulator or not, not meaning that a detailed definition would be necessary.
- *how an entity assesses whether rights and obligations are enforceable* : in numerous rate-regulated activities, the law is establishing general principles, such as the fact that the regulated rate shall cover the costs of the operator and include a remuneration of a regulated asset base; these principles are then declined in so-called rate periods, which last a few years, and are precisely establishing the rate calculation model : the remuneration rate to be applied to the regulated asset base, the nature and level of costs to be covered, the incentive regulation etc.. There could be some situations where it is not easy to determine if the "enforceability" criterium is fulfilled for the periods after the current rate-period - which is a boundary agreement under the aegis of the regulator -. There can be some costs that will be recovered after the current rate-period, for which the rate calculation model is not yet determined. In these situations, we consider that the "enforceability" criteria should indeed be based on the general principles from the law but also on the maturity of the regulation. We understand it could be less easy to demonstrate the enforceability criteria for young regulations giving rise to lot of discussions

between the operator(s) and the regulator or other stakeholders than for stable mature regulations. We think it could be useful to include some guidance or illustrative examples to tackle this regulatory agreement's boundary issue.

- *the interaction between the "enforceability" criterium in the scope and the recognition requirements with the 'more likely than not' threshold* : we tend to consider that a right or an obligation is enforceable if it is highly probable that it exists (and vice versa) and therefore are not quite sure to understand the "more likely than not" threshold which is of lower assurance. We would suggest retaining a higher threshold for recognising regulatory assets and liabilities. This does not mean that later at the measurement stage, the regulatory asset or liability would be valued for its complete historical cost, because for example there can be a risk that specific costs would not be totally eligible.

Total allowed compensation (TAC)

Regulatory returns on a balance relating to assets not yet available for use
We wish to respond to your proposed treatment of regulatory returns on a balance relating to assets not yet available for use, as described in sections B15 and BC96-100 of the ED.
We do not agree with the proposed Guidance on this topic, which in our view is not in line with the objective of the standard, i.e. to provide relevant information that faithfully represents how regulatory income and regulatory expenses affect an entity's financial performance, and how regulatory assets and regulatory liabilities affect its financial position.
In France, for some assets under construction (long-cycle fixed assets), the rate regulation authorises regulated tariffs to include a return on the assets during their construction period. However, the ED (B15) proposes that such returns should not be treated as part of the TAC. This creates a contradiction with the principle of French rate regulation described above.
In our view, the purpose of this project is to consider the customers as a whole i.e. as a customer base. IFRS 15 and other IFRS Standards capture the rights and obligations with individual customers. In contrast, the supplementary approach proposed in the ED accounts for some rights and obligations with the customer base. Having considered a single customer base, we think that the construction of assets and managing a portfolio of assets in progress are part of an entity's obligations specified

in the regulatory agreement. In other words, the construction is a service rendered to the customer base.
Besides, the proposed treatment would therefore lead to recognition of a regulatory liability (BC99) corresponding to the return received on assets in construction, whereas generally, this amount is definitely acquired. Accordingly, we question whether the recognition of regulatory liability, as defined in the ED, would be appropriate. Finally, assets under construction that generate returns during the period of construction belong to a portfolio of assets (and not to stand alone assets). The proposed requirement of the ED would be very complex to implement and questions whether its benefits would exceed its costs.

Differences between IFRS and regulatory principles

In France, regulation is often based on expenses recognised under local GAAP at a date that can differ from the date of their recognition under IFRS (the GAAP difference). This is the case, for example, of some expenses relating to post-employment benefits in application of the corridor method, which is used in French GAAP. These timing differences between the regulatory agreement (based on local GAAP) and IFRSs should in our view give rise to regulatory assets/liabilities. We think the Board should draw up specific guidance to address this issue.

Discount rate

We disagree with the Board’s proposals with regard to determining and using a minimum interest rate for a regulatory asset if there are indications that the regulatory interest rate may be insufficient to provide the compensation. We think that the regulatory interest rate shall be used in all circumstances. Indeed, this is the rate that is contractually applicable (and generally made public in case of a regulator) with the third party/regulator and the basis on which regulatory returns will be earned.
Finally, we are unclear as to the reasons that led the Board to require the assessment of the discount rate’s sufficiency for regulatory assets but not for regulatory liabilities. Thus, we disagree with the resulting proposed asymmetry.

Presentation in the statement(s) of financial performance

We have concerns about the Board’s proposal regarding the presentation of regulatory income/regulatory expenses as a separate line item, immediately below the revenue line (paragraph 67 of the ED). We note that ED proposes a model that is supplementing the requirements in IFRS 15 because this Standard, alone, gives incomplete information about an entity's financial performance. The ED brings the 'missing link' or the 'true-up amount' that faithfully portrays the compensation to which the entity is entitled for that same performance obligation and thus, faithfully reflects the entity's financial performance. In consequence, we consider that regulated income/regulatory expenses should be presented in the same line "revenue" recognised applying IFRS 15. At least, we think the Board should permit entities to either present all regulatory income minus all regulatory expense as a separate line immediately below revenue or in the same line item as revenue.

Disclosure

Since regulatory mechanisms are often complex and few people are familiar with them, we think that financial statements'users need information about the way regulatory agreements operate, and their effects on the company's financial statements now and in the future. Consequently we would argue that the approach adopted in the exposure draft focusses too much on the accounting mechanics, with what appears to be an excessive level of detail (especially with regard to the requirements set out in paragraph 78) that can be overwhelming for the reader without actually providing the most relevant information. We believe that the focus should be put on qualitative financial information, to enable users to better understand how a regulatory agreement affects a company's financial performance.

Likely effects of the proposals and effective date

We would like to take issue with the Board's statement in paragraph BC247 that it "does not expect the costs of applying the proposals, both on initial application and on an ongoing basis, to be significant because to a large extent, the proposed model would use inputs that the Board expects an entity already needs to gather and process in determining regulated rates", notably for the two following reasons:

- Interim financial Reporting: in general, in France, regulations are based on the civil year (on a 12-month basis), with no specific infra-annual (quarter or semester) review with the regulator during the year. As a result, no infra-annual process to collect related data is currently in place. EDF Group communicates quarterly on revenues so the ED will have to be declined at least for quarterly closing to publish IFRS15 revenues and all regulatory income minus all regulatory expense under "Revenues". Indeed, even if the standard leads to the recognition of regulatory income/regulatory expense as a separate line immediately below revenue, revenues cannot be appreciated without taking into account these effects (See our specific paragraph Presentation in the statement(s) of financial performance). Accordingly, we will have to gather or estimate inputs for each interim period and thus, will have to implement specific closing processes.

- Annual financial reporting: applying the new standard will require to adapt processes in order to respect the timing of the closing. Information required by the ED already exists in general on an annual basis, but are built and analysed in a different timing, mainly within the regulation process. Moreover, recording incentive regulation will require to include in the financial process a lot of non-financial indicators.

To conclude, costs related to internal control process and IT tools to enable the respect of deadlines will be needed.

In view of all the above points, we would suggest that the application date of the final IFRS Standard should be 24 months after its publication date, with earlier application possible.

Should you need any further information, please do not hesitate to contact me.

Yours sincerely,

Isabelle Triquera
Group Accounting and Tax Director