

Rate-regulated Activities IASB Exposure Draft EFRAG positions in its DCL

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OIC IASB EFRAG joint event

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OBJECTIVE

- Present EFRAG's preliminary views on the proposals in its Draft Comment Letter (DCL)
- Seek your views on the proposals

**IASB published Exposure Draft
*Regulatory Assets and Regulatory
Liabilities* on 28 January 2021 (the
'ED')**

**EFRAG published its Draft Comment
Letter on the ED on 13 April 2021**

OBJECTIVE AND SCOPE

EFRAG TENTATIVE POSITION

- EFRAG supports the overall objective of the project
- EFRAG is still assessing possible **unintended consequences** including on the possible impact of the scope outside the utilities sector
- EFRAG considers that more specific guidance and examples on what constitutes a regulatory agreement and a description of the characteristics of a regulator would be helpful to appropriately identify activities within the scope

EFRAG IS SEEKING STAKEHOLDERS' VIEWS ON:

- Situations in which the scope would affect activities that should not be in scope
- Views and examples of self-regulation. Should they be in the scope?
- Should the scope consider additional criteria (e.g., limited competition, regulator committed to support the financial viability through the rate-setting process, customer having no ability to avoid price increases)?
- Are you aware of examples of service concession arrangements falling under both the proposed Standard and IFRIC 12?

REGULATORY ASSETS AND REGULATORY LIABILITIES

EFRAG TENTATIVE POSITION

- EFRAG agrees with the proposed definitions of regulatory assets and regulatory liabilities
- EFRAG agrees that the accounting model should focus on total allowed compensation, including the recovery of allowable expenses minus chargeable income, a profit component and regulatory interest which compensates or charges the entity for the time value of money
- EFRAG agrees that regulatory assets and regulatory liabilities meet the definitions of assets and liabilities under the *Conceptual Framework*
- EFRAG agrees that an entity should account for regulatory assets and regulatory liabilities separately from the rest of rights and obligations arising from the regulatory agreement.

TOTAL ALLOWED COMPENSATION

EFRAG TENTATIVE POSITION

- EFRAG supports the proposed definition of total allowed compensation
- EFRAG supports the proposal in the ED that performance incentives form part of the total allowed compensation for goods or services supplied in the period(s) over which the performance criteria are monitored and evaluated

ACCOUNTING FOR CWIP

EFRAG TENTATIVE POSITION

- EFRAG hasn't still formed a view at this stage on the IASB proposal that the regulatory returns for CWIP, in cases where the regulatory agreement allows regulatory returns to be charged to customers during construction, **are only included in profit or loss when the asset is in use**

EFRAG IS SEEKING STAKEHOLDERS' VIEWS ON:

- How common are these type of agreements in your jurisdiction?
- Do you expect any implementation issues relating to the proposals in the ED to defer and recognise revenue from construction work in progress only in the operating phase?
- Which of the two views (view 1 or view 2) on the treatment of regulatory returns on CWIP do you support and why?

ACCOUNTING FOR CWIP

EFRAG TENTATIVE POSITION – CONTINUED

View 1: Against the proposal

EFRAG notes concerns on the proposed treatment of CWIP regulatory returns in situations where the regulatory agreement allows regulatory returns to be charged to customers during construction

- The proposal departs from the alignment of the accounting treatment with the regulatory treatment of regulatory returns
- Potential operational challenges of recognising regulatory returns related to CWIP only when the asset is in use - assets are used on a portfolio rather than individual basis to generate revenue and it is difficult to attribute revenue to a single asset
- Some entities have high volumes of initiated assets under construction and high volumes of these that become operational- and it will be challenging for these entities to apply the proposed treatment of CWIP regulatory returns

ACCOUNTING FOR CWIP

EFRAG TENTATIVE POSITION – CONTINUED

View 2: Support the proposal

EFRAG acknowledges that the IASB proposal will reflect total allowed compensation when the underlying asset is being used to provide goods or services and being consumed (through depreciation) and this will result in a faithful representation of profit patterns particularly for entities that have material and long-duration CWIP

- For such entities, due to the proposed treatment of CWIP, the profit will be misleadingly understated when the asset becomes operational if the regulatory returns were recognised as part of the total allowed compensation during construction
- EFRAG notes that the proposal will contribute to comparability across entities regardless of how regulatory return is structured within regulatory agreements.

RECOGNITION

EFRAG TENTATIVE POSITION

- EFRAG agrees with the proposal that an entity should recognise all its regulatory assets and regulatory liabilities. EFRAG agrees that if it is uncertain whether a regulatory asset or a regulatory liability exists, an entity shall recognise the regulatory asset or regulatory liability if it is more likely than not that it exists
- EFRAG considers that it would be useful for the IASB to provide application guidance on how to implement the various circumstances outlined (paragraph 27 of the ED) about how an entity would determine whether a regulatory asset and a regulatory liability exists
- EFRAG recommends that IASB provide further guidance on derecognition of regulatory assets and regulatory liabilities

EFRAG IS SEEKING STAKEHOLDERS' VIEWS ON:

- Situations of uncertainty regarding the existence of an enforceable right/obligation
- Is the guidance on the boundary of the agreement understood in practice and can be applied without undue cost and effort? What challenges do you anticipate?

MEASUREMENT

EFRAG TENTATIVE POSITION

- EFRAG supports the proposed cash-flow measurement technique because it is closely aligned with the amounts an entity is entitled to receive or obliged to fulfil under the regulatory agreement.
- EFRAG agrees with the proposal to reflect the credit risk that an entity bears when estimating the future cash flows arising from a regulatory asset
- EFRAG supports using either the most likely amount or the expected value method, depending on which approach provides more relevant information.
- EFRAG considers the **requirements on the boundary of the regulatory agreement to be confusing** and could be mixing up the entity's licence to operate with the enforceable rights and enforceable obligations arising from the regulatory agreement
- EFRAG considers that the **guidance on the regulatory boundary should be included in the recognition** part of the ED, and not in measurement

DISCOUNTING

EFRAG TENTATIVE POSITION

- Supports discounting but disagrees with different approaches for assets and liabilities
- Recommends that the IASB consider introducing a practical expedient to exempt entities from discounting if the effects are not significant (similar to IFRS 15)
- Concerned by the complexity of the proposal, particularly regarding the minimum rate
- EFRAG has not formed a view on which discount rate an entity should use and seeks constituents' feedback on how regulatory assets and regulatory liabilities should be discounted

EFRAG IS SEEKING STAKEHOLDERS' VIEWS ON:

- **View 1** – Use the regulatory interest rate for regulatory assets and regulatory liabilities
- **View 2** – Use the general discounting principles in IFRS

Which of the two views on discounting do you support and why?

DISCOUNTING

EFRAG TENTATIVE POSITION – CONTINUED

View 1 – Use the regulatory interest rate

- The regulatory interest rate is negotiated with the regulator and considered objective by users.
- Supporters of this view disagree with the proposed application of a minimum adequate rate as the discount rate for regulatory assets, when the regulatory interest rate provided for a regulatory asset is insufficient. What matters ought to be the discount rate agreed with the regulator, as this represents the rate the entity is entitled to recover (fulfil) when measuring its regulatory assets and regulatory liabilities
- Application of a minimum adequate rate would not be relevant information for users to understand regulatory assets and regulatory liabilities.

DISCOUNTING

EFRAG TENTATIVE POSITION – CONTINUED

View 2 – Follow IFRS discounting requirements

- The objective of discounting is to appropriately reflect the effects of the time value of money – the regulatory interest rate might have a different objective.
- In case of a significant financing component and the regulatory interest rate differs from the market rate, an entity should apply the requirements in IFRS 15 and use the prevailing interest rates in the relevant market

PRESENTATION

EFRAG TENTATIVE POSITION

- EFRAG agrees with the proposal to present all regulatory income minus all regulatory expense as a separate line item immediately below revenue and to include regulatory interest income and regulatory interest expense within this line item
- The proposed presentation is consistent with the objective of reflecting in the statement(s) of financial performance the compensation that the entity is entitled to for a given period regardless of when the related amounts are reflected in the regulated rate(s) charged to customers in that period
- **EFRAG questions whether the gross presentation of the regulatory assets and liabilities on the statement of financial position would be useful for users**
- In case an entity chooses to offset EFRAG considers the off-setting requirements of paragraph 71(b) of the ED to be complicated

DISCLOSURE

EFRAG TENTATIVE POSITION

- EFRAG generally agrees that the proposed disclosures will provide relevant information to users of financial statements to understand the relationship between an entity's revenue and expenses resulting from its rate-regulated activities and provide insights into its prospects for future cash flows
- However, EFRAG considers that the level of detail required of some proposed disclosures might impose a significant burden on reporting entities if this information is not readily available
- EFRAG considers that there will be a **need to identify and prioritise** from the proposed disclosures, only those that will be ascertained to be beneficial to users of financial statements and will not impose an undue burden for preparers

EFRAG IS SEEKING STAKEHOLDERS' VIEWS ON:

- **Which of the disclosures are most useful and which are less useful?**

EFRAG IS ALSO SEEKING VIEWS ON:

- Do you agree with the IASB decision to charge to goodwill and not to retain earnings all the adjustments to regulatory assets and liabilities resulting from the simplified treatment of the **past business combinations**? If not, what do you propose?
- Do you agree that the goodwill-related regulatory balances should not be reclassified to goodwill on the **first-time adoption of IFRS Standards** (proposed amendments to IFRS 1) but recognised as a separate subset of regulatory assets which should subsequently be amortised?
- What are your views about an approach where **acquired regulatory assets (or liabilities) are not exempt from IFRS 3** and are measured at fair value and further discounted at adjusted regulatory interest rate in a manner similar to the provisions of IFRS 9?



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THANK YOU FOR YOUR ATTENTION !

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