EFRAG Secretariat: Isabel Batista, Ioana Kiss, Joaquin Jacobs

IASB project on accounting for regulatory assets and regulatory liabilities - Key messages for EFRAG DCL

Background paper

Objective of this paper

1 The session in this meeting will not cover in detail this document, which is provided as background information. The paper has been provided to the participants of this TEG/CFSS meeting with the purpose of providing a complete picture of the initial reactions (and concerns) on the IASB tentative decisions on the accounting model for regulatory assets and regulatory liabilities. The EFRAG Secretariat believes that this document may support the EFRAG CFSS members in identifying potential areas of concerns for stakeholders in their respective jurisdictions. A summary of the key messages discussed in this paper are included in agenda paper 10-01 for today's meeting.

2 This paper sets out the key messages to be included in an initial draft of an EFRAG draft comment letter on the forthcoming exposure draft on the IASB accounting model for regulatory assets and regulatory liabilities (the model). The messages reflect the views of EFRAG TEG and EFRAG RRAWG members provided in previous meetings. The expert views from EFRAG RRAWG discussed in previous meetings were presented to EFRAG TEG to assist TEG in forming its views.

3 This paper was discussed with EFRAG RRAWG members at its meeting on 19 June 2020 and includes feedback from that meeting. Overall, EFRAG RRAWG confirmed the views and concerns previous expressed at their meeting in October 2019. The EFRAG project team notes that the feedback as written in this paper from RRAWG still needs to be confirmed through the approval of the Chairman's report and the minutes of the meeting.

4 The EFRAG project team notes the wording in the forthcoming exposure draft might be different to the IASB tentative decisions included in this paper, which have been the prime source for discussions so far. Once the exposure draft is published, any differences to the tentative proposals will be discussed with EFRAG RRAWG, EFRAG TEG and EFRAG CFSS to enhance and further develop the EFRAG draft comment letter.

5

Background

6 The exposure draft on the model is expected in October 2020. We understand that the IASB Staff may ask the IASB at its meeting in July 2020 to extend the comment period from the initial suggested period of 120 days to 180 days.

7 The model, when finalised as an IFRS Standard, will replace IFRS 14 *Regulatory Deferral Accounts*, an interim Standard permitting different accounting approaches for rate regulation.

8 EFRAG RRAWG members discussed the model at the meeting in October 2019 and again on 19 June 2020. EFRAG TEG discussed the model at its meetings in November 2019 and a web-cast meeting in February 2020, respectively. The EFRAG Board received a presentation from an IASB member on the model at its meeting in February 2020. The EFRAG Board was not asked to take any decisions. Some EFRAG Board members considered that, based on their current understanding, the scope of the model would not affect many companies in Europe.

Key areas of the model

9 The following aspects of the model are discussed in the paragraphs below:

(a) Objective and general principle of the model

(b) Scope and definition of regulatory assets and regulatory liabilities

(c) Recognition (including regulatory boundary)

(d) Measurement of regulatory assets and regulatory liabilities (including accounting for target profit – regulatory returns and performance incentives)

(e) Amendments to and interaction with IFRS Standards (IFRS 1, IFRS 3, IFRS 5, IAS 1, IAS 36)

(f) Presentation and disclosure requirements

(g) Transition

Objective of the model and general principle

10 The objective proposed in the model is that 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.

11 To meet this objective, the general principle of the model is that an entity shall **reflect the total allowed compensation for the goods or services supplied in a period.** The current working definition is that the total allowed compensation is:

The amount that an entity is entitled to charge customers, in the same or a different period, in exchange for the goods or services supplied in a specified period, in accordance with the regulatory agreement. This definition was confirmed in agenda paper 9A discussed by the IASB in March 2020.

12 The total allowed compensation will be specified in a regulatory agreement and includes the following elements:

(a) allowable expenses and chargeable income; and

(b) target profit (incl. margins on allowable expenses, regulatory returns, regulatory interest and performance incentives).

13 The total allowed compensation is key in the definition of regulatory assets and regulatory liabilities because the model recognises:

(a) A **regulatory asset** when total allowed compensation exceeds the amount already charged to customers under IFRS 15 *Revenue from Contracts with Customers*

(b) A **regulatory liability** when the allowed compensation is lower than the amount already charged to customers under IFRS 15.

14 In applying the model, total allowed compensation has a dual nature:

(a) On one hand, a regulatory nature. This is because its components are items that the regulatory agreement treats as either allowable or chargeable when determining the regulated rate(s).

(b) On the other hand, an accounting nature. This is because an entity is required to determine total allowed compensation for goods or services it supplied in the current period so that it knows whether and when regulatory assets or regulatory liabilities exist and when it has recovered or fulfilled them. When making such a determination, the entity relies to some extent on judgements it needs to make for accounting purposes, for example in determining whether expenditure is an expense or part of the cost of an asset or in estimating an asset's useful life.

15 The forthcoming exposure draft is expected to provide application guidance on the more difficult elements of total allowed compensation, such as accounting for regulatory returns, regulatory interest, and performance incentives.

Key messages

16 EFRAG TEG agreed with the general concern expressed by from EFRAG RRAWG members that the model had become overly complex and difficult to understand and may result in application issues.

RRAWG meeting 19 June 2020

17 RRAWG members confirmed that in their view the proposed requirements have become overly complex and will be burdensome and costly to apply.

18 RRAWG members also thought that further guidance was needed on the application of some of the proposals on recognition, measurement, interaction with other IFRS Standards and transition requirements. RRAWG members also noted that some of the proposals were highly subjective and did not reflect the concepts typically used in regulatory agreements and the general objectives of the regulatory environment relevant to entities that are expected to apply the model.

Scope

19 The IASB has tentatively decided that the scope of the model would apply to:

*Regulatory assets and regulatory liabilities arise from a **regulatory agreement** (regulatory framework) between an entity and a regulator in which the agreement sets out the regulated rate that the entity can charge the customer for goods or services provided. The regulatory agreement has to be binding on both the entity and the regulator.*

*The **regulated rate** is a transaction price that a regulatory agreement entitles an entity to charge customers in a period for goods or services supplied in the same period. The regulated rate is determined based on the **total allowed compensation** agreed between the entity and the regulator.*

20 Entities within the scope of the model will be required to recognise regulatory assets and regulatory liabilities. In the IASB's March 2020 discussion, the focus was no longer on 'defined rate regulation', but rather on a type of rate regulation that meets certain criteria which in turn give rise to regulatory assets and regulatory liabilities.

21 The IASB considers that the feature that distinguishes the type of rate regulation in the scope of the model from other forms of rate regulation is that the basis for setting the regulated rate gives rise to:

(a) rights to add amounts to, and obligations to deduct amounts from, future rate(s) because of goods or services already supplied or because of amounts already charged to customers; and

(b) these rights and obligations arise because the basis for setting the rate establishes not only the amount of total allowed compensation for goods or services supplied in a period but also determines when (i.e. in which periods) that total allowed compensation is included in the rate(s) charged to customers.

22 In its tentative decisions the IASB did not define a regulator. However, the exposure draft might provide some application guidance of the types of regulatory agreements that would be included in the scope. However, the EFRAG Secretariat understands that the guidance will be high-level guidelines rather than overly prescriptive.

Key messages

23 EFRAG TEG members considered that the current definition of defined rate regulation may be too broad and include a wider range of entities than initially anticipated (e.g. entities other than the utility sector could be impacted). TEG members commented that there were different ways of creating a binding agreement (e.g. agreement on defined rate embedded in the initial licence or in the statutes or in a combination of law and agreements) and what matters is the enforceability. EFRAG TEG suggested to the EFRAG Secretariat to test the definition and how it could be applied in practice.

24 EFRAG TEG members agreed that the definition of the regulator was important when determining whether certain activities were within the scope of the RRA project.

25 To respond to EFRAG TEG request, the EFRAG project team is currently undertaking outreach with national standard setters to understand whether the proposed scope is clear and whether it is likely to include any activities or items that would not have expected to be included and vice versa (likely to exclude any activities or items that constituents would have expected to be included).

26 At this stage, we have received feedback from only some European national standard setters, as the current circumstances driven by the covid-19 pandemic have placed significant pressure on available resources at all levels. Nonetheless, feedback so far indicates that the sectors likely to be impacted by the scope are some or all of the utility sector (gas, electricity and water), transport sector (such as airports , railways and public transport more generally), and perhaps the real estate sector (when they are providing goods or services that fall under the scope of the model). The feedback obtained so far, is not sufficient to conclude on which sectors will be affected by the scope of the model and whether the activities affected will be significant. The project team will therefore continue to reach out to constituents to assess the impact of the scope.

RRAWG meeting 19 June 2020

27 Some RRAWG members informed that they were still investigating whether and what extent the transport industry, such as railways, would be impacted. Another key concern cited by several RRAWG members that represent companies that operate concession agreements was the interaction with IFRIC 12 *Service Concession Arrangements.* These RRAWG members were of the view that it was not always clear which of the two sets of requirements an entity should apply and furthermore the proposed requirements for accounting for regulatory assets and regulatory liabilities were different to the requirements in IFRIC 12 although in many cases the economic outcome/intention of the respective transactions were very similar.

28 Some RRAWG members suggested that the scope of the model ought to cover enforceable rights and obligations that are paid by (paid to) the regulator/government instead of the customer. In their view, this was common practice in some jurisdictions (like Italy and Spain) for service concession agreements and regulatory agreements – when the customer could not pay (for whatever reason) the regulator (the government) would step in. In their view, these types of arrangements should be covered by the scope of the model as it should not make a difference whether the entity recovered the agreed allowed compensation from the customer or the government or both.

Definition of regulatory assets and liabilities

29 To apply the general principle in paragraph 11, an entity will be required to recognise regulatory assets and regulatory liabilities. Regulatory assets and regulatory liabilities will arise from a regulatory agreement between a regulator and an entity when the agreement creates enforceable rights and enforceable obligations. The IASB has not specifically defined a "regulator".

30 The concept of total allowed compensation in paragraphs 11 and 12 is used to help an entity in assessing when it would recognise and derecognise regulatory assets and regulatory liabilities and the amount of those assets and liabilities. The current working definitions of regulatory assets and regulatory liabilities is as follows:

(a) **regulatory asset**—the present right to add an amount to the regulated rate(s) to be charged to customers in future periods because the **total allowed compensation** for the goods or services already supplied exceeds the amount already charged to customers.

(b) **regulatory liability**—the present obligation to deduct an amount from the regulated rate(s) to be charged to customers in future periods because the **total allowed compensation** for the goods or services already supplied is lower than the amount already charged to customers.

31 For a regulatory asset and a regulatory liability to exist, the right and/or the obligation must be an **enforceable present right and/or present obligation**.

32 As a result, an entity would recognise in its statement(s) of financial performance:

(a) **regulatory income** if some or all of the total allowed compensation for the goods or services supplied in the current period will be included in revenue in future periods or was included in revenue in previous periods; and

(b) **regulatory expense** if the revenue recognised in the current period includes some or all of the total allowed compensation for goods or services that will be supplied in future periods, or that were supplied in previous periods.

Examples of regulatory assets and regulatory liabilities

Regulatory asset – recovery period is longer than an asset's useful life

33 One example of a regulatory asset would be when the regulatory agreement specifies that the recovery period of an asset under IAS 16 *Property, Plant and Equipment* (PPE) is **longer** than the asset's useful life for IFRS reporting purposes. Consider the following example:

<u>Fact pattern</u>

34 Entity A acquires an item of PPE with a cost of CU 1.000 and a useful life of 4 years. Entity A recognises depreciation under IAS 16 on a straight-line basis. The regulatory agreement specifies that the cost of the PPE will be added to the regulatory asset base (RAB) for recovery in the rates charged to customers over a period of 5 years.

Application of the model

35 Applying the model, the total allowed compensation of CU1.000 representing the allowable expenses incurred in supplying the goods or services, which relate to the consumption of the item of PPE. This consumption is reflected in the IFRS accounts by recognising depreciation of CU250 per year for years 1-4. Under the regulatory agreement the total allowed compensation would be recovered by charging customers CU 200 per year for 5 Years.

In CU	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Allowable expenses – depreciation under IAS 16	250	250	250	250		1.000
Total allowed compensation	**250**	**250**	**250**	**250**		**1000**
Amounts charged to charges	200	200	200	200	200	1000
Difference	**50**	**50**	**50**	**50**	**(200)**	**-**

36 The total allowed compensation for the goods and services provided supplied in years 1-4 **exceeds the amount charged to customers in those years**. In other words, Entity A has charged its customers less than it was entitled to. Applying the model, Entity A recognises a regulatory asset of CU 50 in Year 1. Assuming all stays the same, Entity A also recognises an additional regulatory asset of CU 50 in each of years 2-4.

37 The **regulatory asset of CU 50 in each of the years 1-4 represents Entity A's right to add an increasing amount** when determining the regulated rate in future periods **for goods or services already delivered**. The accumulated regulatory asset of CU200 will be de-recognised in Year 5.

Regulatory liability - recovery period is shorter than an asset's useful life

38 An example of a regulatory liability would be when the regulatory agreement specifies that the recovery period of an asset under IAS 16 is **shorter** than the asset's useful life for IFRS reporting purposes.

Fact pattern

39 Assume the same fact pattern as in the example above, except that the item of PPE has a useful life of 5 years. It is depreciated on a straight-line basis for IFRS purposes. The regulatory agreement states that the cost of the PPE of CU1.000 can be added to the RAB (total allowed compensation) and recovered over a period of 4 Years.

Application of the model

40 Applying the model, Entity A would recognise depreciation of CU200 per year for Years 1-5. Under the regulatory agreement the total allowed compensation of CU 1.000 would be recovered over 4 years by charging customers CU 250 per year.

In CU	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Allowable expenses – depreciation under IAS 16	200	200	200	200	200	1.000
Total allowed compensation	**200**	**200**	**200**	**200**	**200**	**1.000**
Amounts charged to charges	250	250	250	250	-	1.000
Difference	**(50)**	**(50)**	**(50)**	**(50)**	**200**	**-**

41 The amounts charged to customers in years 1-4 exceed the total allowed compensation for the goods or services supplied in those years. Applying the model, Entity A recognises a regulatory liability of CU50 in Year 1. Assuming all stays the same, Entity A will recognise an additional regulatory liability of CU 50 in each of Years 2-4.

42 The regulatory liability of CU 50 in each of the years 1-4 represents Entity A's obligation to deduct an increasing amount when determining the regulated rate to be charged to customers in future periods. The accumulated regulatory liability of CU200 will be de-recognised in Year 5.

Key messages

43 EFRAG TEG agreed that the rights and obligations must be enforceable to result in recognition of assets and liabilities. Some EFRAG TEG members considered that the definition of regulatory assets and liabilities could be better described as 'deferred' regulatory assets and 'deferred' regulatory liabilities or even as 'deferred regulatory income and expenses', to help focus on the narrow purpose of adjusting the performance in profit or loss and integrate IFRS 15.

44 Some TEG members questioned whether regulatory assets and regulatory liabilities met the definitions of assets and liabilities in the IASB's *Conceptual Framework for Financial Reporting (Conceptual Framework)*. EFRAG TEG suggested to get inputs from the EFRAG RRAWG on what do these assets/liabilities represent from an economic point of view.

EFRAG RRAWG meeting 19 June 2020

45 RRAWG members observe that from an economic point of view the entity would be required to reflect actual allowed compensation (performance) in the period it had provided goods or services. This was currently not the case under IFRS reporting. Some EFRAG RRAWG considered that the model would enhance accountability and allow for better stewardship.

Recognition (including the regulatory boundary)

46 The model requires an entity to recognise all regulatory assets and all regulatory liabilities that meet the definition of a regulatory asset and a regulatory liability (see paragraph 20). The IASB tentatively decided to:

(a) require that regulatory assets and regulatory liabilities are recognised if **it is more likely than not that they exist** (i.e. the model sets a symmetrical recognition threshold for regulatory assets and regulatory liabilities in cases of existence uncertainty); and

(b) if there is a low probability of an inflow or outflow or high measurement uncertainty, such probability and measurement uncertainty is considered in the measurement.

47 The model **establishes a threshold only for existence uncertainty**; all other uncertainties are reflected in the measurement. In reaching this tentative decision, the IASB considered the guidance in the *Conceptual Framework*, what is meant by existence uncertainty and the probability of cash flows and measurement uncertainty.

48 The IASB considered that there could be situations where the regulatory agreement is set to expire and must be renewed in the near term, or the regulatory agreement can be terminated by one party giving notice. This raises a question about the boundary of the regulatory agreement in terms of which cash flows are enforceable and should be included when recognising (and measuring) regulatory assets and regulatory liabilities.

49 In most cases, the terms of the agreement that determine this period will be explicit and thus the identification of this period will not be complex. However, if the regulatory agreement is subject to cancellation and renewal options, determining the boundary of the regulatory agreement is more complex.

50 The IASB tentatively decided that when **determining the regulatory agreement boundary,** an entity should consider all options that could affect that boundary, but:

(a) should disregard those options that the holder will not have the practical ability to exercise in any circumstances; and

(b) should not consider the likelihood of exercise or either party's intentions in respect of any option.

51 In assessing whether the party holding an option will have the practical ability to exercise the option, that party should consider all the terms of the regulatory agreement and other facts and circumstances, including the environment in which it operates. For example, a regulator may not be able to replace a regulated entity without significant adverse economic consequences (eg significant costs and/or significant disruption to service), leading to the conclusion that the regulator no longer has the practical ability to exercise the option at this stage.

Key messages

52 EFRAG TEG generally supported the IASB's tentative decision on the recognition criteria of the accounting model. However, EFRAG TEG expressed the following concerns regarding the complexity of applying the recognition criteria:

(a) It was not clear why there was a need for a recognition threshold if an entity had enforceable rights and obligations that arose from the regulatory agreement and had assessed it was in the scope of the model.

(b) The interaction between the recognition threshold (recognise if 'more likely than not') and the probability of inflows or outflows (to be considered in measurement) was unclear. If there was uncertainty in the cash inflows or outflows, it was unclear why an entity would recognise regulatory assets and regulatory liabilities.

(c) Some EFRAG TEG members considered that recognition of regulatory assets should have a high threshold given the uncertainties present in regulation would have preferred "virtually certain" as recognition criterion for regulatory assets –

similar to the recognition criteria in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

53 EFRAG TEG found the IASB tentative decision on the boundary of the regulatory agreement confusing. Similar to EFRAG RRAWG, EFRAG TEG had difficulties with understanding how in practice an entity would determine the boundary of a regulatory agreement and why it was important to make this assessment, given the nature of the regulatory environment to which the model will apply. EFRAG TEG suggested that boundary should be determined based on the regulatory legal framework.

54 EFRAG TEG shared the views expressed by the EFRAG RRAWG that the tentative guidance on determining the boundary was mixing the entity's licence to operate with the regulatory agreement. They suggested that the boundary be tested in practice using more complex examples provided by the EFRAG RRAWG, preferably when there was a combination of regulatory and concession agreements.

EFRAG RRAWG meeting 19 June 2020

55 EFRAG RRAWG members confirmed the views previous expressed and included in paragraphs 53 and 54 above.

Measurement of regulatory assets and regulatory liabilities

56 Under the **general measurement principle** of the model: all regulatory assets and regulatory liabilities, except those covered in the following paragraph, are measured using a **cash-flow-based measurement** technique that measures regulatory assets and regulatory liabilities at historical cost, modified for subsequent changes in the estimates. This is done by:

(a) estimating future cash flows arising from the regulatory assets or regulatory liabilities, including the cash flows relating to the regulatory interest or return; and

(b) discounting the estimated future cash flows using the regulatory interest or return rate unless there is any indication that the regulatory interest or return rate is not adequate.

57 **Exception to the general measurement principle**: regulatory assets and regulatory liabilities that relate to expenses or income that will be included in or deducted from the future rates when cash is paid or received (for example pension costs and asset retirement obligations) are measured by:

(a) using the same measurement basis that the entity uses when measuring the related liability or related asset; and

(b) adjusting the measurement of the regulatory asset or regulatory liability to reflect any risks that are not present in the related liability or related asset.

58 When regulatory assets and regulatory liabilities are measured using the measurement exception in paragraph 57 and the related asset or related liability is remeasured through other comprehensive income (OCI), then any regulatory income or regulatory expenses arising from that remeasurement should also be presented in OCI.

59 When measuring regulatory assets or regulatory liabilities, an entity first identifies the **amount** that will be added to or deducted from the future regulatory rates because the 'total allowed compensation' for goods or services already supplied exceeds, or is lower than, the amount already charged to customers for those goods or services. An entity would then estimate **when** those additions or deductions will be made to or from the future regulatory rates to be charged to customers.

Estimating future cash flows

60 The model requires an entity to estimate future cash flows arising from each regulatory asset and regulatory liability recognised using either **the most likely amount** or the **expected value**, depending on which method the entity concludes would better predict the amount of the cash flows arising from a particular timing difference or group of timing differences. This requirement is consistent with the measurement requirements for variable consideration under IFRS 15. The entity should apply the same method consistently from the origination of the timing difference until its reversal.

(a) The most likely amount – the most likely amount is the single most likely amount in a range of possible cash flow amounts. This may be an appropriate estimate of the amount if there are only two possible outcomes.

(b) The expected value – the expected value is the sum of probability-weighted amounts in a range of possible cash flow amounts. This method may be appropriate when there are a wide range of cash flows in relation to the regulatory asset and/or regulatory liability.

61 The estimated cash flows need to be updated at each reporting date and to account for those changes in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. The model does not require separate impairment procedures for regulatory assets because updating the estimates of future cash flows would capture any downward remeasurements. Therefore, IAS 36 *Impairment of Assets* does not apply to regulatory assets.

62 When the entity is entitled to performance incentives for achieving indicated performance criteria (such as targeted levels of quality and reliability of service, customer satisfaction, level of operational efficiency), such performance incentives form part of the 'total allowed compensation' that an entity is entitled to for supplying goods and services **only** when they are considered in the rates charged to customers. The amount of any bonus or penalty should be **apportioned** as the incentive period progresses, rather than only at a point in time.

Key messages

63 EFRAG TEG and EFRAG RRAWG members generally agreed with the measurement principles of the model, however, the following comments were expressed:

(a) The measurement technique applied by the model seemed to be a mix between an amortised cost and a fair value measurement.

(b) Suggested that the model should not resort to the requirements in IAS 8 when accounting for changes in estimated cash flows but rather provide guidance in the model for defined rate regulation.

EFRAG RRAWG meeting 19 June 2020

64 Some EFRAG RRAWG members suggested that further guidance was needed with respect to the application of the measurement exception for regulatory assets and regulatory liabilities that relate to expenses or income included in the regulatory rate when cash is paid or received.

Accounting for regulatory returns and performance incentives

65 In March 2020, the IASB deliberated whether **regulatory returns on a Capital work in progress (CWIP base)** included in the regulated rates charged to customers during the construction period should be regarded as forming part of total allowed compensation for goods or services:

(a) in the construction period; or

(b) supplied when the asset is being used in providing goods or services to customers.

66 This question is key, as the outcome determines when those regulatory returns affect profit or loss.

67 The IASB noted that the two approaches commonly used by regulators for including regulatory returns on CWIP base in the regulated rates are as follows:

(a) regulatory returns accumulate during the construction period and are included in the regulated rates charged to customers after the construction works have been completed (i.e. during the operating period of the asset); or

(b) regulatory returns are included in the regulated rates charged to customers during the construction period of the asset.

68 The IASB tentatively decided that regulatory returns on a construction work-in-progress base included in the regulated rates charged to customers during the construction period form part of total allowed compensation **only during the period when the asset is in operation** and is being used to supply goods or services. The primary basis for this decision is because during the construction period of the asset to which those regulatory returns relate, no goods or services are being supplied using that asset – so requiring the regulatory return to be recognise don CWIP would be contrary to the general principle of the model.

69 In March 2020, the IASB also tentatively decided that the amounts relating to a **performance incentive** form part of total allowed compensation for goods or services supplied in the period in which the performance criteria are monitored and evaluated. This conclusion is different to the conclusion reached on the accounting for regulatory returns on target profit that relates to assets under construction (CWIP). In the latter case, the IASB concluded that the activity leading to the completion of an asset under construction do not create a service.

Key messages

70 This issue was not yet discussed with EFRAG TEG.

EFRAG RRAWG meeting 19 June 2020

71 EFRAG RRAWG members had mixed views regarding the IASB's tentative decision that regulatory returns on a construction work-in-progress (CWIP) base included in the regulated rates charged to customers during the construction period form part of total allowed compensation only during the period when the asset is in operation and is being used to supply goods or services.

72 Some EFRAG RRAWG members noted that it is not uncommon to recognise revenue over the construction period. Those that did have the view referred to the amendment in IAS 16 *Property, Plant and Equipment* where sales revenue can be recognised before an asset is ready for its intended use. However, some RRAWG members noted that tracking CWIP will be very burdensome. CWIP was not necessarily tracked in such detail for regulatory purposes. Other RRAWG questioned whether this proposal was aligned with the requirements for CWIP under IFRIC 12.

73 EFRAG RRAWG members generally supported the IASB proposals on the treatment of performance incentives in the model. Suggestion was made to improve the wording with respect to defining the performance incentives period for construction-related performance incentives as the period to evaluate the performance of construction.

Discounting estimated cash flows

74 An entity shall discount regulatory assets and regulatory liabilities. An entity will generally use the regulatory interest rate specified in the regulatory agreement. However, when selecting a discount rate to apply to estimated cash flows, the measurement principles of the model for regulatory assets and regulatory liabilities requires an entity to:

(a) apply an **indicator-based approach** to assessing whether the regulatory interest rate or return rate is adequate to compensate the entity for the time value of money and the risks inherent in the cash flows between the origination and reversal of a regulatory asset;

(b) if the regulatory interest rate or return rate is inadequate to compensate the entity for the time value of money and uncertainty inherent in the cash flows, an entity should determine a **minimum adequate rate** to use as the discount rate;

(c) the model specifies that the **minimum adequate rate** is one that the entity would expect to receive for a stream of cash flows with the same timing and uncertainty as those of the regulatory asset, or regulatory liability; and

(d) in cases when the regulatory interest rate or return rate provides excess compensation or excess charge for the time value of money and uncertainty in the cash flows, an entity should:

(i) recognise the excess as regulatory income or regulatory expense immediately if it arises from an identifiable transaction or other event, such as a bonus or a penalty; but

(ii) use the regulatory interest rate or return rate as the discount rate, if that excess does not arise from an identifiable transaction or other event.

75 The model requires an entity to continue to apply the discount rate established at initial recognition of the regulatory assets and regulatory liabilities unless there is a change in the regulatory interest rate provided in the regulatory agreement. It is possible that the regulatory agreement changes the regulatory interest rate at certain time intervals; the entity would then have to use the new regulatory interest rate to update the estimated future cash flows.

Key messages

76 Some EFRAG TEG members disagreed with the discounting approach. They referred either to the general principle of adjusting the rate to reflect the risks or to the IAS 12 *Income Taxes* approach as possible way forward.

77 The RRAWG members identified the following additional concerns:

(a) Regulatory rate of interest or return – EFRAG RRAWG members commented that the regulatory rate of interest or return might not be adequate to compensate the entity for the time value of money and the risks inherent in the cash flows. A suggestion was made that it would be more practical for entities to apply a ‘reasonable’ discount rate at each balance sheet date instead of keeping track of different discount rates established at initial recognition of regulatory items. Another alternative was to use the WACC at each balance sheet date.

(b) Implicit rate of interest or return usually referred to return on capital invested and the terminology created confusion when it was to be used for discounting regulatory assets and regulatory liabilities.

78 Some EFRAG RRAWG members commented that the concept of discounting when measuring regulatory items was not very relevant to those items as the amounts to

be recognised as regulatory assets and regulatory liabilities were initially negotiated with the regulator.

EFRAG RRAWG meeting 19 June 2020

79 RRAWG members confirmed their disagreement with the IASB tentative decision that when the regulatory interest rate is inadequate to compensate the entity for the time value of money and uncertainty inherent in the cash flows, the entity should determine a minimum adequate rate to use as the discount rate.

80 EFRAG RRAWG members pointed out that the regulatory agreement does not use the concept of a minimum adequate rate and introducing such a rate in the model would be a highly subjective and complex exercise for preparers. Some RRAWG members referred to complexities like discounting of deferred tax assets and liabilities, which is why IAS 12 *Income Taxes* does not require discounting.

81 In addition, EFRAG RRAWG members expressed views that the application of a minimum adequate rate would not bring value to users to understand regulatory assets and regulatory liabilities. What mattered was the discount rate agreed with the regulator.

82 The EFRAG RRAWG members that supported discounting said that it should be based on the regulatory discount rate.

Presentation requirements

83 An entity shall present regulatory balances as **separate line items**.

84 Applying the requirements in IAS 1 *Presentation of Financial Statements*, an entity can further disaggregate the required line items and present additional line items or subtotals in the primary financial statements, when such presentation would be relevant to an understanding of the entity's financial position and/or financial performance.

85 In the **statement of financial position**, an entity should present:

(a) regulatory assets and regulatory liabilities as separate line items in addition to the line items required by IAS 1;

(b) applying IAS 1, classify regulatory assets and regulatory liabilities as current or noncurrent, except when a presentation based on liquidity is used; and

(c) offset regulatory assets and regulatory liabilities only if they are expected to lead to adjustments to the same future rate(s) charged to customers and, consequently:

(i) they have the same pattern and timing of reversal;

(ii) they arise in the same regulatory regime; and

(iii) the entity has a legally enforceable right to offset them.

86 In the **statement of comprehensive income**, an entity should present:

(a) all regulatory income and regulatory expense in profit or loss, except as indicated in paragraph 87;

(b) regulatory income and regulatory expense netted as a separate line item (regulatory income or regulatory expense line item immediately below the revenue line item(s) required by IAS 1;

(c) include regulatory interest income and regulatory interest expense within the regulatory income or regulatory expense line item (that means they are not finance cost);

87 The model requires an entity to present in **other comprehensive income (OCI)** regulatory income or regulatory expense that is related to items of expense or income presented in OCI, and present that regulatory income or regulatory expense immediately above or immediately below the related expense or income.

Key messages

88 EFRAG TEG members expressed split views with respect to the presentation of regulatory expenses and regulatory income in profit or loss and the OCI. One EFRAG TEG member disagreed with their presentation in OCI and suggested that only presentation in profit or loss should be allowed under the model.

89 One EFRAG TEG member commented that offsetting of regulatory assets and regulatory liabilities should be optional and not a requirement under the model.

EFRAG RRAWG meeting 19 June 2020

90 Some EFRAG RRAWG members reiterated that the IASB presentation proposal created complexity.

91 EFRAG RRAWG members were divided as to whether regulatory interest income and regulatory interest expense should be included within the regulatory income or regulatory expense line item immediately below the revenue line item. Some members supported the IASB presentation approach as it gives clearer performance of regulatory assets and regulatory liabilities. Other members were of the view that regulatory interest expense and regulatory interest income belong to the financing category and should be presented as such.

Amendments to and Interaction with IFRS Standards

92 The IASB tentatively decided to exclude regulatory assets and regulatory liabilities from the scope of the following IFRS Standards:

(a) IFRS 3 *Business Combinations*

(b) IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*

(c) IAS 1 *Presentation of Financial Statements*

(d) IAS 36 *Impairment of Assets*

93 The IASB has tentatively decided to provide application guidance on the accounting for deferred tax under IAS 12.

94 Furthermore, the IASB has tentatively decided that entities operating a service concession arrangement under IFRIC 12 *Service Concessions Arrangements* shall apply IFRIC 12. However, regulatory assets and regulatory liabilities arising from an arrangement under IFRIC 12 should be recognised under the model (separate from IFRIC 12).

IFRS 3 Business Combinations

95 The IASB tentatively decided that, **as an exception to the recognition and measurement principles** in IFRS 3 *Business Combinations*, an entity should recognise and measure regulatory assets acquired and regulatory liabilities assumed in a business combination applying the recognition and measurement principles proposed in the model (modified historical cost instead of fair value as required under IFRS 3).

96 The IASB reached this decision based on the following reasoning:

(a) The IASB considered that by their nature regulatory assets and regulatory liabilities do not trade in active markets and there are limited observable inputs that could be incorporated into an estimate of their fair value. The lack of an active market would make it difficult for an entity to determine the discount rate that would be used by a market participant to measure regulatory assets and regulatory liabilities at fair value.

(b) The IASB also noted that on the date of the acquisition an acquirer would not pay for regulatory assets and liabilities in isolation but rather consider how regulatory assets and liabilities would contribute to the cash flows of the business as a whole. Consequently, the market approach has limited application when determining the fair value of regulatory assets and liabilities in a business combination.

(c) Measuring regulatory assets and liabilities at fair value at the date of acquisition and **subsequently remeasuring** them by applying the measurement principles of the model, could result in the recognition of subsequent period gains or losses that do not represent any economic event but simply reflect the change of one measurement basis to another. The considered the following subsequent measurement consequences in case a regulatory asset or a regulatory liability was measured at fair value:

  (i) in subsequent periods the entity would apply the model and remeasure the regulatory assets/liability based on the 'most likely amount' of estimating future cash flows which would result in a Day 2 gain or loss.

  (ii) if an entity subsequently updates its estimate of future cash flows and at the same time updates the discount rate because of a change in the rate of interest or return in the regulatory agreement (different to a fair value discount rate/rate of return), this would result in a subsequent gain or loss.

(d) Overall, the IASB considered that even if applying the recognition and measurement principles in IFRS 3 to regulatory assets and regulatory liabilities might bring benefits to users of financial statements, the costs involved would not warrant the benefits.

97 Applying the exception to the recognition and measurement principles of IFRS 3, will mean that an entity would recognise and measure the regulatory asset **using the regulatory discount rate** instead of the market rate. The IASB expects this will be the main difference. **Any difference will therefore be adjusted to goodwill** on the date of the acquisition.

IFRS 5 Non-current Assets Held for Sale and Discontinued Operations

98 The IASB tentatively decided that the measurement requirements of IFRS 5 should **not be** applied to regulatory assets.

IAS 1 Presentation of Financial Statements

99 The IASB tentatively decided to require presentation of regulatory assets, regulatory liabilities and regulatory income or regulatory expense as **separate line items** in the statement of financial position and financial performance respectively. IAS 1 would be amended to this effect.

100 The IASB noted that separate line items are necessary for:

(a) regulatory assets and regulatory liabilities because their characteristics differ from those of other assets and liabilities; and

(b) regulatory income or regulatory expense to provide users of financial statements with a basis for understanding how the entity's financial performance was affected by the supply of goods or services in one period and the inclusion of some or all of the total allowed compensation for supplying those goods or services in the regulated rates charged to customers in a different period.

IAS 36 Impairment of Assets

101 The IASB tentatively decided that regulatory assets will be excluded from the scope of IAS 36. This is because as explained in paragraph 61, the IASB tentatively decided that entities will be required to update their estimates of future cash flows to reflect changes in estimated timing and amount. Therefore, there is no need for a separate impairment test for regulatory assets.

102 At this stage, based on the IASB tentative decisions, no additional application guidance will be provided to address the interaction between the requirements in IAS 36 and the model, in cases when a cash-generating unit includes regulatory assets and regulatory liabilities.

Key messages

103 EFRAG TEG members had mixed views on the exception to the measurement principle in IFRS 3 for regulatory assets and regulatory liabilities acquired in a business combination. Some EFRAG TEG members agreed with the exemption for the reasons provided by the IASB in paragraph 96. Other EFRAG TEG members did not agree with the exception on the basis that there are other assets that do not trade in an active market.

104 EFRAG TEG members shared the concern expressed by the EFRAG RRAWG regarding the need for clarity on the interaction between the accounting model (with measurement based on the regulatory discounted cash flows) and IAS 36, when a CGU being tested for impairment includes regulatory balances. EFRAG TEG members considered that a similar concern existed for IFRS 5 and for any goodwill that arose from a business combination that included regulatory assets and liabilities subject to the IFRS 3 measurement exception.

105 One EFRAG RRAWG member asked whether the fair value measurement principle in IFRS 3 would apply to the other assets and liabilities of the acquired company. The IASB representative confirmed this would be case. The intention was to provide a recognition and measurement exception from the IFRS 3 principles only to regulatory assets and regulatory liabilities that were within the scope of the model. This EFRAG RRAWG member asked whether the IASB had considered the temporary differences that would arise because the assets and liabilities would be recognised at fair value in a business combination for IFRS purposes, but not for regulatory purposes. These could be considered regulatory adjustments, like the ones that the model was addressing.

106 EFRAG RRAWG members thought that the IASB needed to further consider the interaction between IFRS 5 and IAS 36 and the accounting model, particularly when regulatory assets form part of a CGU being assessed as a disposal of a unit or assessed for impairment under IAS 36. It was not clear how the interaction with a CGU that included regulatory assets would work in practice and there was a risk of unintended consequences unless clear guidance was provided.

107 Another EFRAG RRAWG member asked whether the interaction with IAS 23 *Borrowing Costs* had considered the implications of applying IAS 36 to an item of PPE that included capitalised borrowing costs and was used to provide defined-rate regulated goods or services. This member questioned whether in such cases there a risk of an impairment loss because of the different treatment for borrowing costs by the entity and the regulator.

108 One EFRAG RRAWG asked how an entity would treat a terminal value in a concession when the regulator provides some form of terminal value guarantee. Another EFRAG RRAWG explained that such cases are excluded from the scope

of the model as they do not involve payment being recovered from the customer. It was the regulator that provided the guarantee and one would need to turn to existing IFRS Standards, such as IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* to determine the accounting. It would be useful to have guidance on the interaction with IFRIC 12 given the overlay nature of the model. It was not clear how to apply the intangible asset model under IFRIC 12 in combination with the model for regulatory assets and regulatory liabilities.

EFRAG RRAWG meeting 19 June 2020

109 EFRAG RRAWG members reiterated that the IASB needed to further consider the interaction between the model and IFRS 5 and IAS 36, particularly when regulatory assets form part of a CGU. It was not clear how the interaction with a CGU that included regulatory assets would work in practice and there was a risk of unintended consequences unless clear guidance was provided. A similar point was made for assets that had been acquired in a business combination and were used to provide regulatory goods or services.

110 EFRAG RRAWG members reiterated that it would be necessary to have guidance on the interaction with IFRIC 12 given the overlay nature of the model. It was not clear how to apply the intangible asset model under IFRIC 12 in combination with the model for regulatory assets and regulatory liabilities. A question was also raised for cases when an entity has a hybrid model/arrangement under IFRIC 12.

Disclosure requirements

111 The model proposes an **overall disclosure objective** for an entity to disclose information to help users of financial statements understand the effects that regulatory income and regulatory expense, and regulatory assets and regulatory liabilities have on an entity's financial performance and financial position. The overall disclosure objective focuses on reporting an entity's regulatory income, regulatory expense, regulatory assets and regulatory liabilities and does not propose a broader objective to reflect information about the general regulatory and economic environment, the risks associated with it and the effects on the entity's financial statements.

112 Under the accounting model for regulatory assets and regulatory liabilities, an entity should disclose:

(a) a breakdown of the regulatory income or regulatory expense line item in profit or loss into the following components:

(i) originations of regulatory assets, together with qualitative and quantitative information about the reasons for their amounts;

(ii) originations of regulatory liabilities, together with qualitative and quantitative information about the reasons for their amounts;

(iii) recovery of regulatory assets;

(iv) fulfilment of regulatory liabilities; and

(v) changes in the carrying amount of regulatory assets and regulatory liabilities due to changes in estimates, together with qualitative and quantitative information about the reasons for those changes;

(b) a maturity analysis of the carrying amounts of regulatory assets and of regulatory liabilities at the end of the period, and an explanation of how the future recovery of regulatory assets or the future fulfilment of regulatory liabilities is affected by risks and uncertainty;

(c) the discount rate or ranges of discount rates used to discount the estimated cash flows reflected in the carrying amounts of regulatory assets and of regulatory liabilities at the end of the period and, if different, the related regulatory interest or return rate(s) approved by the regulator, together with qualitative and quantitative information about the reasons for those differences; and

(d) a reconciliation of the opening and closing carrying amount of regulatory assets and of regulatory liabilities from the beginning to the end of the period;

(e) any regulatory interest or regulatory return arising on regulatory assets or regulatory liabilities should be disclosed as a separate caption in:

(i) the breakdown of regulatory income or regulatory expense for the period; or

(ii) the reconciliation of the carrying amounts of regulatory assets and of regulatory liabilities from the beginning to the end of the period.

113 In addition, an entity should assess whether the information provided through the disclosure requirements is sufficient to meet the overall disclosure objective. If not, the entity should disclose any additional information needed to meet that objective.

Key messages from EFRAG TEG

114 Some EFRAG TEG members expressed concerns with the level of disclosure requirements and considered that entities might not have readily available the level of granular information required under the proposals.

EFRAG RRAWG meeting 19 June 2020

115 EFRAG RRAWG members expressed concerns with the level of detailed disclosure requirements and considered that entities might not have readily available the level of granular information required under the proposals. EFRAG RRAWG members generally agreed that the materiality principle will need to be applied to narrow down the disclosure requirements under the model.

Transition requirements

116 The transition requirements in the model for regulatory assets and regulatory liabilities:

(a) require an entity that currently applies IFRS Standards to apply the model retrospectively to each prior reporting period presented in accordance with the requirements in IAS 8 (except as noted in paragraph 117);

(b) require a first-time adopter of IFRS Standards to apply the model at the date of transition to IFRS Standards, as defined in IFRS 1 *First-time Adoption of International Financial Reporting Standards*[1]; and

(c) retain the deemed cost exemption in paragraph D8B of IFRS 1.

117 In addition, an entity that currently applies IFRS Standards is permitted to elect not to apply the model retrospectively to business combinations that occurred before the beginning of the earliest period presented. If an entity elects not to apply the model retrospectively to **past business combinations**, the entity should:

(a) recognise only those regulatory assets and regulatory liabilities arising from all past business combinations which still exist at the date of transition to the model; and

[1] If a first time adopter does not apply IFRS 3 retrospectively this might have impact on goodwill.

(b) recognise any resulting change as an adjustment to the carrying amount of goodwill. If that adjustment reduces the carrying amount of goodwill to zero, the entity should recognise any remaining adjustment in retained earnings or, if appropriate, another category of equity.

118 However, if an entity elects to apply the model retrospectively to **past business combinations**, it should apply that election to **all of its** past business combinations and not on a case-by-case basis.

119 On transition to the model for regulatory assets and regulatory liabilities, an entity applying IFRS Standards would:

(a) recognise regulatory assets and regulatory liabilities in accordance with the recognition requirements of the model;

(b) derecognise regulatory balances that in accordance with the model do not qualify for recognition as regulatory assets or regulatory liabilities;

(c) reclassify items that in accordance with the model must be recognised as a regulatory asset or a regulatory liability but in accordance with previous GAAP were recognised as a different type of asset or liability;

(d) apply the measurement requirements of the model to all recognised regulatory assets and regulatory liabilities; and

(e) recognise any resulting adjustment to retained earnings (or other component of equity) at the beginning of the earliest comparative period presented.

120 An entity that is a first-time adopter is required to apply the model at the date of transition to IFRS Standards as defined in IFRS 1 and restate comparative information applying IFRS 1 requirements throughout its financial statements.

121 Additionally, for first-time adopters, paragraph D8B of IFRS 1 provides an exemption permitting entities to use the previous GAAP carrying amount of an item that is used, or was previously used, in rate-regulated activities as its deemed cost for the following reasons:

(a) it eliminates significant practical challenges in restating such items retrospectively, removing non-qualifying amounts or using fair value as deemed cost; and

(b) most first-time adopters with rate regulated activities account for property, plant and equipment in accordance with a historical cost model consistent with IAS 16 and the item for which the exemption is used is required to be tested for impairment using IAS 36 at the date of transition.

122 Furthermore, entities that currently recognise goodwill-related regulatory assets, by considering goodwill in the total allowed compensation and including a charge to customers through the regulatory rate, are required to derecognise such assets on transition to the model. The model requires goodwill-related regulatory assets to be reclassified to goodwill.

123 This requirement would apply only to outstanding balances of goodwill-related regulatory assets as of the date of initial application of the model and any amounts that have already been derecognised in accordance with previous GAAP would not be reclassified.

Key messages

124 EFRAG TEG members generally agreed with the transition requirements of the model. However, they suggested that the IASB should also consider a modified retrospective approach to simplify the transition requirements of the model for regulatory assets and regulatory liabilities similar to the approach in IFRS 15.

125 The EFRAG TEG members reiterated that the transition requirements will have an impact on the impairment test of the CGU under IAS 36, therefore additional guidance was required.

126 EFRAG TEG members agreed that goodwill-related regulatory assets should not be recognised under the model, however, it was not clear why these assets were to be reclassified to goodwill on transition and what this goodwill would represent.

EFRAG RRAWG meeting 19 June 2020

127 EFRAG RRAWG agreed that a modified approach should be explored by the IASB. EFRAG TEG members noted that the transition requirements will have an impact on the impairment test of the CGU under IAS 36, therefore additional guidance was required. EFRAG RRAWG noted the same concern.

128 Some EFRAG RRAWG members questioned why goodwill-related regulatory assets should be derecognised to goodwill under the model and not allocated to other assets.

Appendix – Extract Report of the EFRAG RRAWG Chairman on the EFRAG RRAWG meeting on 23 October 2019

Purpose

130 The purpose of this report is to inform EFRAG TEG of the feedback received from members of the EFRAG Rate-regulated Activities Working Group (EFRAG RRAWG) at a meeting held on 23 October 2019.

Agenda of the EFRAG RRAWG

131 The following topics were discussed at the meeting:

(a) Status of the IASB project and next steps

(b) Scope and definition of regulatory assets and liabilities

(c) Recognition and derecognition

(d) Measurement of regulatory assets and regulatory liabilities

(e) Interaction with IFRS Standards including IFRS 3 *Business Combinations*

(f) Presentation, disclosure and transition.

Status of the IASB project and next steps

132 The IASB representative provided a summary of the IASB tentative decisions to date on the IASB project on the accounting for regulatory assets and regulatory liabilities and noted that an exposure draft is expected in Q2 of 2020.

Scope and definition of regulatory assets and liabilities

133 EFRAG RRAWG members discussed the IASB tentative decisions on scope for defined rate regulation and updated definitions of regulatory assets and regulatory liabilities.

134 EFRAG RRAWG members generally agreed with the definition of the scope and agreed with the IASB the regulatory framework establishes *both* the presence of a *binding* regulatory agreement and a *basis for setting the rate* that gives rise to rights to add amounts to and obligations to deduct amounts from future rate(s) because of goods or services already supplied or because of amounts already charged to customers are both necessary and sufficient to give rise to regulatory assets and regulatory liabilities.

135 Some EFRAG RRAWG members noted that the IASB reference to 'rate-adjustment mechanism' had been removed. In their view, excluding the reference to the rate-adjustment mechanism could broaden the scope of the project.

136 EFRAG RRAWG members agreed that one of the most important inputs is the facts and circumstances as a basis for assessing the enforceability of the regulatory agreement, as self-regulation should be excluded from the scope.

137 Some EFRAG RRAWG members also considered that one of the most important issues was the definition of the regulator.

Recognition and derecognition (including the regulatory boundary)

138 EFRAG RRAWG members discussed the IASB's tentative decisions on the recognition and derecognition principles for regulatory assets and regulatory liabilities.

139 EFRAG RRAWG members supported the recognition and derecognition principles and agreed with the IASB rationale that recognition of regulatory rights and obligations will enhance the way performance for activities within the scope of the model will be reflected in the entity's profit or loss, and provide a more faithful reflection of the entity's rights and obligations stemming from defined rate regulation.

140 EFRAG RRAWG members also discussed the IASB's tentative decisions on how an entity should determine the boundary of the regulatory agreement, and how an entity should account for regulatory assets that would be recovered (or regulatory liabilities that would be fulfilled) through the rates charged to customers over a period beyond the current term of the regulatory agreement (i.e. outside the boundary of the agreement). For example, in cases when the regulatory agreement is set to expire and must be renewed, or to situations where the regulatory agreement can be terminated by either party giving notice to the other.

141 Most (if not all) EFRAG RRAWG members had difficulties with understanding how in practice an entity would determine the boundary of a regulatory agreement and why it was important to make this assessment, given the nature of the regulatory environment to which the model will apply. It was also not clear how to assess practical ability in the context of defined rate regulation as this type of regulation operated within a wider regulatory framework that was also linked to EU law and the licence to operate. The IASB representative present at the EFRAG RRAWG meeting explained that the reference to 'practical ability' and 'ability to exercise', was based on guidance in the *Conceptual Framework*. The IASB representative agreed that it would be necessary to explain this in the application guidance of the forthcoming exposure draft.

142 One EFRAG RRAWG member questioned how the boundary would be determined in case both the entity had an option to renew (say in year 5) and the regulator had to option to cancel (say in year 3). In this case, which option would 'come first' in determining the boundary. The IASB representative thought that it would be the shorter period of 3 years that would determine the boundary.

143 EFRAG RRAWG members considered that the key problem was that the guidance was mixing the licence to operate (which was for a much longer period) and the regulatory agreement. The latter was subject to periodic reviews (and renewals); however, these reviews to assess whether changes to the rates charged to customers and recovery periods were needed. Such renewals did not imply that the regulatory agreement would come to an end. This could also have implications on impairment assessments.

144 Another EFRAG RRAWG member noted that in some jurisdictions there might not be a regulatory agreement *per se* as the regulation stemmed from a broader regulatory framework under EU law. In these cases, it was not possible to link the boundary to the regulatory agreement.

145 Another EFRAG RRAWG member highlighted that in practice most defined rate regulated entities would be recognising regulatory assets and regulatory liabilities beyond the renewal period set out in the regulatory agreement which had a different purpose to potential cancelation of the agreement and the right for the entity to continue to continue beyond that renewal period.

146 Another EFRAG RRAWG member noted that if the IASB were to pursue this guidance, it was important to define what is 'substantive' in the context of defined rate regulation.

147 EFRAG RRAWG members generally agreed with the IASB's tentative decisions on how to account for changes to the boundary agreement and the required disclosure to explain the changes. However, they iterated that their main concern was the guidance on the determination of the boundary agreement.

Measurement of regulatory assets and regulatory liabilities

148 EFRAG RRAWG discussed the measurement principles in the accounting model for regulatory assets and regulatory liabilities and broadly supported the proposed measurement technique. Members expressed the following views:

(a) estimating future cash flows based on incentive schemes - members agreed that currently entities account for regulatory incentive in the way proposed in the model. However, the main practical difficulty would be to estimate the amount of the penalty or bonus to be included in the rate at the year end. Members agreed that the most likely amount method would better capture the measurement of such incentive schemes;

(b) impairment of regulatory assets - some members explained that separating the cash flows from regulatory assets when performing impairment test of the cash-generating unit (CGU) would be operationally difficult and might not give a significantly different outcome. A suggestion was made to include regulatory cash flows in the CGU and consider them in the impairment test in accordance with IAS 36 *Impairment of Assets*. This would serve both as a safeguard and would be operationally simpler;

(c) regulatory rate of interest or return – EFRAG RRAWG members commented that the regulatory rate of interest or return might not be adequate to compensate the entity for the time value of money and the risks inherent in the cash flows. A suggestion was made that it would be more practical for entities to apply a ‘reasonable’ discount rate at each balance sheet date instead of keeping track of different discount rates established at initial recognition of regulatory items. Another alternative was to use the WACC at each balance sheet date;

(d) the implicit rate of interest or return usually referred to return on capital invested and the terminology created confusion when it was to be used for discounting regulatory assets and regulatory liabilities;

(e) the accounting model for defined rate regulation applied the regulatory rate of interest or return asymmetrically:

   (i) when the regulatory interest rate is lower than the minimum adequate rate, then the entity should use minimum adequate rate to discount estimated future cash flows – consequently, the entity should recognise a Day 1 loss, however;

   (ii) when the regulatory interest rate provides an excess compensation, which does not relate to an identifiable transaction or event, then the entity should use the regulatory interest rate to discount estimated future cash flows and there is no recognition of a Day 1 gain.

(f) discounting of regulatory items - some EFRAG RRAWG members commented that the concept of discounting when measuring regulatory items was not very relevant to those items as the amounts to be recognised as regulatory assets and regulatory liabilities were initially negotiated with the regulator.

Interaction with IFRS Standards including IFRS 3 *Business Combinations*

149 EFRAG RRAWG members discussed the interaction of the accounting model for regulatory assets and regulatory liabilities with IFRS 3 and specifically whether the measurement principles in IFRS 3 should apply to regulatory assets and regulatory liabilities acquired in a business combination.

150 EFRAG RRAWG members generally agreed that it make sense for an entity to recognise and measure regulatory assets and regulatory liabilities acquired in a business combination in accordance with the recognition and measurement principles of the model, rather than measuring these at a market value that did not apply to the entity.

151 One EFRAG RRAWG member asked whether the fair value measurement principle in IFRS 3 would apply to the other assets and liabilities of the acquired company. The IASB representative confirmed this would be case. The intention was to provide a recognition and measurement exception from the IFRS 3 principles only to regulatory assets and regulatory liabilities that were within the scope of the model. This EFRAG RRAWG member asked whether the IASB had considered the temporary differences that would arise because the assets and liabilities would be recognised at fair value in a business combination for IFRS purposes, but not for regulatory purposes. These could be considered regulatory adjustments, similar to the ones that the model was addressing. The IASB representative informed that the IASB had not discussed this matter.

152 EFRAG RRAWG members were also asked about the interaction other IFRS Standards and whether application guidance should be developed to provide clarity on how the model would be applied alongside the requirements of existing IFRS Standards. The IASB had tentatively decided that IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations,* IAS 1 *Presentation of Financial Statements* and IAS 36 *Impairment of Assets* would not apply to the model. EFRAG RRAWG members thought that the IASB needed to further consider the interaction between IFRS 5 and IAS 36 and the accounting model, particularly when regulatory assets form part of a CGU being assessed as a disposal of a unit or assessed for impairment under IAS 36. It was not clear how the interaction with a CGU that included regulatory assets would work in practice and there was a risk of unintended consequences unless clear guidance was provided.

153 Another EFRAG RRAWG member asked whether the interaction with IAS 23 B*orrowing Costs* had considered the implications of applying IAS 36 to an item of PPE that included capitalised borrowing costs and was used to provide defined-rate regulated goods or services. This member questioned whether in such cases there a risk of an impairment loss because of the different treatment for borrowing costs by the entity and the regulator.

154 One EFRAG RRAWG asked how an entity would treat a terminal value in a concession when the regulator provides some form of terminal value guarantee. Another EFRAG RRAWG explained that such cases are excluded from the scope of the model as they do not involve payment being recovered from the customer. It was the regulator that provided the guarantee and one would need to turn to existing IFRS Standards, such as IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* to determine the accounting.

155 Another EFRAG RRAWG member commented that it would be useful to have guidance on the interaction with IFRIC 12 *Service Concession Arrangements* given the overlay nature of the model. It was not clear how to apply the intangible asset model under IFRIC 12 in combination with the model for regulatory assets and regulatory liabilities.

Presentation, disclosure and transition

156 EFRAG RRAWG members discussed the IASB tentative decisions on the presentation of regulatory assets and regulatory liabilities and related regulatory income and regulatory expense items, the disclosure objectives and related disclosure requirements for defined rate regulation; and the transition requirements for the model for regulatory assets and regulatory liabilities.

157 EFRAG RRAWG members generally agreed that there should be a separate presentation of regulatory balances in other comprehensive income (OCI) for the regulatory income or regulatory expense that is related to items of expense or income presented in OCI and in profit or loss for all other regulatory income or regulatory expenses, immediately below the line item for revenue.

158 However, some EFRAG RRAWG members emphasised that sometimes it is not easy to disaggregate the CGU and disclose the numbers. For that reason, they stressed the importance to keep the requirements simple so it would be easier for companies to meet the requirement.

159 Some EFRAG RRAWG members noted that qualitative information would be important as could add additional explanation on the regulatory agreement between the entity and the regulator.

160 EFRAG RRAWG members were supportive of the transition requirements for the accounting model for defined rate regulation. Suggestion was made to apply a kind of modified retrospective approach from the first day of the first comparative period presented.

161 With respect to the permitted election to apply the model retrospectively to past business combinations, a view was expressed that entities with significant business combinations will have very different numbers from other entities.