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EFRAG Secretariat: Isabel Batista,
Ioana Kiss, Joachim Jacobs

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IASB project on accounting for regulatory assets and regulatory liabilities

Key messages for EFRAG DCL

Objective

1 This paper sets out the key messages to be included in an initial draft of an EFRAG draft comment letter (DCL) 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 key messages are based on the wording currently available, i.e. the IASB tentative decisions and IASB staff papers. As such, these messages will be subject to changes following the issuance of the Exposure Draft.

2 EFRAG TEG members are requested to inform the EFRAG project team whether they agree with the views cited in this paper and what additional points they would like to include in the initial draft of an EFRAG DCL which will be presented at a future EFRAG TEG meeting. The specific questions to EFRAG on each of the aspects of the model are included below.

Questions for EFRAG TEG

3 Do you have additional comments on the **objective** of the accounting model highlighted in paragraphs 32 to 40? If not please explain.

Scope (paragraphs 41 to 55)

4 Do you have additional comments on the proposed scope? Specifically, do you still consider that the definition of scope might be too broad? Are you aware of any situations in which the proposed scope would affect activities that you do not think should be within the scope? If so, what changes to the scope definition do you propose?

5 Do you agree that the application of the accounting model should be a supplementary model, meaning that an entity would first recognise any assets or liabilities under existing IFRS Standards, before applying the model?

Definitions of regulatory assets and regulatory liabilities (paragraphs 56 to 77)

6 Do some EFRAG TEG members still consider 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'? The EFRAG RRAWG *do not agree* with referring to regulatory assets and regulatory liabilities as 'deferred balances'.

7 Do you agree that the definition of regulatory assets and regulatory liabilities should focus on total allowed compensation, including both the recovery of allowed costs and a profit margin?

8 Do you have any other comments of the definitions of regulatory assets and regulatory liabilities?

Recognition (including the regulatory boundary) (paragraphs 78 to 88)

9 What are your views on applying a 'more likely than not' recognition threshold when an entity is uncertain whether a regulatory asset or a regulatory liability exists? Please explain. If you do not agree, what recognition threshold do you suggest and why?

10 Do you have additional (or different) views to that already provided in paragraphs 85 to 87?

Measurement excluding discounting (paragraphs 89 to 99)

11 Do you have additional comments on the proposed measurement principle (i.e. modified historical cost) for regulatory assets and regulatory liabilities?

12 Do you have any views, agree or disagree with the measurement exception for regulatory assets and regulatory liabilities when regulated rates will be based on future cash flows (ie when the entity receives or pays the related cash)?

Regulatory returns and performance incentives (paragraphs 100 to 110) – **this section has not been previously discussed with EFRAG TEG**

13 What are your views on 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? If you do not agree please explain why.

14 What are your views on the treatment of performance incentives in the accounting model for regulatory assets and regulatory liabilities?

Discounting estimated cash flows (paragraphs 111 to 119)

15 What are your views, do you agree or disagree with the concerns expressed by

	EFRAG RRAWG members on the discounting requirements?
16	Do you have additional comments on the discounting proposals?
	Presentation requirements (paragraphs 120 to 128)
17	Do you have any other comments on the presentation proposals?
	Amendments to and Interaction with IFRS Standards (paragraphs 129 to 142)Do EFRAG TEG members continue to have mixed views on the exception to the measurement principle in IFRS 3 for regulatory assets and regulatory liabilities acquired in a business combination? Please explain.
18	Do EFRAG TEG members share the views and concerns expressed by EFRAG RRAWG members in paragraphs 142?
19	Do you have any other comments on the amendments to and interaction with IFRS Standards?
	Disclosure requirements (paragraphs 143 to 148)
20	Do you have any other comments on the disclosure requirements?
	Transition requirements (paragraphs 149 to 161)
21	Do you have any other comments on the transition requirements?

Background

22 The exposure draft on the model is expected in December 2020. We understand that the IASB Staff will ask the IASB at its meeting in September 2020 to extend the comment period from the initial suggested period of 120 days to 180 days. The EFRAG RRAWG supports the extension of the comment period.

23 The IASB project, initially titled rate-regulated activities, focuses on the accounting for regulatory assets and regulatory liabilities. Since IFRS adoption in 2005, many companies operating in a rate-regulated environment have raised the question about whether rights and obligations arising from rate regulation would qualify for recognition under the IASB's *Conceptual Framework for Financial Reporting (Conceptual Framework).* Some EU companies recognised (and still recognise) regulatory balances using different accounting methods and others do not. The IASB has concluded that regulatory assets and regulatory liabilities meet the definitions of assets and liabilities under the Conceptual Framework and provide useful information to users of companies that have regulatory balances.

24 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.

25 The expert views from the EFRAG RRAWG discussed in previous meetings were presented to EFRAG TEG to assist EFRAG TEG in forming its views. The feedback received from EFRAG RRAWG members is included in the chairman's reports following the RRAWG meeting on 19 June 2020 (Paper 07-04) and RRAWG meeting on 23 October 2019 (Paper 07-05). The Chairman of the EFRAG RRAWG will present the chairman's report of the June 2020 EFRAG RRAWG during today's session. A few members of the EFRAG RRAWG members will also attend the session to allow EFRAG TEG members to ask questions and clarify any issues regarding the practical application of the model and other related matters.

26 EFRAG TEG discussed the various aspects of the accounting model for regulatory assets and regulatory liabilities at its meetings in November 2019 and a web-cast

meeting in February 2020, respectively. The views expressed during this EFRAG TEG-CFSS meeting are summarised within relevant sections of this paper.

27 At its July meeting in July 2020, EFRAG CFSS and EFRAG TEG received an update on the outreach already undertaken by the EFRAG project team on the scope of the model and the intended preliminary outreach, including an effect analysis, for the forthcoming months before publication of the ED. At this meeting, CFSS members were asked whether they would like to participate in the testing of the scope and also to provide the EFRAG project team with names of companies that would be interested in this exercise and also in testing the application of the model once the ED was available. EFRAG TEG-CFSS did not discuss the IASB's tentative decisions. The EFRAG project team will ask EFRAG CFSS members for views on the IASB proposals at a future meeting, before or after the ED is published.

28 The EFRAG Board received a presentation from an IASB Board 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.

29 The EFRAG project team notes that as the IASB finalises and improves the drafting of the expected proposals, the wording in the forthcoming exposure draft might be different to the IASB tentative decisions included in this paper, which have been the primary source for discussions so far.

30 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.

Key areas of the model

31 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 *First-time Adoption of International Financial Reporting Standards*, IFRS 3 *Business Combinations*, IFRS 5 Non-*current Assets held for sale and Discontinued Operations*, IAS 1 *Presentation of Financial Statements*, IAS 36 *Impairment of Assets*)

(f) Presentation and disclosure requirements

(g) Transition.

Objective of the model and general principle

32 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.

33 To meet this objective, the general principle of the model is that an entity shall **reflect in its financial statements the total allowed compensation for the goods or services supplied in a period.** The model focuses on increases in future rates (regulatory assets) enforceable under the regulatory agreement for goods or services already supplied and on decreases in future rates (regulatory liabilities)

because of compensation already charged to customers for goods or services to be supplied in a future period.

34 The total allowed compensation is defined as:

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.

35 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).

36 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.

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

(a) First, 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). This regulatory binding nature is what makes them enforceable.

(b) Second, 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.

38 The forthcoming exposure draft is expected to provide application guidance on the more difficult elements of total allowed compensation.

Key messages from EFRAG TEG

39 EFRAG TEG expressed the view that the model had become overly complex and difficult to understand and may result in application issues. The complexity arose mainly because of the detailed proposed requirements in some areas of the model, such as recognition and measurement, exceptions to IFRS principles and detailed disclosure requirements.

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40 EFRAG RRAWG members 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. They also noted that some of the proposals were highly subjective and did not reflect the concepts typically used in regulatory agreements/regulatory frameworks and the general objectives of the regulatory environment relevant to entities that are expected to apply the model.

Scope

41 The IASB has tentatively decided that the scope of the model would apply to an entity's regulatory assets and regulatory liabilities.

42 For regulatory assets and regulatory liabilities to exist, the following conditions need to be met:

(a) The entity is a party to a regulatory agreement between the entity and a regulator which consists of a set of enforceable conditions that are binding on both the entity and the regulator.

(b) the agreement sets out the regulated rate that the entity can charge the customer for goods or services provided.

(c) The regulated rate is determined in such a way that some or all of the total allowed compensation for goods or services provided in one period is charged to customers in a different (past or future) period. (When all the total allowed compensation for goods or services supplied in a period is always charged in the same period, `no regulatory asset or regulatory liability would arise).

43 Entities within the scope of the model will be required to recognise regulatory assets and regulatory liabilities. The focus of the scope is no longer on 'defined rate regulation' nor on 'activities, but rather on a type of rate regulation that meets the above conditions which in turn give rise to regulatory assets and regulatory liabilities.

44 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.

45 In its tentative decisions the IASB did not define a regulator. However, it is expected that the forthcoming ED might provide some application guidance of the types of regulatory agreements that would be included in the scope. For example, one of the questions raised several times by EFRAG RRAWG members is whether a service concession agreement should be considered as a regulatory agreement and if so, whether the accounting model or IFRIC 12 *Service Concession Arrangements* should be applied – only to regulatory assets and regulatory liabilities, and if so how to differentiate between the items that are accounted for under IFRIC 12 today and how items that should be accounted for under the model but which arise from the service concession arrangement.

Key messages from EFRAG TEG

46 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).

47 EFRAG 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.

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

49 To respond to the EFRAG TEG request, the EFRAG project team has started to undertake outreach with European national standard setters (EFRAG CFSS members) 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).

50 At this stage, the project team has only received feedback from a few European national standard setters, as the covid-19 pandemic has placed significant pressure on available resources at all levels.

51 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.

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52 Some EFRAG RRAWG members informed that they were still investigating whether and to what extent the transport industry, such as railways, would be impacted.

53 Several RRAWG members that represent companies that operate concession agreements wanted to better understand the interaction with the model and with IFRIC 12. These RRAWG members were of the view that it was not always clear which of the two sets of requirements an entity should apply. 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 substance (in terms of outcome and/or intention) of the respective transactions were very similar.

54 Some EFRAG RRAWG members suggested that the scope of the model ought to cover enforceable rights and obligations that are recovered (fulfilled) by third parties (including a regulator) on behalf 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, the government, an insurance company or any third party. Consequently, some EFRAG RRAWG members suggested that the model for regulatory assets and regulatory liabilities should be independent of who pays for the services or goods delivered.

55 Some EFRAG RRAWG members considered that it was not always easy to determine who the customer is. An example was given of a bus service where the town sets the tariffs and oversees them. This type of agreement was enforceable (when a user bought a ticket, that constituted a contract), although the town was not a regulator. There was a question about who the real customer was whether it was the user of the bus service or the town where the bus service operated? This example illustrated that it was not always easy to determine who the customer might be. In their view the definition of the customer should be broadened to avoid scoping out entities that should be scoped in.

Definition of regulatory assets and liabilities

56 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 tentatively decided that an entity should account for regulatory assets and regulatory liabilities separately from the rest of the regulatory agreement.

57 The IASB has not specifically defined a “regulator” because the characteristics of regulators vary greatly across jurisdictions and specifying these characteristics is not necessary for the rights and obligations created by the regulatory agreement to be enforceable. However as mentioned in paragraph 45 some guidance might be needed concerning which types of regulatory agreements the IASB intends to be included in the scope.

58 The concept of total allowed compensation in paragraphs 33 and 35 above 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 are 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. In other words, the entity has **under-charged** for goods or services provided.

(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. In other words, the entity has **over-charged** for goods or services provided/to be provided.

59 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**.

60 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.

61 We understand that the exposure draft will provide illustrative examples. However, the examples will accompany, but will not be part of the forthcoming IFRS standard on regulatory assets and regulatory liabilities. Some typical examples of when regulatory assets and regulatory liabilities will arise from a regulatory agreement include:

(a) Input costs and quantity (volume) estimation variances;

(b) Insufficient regulatory interest rate;

(c) Recovery period longer/shorter than an asset’s useful life;

(d) Regulatory returns of an asset not yet in use;

(e) Pre-funding of an asset(s) by customers.

62 The paragraphs below illustrate a regulatory asset and a regulatory liability described in paragraph 61(c).

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

63 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 fact pattern:

Fact pattern

64 Entity A acquires an item of PPE with a cost of CU1.000 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 ([1]RAB) for recovery in the rates charged to customers over a period of 5 years.

Application of the model

65 Applying the model, the total allowed compensation of CU1.000 represents 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 CU200 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**		**1.000**
Amounts charged to charges	200	200	200	200	200	1.000
Difference	**50**	**50**	**50**	**50**	**(200)**	**-**

66 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 under the regulatory agreement. Applying the model, Entity A recognises a regulatory asset of CU50 in Year 1. Assuming all stays the same, Entity A also recognises an additional regulatory asset of CU50 in each of years 2-4.

67 The **regulatory asset of CU50 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 with a corresponding charge to regulatory expense.

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[1] The regulatory Asset Base (RAB) can be described as a system of long-term tariff (rate) design aimed primarily at encouraging investment in the construction, expansion and modernisation of infrastructure. Typical components of RAB are existing assets, depreciation, capital contributions, working capital and new investments.

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

68 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

69 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

70 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 CU250 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**	**-**

71 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 CU50 in each of Years 2-4.

72 The regulatory liability of CU50 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 with a corresponding credit to regulatory income.

Key messages from EFRAG TEG

73 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.

74 Some TEG members questioned whether regulatory assets and regulatory liabilities met the definitions of assets and liabilities in the *Conceptual Framework*. EFRAG TEG suggested that the EFRAG project team get inputs from the EFRAG RRAWG on what these assets/liabilities represent from an economic point of view.

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75 EFRAG RRAWG members observed 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, including IFRS 15. Some EFRAG RRAWG considered that the model would enhance accountability and allow for better stewardship. It would provide users of financial statements with useful information about the entity's real performance for the period in which the goods or services were provided.

76 EFRAG RRAWG considered that the examples presented in paragraphs 63 to 72 above, for a regulatory asset and a regulatory liability, met the definitions of an asset and a liability (respectively) under the *Conceptual Framework*.

77 However, one EFRAG RRAWG noted that, for a regulatory liability, it was confusing, in some cases, to link it to the provision of goods or services. One example could be a pre-funding arrangement for advance billing and the entity had not provided goods or services in the period(s) of the advance billing. In this case, the goods or services could be provided in a future period.

Recognition (including the regulatory boundary)

78 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 43 above).

79 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 they exist** (i.e. the model sets a symmetrical recognition threshold for regulatory assets and regulatory liabilities in cases of existence uncertainty). If there is a low probability of an inflow/outflow or high measurement uncertainty, such probability and measurement uncertainty is considered in the measurement.

80 The model **only establishes a threshold 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* related to existence uncertainty, and measurement uncertainty.

81 The boundary of a regulatory agreement determines which estimated cash flows are included in the measurement of a regulatory asset and a regulatory liability. This assessment requires a level of judgment. 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.

82 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.

83 The IASB tentatively decided that when **determining the regulatory agreement boundary,** an entity should consider all options that could affect that boundary, but shall disregard a right held by any party if there are no circumstances in which that party has the practical ability to exercise that right. For example, if exercising that right by a regulator could lead to serious disruptions in the provision of goods or services that serve the public at large.

84 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 (e.g., 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 from EFRAG TEG

85 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 and they would have preferred "virtually certain" as a recognition criterion for regulatory assets – similar to the recognition criteria in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

86 EFRAG TEG found the IASB tentative decision on the boundary of the regulatory agreement to be 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 framework rather than being an accounting judgment.

87 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 to be provided by the EFRAG RRAWG, preferably when these relate to a combination of regulatory and concession agreements.

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88 EFRAG RRAWG members confirmed the views previous expressed and also included in paragraphs 85 and 87 above.

Measurement of regulatory assets and regulatory liabilities

89 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.

90 **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 asset or related liability (e.g. IAS 12 *Income Taxes* or IAS 37); and

(b) adjusting the measurement of the regulatory asset or regulatory liability to reflect any risks that **are not present in the related asset or related liability**. Examples of uncertainties that might not be present in the related asset or related liability include demand risk and credit risk.

91 When regulatory assets and regulatory liabilities are measured using the measurement exception in paragraph 90 above 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.

92 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.

93 Once the entity has received or paid cash to recover the related asset (settle the related liability) it shall stop applying the measurement exception in paragraph 90 and measure the remaining part of the regulatory asset or regulatory liability under the apply the measurement principle for regulatory assets and regulatory liabilities.

Estimating future cash flows

94 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.

95 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 does not apply to regulatory assets.

96 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' for supplying goods and services in the

period when the entity's performance occurs (regardless of when that incentive is included in the regulated rates). The amount of any bonus or penalty should be **apportioned** when an entity's performance is evaluated over a time frame that is not yet complete at the end of the reporting period. In such case, the entity will need to estimate the amount of the incentive which should be includes as part of the total allowed compensation for goods or services supplied in the same reporting period and the portion of the estimate that relates to the next reporting period.

Key messages from EFRAG TEG

97 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.

98 EFRAG TEG did not specifically discuss the measurement exception in paragraph 90.

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99 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.

Regulatory returns and performance incentives

Regulatory returns

100 Regulatory returns are generally a significant part of an entity's target profit to which it is entitled. Regulatory returns, which are included in total allowed compensation, sometimes are granted when an entity is constructing a particular asset to be used to provide goods or services.

101 In March 2020, the IASB deliberated whether **regulatory returns on an asset not yet in use (ie under construction)**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.

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

103 The IASB noted that the two approaches commonly used by regulators for including regulatory returns on the asset not yet in use 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.

104 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 recognised on the asset not yet in use would be contrary to the general principle of the model.

Performance incentives

105 A regulatory agreement may provide an entity with various forms of performance incentives to compensate an entity for meeting its performance targets. This is very typical for incentive-based type rate regulation, which is very common in European jurisdictions.

106 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 is regardless of whether performance relates to construction work or the provision of goods or services. This conclusion is different to the conclusion in paragraph 104 above reached by the IASB on the accounting for regulatory returns on target profit that relates to assets under construction (CWIP).

Key messages from EFRAG TEG

107 This issue was not yet discussed with EFRAG TEG.

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108 EFRAG RRAWG members had mixed views regarding the IASB's tentative decision that regulatory returns on an asset not yet in use (also referred to construction work in progress or CWIP) 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.

109 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 where sales revenue can be recognised before an asset is ready for its intended use. However, some EFRAG RRAWG members noted that tracking CWIP will be quite burdensome as it was not necessarily tracked in such detail for regulatory purposes. Other EFRAG RRAWG members questioned whether this proposal was aligned with the requirements for CWIP under IFRIC 12.

110 EFRAG RRAWG members generally supported the IASB proposals on the treatment of performance incentives in the model. A suggestion was made to define the 'performance incentives period' for construction-related performance incentives as the period to evaluate the performance of construction.

Discounting estimated cash flows

111 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 there are indicators that regulatory interest rate is not 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; 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.

112 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 from EFRAG TEG

113 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 approach as a possible way forward.

114 EFRAG TEG shared members shared similar concerns to those identified by EFRAG RRAWG members in the paragraphs below.

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115 RRAWG members confirmed their disagreement with the IASB tentative decision that when the regulatory discount rate (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.

116 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 EFRAG RRAWG members referred to the complexities associated with discounting of deferred tax assets and liabilities, which is why IAS 12 does not require discounting.

117 The RRAWG members identified the following additional concerns:

(a) Regulatory rate of interest or return –. 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 weighted average cost of capital (WACC) at each balance sheet date.

(b) Implicit rate of interest or return usually refers to return on capital invested and the proposed terminology might create created confusion when used to discount regulatory assets and regulatory liabilities under the model.

118 Some EFRAG RRAWG members commented that the concept of discounting when measuring regulatory items was not very relevant to regulatory assets and regulatory liabilities as the amounts to be recovered (settled) were initially

negotiated with the regulator. It was therefore questionable why they should be discounted. 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.

119 The EFRAG RRAWG members that supported discounting said that it should be based on the regulatory discount rate (regulatory interest) which is used to compensate the entity for the time lag until recovery of a regulatory asset or fulfilment of a regulatory liability

Presentation requirements

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

121 Applying the requirements in IAS 1, an entity is required to 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.

122 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.

123 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 124;

(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; and

(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);

124 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 (for example pension costs and asset retirement obligations under IAS 19 *Employee Benefits*), and present that regulatory income or regulatory expense immediately above or immediately below the related expense or income.

Key messages from EFRAG TEG

125 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.

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126 Some EFRAG RRAWG members noted that the IASB presentation proposal created complexity.

127 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.

128 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

129 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*

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

131 Furthermore, the IASB has tentatively decided that entities operating service concession arrangements shall apply IFRIC 12. However, regulatory assets and regulatory liabilities arising from an arrangement under IFRIC 12 should be recognised under the model (separately from IFRIC 12). In its discussions, the IASB did not elaborate further on how the two models might work together.

IFRS 3 Business Combinations

132 The IASB tentatively decided that, **as an exception to the recognition and measurement principles** in IFRS 3 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 at the acquisition date as required under IFRS 3).

133 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.

134 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

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

IAS 1 Presentation of Financial Statements

136 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.

137 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

138 The IASB tentatively decided that regulatory assets will be excluded from the scope of IAS 36. This is because as explained in paragraph 95 above, 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.

139 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 from EFRAG TEG

140 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 133 above. 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.

141 EFRAG TEG members shared the concerns expressed by the EFRAG RRAWG regarding the need for clarity on the interaction between the measurement principles under the accounting model which focus on regulatory cash inflows and outflows and IAS 36, when a CGU being tested for impairment includes regulatory assets and regulatory liabilities. 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 regulatory liabilities subject to the IFRS 3 measurement exception.

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142 EFRAG RRAWG reiterated the concerns previously expressed and summarised below:

(a) 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 decisions confirm 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.

(b) 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. A similar point was made for assets that had been acquired in a business combination and were used to provide regulatory goods or services.

(c) 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.

(d) 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.

Disclosure requirements

143 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.

144 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.

145 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.

146 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

147 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.

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148 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

149 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 150 below);

(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*[2]; and

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

150 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

(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.

151 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.

152 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

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

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

153 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.

154 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.

155 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.

156 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 from EFRAG TEG

157 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.

158 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.

159 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.

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160 EFRAG RRAWG agreed that the modified retrospective approach should be explored by the IASB. EFRAG RRAWG noted the same concern as EFRAG TEG in paragraph 157.

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