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Analysis of feedback and EFRAG Secretariat recommendations

- 1 This agenda paper has an analysis of the feedback received on EFRAG's Draft Comment Letter and its consultation of the IASB Exposure Draft *Regulatory assets and Regulatory liabilities* (the ED) and the EFRAG Secretariat recommendations for the drafting of the final comment letter based on this feedback.
- 2 EFRAG received feedback in three different ways:
 - (a) *Outreach events* – Feedback was received from 11 outreach events including closed consultations with various stakeholders- preparers including a multiple-utilities preparer forum, standard setters, a utilities regulator and a jointly hosted EFRAG, EFFAS and IASB user webinar involving specialist users (see analysis in agenda paper 05-05 and list of outreach events in Appendix 1 and 2 of agenda paper 05-05).
 - (b) *Effect analysis* – The effects analysis examined the effects of applying the proposals in the ED (detailed analysis in agenda paper 05-06). The findings are based on preparer and user surveys including a recent survey issued after¹ the ED and an earlier survey issued before² the ED. These effects-analysis findings are incorporated into the analysis of specific, related ED questions. The numbers of respondents to the two surveys were as follows:

	Users	Preparers
Pre-ED survey	8	15
Post-ED survey	7	8

- (c) *Comment letters* – 12 comment letters received at the time of writing. Of these 12 respondents, six respondents were National Standard Setters (NSS) that represented views from multiple constituents/entities, one respondent represented the collective views of the three largest Grid Operators in a particular EU jurisdiction, one respondent represented the collective views of 23 EU-based energy companies and one respondent was a user association. The comment letters response breakdown by type of respondent is in Figure 1 below. This paper summarises the main messages from the comment letters.

¹ Separate preparer and user surveys open from June to end of July 2021

² Separate preparer and user surveys open from October 2020 to January 2021

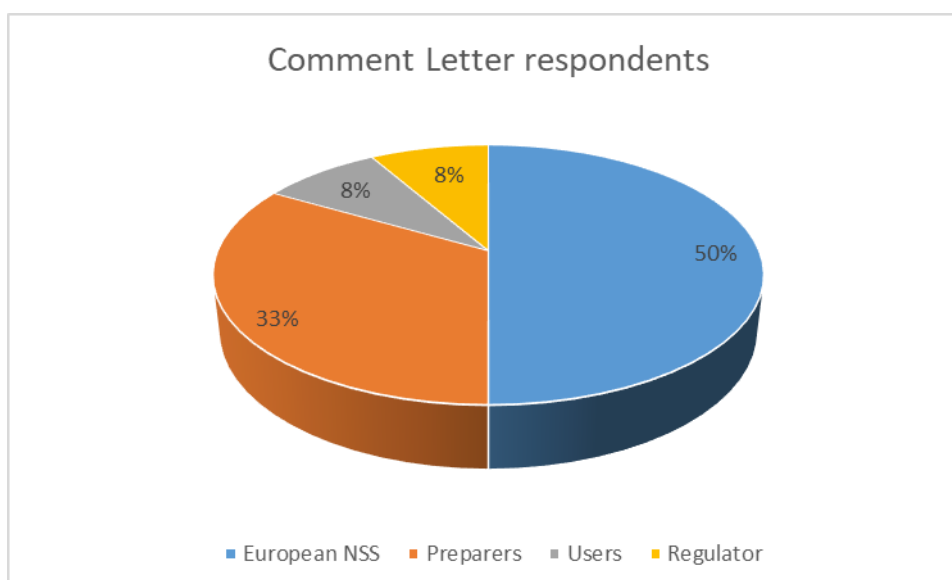


Figure 1 - Comment Letter respondents by type

- 3 In the comment letters analysis, the terms in the below table are used to describe the extent of responses to different questions of the ED. The use of these terms is a useful convention. However, as noted, two of the comment letters represent the views of multiple preparers, and we are cognisant that the additional weighting that ought to be accorded to these responses is not reflected in the use of these terms. The multiple representation of any response is mainly considered in the qualitative analysis of the content of the responses.

Term	Extent of response
Most	80%-100%
Many	50% - 80%
Some	25%-50%
A few	more than one to 25% of respondents

Summary of key changes in EFRAG final comment letter

- 4 The detailed analysis of feedback to each of the ED questions includes the EFRAG Secretariat's recommendations for drafting the final comment letter based on the collective feedback from the outreach findings, effects analysis and analysis of comment letters received. The drafting of the final comment letter was based on the EFRAG Secretariat's recommendations for each question. This summary only highlights where, based on the collective constituents' feedback, there is either a change from or key addition made to the drafting of EFRAG's final comment letter view relative to the draft EFRAG comment letter.

Objective and scope-Question 1 of the ED

- 5 In addition to the views expressed in the draft comment letter on the scope of the proposed Standard, in the final comment letter, EFRAG recommends the IASB explicitly state that regulatory assets and regulatory liabilities reflect future adjustments to the revenue amounts reported under IFRS 15 *Revenue from Contracts with Customers*. EFRAG recommends the IASB sets specific scope exclusions (e.g., for self-regulation) and provides a definition of 'customers' as the concept of 'customers' in the ED applied to enforceable rights and obligations related to a group of customers which is different from the definition of a customer in IFRS 15 that focuses on contracts with individual customers.

- 6 EFRAG also recommends the IASB clarifies the following additional points to ensure appropriateness and enhance clarity on scope eligibility:
- (a) to clarify whether allowable income in regulatory agreement that is based on sector average is in scope. Due to existence and measurement uncertainty EFRAG consider that due to existence and measurement uncertainty these items should not be recognised even if they are considered to be in scope;
 - (b) to clarify whether instances of recognition and measurement uncertainty (e.g., due to demand risk) for regulatory assets and regulatory liabilities are in scope. As addressed in Questions 4 and 5, EFRAG considers that recognition should not occur if there is high existence and measurement uncertainty;
 - (c) to clarify that compensation from a third party is in the scope of the proposed Standard. EFRAG considers that payment by third parties should not preclude from an inclusion in the scope of the proposed Standard;
 - (d) to structure examples that reflect the complexities existing in practice; and
 - (e) to refine the definitions of regulatory agreement and regulated rate in Appendix A to avoid the circular cross-reference.

Regulatory assets and regulatory liabilities- Question 2 of the ED

- 7 There were several sub-questions on definitions addressed in Question 2 including on the proposed definitions of regulatory assets and regulatory liabilities and whether these meet the Conceptual Framework definition. Another sub-question was on whether constituents' agree with the proposed definition of total allowed compensation.
- 8 EFRAG notes that the recognised regulatory liability that arises when deferring regulatory returns on assets not yet in use reflects the mechanics of the proposed accounting model, does not represent an economic obligation, and does not meet the ED's definition of a regulatory liability.
- 9 On the total allowed compensation definition, EFRAG notes that in jurisdictions where the allowed income in the regulatory agreement and thereafter regulated rates charged to customers were based on sector average costs, there are questions on how the total allowed compensation definition would work. As a result, EFRAG asks the IASB to clarify that if cases where sector average costs determine regulated rates are in scope, what part of the allowed income/sector average costs should be considered as an allowable expense when determining total allowed compensation.

Total allowed compensation- Question 3 of the ED

- 10 *Regulatory returns on construction work in progress (CWIP)*: In the final comment letter, based on overall feedback received, EFRAG disagrees with the proposed requirement for the deferral of CWIP regulatory returns charged to customers during construction (Paragraph B15 of ED). This is unlike the EFRAG draft comment letter where EFRAG did not have a conclusive position and expressed two views (view 1 disagreeing with the ED proposal and view 2 agreeing with it).
- 11 *Allowable expense*: In the final comment letter, EFRAG highlights concerns- that were not in the draft comment letter on the applicability of paragraph B3-B9 requirements (allowable expense requirements) across diverse regulatory regimes including, as highlighted in some jurisdictions, those where costs are based on sector averages and where recoverable expenses are based on the regulatory agreement costs that differ from IFRS expenses (i.e., permanent differences). EFRAG recommends that the IASB further reviews the B3-B9 requirements and clarifies the applicability of these requirements for the jurisdictions where recoverable costs are based on sector averages or the regulatory agreement costs (and not IFRS expenses). EFRAG raises other points of clarification on the total

allowed compensation components (e.g., whether inflation-adjusted assets are part of regulatory returns, whether average costs should be considered as part of the performance incentives component of the total allowed compensation).

Recognition- Question 4 of the ED

- 12 Based on feedback received, unlike the draft comment letter where EFRAG broadly supported the proposed “more likely than not” recognition threshold, to address concerns on enforceability and reliability of information, EFRAG recommends the IASB to consider introducing a higher recognition threshold (i.e., highly probable) similar to recognition threshold for variable consideration under IFRS 15. This is due to existence uncertainty that can arise for some items within the regulatory agreements. For example, as pointed out in Questions 1 and 2, when recoverable costs under regulatory agreements are based on sector averages.

Measurement- Question 5 of the ED

- 13 No key change from the position expressed in the draft comment letter where EFRAG supported the ED proposal. As noted in Questions 1 and 2, EFRAG notes that there is existence and measurement uncertainty for recoverable costs that are based on sector averages. As noted in response to those questions, EFRAG considers that these items should not be recognised even if they are considered to be in scope. Some points for clarification are raised (e.g., allocation of credit risk to individual items).

Measurement (discounting)- Question 6 of the ED

- 14 Based on the feedback received, unlike the EFRAG draft comment letter where EFRAG did not have a conclusive position and expressed two views, EFRAG disagrees with the IASB proposal for entities to apply a minimum interest rate for discounting regulatory assets if the regulatory interest rate is considered to be insufficient.
- 15 EFRAG proposes that should the IASB retain its proposal it should incorporate a rebuttable presumption that the regulatory interest rate is the appropriate discount rate for both regulatory assets and regulatory liabilities. This would reduce the burden on preparers of assessing the sufficiency of the discount rate at each reporting period.
- 16 EFRAG recommends the IASB applies the same criteria for discounting regulatory assets and regulatory liabilities, including the application of a minimum interest rate when applicable. Having symmetrical requirements will add to the usefulness of financial information for users of financial statements.

Measurement exception (items affecting regulatory rates when cash is paid or received)- Question 7 of the ED

- 17 There is no key change from the position expressed in the draft comment letter where EFRAG supported the ED proposal. Some points for clarification are raised (e.g., actuarial gains or losses from pension benefits remeasurements).

Presentation- Question 8 of the ED

- 18 There is no key change from the position expressed in the draft comment letter where EFRAG supported the ED proposal.

Disclosures- Question 9 of the ED

- 19 Based on the feedback received, EFRAG recommends that the IASB refine the wording of the overall and specific objectives to ensure the disclosures focus on the usefulness of information (i.e., consider what analytical needs underpin the disclosures).

- 20 Based on both user and preparer feedback, EFRAG notes how the ED's proposed specific disclosures could be prioritised. EFRAG recommends adding language that explicitly waives entities from the specific disclosures when appropriate.

Other matters (transition requirements, interaction with other standards and likely effects)- Questions 10, 11 and 12 of the ED

- 21 Given the feedback received from respondents, that the full retrospective application will be very complex and burdensome for many entities, EFRAG recommends a prospective or a modified retrospective application with exemptions or practical expedients for assets that have a long useful life and for CWIP regulatory returns.
- 22 Unlike the draft comment letter where EFRAG did not express a view, EFRAG supports the ED's proposed exception to IFRS 3 *Business Combinations* recognition and measurement requirements for acquired regulatory assets and assumed regulatory liabilities.
- 23 There is no key change from the position expressed in the draft comment letter on likely effects.

Other comments- Question 13 of the ED

- 24 There is no key change from the draft comment letter other than asking the IASB to clarify the basis that regulatory assets and regulatory liabilities are considered to be monetary items.

Detailed feedback per ED question

Question 1 - Objective and scope

Summary of feedback

Outreach events

- 25 In general, the objective and scope of the model were considered appropriate, however, some concerns were expressed regarding:
- (a) the concept of total allowed compensation – the proposals on total allowed compensation would not make it possible to achieve the objective of the project because of:
 - (i) misalignment between the total allowed compensation model and regulatory regimes - the principle of total allowed compensation leads to a shift of profits across periods that was not in line with the actual regulatory results. This would require users of financial statements to be provided with additional information in order to explain the reported performance of the company;
 - (ii) permanent differences – differences might arise due to the application of IFRS Standards as the measurement basis for total allowed compensation instead of regulatory guidance for such amounts. The ED was not explicit about how such permanent differences would be treated and whether they would be outside of the scope of the proposed Standard;
 - (b) clarity on scope – it was considered necessary to clarify the scope as in some regulatory regimes, the regulatory rates set by the regulator could also be modified by the company depending on demand or seasonality.
 - (c) time needed for enforceability – in some regulatory regimes, existing timing differences did not form an enforceable present right to recognise a regulatory asset. While there were timing differences, these differences were hard to estimate because the measurement depended on the performance of the competitors and the sector as a whole. The regulatory period after which the performance of the sector was released (and the right became enforceable) was usually a lengthy one (5 years).
- 26 The proposals on scope might be more complex to apply in practice compared to the simplistic illustrative examples provided in the ED. In some jurisdictions, there would be very few companies with the type of rate regulation described in the ED.
- 27 The applicability of the proposals on scope to financial institutions was less obvious.
- 28 Furthermore, EFRAG received limited feedback from entities outside the utility sector. However, the limited feedback received from outreach with companies (within one jurisdiction) operating in the European railways and European telecom sector indicated that they would not be affected by the scope of the ED as the regulatory regime in which they operated would not create regulatory assets and regulatory liabilities as defined in the ED.
- 29 One respondent considered that there was no need for specific guidance on defining the regulator.
- ##### Effect analysis
- 30 As shown in the pie chart (Figure 2 below), the feedback received from the preparer survey indicated that it was not always clear to preparers what was within the scope of the proposed Standard.

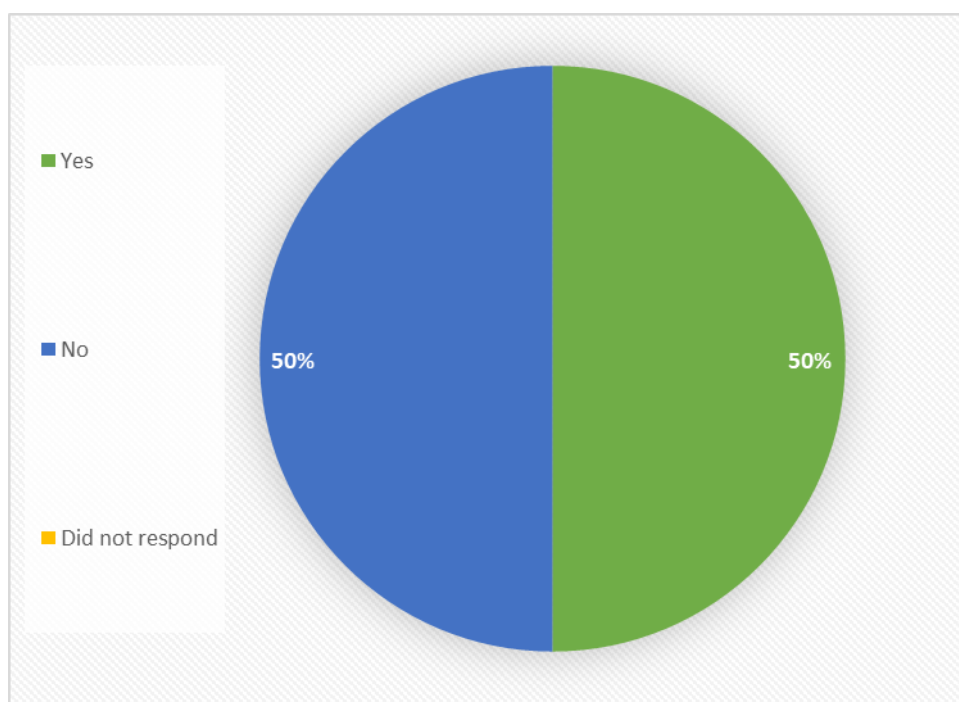


Figure 2 - Application of the concept, whether regulatory agreement gives rise to regulatory assets and liabilities, is clear enough

- 31 The preparer respondents made the following suggestions for the IASB to consider related to the scope:
- to further clarify the definition of a regulatory agreement giving rise to regulatory assets and regulatory liabilities. The definition could be tightened along the lines of a 'specified regulatory agreement'. To specify whether a regulatory framework could give rise to regulatory assets and regulatory liabilities when a regulatory agreement per se did not exist;
 - to provide examples of scope exclusions, i.e., what was not intended to be covered by the scope such as price cap arrangements;
 - to introduce a definition of a 'regulator' to prevent self-regulation from falling within scope. The regulator could be defined as an independent third party such as a government or the state and was not necessarily a regulatory body;
 - to provide guidance on the use of the term 'customers' in the ED because the concept of 'customers' with a focus on a group in the ED was different from the definition of a customer in IFRS 15;
 - to clarify whether the recovery/ settlement of total allowed compensation by third parties other than the customer fell within the scope;
 - to clarify if amounts charged to customers and settled by third parties can be in scope.
- 32 There was uncertainty whether certain circumstances fell within the scope of the proposed Standard or IFRIC 12 *Service Concessions Arrangements* (e.g., in IFRIC 12 under the hybrid model and the financial asset model it was not clear if future tariff increases should adjust the estimated future cash flow of the financial asset or be accounted according to the ED).

Comment letters

- 33 Objective of the ED – Most respondents (none out of twelve) agreed with the **objective** of the proposed Standard to provide relevant information to users of financial statements that faithfully represents how an entity's financial performance and financial position are affected by rate regulation.

- 34 **Scope** - Many respondents (five out of twelve) were in general **supportive of the scope** of the proposed Standard. However, various concerns and enhancement proposals were provided as follows:
- (a) One respondent noted that the proposals on the scope were descriptive of rather than defining what was in scope and that what was in scope has to be inferred from recognition and measurement requirements. Another respondent (NSS) noted the shift in focus from 'defined rate regulations and regulatory activities' in the 2014 IASB Discussion Paper to 'regulatory agreements' in the ED may result in the inclusion of a broader range of activities in the scope than initially considered when the IASB started the project.
 - (b) One respondent (NSS) noted that the scoping, as well as recognition and measurement requirements, seem to imply that a one-to-one relationship exists between the company's own costs and its allowable income. The respondent noted they had identified regulatory regimes where the allowable income is based on industry/sector average costs and not the individual company's cost base. The ED is unclear whether these types of activities would be in scope and/or whether regulatory assets and regulatory liabilities would need to be recognised.
 - (c) A few respondents (two out of nine) commented that the proposals on the scope were clear to enable an entity to determine whether a regulatory agreement gave rise to regulatory assets and regulatory liabilities. However, some of the examples provided in the ED (e.g., paragraph 13) were too simple and did not consider the complexities of various regulatory regimes. For example, one respondent (NSS) thought that the "regulator" should have some attributes of a governmental body or an entity with delegated authority. Another respondent noted clarity on the scope but highlighted their concerns on the notion of total allowed compensation requirements (specifically B3 to B9 related to allowable expenses and B15 related to construction work in progress (CWIP) regulatory returns).
 - (d) One respondent from financial institutions noted that an intercompany agreement or a master service agreement might result in differences in timing with a defined rate. This might lead to recognition of regulatory assets and regulatory liabilities that were created with itself or with other entities under common control. Therefore, the respondent considered it necessary to explicitly define in the ED the legal form of the regulatory agreement and the characteristics of the regulator to avoid unintended consequences.
 - (e) Most respondents (ten) had recommendations on how to ensure the scope of the proposed Standard was appropriate and/or how to enhance clarity on its definition. The recommendations made were as follows:
 - (i) not to consider scoping criteria in addition to the features listed in paragraph 6 of the ED;
 - (ii) to clarify whether compensation from a third party was in the scope of the proposed Standard;
 - (iii) to clarify activities that are not in scope (set specific scope exclusions for example insurance contracts);
 - (iv) to develop additional application guidance on assessing the enforceability of rights and obligations created by the regulatory agreement;
 - (v) to explicitly state that regulatory assets and regulatory liabilities existed only if they reflect future adjustments to the revenue amounts reported by applying the IFRS 15 requirements;

- (vi) to clarify whether the existence of a regulator is required to assess whether regulatory assets and obligations exist; and
 - (vii) to consider providing or retaining the definition of a 'rate regulator' in IFRS 14 *Regulatory Deferral Accounts*;
 - (viii) a respondent from financial institutions noted the need to clarify whether the reference to "a rate that an entity charges in contracts with customers" explicitly restricts the scope of the proposed Standard to the scope of IFRS 15 or whether there is the need to carry out further analysis beyond this scope, especially concerning the application of IFRS 9 *Financial Instruments*. The respondent recommended that the definition of a regulatory agreement should restrict the scope of the proposed Standard and a careful assessment that the proposed requirements do not create any distortion in their interactions with other IFRS requirements especially IFRS 9.
- 35 A few respondents (NSS) were not concerned by the scope, as they assessed and commented that they had not identified any situations in which the proposals on scope would affect activities that, in their view, were not subject to rate regulation but would give rise to regulatory assets and regulatory liabilities.
- 36 One respondent did not specifically mention scope although noted that it supported the IASB project.
- 37 Regulator and regulatory agreement - Most respondents suggested that for appropriately identifying entities within the scope of the proposed Standard, it would be beneficial to also define the '**regulator**' and its characteristics and to specify that "self-regulation" was not in the scope of the proposed Standard.
- 38 However, one respondent agreed that the ED proposals should apply to all regulatory agreements and not only those that have a particular legal form or those enforced by a regulator with particular attributes. One respondent (NSS) noted that restricting the definition of a regulatory agreement to certain legal forms or certain characteristics of a regulator would narrow the scope of the ED without any discernible benefit. Moreover, it would not be possible to anticipate the diverse legal designs of regulatory regimes.
- 39 The following suggestions were made by respondents in respect of defining the regulator:
- (a) One respondent (NSS) thought that the 'regulator' should have some attributes of a governmental body or an entity with delegated authority.
 - (b) Another respondent (NSS) observed that IFRS 14 includes a definition of a 'rate regulator'. This respondent noted that the IASB has neither discussed the existence of that definition in the Basis for Conclusions on the ED nor explained why it had decided to not retain this definition. This respondent explained that the existence of a regulator is required, the IASB should assess how this definition has been applied in the jurisdictions that decided to adopt IFRS 14 and explain why it decided not to retain that definition in its proposals.
 - (c) Many respondents encouraged the IASB to provide additional guidance and specific examples on what constituted a **regulatory agreement**.
 - (d) One respondent recommended the IASB to clarify the definition of a regulated rate.
- 40 Sectors outside of the utility sector - Many respondents made an assessment that the proposed Standard would have only limited **impact** in their jurisdictions affecting mainly the utilities sector. In one jurisdiction, preparers from the electricity distribution sector concluded that based on the characteristics of their regulatory

regime they would not fall in the scope of the proposed Standard due to significant recognition and measurement uncertainty.

- 41 As noted before, a respondent from financial institutions recommended the IASB to introduce more clarity on the interaction of the proposed Standard with IFRS 15 (definition of customers) and IFRS 9. This respondent observed that an intercompany agreement or a master service agreement may result in differences in timing with a defined rate. This may in turn lead to the recognition of regulatory assets and regulatory liabilities that are created with itself or with other entities under common control.
- 42 Other assets within the regulatory agreement - A few respondents supported the IASB's tentative view that no other assets and liabilities apart from the regulatory assets and liabilities should be recognised under the proposed Standard.

EFRAG Secretariat recommendations

- 43 Based on the feedback received, EFRAG Secretariat recommends that EFRAG's final position reflects the following points:
- (a) EFRAG agrees with the **objective** of the proposed Standard to provide relevant information to users of financial statements that faithfully represents how an entity's financial performance and financial position are affected by rate regulation.
 - (b) EFRAG recommends that the IASB explicitly state that regulatory assets and regulatory liabilities reflect future adjustments to the revenue amounts reported under IFRS 15. EFRAG considers that it will be helpful to set specific scope exclusions (e.g., for self-regulation) and to provide a definition of 'customers' as the concept of 'customers' in the ED is different from the definition of a customer in IFRS 15.
 - (c) EFRAG considers that more specific guidance and examples on what constitutes a regulatory agreement would be helpful to appropriately identify activities within the scope of the proposed Standard.
 - (d) EFRAG considers that it would be helpful to describe the characteristics of a regulator to avoid a wider application of the proposed Standard than appropriate. At a minimum, EFRAG encourages the IASB to be explicit whether the existence of a regulator is required to assess whether rights and obligations created by the regulatory agreement meet the definition of regulatory assets and regulatory liabilities and, in addition to the proposed characteristics in the ED, require that a regulator is an independent third-party that is empowered by statute or contract.
 - (e) EFRAG recommends the following additional points to the IASB to ensure appropriateness and enhance clarity on scope eligibility:
 - (i) to clarify whether allowable income based on sector average is in scope;
 - (ii) to clarify whether instances of recognition and measurement uncertainty (e.g., due to demand risk) for regulatory assets and regulatory liabilities are in scope. EFRAG considers that recognition should not occur when there is high existence and measurement uncertainty;
 - (iii) to clarify that compensation from a third party is in the scope of the proposed Standard. EFRAG considers that compensation from a third party should not be precluded from scope;
 - (iv) to structure examples that reflect the complexities existing in practice;
 - (v) to refine the definitions of regulatory agreement and regulated rate in Appendix A to avoid the circular cross-reference.

Question for EFRAG TEG/EFRAG Board

- 44 Does EFRAG TEG/EFRAG Board agree with the EFRAG Secretariat recommendation? If not, what alternative do you propose?

Question 2 - Regulatory assets and regulatory liabilities (definitions)

Summary of feedback

Outreach events

- 45 In some jurisdictions, the enforceability of the rights and obligations created by the regulatory agreement was questioned because of:
- (a) Measurement uncertainty - an entity had a right or obligation, created by the regulatory agreement, to add or reduce an amount in determining the future tariffs. However, due to the process of setting up the tariffs which are in some jurisdictions based on benchmark/sector averages rather than on an entity's costs, there was significant uncertainty about these amounts. The tariffs were based on the performance of the sector as a whole and determined after the publication of the financial statements of the entity; Furthermore, some constituents noted that the level of certainty when estimating the future cash flows depended on the strength and maturity of the prevailing regulatory framework.
 - (b) Regulatory period – in another jurisdiction, the regulatory period had a long-term duration, and the regulator would only determine how the benchmark tariff is calculated after the passage of this period. Therefore, there was a lot of uncertainty as to whether these entities would get back the compensation for the investment included in the regulated rates. Companies were not informed what the benchmark tariff was – this meant they would not know whether costs incurred above the benchmark calculated by the regulator would be recovered. This was a regulatory system used to incentivise companies to be effective.

Effect analysis

- 46 The surveys for both preparers and users did not address this topic.

Comment letters

- 47 Definitions: Most respondents, generally agreed with the proposed definitions, and two respondents disagreed. Some respondents did not respond to this question (parts of this question). Comments provided were as follows:
- (a) Most respondents agreed with the proposed definitions of regulatory assets and regulatory liabilities. However, one of these respondents noted a situation that involved compensation from the regulator after the merger of two entities. This respondent explained that the 'merger-related compensation' does not arise from the delivery of goods or services, but the merger itself, and thus appeared to fall outside the definition of a regulatory asset. The respondent informed that when two grid operators merge, the new total allowed compensation will be lower than the sum of the total allowed compensation for the two before the merger.
 - (b) Another respondent reiterated the recommendation in their answer to Question 1 on Scope, on the need to have further clarifications on the notion of 'enforceable rights and obligations'. In their answer to Question 1 of the ED, this respondent noted that the notion of 'enforceability' is still creating some confusion in practice and recommended the IASB to:
 - (i) develop additional application guidance for assessing whether rights and obligations are enforceable;

- (ii) consider adding a definition of 'enforceable rights and obligation' in Appendix A to any final Standard; and
 - (iii) clarify the interaction between 'enforceability' and the recognition requirements in paragraphs 25–28 of the ED.
- (c) The two respondents that disagreed with the definitions of regulatory assets and regulatory liabilities noted that in their jurisdiction, for certain regulated entities, the total allowable compensation is determined based on the average cost base of the sector (not on the entity's own cost base). It was unclear whether such cases would fall within the proposed definition of total allowed compensation and what part of the average cost should be cost compensation (allowable expenses) versus performance incentive.
- (d) Most respondents generally agreed that the proposed definitions refer to total allowed compensation. However, one respondent noted that a minority of its members believed that an alternative cost deferral approach could have been chosen, in line with the US GAAP (Topic 980). In the view of this minority member, the proposed alternative method would create far fewer operational challenges than the current ED.
- (e) Most respondents agreed that regulatory assets and regulatory liabilities meet the definitions of assets and liabilities under the Conceptual Framework. However, some of these respondents suggested specific clarifications to the definition of a regulatory liability and one respondent disagreed that a regulatory liability for regulatory returns on assets not yet in use meets the definition of a liability under the Conceptual Framework.
- 48 Separate accounting for regulatory assets and regulatory liabilities - Most respondents agreed that regulatory assets and regulatory liabilities should be accounted for separately from the rest of the regulatory agreement. Some respondents did not answer this question.
- 49 Recognition results in information that is not useful Many respondents identified the following cases when recognition of regulatory assets and regulatory liabilities would not provide useful information to users of financial statements:
- (a) Recognising a regulatory liability for regulatory returns on assets not yet in use.
 - (b) In jurisdictions where the regulatory rates were based on sector average costs, rather than an entity's own costs. In these jurisdictions, there was a high level of uncertainty regarding the amounts the entity was entitled to recover (settle).

EFRAG Secretariat recommendations

- 50 Based on the feedback received in response to the EFRAG DCL on ED, EFRAG Secretariat recommends that EFRAG's final position reflects the following additional comments:
- (a) Definitions - compensation not forming part of total allowed compensation – Recommend the IASB to provide clarification and application guidance when compensation will not form part of total allowed compensation (while previously was considered total allowed compensation) and therefore will not meet the definitions of regulatory assets and regulatory liabilities. We propose to include the example provided by one respondent:

"If two grid operators merge, the new total allowed compensation will be lower than the sum of the total allowed compensation for the two before the merger. This is due to a more demanding benchmark for larger operators than for small ones. The regulator compensates for this disadvantage by giving the merged company a right to charge the net present value of the difference for the first

30 years. This amount is not segregated from other underbilling and accrues interest and may be included in the rates when the operator chooses to.” The respondent noted that as this ‘merger-related compensation’ does not arise from the delivery of core goods or services, but from the merger itself, it seems to fall outside the definition of a regulatory asset.

- (b) Enforceable rights and obligations - Highlight the need to have further clarifications on the notion of ‘enforceable rights and obligations’ and refer to the concern captured in EFRAG’s response in question 1 (scope).
- (c) Related to Question 3, two respondents recommended the IASB to reconsider their proposals of aligning certain items of the allowed income within the regulatory agreement and IFRS expenses so as to ensure that IFRS financial statements reflect the economic substance of the pervasive underlying regulatory agreements. These agreements are configured on an allowance-based model, not a cost-based model. Thus, the focus ought to be on recognising the allowed income of an underlying regulatory agreement for a given financial year and not on when related costs according to IFRS were recognised.
- (d) A similar concern with paragraphs B3-B9 of the ED was noted by another respondent (NSS) in which they express concerns regarding permanent differences that might arise when applying paragraph B5. Another respondent also said that they believed that the financial statements should reflect rights and obligations arising from the regulatory agreements and that the ED proposals are written to achieve matching between IFRS and the allowed income under the regulatory agreement. On this same topic, one respondent observed that in its jurisdiction, regulation is often based on expenses recognised under local GAAP at a date that can differ from the date of their recognition under IFRS (the GAAP difference). This is the case, for example, of some expenses relating to post-employment benefits in the application of the corridor method, which is used in local GAAP. These timing differences between the regulatory agreement (based on local GAAP) and IFRSs should in the respondent’s view give rise to regulatory assets/liabilities and recommended the IASB to provide specific guidance to address this issue.
- (e) Standard cost/ sector average type of rate-regulation - Encourage the IASB to further examine rate-regulation in jurisdictions where there is a “standard cost” or “benchmark cost” that replaces the actual cost for some of the operations. For some entities operating in these jurisdictions, the total allowable compensation is not determined based on the entity’s individual cost base but on the average cost base of the sector. This was reported to EFRAG by three different jurisdictions.
 - (i) Explain that in these jurisdictions the entity may be entitled to compensation but does not have sufficient insight into the regulatory rates and the future compensation that it will receive until the regulator provides such rates to the entity. The respective entities only have limited insight on the Regulatory Asset Base (RAB) and are for example not allowed to share or receive information from the other regulated entities to be informed about the RAB and sector efficiencies. This would significantly increase the uncertainty on the existence of regulatory assets and regulatory liabilities and their related amounts and therefore question the usefulness of recognising regulatory assets and regulatory liabilities subject to high levels of uncertainty.
 - (ii) Entities operating in these jurisdictions have noted that the current definitions were unclear about the applicability of the concept of “total allowable compensation”; and secondly what part of the average cost should be cost compensation (allowable expenses) versus performance

incentive. In their view, this distinction is crucial in the application of the proposed accounting model.

- (iii) It would be helpful for the IASB to provide examples of this type of hybrid rate-regulation in which the rates are based on a mix of sector average costs and linked to incentives and how the assessment of enforceable rights and enforceable obligations should be made for this type of hybrid rate-regulation.
- (f) Regulatory liabilities that do not meet the definitions - Note that some of EFRAG's constituents do not agree that the recognition of a regulatory liability when applying paragraph B15 of the ED on the accounting for regulatory returns on CWIP when the asset is still not in use. This is because such a regulatory liability does not exist, either legally or economically (i.e., there is no arising legal obligation or obligation from the regulator for the entity to lower tariffs charged to customers at a future date). By making an investment approved by the regulatory authority, the entity has supplied services and received consideration in the form of a regulatory return.
- (g) Although not specifically mentioned by respondents in their comment letters to EFRAG, the EFRAG Secretariat considers that similar to the above, a regulatory liability that is recognised when the recovery period of an asset is shorter than the asset's useful life does not meet the ED's definition of a regulatory liability. This is because the entity's present right to recover the asset is not dependent on the timing of recognition of the related IFRS depreciation expense, and thus the entity has no further obligation. These regulatory liabilities are recognised solely due to the mechanics of ED's proposed model and there is no enforceable present obligation (such amounts will not appear as future adjustments in the rate-setting by the regulator).
- (h) Recognition that results in information that is not useful – Highlight that EFRAG has identified some situations in which the proposed requirements (paragraphs B3 to B9 on allowable expense and B15 on CWIP regulatory returns) would result in regulatory assets and regulatory liabilities being recognised when their recognition would provide information that is not useful to users of financial statements.

Question for EFRAG TEG/EFRAG Board

51 Does EFRAG TEG/EFRAG Board agree with the EFRAG Secretariat recommendation? If not, what alternative do you propose?

Question 3 – Total allowed compensation

Summary of feedback

Outreach events

Comments on total allowed compensation

- 52 Constituents welcomed the approach taken and the components included in total allowed compensation. But it was also stated that the definition of total allowed compensation might create uncertainties (e.g., when compensation is based on sector averages) and differences in timing might be subject to interpretations (three respondents) (NSSs) For the utility sector, a constituent noted that it is also an issue whether the incentives are considered in the target profit or are part of the allowable expenses.
- 53 A constituent opposed the treatment of components under total allowed compensation (e.g., allowable expense). This constituent stated that the approach taken would contradict the objective of the project to align the accounting with the regulatory regime.

Comments on regulatory returns on construction work in progress

- 54 The proposed approach to defer regulatory returns to the period when the asset is in use was questioned by various constituents. The following concerns were expressed:
- (a) Two respondents stated that there was no reason to account for a regulatory liability because the transaction would not fulfil the definition (e.g., adjust future rates). The return is a normal component of compensation during construction.
 - (b) One respondent (NSS) stated that the proposed guidance would lead to a deferral of a (significant) portion of the regulatory return into the future and impact financial statement user analysis negatively. Financial statements would not faithfully reflect the effects of regulation which could prevent companies from obtaining financing.
 - (c) Three respondents (incl. two NSS) explained that the revenue charged to the customers for regulatory returns on CWIP during construction compensate for a different obligation (e.g., managing a continuously usable infrastructure) so that deferral would distort the profit pattern.
 - (d) One respondent (NSS) stated that comparability should not take precedence over the relevance of information.
 - (e) Users noted that having a right to charge the customer would create a positive signal for users as they typically look for cash flows. Consequently, a regulatory liability would not be appropriate.
 - (f) Similarly, another user respondent suggested that performance should reflect cash inflows. The entity has revenue receipts during construction and therefore performance should reflect this economic reality.
 - (g) Two respondents stated that the compensation would be allocated to the group of assets as a whole, so it would be operationally difficult to distinguish regulatory returns for different assets, as those are not tracked separately. These difficulties and associated costs may exceed the users' benefits.
- 55 One NSS supported the IASB approach and did not see any issues arising in their local regulatory regime. The constituent stated that including regulatory returns during the construction would result in a mismatch between income and related expenses as depreciation occurs the asset is in use.
- 56 A regulator constituent pointed out that the IASB's proposed guidance could be an incentive to accelerate project completion by entities if regulators would – as a consequence of the proposed guidance - change regulation and only allow charging rates to customers when the asset is completed. Such a change could help to prevent the early distribution of dividends and adverse, premature capital outflows.

Effect analysis

Effects analysis survey feedback- Preparers (Eight respondents)

- 57 As shown in the pie chart in Figure 3, 50% of the preparer respondents (four of eight respondents) stated that the regulator would not oblige them to refund the regulatory return charged to customers if the asset construction project is never completed. This finding shows that, at least for some entities, when the regulatory returns are granted during construction by the regulator, it relates to a fulfilled performance obligation. Some preparer respondents (two of eight respondents – 25%) stated that the regulation would oblige them to refund the return on failure to complete projects.

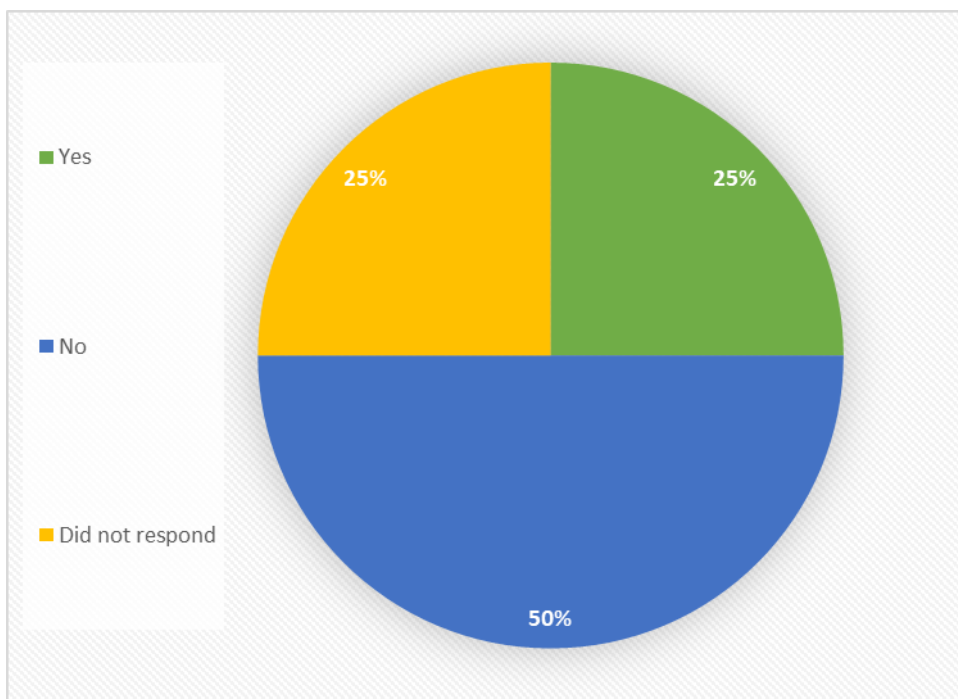


Figure 3 - Obligation to refund the regulatory return charged to customers during construction when the constructed asset is not completed

- 58 Some respondents indicated they do not link the compensation for regulatory returns on CWIP to delivery of goods and services to customers and that it compensates for something different (e.g., the delivery of public services), as shown in the following figure 4.

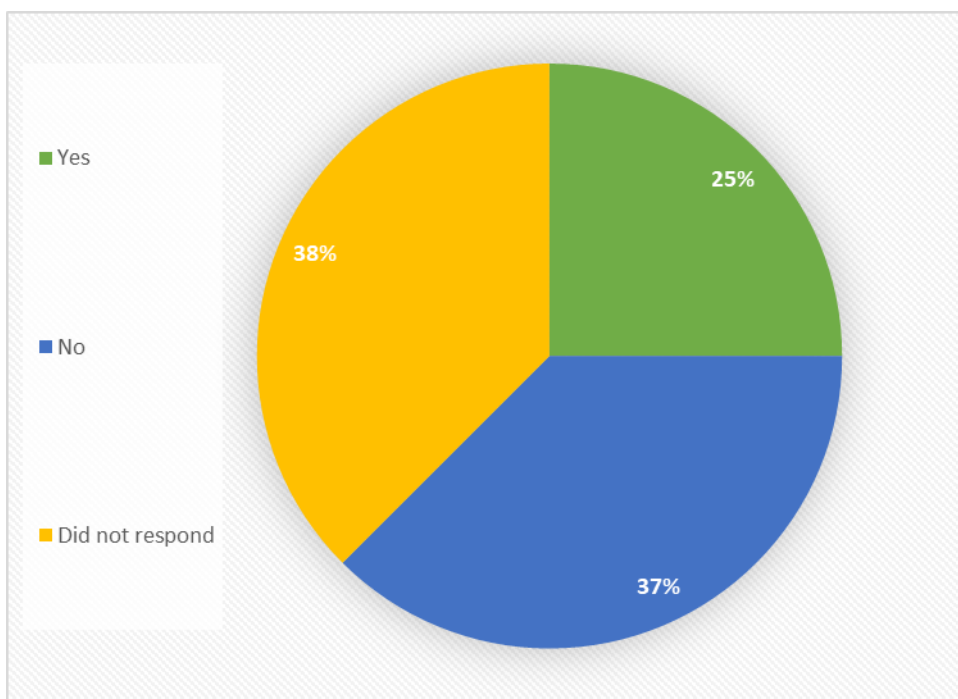


Figure 4 - Link between the delivery of goods or services and compensation for regulatory returns on CWIP

- 59 As shown in Figure 5, some respondents (four of eight respondents - 50%) indicated that regulatory return on CWIP as a proportion of either total allowed compensation or revenue was either moderate (three of eight respondents- 37.5%) or significant (one of eight respondents- 12.5%). This finding shows that regulatory returns on CWIP can be material for some entities and the chosen accounting approach will have a material impact for these entities.

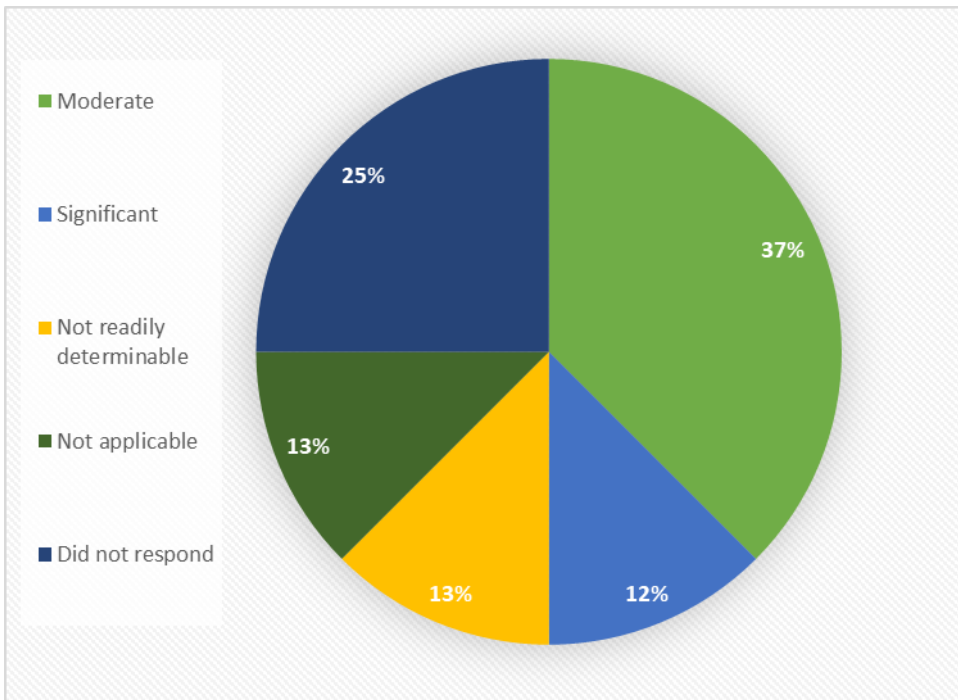


Figure 5 - Regulatory return on CWIP charged as a proportion of either total allowed compensation or revenue

60 Many respondents indicated they would foresee implementation challenges in identifying the regulatory return related to assets under construction (shown in figure 6 below). Some respondents did not see any challenges and one preparer did not respond.

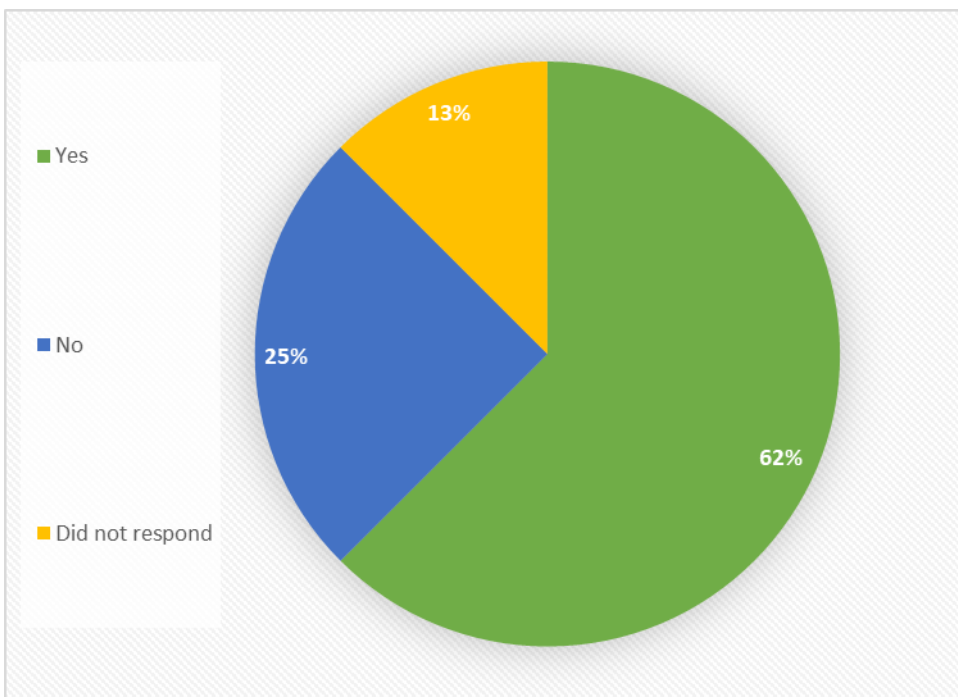


Figure 6 - Implementation challenges in identifying regulatory returns related to a regulatory asset base including CWIP or linking regulatory returns to a particular asset

61 Many respondents expected challenges in using a reasonable and supportable basis to determine how to allocate the return over the remaining period (shown in figure 6 below). Some respondents did not see challenges and one preparer did not respond to that question. Those that responded and expected implementation challenges stated the following:

- (a) One preparer stated that as regulatory returns are made based on a homogenous regulatory base, it would be difficult to carve this out into individual assets that may unwind over different periods.
- (b) Another preparer stated that this would mean rolling back up to 2 years and quantifying restatements for each of the individual relevant projects and the incurred cost would far exceed the benefits.

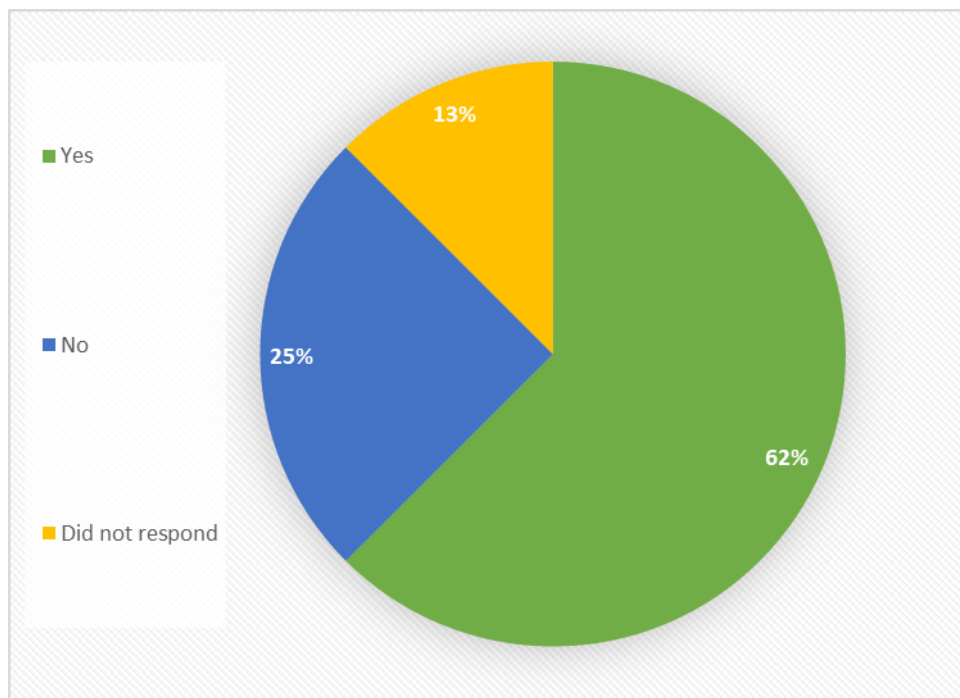


Figure 7 - Identification of challenges in using a reasonable and supportable basis to determine how to allocate the return over the remaining periods

Effects analysis survey feedback- Users (Seven respondents)

- 62 Many user respondents stated that they would be required to adjust their analytical models when regulatory returns would be deferred into future periods (shown in figure 8). The users that would adjust their models gave the following reasons:
- (a) One user responded that cash flows would differ from profit or loss, and this would understate the profitability of the project as it would seem the company receives no remuneration during construction.
 - (b) Another user responded that where regulatory regimes allow companies to earn a return during the construction of an asset, this return should be reflected in the performance reported during construction and not deferred to the operational period. The respondent noted that the regulated entity is remunerated for the construction risk and creating additional capacity.

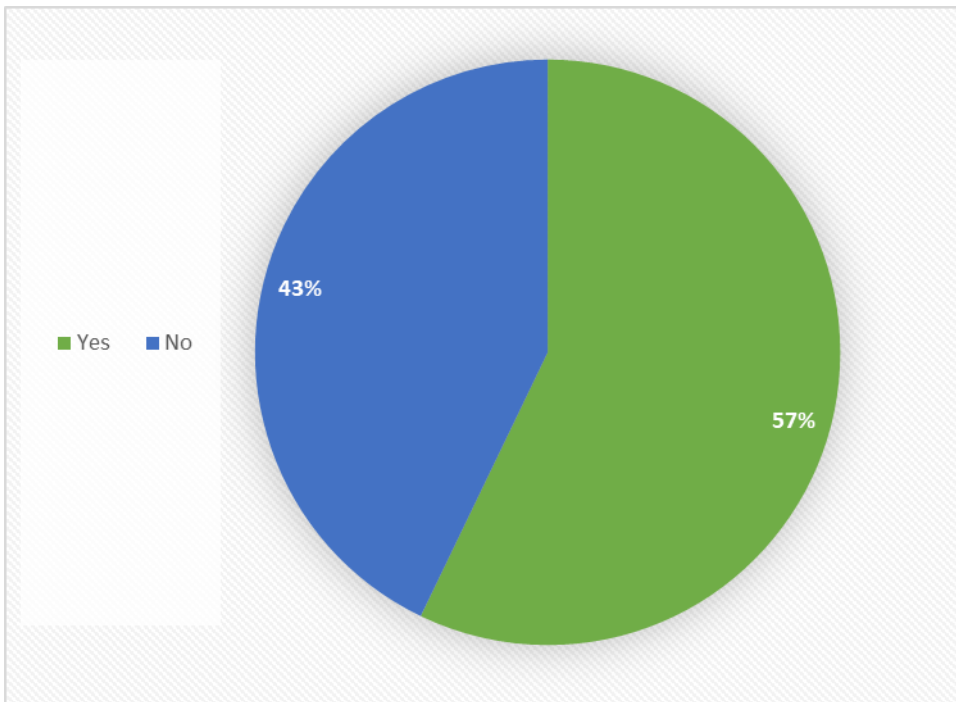


Figure 8 - Need to adjust analytical models

63 Many users stated that they were not aware of particular business models that would be affected by the proposed requirements for CWIP (shown in figure 9). The three respondents (43%) that were aware of particular business models impacted had the following comments:

- (a) One user stated that especially affected would be fully regulated companies such as electricity transmission companies where the CAPEX over RAB ratio is high.
- (b) One user stated that especially affected would be electricity networks and some regulated gas transport assets.
- (c) One user stated that large single-asset investment projects, which receive returns during construction, or companies exposed to sizeable multi-year construction projects would be affected.

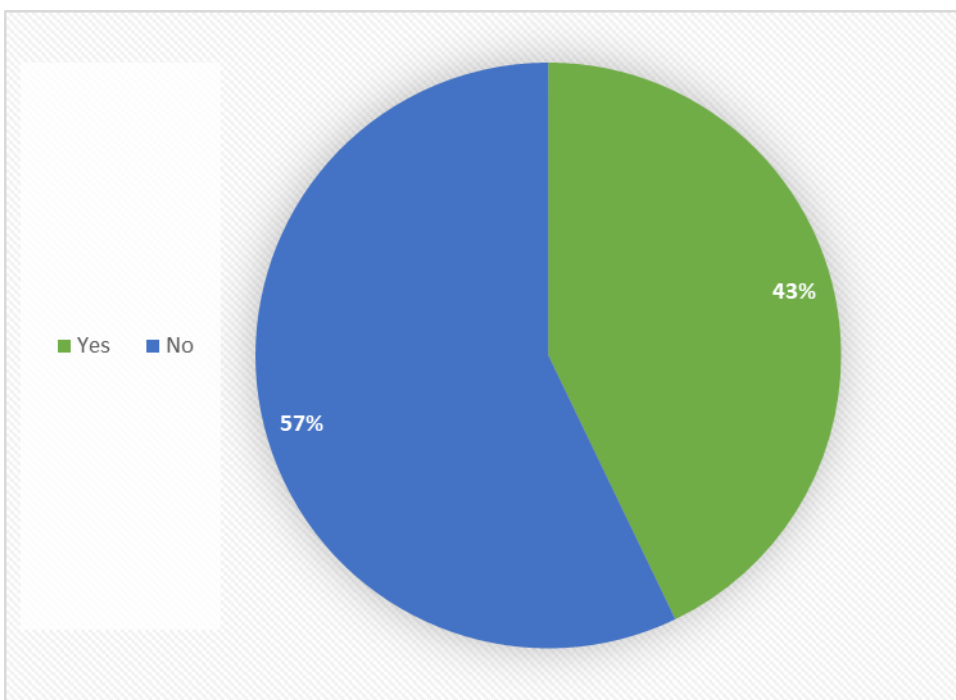


Figure 9 - Are particular business models affected?

- 64 As shown in Figure 10, some users did not expect material impacts on financial statements or non-GAAP metrics. But one user responded that he would not be able to trust the P/L, and this would have to make an assumption on the cash flows received from assets under construction and reduce numbers from profit or loss.

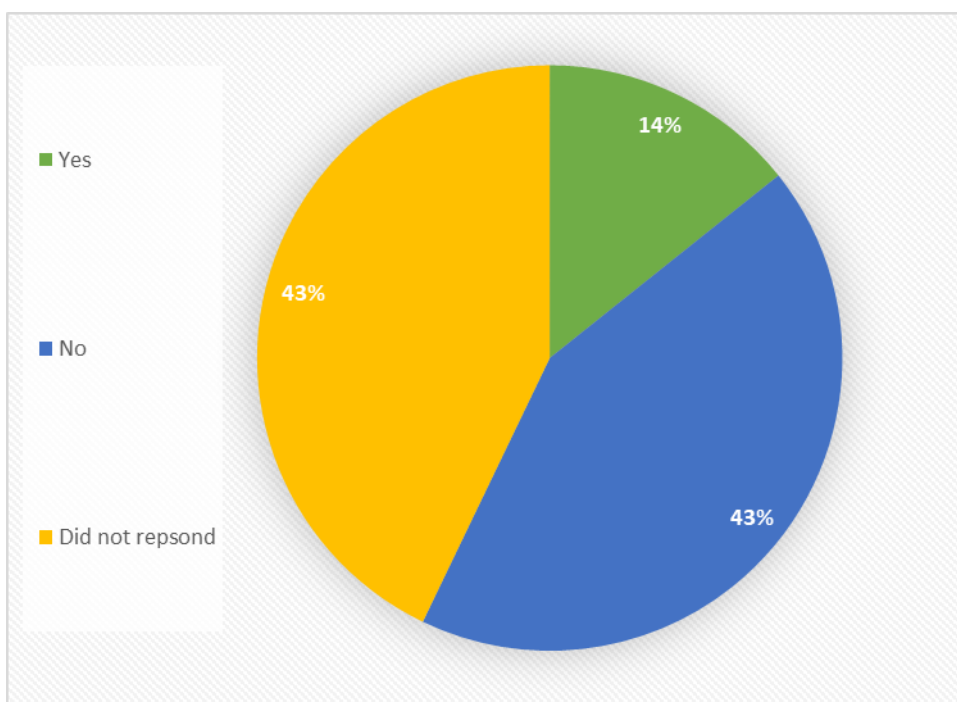


Figure 10 - Material impacts on financial statements or non-GAAP metrics from the proposed treatment of CWIP

Comment letters

Agree with the proposed guidance on how to determine total allowed compensation?

- 65 Some respondents seemed to unreservedly support the IASB's proposals for the inclusion of components into total allowed compensation for goods or services supplied.
- 66 Many respondents supported the general concept of the total allowed compensation, but had reservations on different aspects of its determination as outlined below:
- Many respondents opposed the suggestion to defer regulatory returns on CWIP to when the asset is in use and explicitly agreed with or were consistent with view 1 of the EFRAG draft comment letters.
 - Some respondents questioned how to treat sector-average cost under the proposed requirements for total allowed compensation.
 - Some respondents questioned how inflation adjustment would be treated under the proposed requirements.

Regulatory returns

- 67 The respondents that opposed the proposed treatment of regulatory returns on CWIP did so for the following reasons:
- Conceptual reasons:

- (i) Some respondents argued that the construction may provide compensation for other goods or services that may not be directly related to supplying goods or services to customers but fulfil a specific performance obligation (e.g., rendering of public services).
 - (ii) Some respondents argued that the definition of a regulatory liability, recognised as a result of applying paragraph B15 of the ED, would not be fulfilled because there is no present legal or economic obligation arising from a regulatory agreement to reduce future tariffs charged to customers (e.g., when the CWIP is incomplete).
 - (iii) Some respondents pointed out that although the proposal would aim at matching allowed expense and regulatory return (revenue), the matching principle would be inconsistent with the economic rights and obligations arising from the regulatory agreement.
 - (iv) Some respondents stated that seeking comparability across different types of arrangements should not take precedence over the relevance of information, especially in comparisons between different sectors or different jurisdictions.
 - (v) One respondent expressed concerns about emerging inconsistencies that the proposed guidance would implicitly create differences in recognition, because:
 - regulatory returns on CWIP that are certain would be deferred into the future, whereas
 - other returns would not be deferred, although those would not be certain, based on the more-likely-than-not threshold.
 - (vi) Some respondents noted that inconsistencies between the accounting for regulatory returns versus incentives/penalties on CWIP should be avoided.
- (b) Information usefulness: Some respondents argued to defer regulatory returns on CWIP into the future would give investors information that does not faithfully reflect the effects of rate regulation and would make investments into rate-regulated businesses less attractive. Users also stated that having a right to charge the customer would be a positive signal from their perspective, whereas the proposed guidance would not support such a signal.
- (c) Operationality and cost-benefit considerations:
- (i) Some respondents highlighted that the application of the guidance would be accompanied by high implementation and operational costs since the regulatory return would need to be allocated to single assets without having the technical systems and databases to comply with the proposed guidance. This is consistent with the response of some respondents to the EFRAG draft comment letter questions that they would expect general implementation issues on the CWIP proposals.
 - (ii) One respondent stated that a full retrospective application would increase challenges to gather the data, especially in cases where companies would have to go far back in time to ensure the correct allocation of regulatory returns on CWIP to the respective 'assets under construction' projects. This would also lead to concerns as already recognised regulatory returns would have to be deferred into the future.

68 One respondent did not answer this question.

Do you agree with the proposed guidance in paragraphs B3–B27 on total allowed compensation?

- 69 Some respondents support the IASB's proposals for applying the guidance in paragraphs B3- B27 of the ED regarding total allowed compensation.

Concerns about the proposed Standard's application to specific circumstances

- 70 Others questioned the application of the guidance to their specific circumstances:
- (a) Some respondents questioned how to account for inflation adjustments that were provided by the regulator and whether these were allowable expenses or a regulatory return on the asset.
 - (b) Some respondents stated that there was no guidance on situations where the sector average cost for the period would affect the regulated income for the same period (in total or partially):
 - (i) Some respondents noted the increased challenges in determining total allowed compensation as sector-average amounts would typically not be available.
 - (ii) One respondent questioned whether sector-average expenses would be in the scope of the proposed Standard and be part of the total allowed compensation concept. It was also noted that there should be no regulatory asset or regulatory liability as the estimate would not be reliable, the reliability criteria should be incorporated into the proposed guidance.
 - (iii) One respondent questioned whether regulated entities would be required to split the compensation into an allowable expense and incentive component.

Concerns about the application of the total allowed compensation (allowable expense) concept

- 71 Some respondents opposed the IASB's proposals in paragraphs B3 – B9 of the ED especially with emphasis that costs were included in total allowed compensation in the period when entities would incur expense under IFRS and that this would not be aligned with their local regulatory agreements. These respondents had the following arguments:
- (a) One respondent argued that the misalignment between the regulatory recovery period and an asset's useful life does not result in any adjustment of future rates charged to customers under any known regulatory framework as specified in the definition of regulatory assets and regulatory liabilities. Consequently, under this circumstance, the proposal results in regulatory assets and regulatory liabilities that are inconsistent with the IASB definition of these terms.
 - (b) One respondent opined that the proposed approach would lead to timing differences as the existence of regulatory allowable expense and IFRS expense may be different affecting the period (see above) or the total amount (so-called permanent differences). The respondent suggested that the IASB should clarify that permanent differences would be part of target profit (e.g., any component of target profit as mentioned in paragraph 88 of the Basis for Conclusions of the ED) and that the recovery of allowable expenses considered in total allowed compensation should be based on the regulatory agreement.
- 72 Some respondents did not answer the question.

Provision of further guidance on the concept of total allowed compensation

- 73 Many of the respondents supported further guidance on the application of the concept of total allowed compensation, and they had the following comments:
- (a) Clarification would be required for the treatment of sector-average costs (three of twelve respondents – 25%) or it should be scoped out of the proposed Standard.
 - (b) Clarification would be required for the treatment of situations with time-lag/inflation adjustments (three of twelve respondents – 25%).
 - (c) Suggestion to reconsider guidance in paragraphs B15 and B3-B9 to align accounting with the regulatory treatment (two of twelve respondents – 17%) or retain paragraph 11 and amend as follows (one of twelve respondents – 8%):
 - (i) Eliminate the exception in paragraph B15 of the ED for regulatory returns on CWIP that proposes the deferral of regulatory returns to when the asset is in use.
 - (ii) Change the guidance in paragraph B3-B9 to define an amount that recovers allowable expenses minus chargeable income as the expense or income by applying the regulatory requirements.
 - (iii) Clarify that an entity identifies its performance obligations based on the regulatory agreement and that performance obligation does not necessarily mean supply of goods or services to customers.
 - (d) One respondent suggested the IASB should develop specific application guidance to address the circumstances where allowable expenses affect regulated rates as specified in the regulatory agreement and not based on IFRS expense.
- 74 Three respondents did not answer the question.

EFRAG Secretariat recommendations

CWIP regulatory returns

- 75 Based on the feedback received from constituents, and from the July 2021 EFRAG TEG meeting tentative decisions where there was consensus on disagreeing with the CWIP proposals, and the June 2021 EFRAG RRAWG-TEG meeting deliberation, the EFRAG Secretariat recommends that in the final comment letter EFRAG supports view 1 of the draft comment letter and disagrees with the proposed requirement for the deferral of CWIP regulatory returns charged to customers during construction (Paragraph B15 of ED).
- 76 More than was the case in the draft comment letter, the final comment letter should expand on the reasons for disagreeing with the proposal with an articulation of the conceptual reasons (i.e., a performance obligation is fulfilled, there are diverse regulatory regimes and deferral of regulatory returns for all agreements is inappropriate), the usefulness of information from effects analysis and outreach, and operationality and cost-benefit considerations gotten from the feedback from constituents, EFRAG TEG tentative decisions and EFRAG RRAWG-TEG deliberations.

Components of total allowed compensation (allowable expense less chargeable income and performance incentives)

- 77 Based on the feedback received and where most respondents agreed with the proposed guidance on total allowed compensation except for that relating to CWIP regulatory returns, the EFRAG Secretariat recommends that in the final comment letter, EFRAG retains the broad support expressed in the draft comment letter for the notion of the total allowed compensation and its proposed overall guidance with

three components (allowable expense less chargeable income, regulatory returns except for those related to CWIP, performance incentives).

- 78 However, as highlighted in some comment letters, there are concerns with the proposed determination of the allowable expense component of the total allowed compensation (paragraphs B3 to B9) in the context of it not being applicable to certain regulatory regimes. For example,
- (a) parts of the proposed requirements would lead to timing differences that are misaligned to the local regulatory regime;
 - (b) the application of B3-B9 in some jurisdictions could also result in the recognition of regulatory assets and regulatory liability that are a by-product of the mechanics of the accounting model rather than reflecting enforceable economic rights or obligations arising from the regulatory agreement (e.g., paragraph 2B and 2C of the Illustrative Examples of the ED). This would result in information that is not useful for users of financial statements.
- 79 Total allowed compensation is a key building block of the proposed Standard as timing differences that determine the recognition of regulatory assets and regulatory liabilities are based on total allowed compensation. There would be a concern if the proposed model is not applicable in certain regimes. Therefore, the EFRAG Secretariat suggests that in the final comment letter EFRAG highlights these concerns albeit that it has come from a minority of respondents and recommends that the IASB further analyses the applicability of paragraph B3-B9 requirements (allowable expense requirements) across diverse regulatory regimes including those where costs are based on sector averages and where recoverable expenses are based on the regulatory agreement. The further review by the IASB should also ensure that the regulatory assets and regulatory liabilities recognised due to the application of paragraph B3-B9 requirements are consistent with the proposed definitions of regulatory assets and regulatory liabilities, and they represent economic enforceable rights and obligations (i.e., are not a by-product of the accounting model mechanics).
- 80 Finally, the EFRAG Secretariat recommends that in the final comment letter EFRAG should suggest the IASB provide clarifying guidance on the following aspects of the total allowed compensation that raised concerns among constituents:
- (a) cases where the components of the total allowed compensation could be overlapping (i.e., clarify whether inflation adjustments are allowable expense or regulatory returns on the asset).
 - (b) cases where the allowable expense was based on sector average expenses for the period (in total or partially) and clarify whether these situations are in scope of the proposed Standard.
 - (c) when sector average expenses comprise elements of allowable expense and incentive component (i.e., there is a seeming overlap between the allowable expense and performance incentive component). The IASB should clarify the respective component of the total allowed compensation for this situation.
 - (d) cases where the allowable recoverable expenses that affect regulated rates are specified in the regulatory agreement and are not the IFRS expenses (so-called permanent differences).
- 81 The IASB should clarify that when an entity identifies its performance obligations based on the regulatory agreement (e.g., during construction of assets), the performance obligation does not necessarily mean the supply of goods or services to customers.

Question for EFRAG TEG/EFRAG Board

82 Does EFRAG TEG/EFRAG Board agree with the EFRAG Secretariat recommendation? If not, what alternative do you propose?

Question 4 - Recognition

Summary of feedback

Outreach events

- 83 Some outreach participants noted that the facts and circumstances, listed in paragraph 27 of the ED (applied when exercising judgement in assessing existence and recognising regulatory asset and liability), **appear to question the enforceability of the rights and obligations in the regulatory agreement** (paragraph 9 of the ED). Further guidance was needed on the interaction between paragraph 9 of the ED (enforceability of a regulatory agreement) and the factors to assess the existence of regulatory assets and regulatory liabilities listed in paragraph 27 of the ED.
- 84 The following concerns were noted with assessing the existence of regulatory assets and regulatory liabilities which in turn would affect their recognition:
- (a) One participant stated that the requirement to have enforceable rights and obligations should be a condition for the recognition and measurement of regulatory assets and regulatory liabilities. This is because, in the jurisdiction where this respondent operates, the regulated rate is determined based on industry average costs determined and approved by the regulator and communicated to the entity at a later stage. This respondent opined that these regulatory assets may not qualify for recognition.
 - (b) Participants in an outreach event from one jurisdiction noted there could be situations in their jurisdiction where there is uncertainty regarding the existence of an enforceable right or enforceable obligation under a regulatory agreement. These participants suggested that a 'reliability' criterion be introduced in recognition. These participants highlighted the specific regulatory environment for Regional Grid Operators (RGOs) in their jurisdiction does not allow recovery of an entity's own cost base; rather, it is based on the average cost base of the sector. As entities' (i.e. RGOs) sharing information on costs is restricted, entities cannot anticipate sector averages. Consequently, in this jurisdiction, the regulatory agreement does not give rise to stable and predictable cash flows for recoveries and settlements arising from timing differences.

Effect analysis

- 85 The surveys for both preparers and users did not address this topic.

Comment letters

- 86 Enforceability – Some (three) respondents did not highlight enforceability issues in relation to recognition.
- 87 Many (five) respondents said they identified situations where there is uncertainty on if there is an enforceable right or enforceable obligation. These respondents observed that the following factors created uncertainty:
- (a) Legal requirements are not sufficiently clear;
 - (b) Regulatory environments where entities do not have sufficient insight into the regulatory rates as these are calculated based on sector averages/sector benchmarking rather than on the entities own costs;

- (c) High-demand risk. – demand risk is an important driver of the outcome uncertainty about whether a regulatory asset or a regulatory liability exists because high demand risk can affect cash flows. It may be rare that demand risk would be so high to affect recognition of regulatory assets and regulatory liabilities. However, demand risk is much higher than in the circumstances in which customers have little or no choice but to buy the entity’s goods or services. As explained in the section on scope, the IASB has potentially extended the scope of the proposed Standard since it developed the “stricter” conditions in its 2014 DP which included the criteria that customers had little or no choice for the goods or services.
- 88 Recognition of all regulatory assets and regulatory liabilities - Most respondents that answered this question agreed that an entity should recognise all its regulatory assets and regulatory liabilities. However, some of these respondents made the following observations/suggestions to the IASB:
- (a) There are cases when not all enforceable rights and obligations arising from a regulatory agreement would lead to the recognition of the regulatory assets and regulatory liabilities applying the proposed requirements in paragraphs B3-B9
- (b) The demand risk is an important driver of the outcome uncertainty – this should be better explained by the IASB, especially given the extended scope in the ED compared to the scope described in the IASB’s 2014 DP.
- (c) In some circumstances, it may be very complex to assess whether it is more likely than not that an asset exists. Consequently, the IASB should consider introducing a higher threshold for the recognition of a regulatory item when it is uncertain whether it exists. All regulatory assets and regulatory liabilities that cannot be estimated reliably should not be recognised.
- (d) As previously mentioned in response to Question 1 on scope, one respondent asked for clarity about whether the scope would affect adjustments that were beyond adjustments to IFRS 15, and specifically the application of IFRS 9.
- 89 Recognition of all regulatory assets and regulatory liabilities-recognition criteria for reliable measurement - Two respondents noted that because of the way the regulated rate is determined in their jurisdiction (based on sector averages rather than on an entity’s own costs), entities only have limited insight on the regulatory asset base (RAB) and are not allowed to share or receive information from other regulated entities on the RAB and sector efficiencies. These situations can significantly increase the measurement uncertainty (unreliability) of estimates to be made. Therefore, these respondents are of the view that a measurement uncertainty threshold should be included in the recognition criteria of regulatory assets and regulatory liabilities; that is, they should not be recognised to the extent they would not be able to be reliably measured.
- 90 Recognition threshold – Four respondents agreed that a ‘more likely than not’ recognition threshold applies when it is uncertain whether a regulatory asset or regulatory liability exists. Four respondents did not answer this question.
- 91 However, four respondents did not agree that a ‘more likely than not’ recognition threshold is appropriate, given the level of estimation and uncertainty inherent in regulatory agreements. These respondents consider that a higher recognition threshold is required and made suggestions to strengthen the recognition threshold when uncertainty exists.
- (a) Consider the “highly probable” threshold in IFRS 15 that constrains the estimates (amounts recognised) for variable consideration. Under IFRS 15 (paragraph 56) variable consideration should only be included in the transaction price to the extent that it is **highly probable** that a significant reversal of the cumulative revenue recognised will not occur when the

uncertainty associated with the variable consideration is subsequently resolved.

- (b) Consider incorporating a measurement uncertainty threshold in the recognition criteria of regulatory assets and regulatory liabilities i.e. they would not be recognised to the extent they would not be reliably measured.

EFRAG Secretariat recommendations

92 Based on the feedback received in response to the EFRAG DCL on ED, EFRAG Secretariat recommends that EFRAG's final position reflects the following additional comments:

- (a) Note in the EFRAG FCL that some respondents (three) identified situations where there is uncertainty on if there is an enforceable right or enforceable obligation (due to legal requirements, regulatory environments where entities have limited insight on amounts to recover (settle), and high-demand risk). This concern was raised during both the outreach feedback and comment letter responses.
- (b) Ask the IASB to further investigate these cases of uncertainty that would have a material effect on the measurement of a regulatory asset and regulatory liability. In such cases, it would be more appropriate, from both usefulness and cost-benefit perspective, to disclose the information rather than recognise a regulatory asset or a liability that cannot be measured reliably. Furthermore, for cases of high uncertainty, in which regulatory assets and regulatory liabilities are recognised, recommend that the proposed Standard explicitly states that where significant judgement is required, the nature of this judgment should be disclosed in accordance with IAS 1.
- (c) As pointed out in the analysis of Question 2, many respondents identified the following cases when recognition of regulatory assets and regulatory liabilities that would not provide useful information to users of financial statements:
 - (i) Recognising a regulatory liability for regulatory returns on assets not yet in use.
 - (ii) In jurisdictions where the regulatory rates were based on sector average costs, rather than an entity's own costs. In these jurisdictions, there was a high level of uncertainty regarding the amounts the entity was entitled to recover (settle).
- (d) Ask the IASB to consider whether for cases of high uncertainty a stricter recognition threshold is needed along the lines of the recommendations made by some respondents to consider the "highly probable" threshold in IFRS 15 that constrains the estimates (amounts recognised) for variable consideration.

Question for EFRAG TEG/EFRAG Board

93 Does EFRAG TEG/EFRAG Board agree with the EFRAG Secretariat recommendation? If not, what alternative do you propose?

Question 5 – Measurement

Summary of feedback

Outreach events

- 94 Regulatory boundary - Two participants commented that the proposed guidance for determining the regulatory boundary was not clear. There are cases in which the entities operate when the conclusion of the new tender is pending, and it is not clear

if these entities would fall within the regulatory boundary and should apply the model.

- 95 In some situations, the regulation was based on overarching legislation, without any guidance about renewal or cancellation. The tariff was set by the regulator for a long-term period and revised regularly within shorter timeframes. More guidance on the concept of the boundary of the regulatory agreement was needed in situations where there was no 'formal' limit for the regulation to be applicable. The question was whether the regulatory boundary was the longer period or the shorter timeframe which was used mainly to revise the tariffs.
- 96 Other measurement aspects - Measurement of the regulatory assets and liabilities was considered a critical aspect of the ED by some participants from some jurisdictions in other jurisdictions participants did not consider measurement of regulatory assets and regulatory liabilities to be an issue as investments are closely aligned/ approved by the regulator.
- (a) One participant observed that it may sometimes be challenging to reliably estimate the future cashflows of a regulatory asset or regulatory liability, either using "the expected value method" or "the most likely amount method". This could be difficult to achieve due to unexpected events (such as COVID-19) or the challenging task of defining the risks, in particular the credit risk. For example, in the railway sector, the entity that manages the railway infrastructure does not know, at initial recognition, which companies will use a railway in the future.
- (b) Some participants asked for clarification on how often credit risk would be reflected in measurement. Furthermore, some asked whether demand risk be considered as well. Participants from RGO's in the Netherlands also questioned how regulatory assets and regulatory liabilities could be measured given the specific regulation (benchmarking to the sector cost base) in the Netherlands. These participants also questioned how the interaction with the revaluation model in IAS 16 *Property, Plant and Equipment* should be considered.

Effect analysis

- 97 The surveys for both preparers and users did not address this topic.

Comment letters

- 98 Most respondents did not respond to EFRAG's question regarding the regulatory boundary and whether the proposed guidance on the boundary was clear. One respondent asked for further clarification on how to determine the regulatory boundary.
- 99 Other measurement aspects – In line with EFRAG's preliminary position, most respondents agreed with the proposed measurement basis. However, some respondents noted the following:
- (a) Three respondents expressed concerns with the proposed measurement basis in cases where measuring regulatory assets and regulatory liabilities is challenging mainly because regulated rates are based on sector averages instead of an entity's own costs.
- (b) One respondent noted it was not clear how to allocate credit risk to regulatory assets and suggested that the IASB provide additional guidance on how estimates of credit risk should be allocated to individual regulatory assets. For example, should an entity expect a credit risk on the payments due by some customers amounting to 100, to which regulatory assets would it allocate this amount it might not be able to collect? Would it be on a prorated basis to the estimated cash flows of the assets which recovery periods are longer than

their useful lives (for example 10 allocated to 10 assets or 100 to only one of these assets)?

- (c) Some respondents questioned whether applying the “most likely amount” or “expected value” would work in all cases given the levels of uncertainty in the amounts to be recognised. The reasons for this are explained in the analysis in Question 4 on recognition (legal requirements not sufficiently clear, type of rate regulation and high demand risk).

100 Impairment - One respondent (NSS) (in response to Question 11 on other IFRS Standards) did not agree with the concept that there is no required impairment test in the model. This respondent had a strong opinion that – both for practical and conceptual reasons - regulatory assets and liabilities and their related cash flows should be included in the IAS 36 impairment tests on CGU-level. This respondent considered that this is the most practical way to perform a robust IAS 36 impairment test. Additionally, this provides additional safeguards that the IAS 36 impairment test is performed consistently and that on an overall CGU-level the total net amount of assets (including regulatory assets and liabilities) is recoverable.

EFRAG Secretariat recommendations

101 Based on the feedback received, EFRAG Secretariat recommends that EFRAG’s final position be the same as in the draft comment letter and to include the following additional comments on measurement aspects of the proposed Standard. One suggestion could be to highlight that the different interpretations of boundary of a regulatory agreement can arise and explain briefly why - i.e. consider the current price control period (typically 3-5-year period) or the licence period over which the entity typically has enforceable rights and obligations, as regulators unlikely have practical ability to exercise their right to cancel the regulatory agreements.

- (a) The concern regarding the measurement of regulatory assets and liabilities that arise from regulation where rates are based on sector averages is already mentioned in the answer to Question 4. Include a reference to the relevant paragraphs to avoid repeating the same concern.
- (b) Recommend the IASB to provide additional guidance on how estimates of credit risk should be allocated to individual regulatory assets.
- (c) A possible way to address the measurement concerns of some respondents when the amounts are uncertain is to allow an entity to apply a normal change in estimate principles of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* in case, after initial recognition, a different method better predicts the cash flows. The proposed Standard requires an entity to apply the chosen method (the “most likely amount” or “expected value”) consistently from initial recognition to recovery or fulfilment.
- (d) Only one respondent recommended requiring an impairment test for regulatory assets and regulatory liabilities – other respondents did not mention that an impairment test in accordance with IAS 36 should be required. On this basis, and because EFRAG has supported the proposed cash-flow measurement technique in its preliminary view in the draft comment letter, the EFRAG Secretariat recommends not including this point in EFRAG’s FCL. We note that in the EFRAG draft comment letter response to Q 11 (Other IFRS Standards), we have asked that the IASB clarifies the interaction between the proposed Standard and IAS 36 when regulatory assets form part of a cash-generating unit for the purposes of goodwill impairment testing.

Question for EFRAG TEG/EFRAG Board

102 Does EFRAG TEG/EFRAG Board agree with the EFRAG Secretariat recommendation? If not, what alternative do you propose?

Question 6 - Discount rate

Outreach events

- 103 Regulatory interest rate - Most participants, including users, supported applying the regulatory interest rate. This is consistent with View 1 in EFRAG's preliminary views
- 104 Exemption from discounting - Some participants expressed concerns with discounting of regulatory assets and regulatory liabilities especially when the effects of discounting were insignificant and like EFRAG in its preliminary views recommended that the IASB consider introducing a practical expedient to exempt entities from discounting if the effects of discounting are not significant.
- 105 Applying the minimum interest rate concept - Most participants did not support the IASB proposal of using the minimum interest rate for regulatory assets when the regulatory interest rate provided for a regulatory asset was insufficient. The objective of the proposed requirement was not clear and did not reflect existing regulatory practice. In some regulatory regimes, the regulatory discount rate compensated for the equity and the financing component (so it was compensating for more than the time value of money). Specific concerns included:
- (a) One user noted that determining a minimum rate will result in incomparable reporting across entities and users will struggle to discern how such rates were determined;
 - (b) determining what is a minimum rate for regulatory assets is highly subjective;
 - (c) discounting cash flows by applying a minimum interest rate, would lead to a day-one loss which respondents said would be counterintuitive and would not provide relevant information to users;
 - (d) in some jurisdictions (for example the US where some European companies have significant operations) the fair rate of return was significantly higher than the market rate. Applying IFRS principles (using the lower rate) would result in a significant gain when discounting regulatory assets. This would not result in useful information for users of financial statements;
 - (e) the regulatory interest rates for operating expenses and capex can be different. For example, for capex, the regulatory interest rate is often based on WACC and for operating expenses based on an adjusted local LIBOR rate;
 - (f) one respondent thought that if there were cases when the regulatory rate was considered inappropriate, the suggestion would be to define a specific rate, which ought to be applied symmetrically for regulatory assets and regulatory liabilities. Furthermore, there should be a clear understanding of why the regulator does not allow a return (expected to hold for limited circumstances). If the IASB decided to keep the proposal for determining a minimum interest rate, it would need to develop objective criteria on setting the 'minimum' rate to prevent judgemental/subjective discussions.
 - (g) other respondents also questioned why the IASB had proposed a minimum rate only for regulatory assets and not regulatory liabilities.

Effect analysis

Effect analysis survey feedback-Preparers (Eight respondents)

- 106 Purpose of the regulatory interest rate- The majority of preparers that answered this question said that the regulatory interest rate compensates for the time value of

money and other factors such as business risks. One preparer noted that there is no regulatory interest rate clearly indicated in the regulatory agreement. Based on an initial analysis, this respondent expressed difficulty identifying the regulatory interest rate within the mechanism provided by the regulator. And noted that further analysis of whether WACC is used in the calculation of regulatory returns on asset base contains an element relating to compensation for the time lag is required.

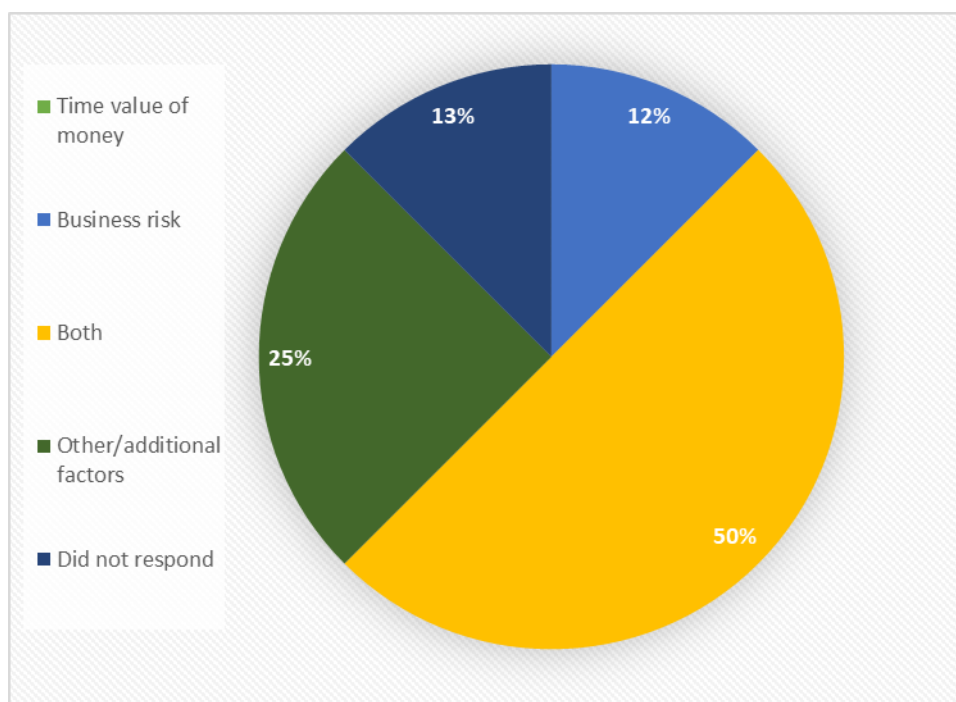


Figure 11 - What does the regulatory interest rate compensate for in your jurisdiction?

- 107 Outcome of applying the minimum interest rate to regulatory assets – of the preparers that answered this question three said it would result in a gain in profit or loss and the other two said it would result in a loss in profit or loss.
- 108 Implementation challenges with applying the discounting proposals, particularly estimating the minimum discount rate – of the preparers that answered this question, five said that it would result in implementation challenges.
- One preparer said that believed that in every case making estimates and judgements may result in some implementation issues;
 - Another respondent highlighted that the proposal could create implementation challenges because it is highly judgmental to determine if the regulatory rate is insufficient and that the regulatory WACC is generally defined by the regulator considering adequately the time value of money. In fact, the regulatory interest rate (or WACC) is subject to negotiation with the regulator and already represents the rate at which a regulated entity recovers (fulfils) a regulatory asset (liability). Furthermore, estimating a minimum interest rate when the regulatory one is deemed to be insufficient would be very complex and open to a high degree of judgement, subject to agreement's issues with auditors. Also, it would result in a misalignment with the measurement of regulatory liabilities, for which the estimation of a minimum interest rate is not required, where generally the regulatory agreement provides the same rate for assets and liabilities.

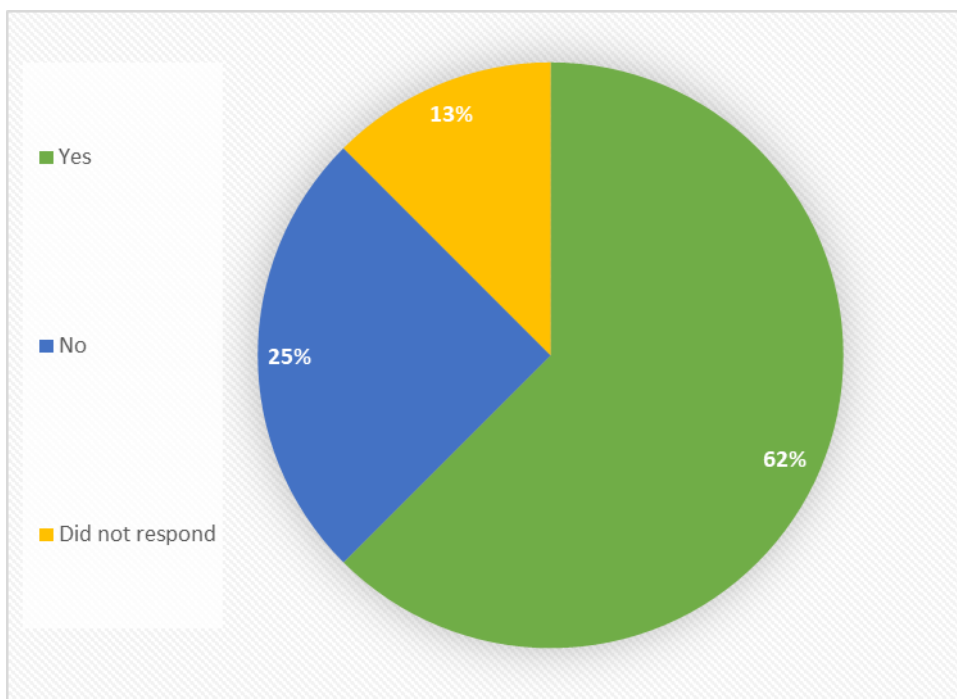


Figure 12 - Do you expect implementation issues with the proposals for discounting and specifically with estimating the minimum interest rate when insufficient?

109 Implementation challenges to determine a single discount rate when the regulatory interest rate is uneven – of the preparers that answered this question, three respondents did not identify implementation challenges and four respondents did.

- (a) One preparer noted that there are recurring situations whereby regulatory assets are subject to a time lag of between 6 months and 2 years until they are included in the rates. And there are thousands of individual regulatory assets with different maturities, especially resulting from the allocation of corporate and regional overheads to individual components of PP&E. Consequently,
- (i) the regulated entity first computes an estimated effective regulatory interest rate and measures the related regulatory asset when it obtains an enforceable right to obtain increases in tariffs.
 - (ii) Second, the regulated entity updates these computations when the regulator determines the actual return and actual period over which the entity is entitled to bill increased tariffs.
 - (iii) Third, the regulated entity regularly updates the computations, because the regulator often changes the nominal regulatory interest rate over the long life of the regulatory assets. The regulatory assets may have maturities of up to 50 years (example: corporate overheads allocated to civil works and included in Water treatment plants).
- (b) This respondent suggested the use of a cost deferral approach, which provides a fair representation of the intentions of the parties in the US water regulations. Alternatively, the use of a practical expedient that would enable to apply an approach similar to the approach used in IAS12 to measure regulatory assets resulting from the allocations of overheads. In this scenario, the listed companies that apply the practical expedient would disclose this fact and would disclose the carrying value of the related regulatory assets.

110 Practical expedient not to discount, if the effects of time and risks were not significant – of the preparers that answered this question, five answered “yes” and two answered “no”.

Effects analysis survey feedback- Users (Seven respondents)

- 111 Present value (PV) of regulatory cash flows considered - four users said they consider the PV of regulated cash flows and the other three did not.
- 112 ED's discounting proposal enhances analysis – three users had no opinion, two said no and two said yes. The users that said no did not elaborate. The users that said yes, explained that:
- (a) One user understood that the ED's proposals for discounting differ from US GAAP. Since they rate companies globally this user prefers converged accounting solutions and would recommend the IASB considers aligning the proposals for discounting with the well-established US GAAP solution.
 - (b) The other user noted that additional disclosure may be required to explain what interest rate applied; interest rate makes sense for short term recoverable amounts; regulator may allow a specific rate for these amounts or cost of debt allowance could be applied; needs to be clear that interest cost does not refer to the overall rate of return (i.e., WACC).

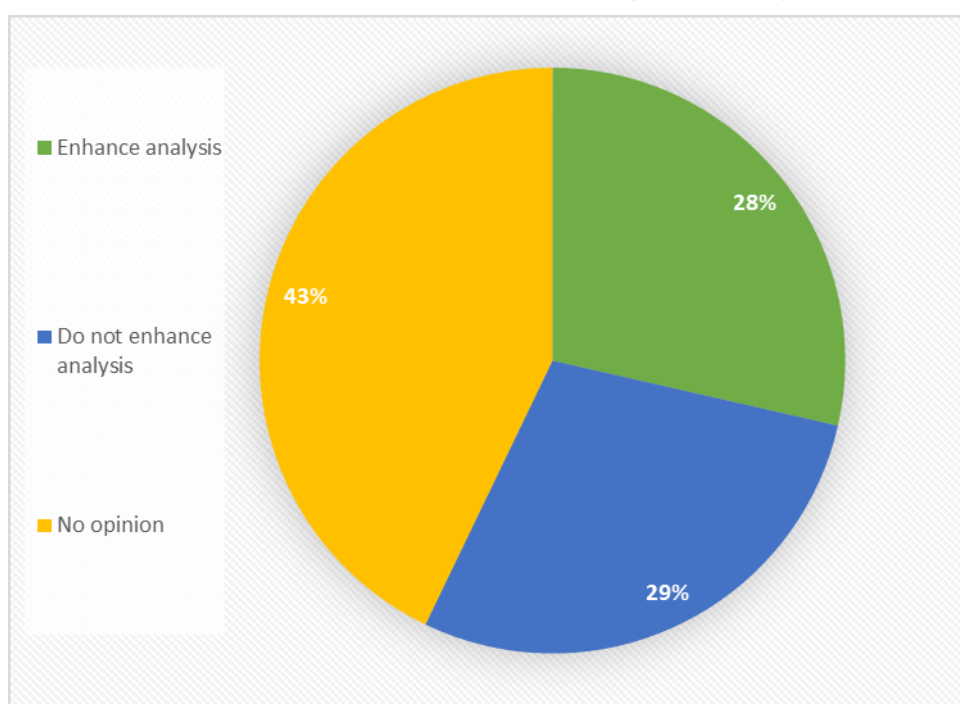


Figure 13 - Proposals enhance analysis?

Comment letters

- 113 View 1 (regulatory interest rate) or View 2 (apply IFRS requirements):
- (a) Most respondents supported applying the regulatory interest rate (View 1).
 - (b) One respondent supported View 2 in EFRAG's DCL. This respondent recommended that the IASB provides a practical exemption, from the beginning of the regulatory agreement, if the regulatory rate is not significantly different from the minimum rate. This respondent considers that the discounting of regulatory assets and liabilities captures the effect of the time value of money, and so support View 2 proposed in the EFRAG draft comment letter that considers the discounting of regulatory assets and regulatory liabilities should follow the general discounting principles in IFRS Standards.
 - (c) A respondent did not reply to this question.
- 114 Applying the minimum rate for regulatory assets if the regulatory rate is insufficient: Most respondents (eight out of twelve) did not agree with this proposal.

- (a) These respondents highlighted that the use of the minimum interest rate would not provide useful information to users and would be difficult and costly for preparers to try to assess the minimum rate for regulatory assets. Another respondent noted that there will be a question about what minimum rate should be used to compensate regulated entities' investments. Using a specific WACC for each individual entity will not facilitate comparability and will be confusing. Furthermore, to compensate the future time value of money used to finance the regulated rates in every country will not support the minimum interest rates that provide an acceptable return. This respondent (user) therefore considers that the regulated rate is the most adequate rate to be applied. The more jurisdictions that use comparable return rates, the more effective the new Standard will be.
- (b) Four respondents questioned why the IASB proposal to apply a minimum interest rate only applied to regulatory assets (and not to regulatory liabilities) citing a lack of clarity about the rationales for not assessing whether the regulatory interest for regulatory liabilities is sufficient.

115 Situations in which it would be appropriate to use a discount rate that is not the regulatory interest rate:

- (a) Most respondents (six out of twelve) did not identify situations in which it would be appropriate to use a discount rate that is not the regulatory interest rate. These respondents generally believe that the regulatory discount rate is sufficient to compensate the entity for the time value of money and risks associated with the regulatory asset.
- (b) One respondent noted that the ED suggests that generally there is a single regulatory rate (for example based on WACC). However, this respondent explained that for different timing differences, the regulator allows for different rates of return; for example, a WACC-based regulatory rate for timing difference on PP&E, and an interest-based regulatory rate for opex/volume-related timing differences settled within a reasonable short time frame (< 5 years). This respondent is of the opinion that depending on the nature of the timing difference, the appropriate regulatory rate should be used.

116 Uneven interest rates (paragraph 54 of ED): A few respondents (three) gave feedback on uneven interest rates:

- (a) One respondent disagreed with the proposal on the basis that in some cases it will be challenging to apply and result in significant operational difficulties.
- (b) One respondent agreed with the proposal but notes that the ED's Illustrative Example 5 could imply that in such cases, an entity shall always use an effective interest rate. The respondent, therefore, recommends clarifying that Example 5 illustrates only one of the possible ways to comply with the requirements of paragraph 54 of ED. (Paragraph 54 requires an entity to translate uneven regulatory interest rates into a single rate, at initial recognition, and use that rate throughout the life of the regulatory asset or regulatory liability. Paragraph 54 adds that in determining that single rate, an entity shall not consider possible future changes in the regulatory interest rate.)
- (c) Another respondent noted cases where the proposals are not clear (when a regulatory liability is fulfilled over a term that is longer than a regulatory capital base considered by a regulatory agreement). To achieve consistent application of the proposals, the respondent recommends the IASB provides an illustrative example, or application guidance, to cover this fact pattern.

EFRAG Secretariat recommendations

- 117 The EFRAG Secretariat recommends maintaining recommending to the IASB to consider introducing a **practical expedient**, like in IFRS 15, to exempt entities from discounting if the effects of discounting are not significant.
- 118 Based on the feedback received in response to the EFRAG DCL to the ED, EFRAG Secretariat recommends that EFRAG's final position reflects the following additional comments.
- (a) Minimum interest rate for regulatory assets – In line with the feedback received, the EFRAG Secretariat recommends that **EFRAG supports View 1** (i.e., always apply the regulatory interest) and disagrees with applying the minimum interest rate for regulatory assets. View 1 was supported by most respondents, including preparers and users. However, should the IASB decide to maintain the application of a minimum discount rate for those rare cases when the discount rate is deemed to be insufficient, the EFRAG Secretariat recommends that:
- (i) Encourage the IASB to consider whether in its outreach work it has identified instances where the regulatory rate is not considered to sufficiently compensate the entity, and how common such instances are.
 - (ii) Should the IASB decide to keep the concept of minimum interest rate, EFRAG recommends that the IASB simplifies the application of the minimum interest rate concept in a way that benefits both preparers and users without any material compromise on the usefulness of the information provided in the financial statements. For example, a **rebuttable presumption** that the regulatory interest rate is an appropriate discount rate for both regulatory assets and regulatory liabilities would reduce the burden on preparers of assessing the sufficiency of the discount rate at each reporting period except in rare cases where specific circumstances indicate that this is not appropriate.
 - (iii) Recommend the IASB to clarify that, given the nature of rate-regulation, instances where the regulatory rate is not considered to be sufficient are expected to be rare, and provide examples of these instances.
 - (iv) Recommend to the IASB to apply the same criteria for discounting regulatory assets and regulatory liabilities, including the application of a minimum interest rate when applicable. Having symmetrical requirements will add to the usefulness of financial information for users of financial statements.
- (b) Uneven interest rates - recommend the IASB to provide an illustrative example, or application guidance, to cover more complex scenarios of determining a single interest rate when rates are uneven. This could include the example provided by one respondent. Furthermore, recommend the IASB to clarify that Example 5 illustrates only one of the possible ways to comply with the requirements of paragraph 54. (Paragraph 54 requires an entity to translate uneven regulatory interest rates into a single rate, at initial recognition, and use that rate throughout the life of the regulatory asset or regulatory liability. Paragraph 54 adds that in determining that single rate, an entity shall not consider possible future changes in the regulatory interest rate.)

Question for EFRAG TEG/EFRAG Board

- 119 Does EFRAG TEG/EFRAG Board agree with the EFRAG Secretariat recommendation? If not, what alternative do you propose?

Question 7 - Items affecting regulated rates only when related cash is paid or received

Outreach events

120 The outreach events did not address this topic.

Effects analysis

121 The surveys for both preparers and users did not address this topic.

Comment letter analysis

Do you agree with the measurement proposals for such specific situations?

122 Many respondents (five) generally agreed with the measurement principles stated in paragraphs 59-66 of the ED that an item of expense or income should be included in the regulated rates in the period only when an entity pays or receives the related cash, or soon after that the regulatory asset or regulatory liability should be measured using the same basis as the related asset or liability.

123 Some respondents (three) stated that more guidance would be required:

- (a) One respondent requested more guidance on the treatment of actuarial remeasurements that are not recycled through profit or loss after they were recognized in other comprehensive income (OCI).
- (b) One respondent requested clarifications on the term “soon after that” as used in paragraph 59 of the ED, especially whether this would exclude longer-term charges to customers and on certain employee benefits payments that are prepaid to certain funds before these are paid to the employees
- (c) One respondent requested more guidance for pensions in the context of the boundary concept as explained under paragraph 34 of the ED.

Do you agree with the proposal to present regulatory income or regulatory expense in other comprehensive income in this case?

124 Many respondents (four) generally agreed with the approach stated in paragraph 69 of the ED that the entity shall present the resulting regulatory income or regulatory expense in OCI to the extent that the regulatory income or regulatory expense results from remeasuring the related liability or related asset through OCI. Although one respondent noted that the recognition in OCI should not be restricted to items arising from paragraph 61 of the ED.

125 One respondent did not see any practical relevance in the respective jurisdiction and many respondents (four) did not respond.

EFRAG Secretariat's recommendations

126 After considering the feedback received from constituents, the EFRAG Secretariat recommends that the EFRAG positions expressed in the draft comment letter be retained in the final comment letter. In addition, that EFRAG recommends that the IASB provides clarifying guidance and a comprehensive example on the presentation in OCI of certain items that affect regulated only when related cash is paid or received (e.g. actuarial gains or losses from pension benefits remeasurements).

Question for EFRAG TEG/EFRAG Board

127 Does EFRAG TEG/EFRAG Board agree with the EFRAG Secretariat recommendation? If not, what alternative do you propose?

Question 8 - Presentation in the statement(s) of financial performance

Outreach events

- 128 Users agreed with a presentation of regulatory income minus regulatory expense as a separate line item in the operating section, provided that the detailed information would be disclosed in the notes.
- 129 A preparer found the title of the separate line item for regulatory income (expense) just below the revenue line item confusing. It was not clear whether this line item included all regulatory income and expense or only the timing differences described by the ED.
- 130 A standard setter found the conditions for offsetting the regulatory assets and liabilities too strict due to the requirement that the amounts offset are expected to be settled in the same period. The respondent suggested the application of the same offsetting rules as those for deferred tax assets and liabilities where the timing of settlement was not important.

Effect analysis- user feedback

- 131 As shown in Figure 14, many users agreed that the IASB proposals on presentation would enhance the analysis of financial statements of rate-regulated entities.

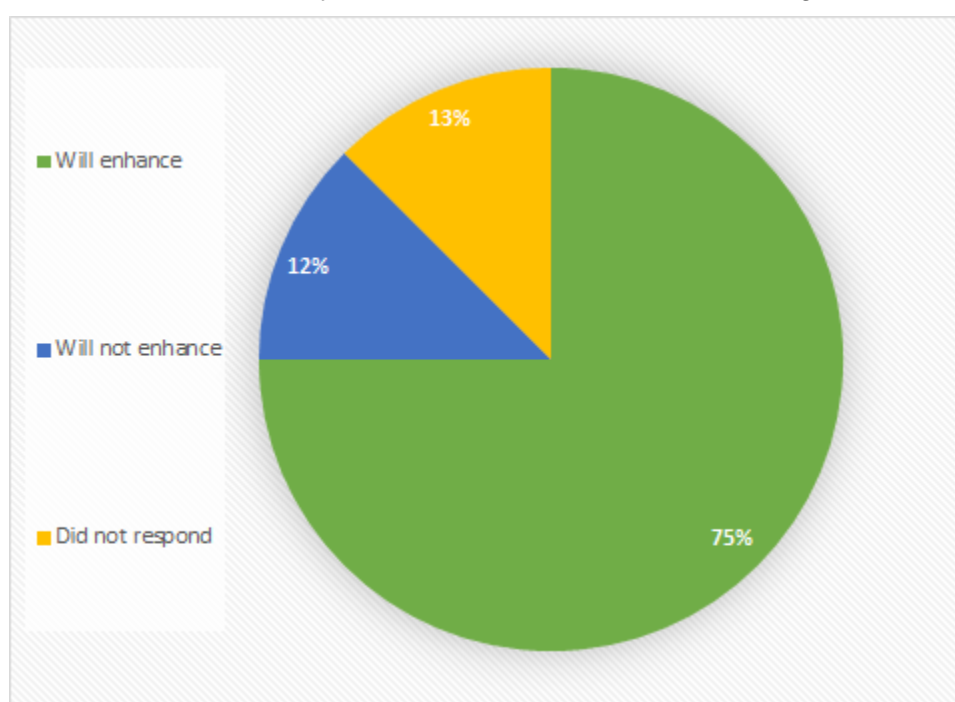


Figure 14 - Presentation enhances analysis

- 132 One respondent, although expressing general support, noted that differences between US GAAP and IFRS treatments would result in differences in ratios that will negatively impact comparability. This user recommended a more converged solution with existing US GAAP.

Comment letters

- 133 Many respondents gave feedback on the ED's proposed presentation requirements.

Separate line item

- 134 Five of twelve respondents commented on this question.
- 135 Those who responded (five) generally agreed with the IASB proposals on the presentation of all regulatory income minus all regulatory expense as a separate line item immediately below revenue. One user respondent specifically noted that they supported the presentation of regulatory income/expenses in a separate line,

and also supported a clear distinction between regulatory assets and regulatory liabilities.

- 136 One respondent highlighted that the label of this line item could be confusing as one can consider that all of the income generated through the regulated activities is presented in this line item, while it should only reflect the net effect of the overlay approach in addition to the revenue already reported applying IFRS 15 and recommended the IASB to use an appropriate description to avoid such confusion.
- 137 One respondent had mixed views and suggested making the presentation in a separate line item optional, depending on to which extent the entity was subject to a demand risk (risk of customer turnover or churn). The entities with high customer turnover could present regulatory income (expense) as a separate line item; the others – with a stable customer base where the regulatory income is very similar to the revenue recognised under IFRS 15, could present the regulatory income (expense) in the same line item as revenue and to provide additional disclosures in the notes.

Regulatory interest income (expense)

- 138 Four out of twelve respondents commented on this question.
- 139 Two out of three respondents supported the IASB proposal to include the regulatory interest income and regulatory interest expense within the line item of regulatory income minus regulatory expense on the grounds of simplicity and because the pricing of goods and services normally reflects costs of funding and forms an integral part of revenue and, therefore, should not be reported separately as financial income.
- 140 One respondent considered that regulatory interest income (expense) should be presented in the financing section of the statement of financial performance, in line with the Exposure Draft *ED/2019/7 General Presentation and Disclosures*.

Presentation in the statement of financial position

- 141 Although the IASB did not ask a question in respect of the statement of financial position's proposals, two respondents commented on this topic.
- 142 One respondent disagreed with the IASB proposals in respect of offsetting regulatory assets and liabilities and considered them as being too strict due to the requirement to assess that the amounts offset are expected to be settled in the same period. The respondent suggested the removal of this requirement (paragraph 71(b) of the ED).
- 143 Another respondent highlighted that significant judgement is required to present separately current and non-current regulatory assets and liabilities as required by paragraph 70(b). The respondent also suggested that the IASB includes in the BC some reasoning for permitting instead of requiring the offsetting of regulatory assets and liabilities (paragraph 71 of the ED).

EFRAG Secretariat's recommendations

- 144 Considering the feedback received from constituents, the EFRAG Secretariat recommends EFRAG retains the position of its draft comment letter and includes the concern about the significant judgement required to present separately current and non-current regulatory assets and liabilities as required by paragraph 70(b).
- 145 The EFRAG Secretariat considers that the ED defines in paragraphs 16(a) and 16(b) what is meant by regulatory income and regulatory expense and, therefore, does not recommend adding the comment about changing the labelling of the line item 'regulatory income minus regulatory expense'. In addition, the EFRAG Secretariat considers that the disclosures required in paragraph 78 of the ED ought to depict the components of this line item. The EFRAG Secretariat notes the strong support from users for the separate presentation (i.e., from effects analysis, user

comment letter and user outreach event) and considers that the proposal for an optional separate presentation (with only a separate presentation for entities with demand risk) would lessen the comparability of information across entities.

Question for EFRAG TEG/EFRAG Board

146 Does EFRAG TEG/EFRAG Board agree with the EFRAG Secretariat recommendation? If not, what alternative do you propose?

Question 9 - Disclosure

Outreach events

- 147 The proposed disclosure requirements were considered useful for providing users of financial statements with information that along with the information required by other IFRS Standards would enable them to understand the effects of rate regulation over an entity's financial performance, financial position, and prospects for generating future cash flows.
- 148 However, there were some concerns expressed by preparers with regards to the level of detail required to meet the overall disclosure objective set in the ED. The concerns revolve around the following:
- (a) CWIP disclosures - the application of paragraph B15 of the ED (regulatory returns on assets not yet available for use) would result in unnecessarily complex disclosures. Entities would need to explain to users the effects of such accounting treatment. The CWIP proposals could also lead to generating otherwise-unneeded alternative performance measures in order to show the effect of regulatory returns;
 - (b) Availability of quantitative information - the information about allowable expenses for depreciation differences or regulatory returns on CWIP was not currently available;
 - (c) IT costs - IT systems needed to be tailored to enable tracking of different components forming regulatory assets. These components had to be tracked individually due to different reversal periods;
 - (d) Interim financial reporting – there were no material changes within a six-month period that would justify the high operational burden of preparing disclosures for the interim financial reporting;
- 149 Fulfilling the disclosure requirements in the ED could only use a limited amount of the information from the regulatory accounts because as noted in responses to Questions 2 and 3, the total allowed compensation proposals were in majority of cases not in line with the regulatory system.
- 150 There was also a concern that in addition to the disclosure requirements, due to other proposed requirements of the model (e.g. CWIP regulatory returns) - alternative KPIs and additional disclosures had to be added to explain the impacts caused by applying the total allowed compensation proposals;
- 151 On the other hand, users of financial statements supported the disclosures and considered that providing a breakdown of regulatory income and regulatory expense was very important. Furthermore, the following disclosures were seen as helpful for users and, in their opinion, would not add cost for preparers as some jurisdictions already provided this information:
- (a) a breakdown of regulatory interest income on regulatory assets and regulatory liabilities;

- (b) a maturity breakdown of relevant balances;
- (c) reconciliation of regulatory assets and regulatory liabilities in the balance sheet;
- (d) information about rewards and penalties giving rise to regulatory assets and regulatory liabilities.

Effect analysis

User Feedback

- 152 Users indicated that having more transparency on non-current regulatory items and their reconciliation would allow a better understanding of regulated revenues, although this would not materially change the way regulated entities were being analysed.
- 153 Users generally expressed support for the disclosure requirements proposed in the ED. From the rating of the relative importance of four categories of specific disclosures shown in the chart below (Figure 13), it can be inferred that from a weighted-average perspective, the user respondents consider the reconciliation of asset/liability balances (paragraph 78) and the breakdown of regulatory income (paragraph 83) to be more important than discount rates (paragraphs 80-b and c) and maturity analysis breakdown (paragraphs 80-a and 81). This finding is consistent with the feedback from the user outreach webinar.
- 154 Furthermore, users commented that:
- (a) maturity analysis and risks were more related to credit analysis; and
 - (b) discount rates were already disclosed by regulated companies.

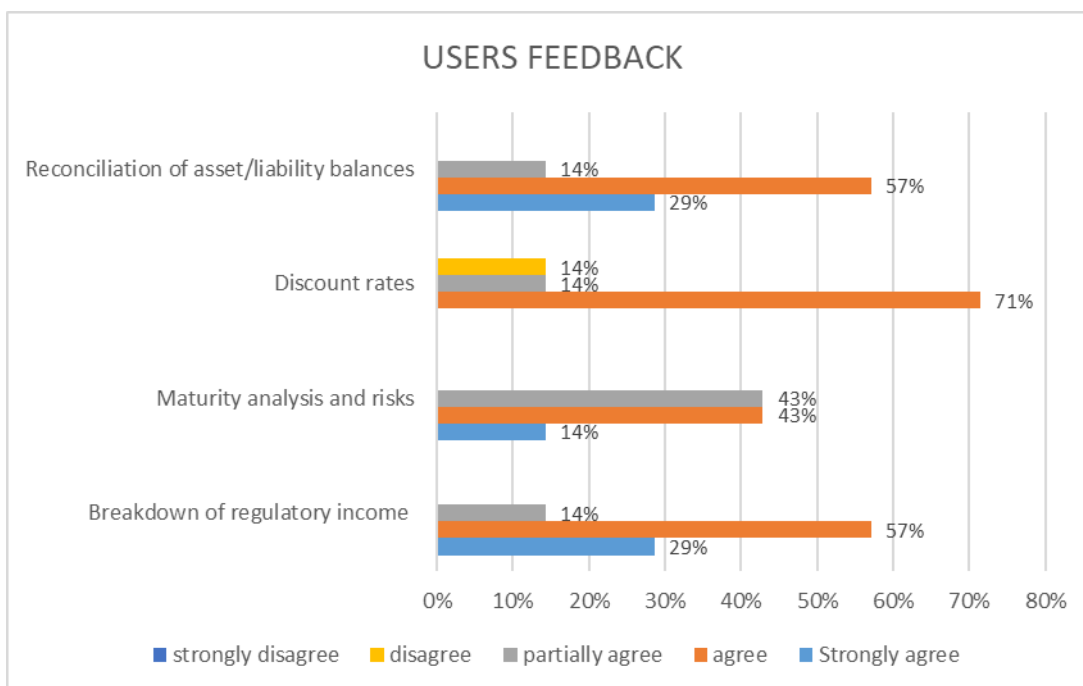


Figure 15 - Users feedback on disclosures

Preparer feedback

- 155 As shown in the below pie chart (Figure 14), half of the preparer respondents indicated that the information required under the model was only partly available.

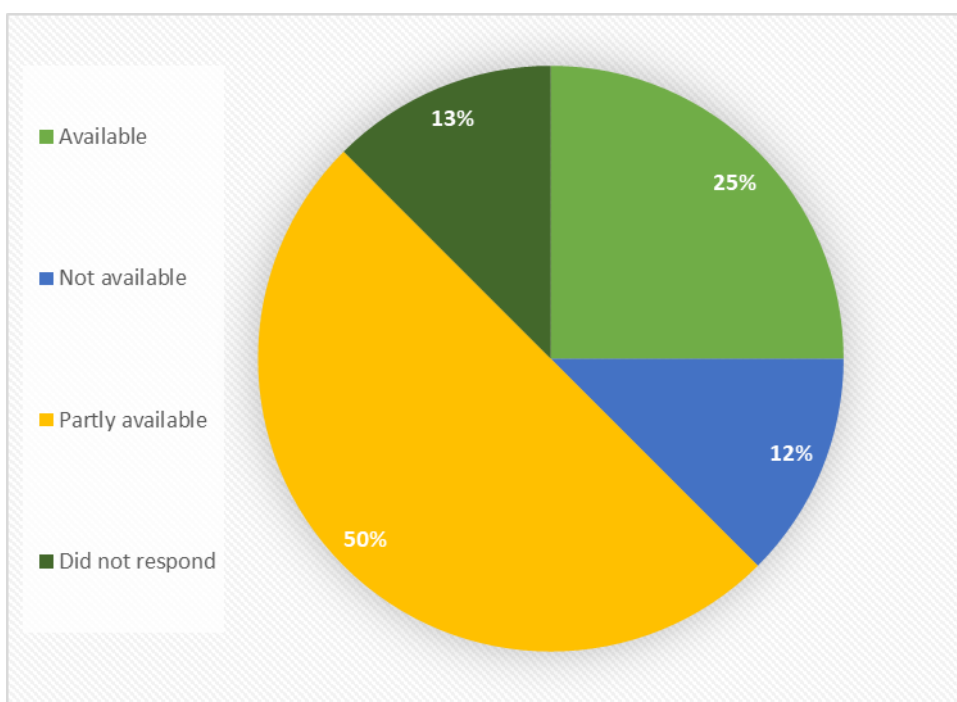


Figure 16 - Preparers disclosures - is the information needed for disclosures available?

- 156 Some preparers commented that for most of the disclosures required under paragraphs 78, 80 and 83 of the ED, there was no information readily available in their accounting systems. In particular, disclosures under paragraph 78 would be complex to provide as the regulated entity would have to disclose changes in all estimates included in the measurement of regulatory assets and regulatory liabilities
- 157 Furthermore, the required disclosures were not always meaningful on a stand-alone basis, i.e., some regulatory assets generated nominal returns higher than the local WACC, however, the overall returns granted by the regulator guaranteed the financial viability of the regulated entity. Additionally, the recognition of regulatory assets depended to a great extent on the maturity of the regulatory regime.
- 158 A suggestion was made that it might be useful to consider the approach identified in the ED *Disclosure Requirements in IFRS Standards – A Pilot Approach* moving from a 'checklist' approach to identifying information that is relevant for each specific disclosure objective.

Comment letters

- 159 Most respondents (six) agreed with the overall disclosure objective and considered that the specific disclosure objectives of the proposed Standard were useful.
- 160 One respondent proposed a disclosure objective similar to the one in IFRS 14 and described in paragraph³ BC191 of the Basis for Conclusions to the ED. The respondent opined that the disclosure requirements focused too much on the 'accounting mechanics' of the ED and does not put the focus on the essential information users need—such as how the regulation has affected and is expected to affect an entity's financial performance.
- 161 Some of the respondents raised the following concerns and observations on the proposed disclosure requirements:

³ BC 191 states that the disclosure objective in IFRS 14 is that an entity should disclose information that enables users of financial statements to assess: a) the nature of, and the risks associated with, the rate regulation that establishes the price (s) that the entity can charge customers for the goods or services it provides; and b) the effects of that rate regulation on its financial position, financial performance, and cash flows.

- (a) the unit of account for disclosure purposes was not clear (whether the disclosures in the notes should be presented per regulation or in aggregate for several operations or subsidiaries and consider whether it is meaningful to provide disclosures on a stand-alone basis). Providing the disclosures under paragraphs 78 (a)-(d) may not be simultaneously applicable for one unit of account.
 - (b) the disclosures requirements in paragraphs 77-83 of the ED (specific objectives and detailed requirements) were considered to be too granular and could be interpreted and applied as checklists.
 - (c) a sophisticated IT system was required to achieve the disclosure objectives in the ED.
 - (d) the misalignment between the notion of total allowed compensation proposed in the ED and the requirements of local regulatory regimes might require alternative performance measures- over and above the proposed disclosures- to explain the effects of the proposed Standard. The respondent noted that users might not fully understand that the disclosures reflected only the total allowed compensation according to the proposed model rather than the underlying national regulatory system.
- 162 Many respondents made suggestions for prioritising the disclosure requirements and these include the following:
- (a) to word the specific disclosure requirements proposed in paragraphs 78, 80, 81 and 83 of the ED as examples of possible disclosures rather than as mandatory provisions;
 - (b) to include a provision in paragraph 74 of the ED⁴ which would allow certain specific disclosures to be waived by an entity;
 - (c) the focus of disclosure should be on the recognised assets and liabilities at year-end, as well as those balances that have not been recognised;
 - (d) a full reconciliation from the opening to the closing carrying amounts of regulatory assets and regulatory liabilities was not necessary, as long as the main movements and/or developments were disclosed and explained;
 - (e) to weigh the expected user benefits against the preparers' concerns around the detailed nature of the proposed disclosure requirements to select those requirements that would not impose an undue burden on preparers;
 - (f) to aggregate some of the information required under paragraph 78 of the ED or provide a combination of 'high-level' qualitative and quantitative information that helped users understand how a regulatory agreement affected an entity's performance.
- 163 One of the respondents suggested the need for the IASB to clarify the specific disclosure objective of paragraph 82 (i.e., to disclose information to understand any changes in regulatory assets and regulatory liabilities that were not a consequence of regulatory income or regulatory expense).
- 164 One of the comment letters had recommendations to expand the disclosures as follows:
- (a) to expand paragraph 80(d) of the ED to disclose:
 - (i) the amount deducted in estimating future cash flows if the entity bears the credit risk with reference to paragraph 38 of the ED;

⁴ Paragraph 74 states that "an entity shall determine the level of detail necessary to satisfy the overall disclosure objective and the specific disclosure objectives..."

Analysis of feedback and EFRAG Secretariat recommendations

- (ii) the method used to estimate uncertain cash flows (given the two possibilities allowed for by paragraph 39 of the ED); and
 - (iii) whether the entity is assessing each regulatory asset and each regulatory liability separately or is considering any of them together with others in line with the requirements in paragraph 40 of the ED.
- (b) to explicitly require disclosure of significant judgements made by the management:
- (i) to conclude on the boundary of a regulatory agreement and how the boundary impacted the measurement of regulatory assets and regulatory liabilities; and
 - (ii) to establish that the entity fell within the specified circumstances where the discount rate would not be the regulatory interest rate.

165 A user organisation specifically asked that disclosure include:

- (a) a clear reconciliation of regulatory assets and regulatory liabilities; and
- (b) a breakdown of income and expenses related to regulatory assets and how many years it will take to recover the investments.

EFRAG Secretariat recommendations

Disclosure objectives

166 Based on the feedback received, the EFRAG Secretariat recommends that in the final comment letter, EFRAG retains its broad support made in the draft comment letter for the overall and specific disclosure objectives.

167 The EFRAG Secretariat notes that most comment letter respondents have supported the proposed Standards' overall and specific objectives but one of the comment letters has proposed a broader disclosure objective similar to that of IFRS 14. In the respondent's view, the proposed overall disclosure objective is focused on providing information on accounting items (regulatory income, regulatory expense, regulatory liabilities) and does not put the focus on the essential information users need—such as how the regulation has affected and is expected to affect an entity's financial performance.

168 The EFRAG Secretariat considers the overall and specific disclosure objectives are aligned with the ED *Disclosure Requirements in IFRS Standards – A Pilot Approach*. The EFRAG Secretariat also takes account of the IASB arguments made in paragraphs BC 194 of the Basis for Conclusions to the ED that a broader objective, similar to IFRS 14, might result in requirements to disclose further information that is not necessary to meet the proposed disclosure objectives (e.g., on regulatory capital base, and information on the effects of regulation even if no regulatory assets or regulatory liabilities existed at any time during any period reported in the financial statements).

169 Hence, the EFRAG Secretariat recommends while retaining support for the ED's overall and specific objectives, EFRAG should recommend that the IASB refines the wording within these objectives in a manner that further emphasises a focus on the usefulness of information (e.g., by describing the type of assessment of information that is expected within the specific objectives).

Specific disclosure requirements

170 The EFRAG Secretariat recommends that in the final comment letter, EFRAG acknowledges there is support for the proposed disclosures from users but there a range of concerns from preparers about the burdens of the proposed disclosures including due to the current unavailability of underlying quantitative information, lack of IT systems to prepare the disclosures. EFRAG should also note that in addition to the disclosure requirements, some constituents are concerned that ED proposals

- for total allowed compensation (CWIP regulatory returns) may result in the need for the reporting of alternative performance measures. There is also a concern about burdens associated with interim reporting.
- 171 The EFRAG Secretariat recommends that EFRAG proposes the disclosures be prioritised to ensure the proposed disclosure requirements do not impose an undue burden imposed on preparers without providing ascertained benefits for users.
- 172 In proposing which disclosures should be prioritised, EFRAG should reflect both users' and preparers' feedback. The user feedback shows that the reconciliation of regulatory assets and regulatory liabilities and breakdown of regulatory income (expense) (i.e., paragraph 78) is considered important. At the same time, as the feedback from the effects analysis shows, preparers are constrained in providing this information.
- 173 The EFRAG Secretariat notes the suggestion made in respect of paragraph 78, disclosure requirements could focus on the recognised regulatory assets and regulatory liabilities at year-end with only the main movements being disclosed and explained. However, the EFRAG Secretariat notes that the EFRAG effects analysis and user outreach showed that disclosures on the breakdown of regulatory income and reconciliation of balances were considered as more important categories of disclosures than those on discount rates and maturity analysis. The EFRAG Secretariat also notes that in its response to the *Disclosure Requirements in IFRS-Pilot Approach*, EFRAG has supported the quantitative reconciliation that explains reasons for changes in the amounts recognised in the statement of financial position for other IFRS Standards as these could be more understandable for users than a qualitative description.
- 174 The EFRAG Secretariat notes that a regulator constituent has suggested expanding specific requirements. The EFRAG Secretariat considers that the proposed expanded requirement is implicit within the current specific disclosures and would be prescriptive on certain aspects relative to others and it needs to be further established whether the specific identified expanded disclosures are useful to users.
- 175 The EFRAG Secretariat recommends that EFRAG should make the following suggestions for the IASB to consider in prioritising disclosures:
- (a) to include a provision in paragraph 74 of the ED which would allow certain specific disclosures to be waived by an entity when these would not be essential to the understanding of financial performance.
 - (b) to word the specific disclosure requirements proposed in paragraphs 78, 80, 81 and 83 of the ED as indicative disclosures rather than as mandatory provisions.
 - (c) to aggregate some of the information required under paragraph 78 of the ED or provide a combination of 'high-level' qualitative and quantitative information that helps users to understand how a regulatory agreement may have affected an entity's performance.
 - (d) based on users' feedback, to consider the disclosures related to maturity analysis (paragraphs 80-a and 81) and those related to discounting (paragraphs 80-b and c) to be of relatively lower importance to some users than the rest of the disclosures.
- 176 The EFRAG Secretariat recommends that EFRAG should propose that the IASB clarifies the following:
- (a) the unit of account for disclosure purposes (i.e., whether the disclosures in the notes should be presented per regulation or in aggregate for several operations or subsidiaries, and consider whether it is meaningful to provide disclosures on a stand-alone basis)

- (b) the specific disclosure objective for paragraph 82 of the ED (i.e., to disclose information to understand any changes in regulatory assets and regulatory liabilities that were not a consequence of regulatory income or regulatory expense). The ED (Appendix A) does not define regulatory income and regulatory expense. The regulatory income and regulatory expenses arise from changes in regulatory assets and regulatory liabilities. Other than from acquisitions and foreign currency translations, it is difficult to identify how changes in regulatory assets and regulatory liabilities would be unrelated to regulatory income and regulatory expenses. An illustrative example of what the IASB intends to be reflected in the proposed reconciliation will be helpful for constituents.

Question for EFRAG TEG

- 177 Does EFRAG TEG agree with the EFRAG Secretariat recommendation? If not, what alternative do you propose?

Question 10 - Effective date and transition

Outreach events

- 178 It was noted that a first-time application might be very difficult leading to undue costs and efforts as companies did not have all the information required by the ED. This was particularly the case for the retrospective application requirements regarding regulatory returns on assets not yet available for use (paragraph B15 of the ED). It was suggested to provide a modified retrospective approach with exemptions for assets with a long useful life (which could be based on regulatory rules taking into account for example one regulatory period).

Effect analysis

- 179 Many respondents (four out of six) preparers who responded to this question, mentioned the important implementation challenges related to the full retrospective approach, such as:
- (a) to account for regulatory returns on an asset-by-asset basis would be extremely onerous as regulatory returns on specific assets are not required to be tracked within our industry and by our regulator. Sourcing the information and unpicking how it interacts with the regulatory model in this way would be problematic as returns are made on the regulatory base as a whole.
 - (b) High volumes of transactions to be restated and additional deferred taxes on these additional restatements;
 - (c) different regulations in different countries resulting in different types of restatements. Consequently, two sets of accounts and forecasts would need to be prepared which would require significant updates of processes, controls, and IT tools. It would also result in misalignment with regulator accounting and rate-making processes; etc.
 - (d) retrospective application on CWIP regulatory returns will be particularly difficult;
- 180 One preparer noted that IFRS 3 *Business Combinations* exception for past business combinations (i.e. that regulatory assets/liabilities acquired in a business combination are not measured at fair value but recognised and measured according to the proposed Standard requirements of a cash-flow-based measurement technique) will not simplify the transition. This respondent supported EFRAG's draft comment letter proposal to charge to retained earnings, the adjustments to regulatory assets/liabilities instead of goodwill as it would result in a real simplification for the past business combinations.

Comment letters

- 181 Many respondents (six) commented on this question.
- 182 None of those respondents entirely supported the full retrospective approach, although some acknowledged that it would increase comparability.
- 183 The respondents stressed that the full retrospective application would be very complex and burdensome for many entities and suggested measuring regulatory assets and liabilities at the opening balance of the comparative period at the discounted cash flow amount.
- 184 The modified retrospective approach without restating comparative information was also proposed by a respondent,
- 185 It was noted that the transition requirements would be influenced by the IASB decisions on CWIP regulatory returns, and some practical expedients were suggested, such as to apply this requirement prospectively, or to require a modified retrospective approach with exemptions (for example for assets with a long useful life) or to require retrospective application only to assets that are made available for use on or after the beginning of the earliest period presented.
- 186 Many respondents highlighted significant implementation efforts required to apply the future standard (tailoring or changing IT systems, training staff, etc). Therefore, they suggested an effective date of at least 24-36 months after the publication of the final standard with early application permitted.
- 187 One respondent noted that since the transition requires a very significant effort we recommend a simplified retrospective approach, like the one detailed in IFRS 16 *Leases*. According to this alternative scenario, the entities would not restate comparative information, recognising the cumulative effect of initially applying this Standard as an adjustment to the opening balance of retained earnings at the date of initial application. The regulatory assets and regulatory liabilities should be measured using a method similar to the one documented in paragraph C8 of IFRS 16.
- 188 Four respondents commented on the relief for the past business combinations, proposed by the IASB.
- 189 One respondent agreed with the relief proposed. Another- suggested aligning it with the IFRS 1 *First-time Adoption of International Financial Reporting Standards* exemptions in respect of past business combinations. Another respondent questioned the necessity of this relief as in practice entities applied paragraph 50 of IFRS 3. This paragraph specifies that *'after the measurement period [of a business combination] ends, the acquirer shall revise the accounting for a business combination **only** to correct an error in accordance with IAS 8*. Hence, no adjustments to the past business combination would be required.
- 190 A fourth respondent welcomed the IASB proposals but asked to clarify what was meant by regulatory assets and liabilities *"which still exist at the date of transition"* referred to in paragraph C4(c).

EFRAG Secretariat's recommendations

- 191 Considering the feedback received from constituents regarding the significant efforts required to apply the proposed Standard, the EFRAG Secretariat recommends an effective date of at least 24-36 months after the publication of the final Standard with an early application permitted.
- 192 Given the feedback received from respondents, that the full retrospective application will be very complex and burdensome for many entities, the EFRAG Secretariat proposes that the final comment letter recommends a prospective or a modified retrospective application with exemptions or practical expedients for assets that have a long useful life and for CWIP regulatory returns.

- 193 In respect of the exception to IFRS 3 requirements on past business combinations, based on the feedback received, EFRAG Secretariat recommends EFRAG agree with the exception and ask the IASB to clarify how it interacts with paragraph 50 of IFRS 3 which states that '*after the measurement period [of a business combination] ends, the acquirer shall revise the accounting for a business combination **only** to correct an error in accordance with IAS 8*' and to clarify the meaning of regulatory assets and liabilities '*which still exist at the date of transition*' referred to in paragraph C4(c).

Question for EFRAG TEG

- 194 Does EFRAG TEG agree with the EFRAG Secretariat recommendation? If not, what alternative do you propose?

Question 11 - Other IFRS Standards

Outreach events

IFRIC 12 Service Concession Arrangements

- 195 A standard-setter respondent noted a general fear of double counting and that they also were still looking for a real-life example of interaction with IFRIC 12.

IFRS 3 Business Combinations exception

- 196 One standard setter commented that the discount rate for the acquirer could be different from the regulatory rate and can be WACC or another rate. License on concession can create a big intangible on acquisition, as well as important goodwill balances in their jurisdiction (for grid infrastructure).

- 197 Another standard-setter respondent commented that the day 2 gains or losses should not be considered in isolation and noted that from a conceptual perspective it was almost impossible to determine the fair value on acquisition in a monopoly situation. The cash flows are entity-specific and therefore fair value measurement does not make sense in such situations, and hence he supported the IFRS 3 exception. The respondent also agreed that it would be useful to ask how the price for an acquisition of an entity subject to rate regulation was determined.

IAS 36 Impairment of Assets

- 198 One participant noted that it was not clear whether CGUs should include regulatory assets and regulatory liabilities. He noted that the Basis for Conclusions clarifies that the corresponding cash flows are highly independent and consequently regulatory assets are inherently measured using future cash flows; however, those cash flows are ultimately arising from contracts with customers and therefore are also used to estimate the recoverable amount of other assets in a CGU.

IAS 16 revaluation model and IFRS 3 purchase price allocation (PPA)

- 199 A standard setter raised an issue of how a measurement of PPE at fair value (either under IAS 16 – revaluation model or as a result of a Purchase Price Allocation (PPA) under IFRS 3) would interact, if any, with the recognition of regulatory assets and liabilities. In its opinion, the difference in valuation between original book value and fair value could create timing differences which might result in double counting.

Effect analysis

- 200 Only one preparer respondent commented on the impact of the IASB proposals on IFRS 3 and IFRS 1 on goodwill balances stating that the IASB proposals will result in the increase of goodwill balances.
- 201 On IFRIC 12, half of the preparer respondents stated that they did not find any aspects of the interaction of the proposed model with IFRIC 12 problematic for practical application purposes.

- 202 The other half of the respondents mentioned the following points:
- (a) It was not clear how an operator under the financial asset model would have additional unrecognised amounts that should be recognised as regulatory assets and regulatory liabilities. This being the case, one respondent recommended excluding these types of contracts from the scope of the proposed standard.
 - (b) There was no clarity where concession arrangements fall under the scope of the proposed model or IFRIC 12, for example under the hybrid and the financial asset model it is not clear if future increase of tariffs should adjust the estimated future cash flows of the financial asset under IFRIC 12 or be accounted according to the ED.
 - (c) The need for additional guidance and illustrative examples to determine what are enforceable rights and obligations in concession arrangements, especially in foreign countries where the regulation is not mature.

Comment letters

General comments

- 203 One respondent proposed an explicit reference in the definition of a regulatory agreement to restrict the scope of the ED to that of IFRS 15, and a careful assessment that the proposed requirements do not create any distortion in their interactions with other IFRS and especially with the requirements for accounting for financial instruments under IFRS 9.

IAS 12 Income Taxes

- 204 Two responses to this question were received.
- 205 One respondent found the application guidance in paragraphs B41–B46 of the ED on the interaction between the proposed requirements and IAS 12 *Income Taxes* helpful.
- 206 Another respondent found the application guidance confusing and paragraphs B45, B46 contradictory in respect of presentation of regulatory assets and liabilities net or gross of tax.

IFRIC 12 Service Concession Arrangements

- 207 Many respondents (five) commented on this question.
- 208 Some respondents (three) acknowledged the lack of practical examples on the interaction of the proposed model with IFRIC 12 and considered that paragraph B47 of the ED should be supplemented by additional guidance and illustrative examples to better help preparers distinguish which arrangements within the scope of IFRIC 12 could also create regulatory assets and regulatory liabilities. Simply stating that “*some arrangements within the scope of IFRIC 12 may create regulatory assets or liabilities*” was not considered to be enough.
- 209 One respondent suggested that the interaction with financial and intangible assets models of IFRIC 12 should also be clarified. For example, to clarify that for the intangible assets model this standard applies only to the assets from operations and not from construction and that the entity should avoid any risk of double counting between the two.

IFRS 3 Business Combinations exception

- 210 Two out of three respondents agreed with the IFRS 3 exception to recognise and measure regulatory assets acquired and regulatory liabilities assumed in a business combination applying the recognition and measurement principles proposed in the ED (modified historical cost), rather than recognise and measure them at fair value.

- 211 One respondent disagreed with the IASB proposal it could increase the amount of goodwill recognised in the financial statements of the acquirer and further complicate the impairment test.

IAS 36 Impairment of Assets

- 212 Three responses on this question were received with mixed views expressed.
- 213 One respondent considered that both for practical and conceptual reasons regulatory assets and liabilities and their related cash flows should be included in the IAS 36 impairment tests on CGU-level.
- 214 Another respondent supported the IASB proposal to exclude the cash flows from regulatory assets and regulatory liabilities from the impairment test.
- 215 One respondent asked for further clarification on how the regulatory assets, regulatory liabilities and the related CGU would interact in practice when the impairment test is made, given the proposed amendments to paragraphs 43 and 79 of IAS 36 in Appendix D of the ED.

IAS 16 revaluation model and IFRS 3 purchase price allocation (PPA)

- 216 One respondent asked for clarification on how the measurement of PPE at fair value (either under IAS 16 – revaluation model or as a result of a PPA under IFRS 3) would interact, if any, with the recognition of regulatory assets and liabilities. In this respondent's view, it was unclear whether the value of timing difference will be affected by the eventual revaluation of the PP&E from amortised cost to fair value and whether any double counting would arise.

EFRAG Secretariat's recommendations

IAS 12 Income Taxes

- 217 Given the feedback received, the EFRAG Secretariat suggests that EFRAG asks the IASB to clarify the application guidance in paragraphs B45, B46 in respect of presentation of regulatory assets and liabilities net or gross of tax and to consider adding an illustrative example on this topic.

IFRIC 12 Service Concession Arrangements

- 218 Given the feedback received, the EFRAG Secretariat does not recommend any changes in the final comment letter to the EFRAG response to this question in the DCL.

IFRS 1 First-time Adoption of International Financial Reporting Standards

- 219 Given no feedback and the absence of concern on this topic, the EFRAG Secretariat recommends that EFRAG agrees with the IASB proposed amendments to IFRS 1.

IFRS 3 Business Combinations exception

- 220 The constituents feedback supports the consensus arrived at the July EFRAG TEG meeting to agree with the proposed IFRS 3 exception. Given the overall feedback received and taking account of cost-benefit and practical implementation considerations, the need for a recognition exception, and extending the reasoning applied to exceptions of other IFRS Standards from the IFRS 3 requirements, the EFRAG Secretariat recommends that in the final comment letter, EFRAG agrees with the IASB proposal to provide an exception for acquired regulatory and assumed regulatory liabilities from the IFRS 3 recognition and measurement principles.

IAS 36 Impairment of Assets

- 221 Given the feedback received, the EFRAG Secretariat does not recommend any changes to this question in the DCL.

IAS 16 - IFRS 3 revaluation model

- 222 The ED stipulates (paragraph 12 (a)) that “differences in timing arise because the regulatory agreement includes part of that total allowed compensation in determining the regulated rates for goods or services supplied in a different period (past or future)”.
- 223 Therefore, the fact that the regulatory asset base equals the revalued amount of Property, Plant and Equipment (PPE) and hence its depreciation does not have any impact on origination or not of the timing difference. Even if the value of PPE in the example equals to its regulatory asset base, the timing difference could still arise if the period when the entity is allowed to charge it to customers through the rates differs from the period when the respective depreciation expense is recognised.
- 224 EFRAG Secretariat recommends that the IASB provides additional guidance on how the differences between the regulatory asset base and IFRS asset values should be treated (for example, if the amount of PPE for regulatory purposes differs from IFRS amounts) and to provide examples illustrating these situations.

Question for EFRAG TEG

- 225 Does EFRAG TEG agree with the EFRAG Secretariat recommendation? If not, what alternative do you propose?

Question 12 - Likely effects of the proposals

Outreach events

- 226 Some participants observed that the impact of the new standard on the market should be positive, considering that analysts usually give relevance to regulatory assets and liabilities. Currently, there was a divergence in practice (some entities recognised regulatory assets and liabilities, others – did not). The new standard will improve the comparability between entities that operate in rate-regulated sectors, and this should help users of financial statements. Other preparer and user participants agreed.
- 227 One participant specifically noted that a further positive effect for the market could be that a new accounting standard that requires entities to measure regulatory assets and liabilities, will bring greater awareness and precision in the definition of tariff plans by the authorities. It was expected that the regulatory agreements and tariff plans would have to be enhanced, where they are currently not precise on some aspects that are needed to support the accounting.

Effects analysis (eight preparer respondents)

- 228 On the question of the impact of the proposals on the financial statements, two respondents (25%) indicated the impact on the balance sheet would be moderate at least whereas three respondent (37.5%) expected a significant impact. One respondent (12.5%) only expected a minimal impact.

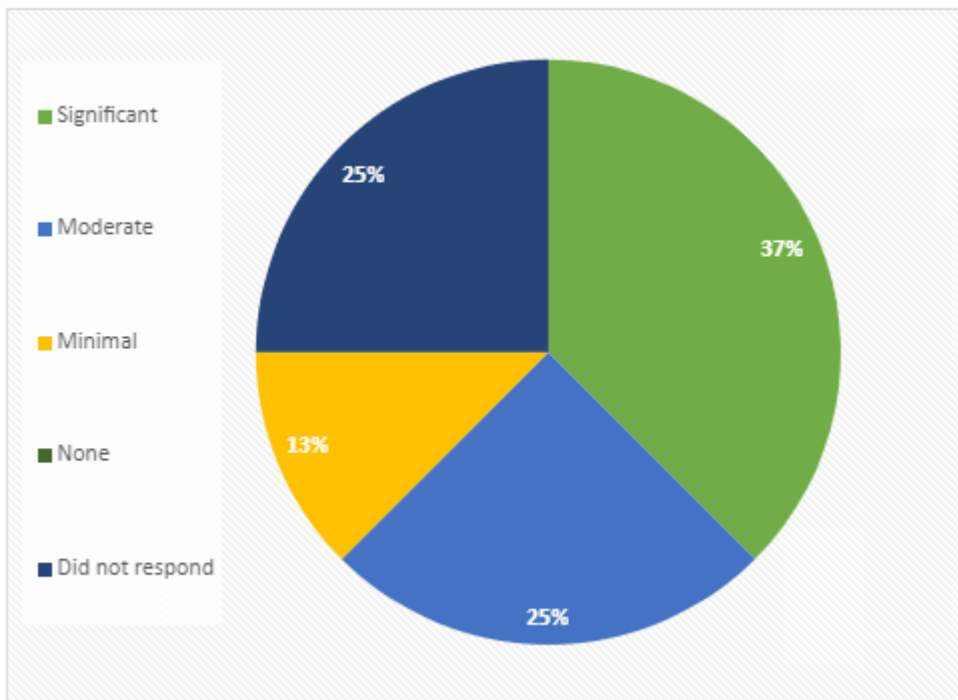


Figure 17 - Impact of the proposals on the balance sheet

229 Three respondents (37.5%) expected a moderate impact, and two respondent (25%) expected a significant impact.

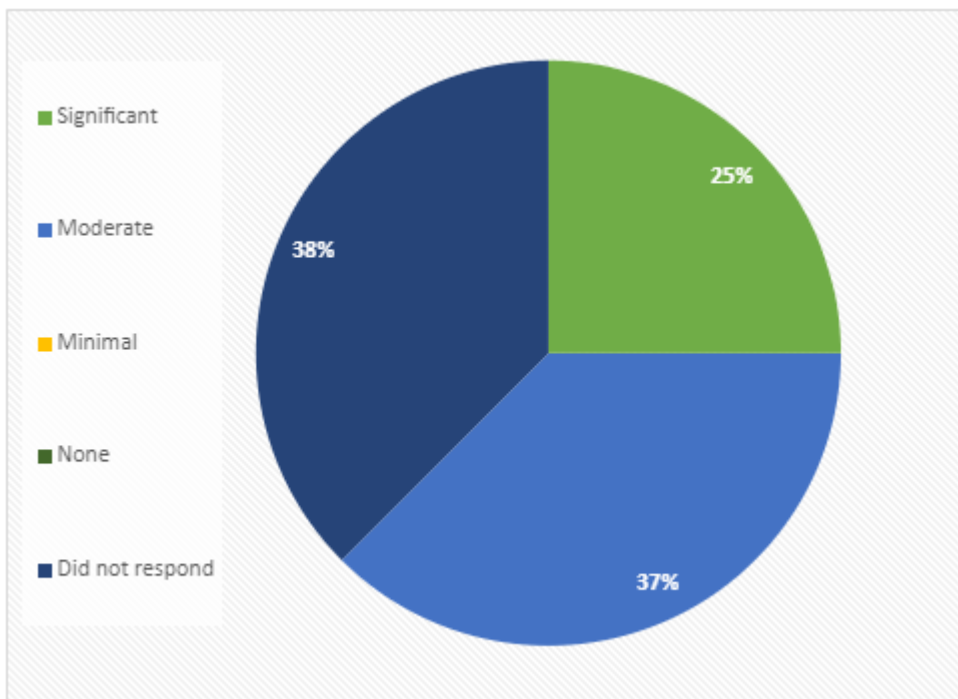


Figure 18 - Impact of proposals on profit or loss and performance

Survey question-What do you anticipate will be the level of costs to incur to implement the proposals for accounting for regulatory assets and liabilities?

230 Many of the survey respondents assessed that the level of costs incurred to implement the proposals would be moderate, while three respondents (37.5%) expected significant costs.

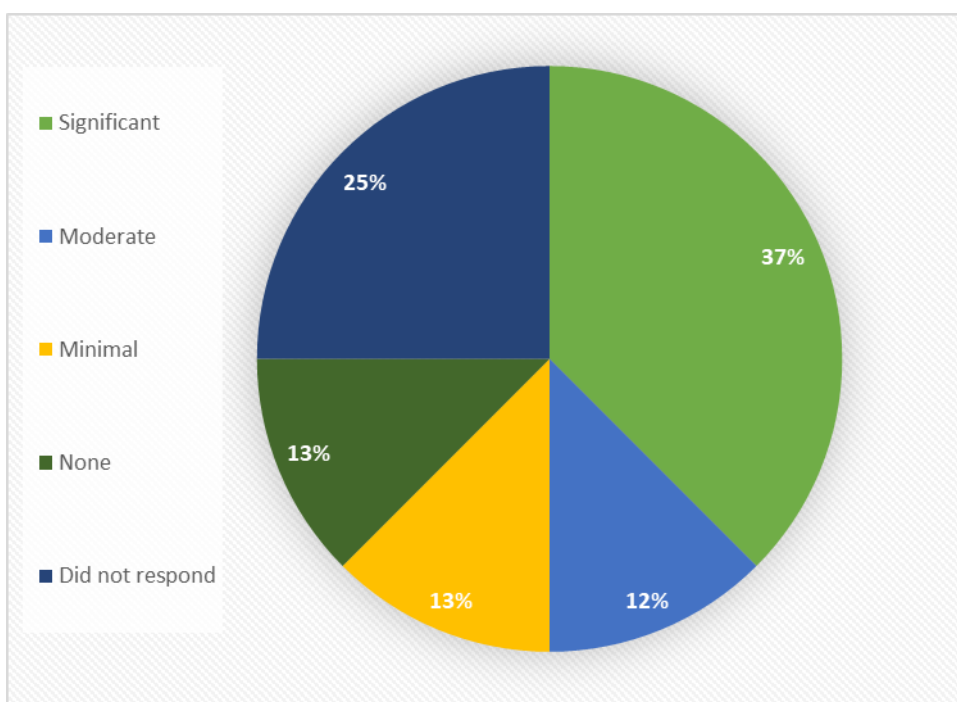


Figure 19 - Level of costs to incur to implement the proposals

231 The respondents had the following comments:

- (a) Two respondents commented that the costs would be highly significant if the entity would be required to allocate the regulatory returns on an asset-by-asset basis to determine the regulatory returns on CWIP that are to be deferred until assets come into use.
- (b) One respondent commented that a negative cost-benefit will arise due to: the proposals to determine effective and minimum interest rates; recurring remeasurements of individual regulatory assets and regulatory liabilities; burdensome disclosures; and full retrospective transition requirements.
- (c) One respondent commented that the one-off implementation costs might be limited due to similarities between their current regulatory accounting and the proposed Standard. However, the respondent stated that he would imagine that preparers not experienced in the proposed accounting model in other jurisdictions would face significantly higher implementation costs. In this respondent's view varying aspects may lead to significant one-off or ongoing implementation costs:
 - (i) Guidance on CWIP will require companies to establish tools to comply with this proposed guidance;
 - (ii) Providing a breakdown of the positions considered as regulatory assets/liabilities and monitoring changes on this granular level involves high ongoing administrative costs.

232 Considering the results from the earlier and this survey 30% of the respondents noted that they would expect moderate implementation costs and 22 % expected significant cost. The same proportion only expected minimal cost. All other respondents (26%) did not know or did not respond to the question.

If you replied to the first survey of the early-stage effects analysis, have you changed your view on the anticipated level of costs?

233 Only four of the respondents had participated in the earlier survey. Two of them (25%) increased their estimate of implementation costs made in the earlier survey,

the other two (25%) did not change their previous assessment of the expected cost level.

The ED supports preparers' efforts to provide users of financial statements with relevant information. To what extent do you agree?

- 234 On aggregate, many of the respondents agreed with the statement that the ED would support the efforts to provide relevant information.

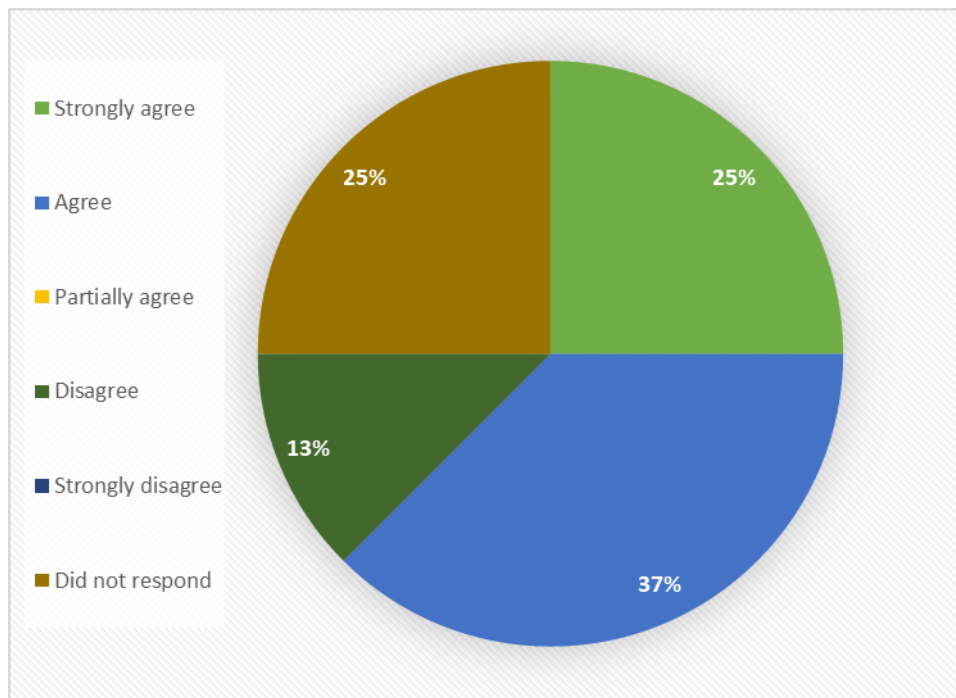


Figure 20 - ED supports preparers' efforts to provide relevant information - to what extent do you agree

Survey question-The ED appropriately reflects the complexity of existing rate-regulation regimes. To what extent do you agree?

- 235 On aggregate, some of the respondents partially agreed to the statement that the ED would appropriately reflect the complexity of their regulatory regime and two respondents agreed to the statement. No one agreed strongly, but one respondent disagreed.

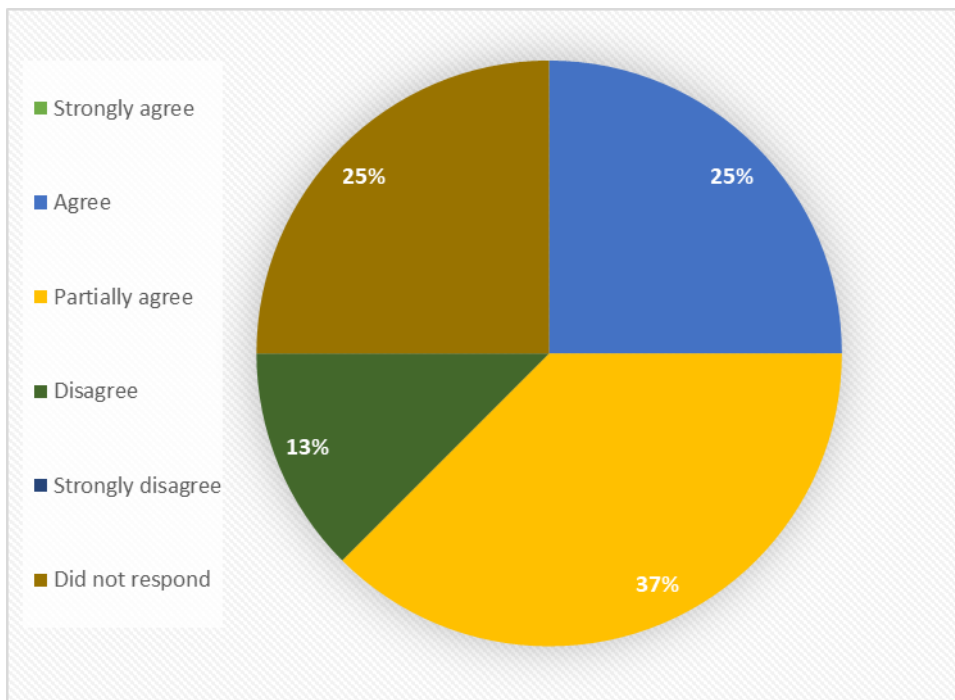


Figure 21 – ED appropriately reflects regulatory complexity - to what extent do you agree

Survey question-The information needed to implement the ED requirements is readily available. To what extent do you agree?

- 236 Many of the respondents only partially agreed or disagreed with the statement that the information needed to implement the ED would be readily available. One respondent strongly agreed, and two respondents did not respond to this statement.

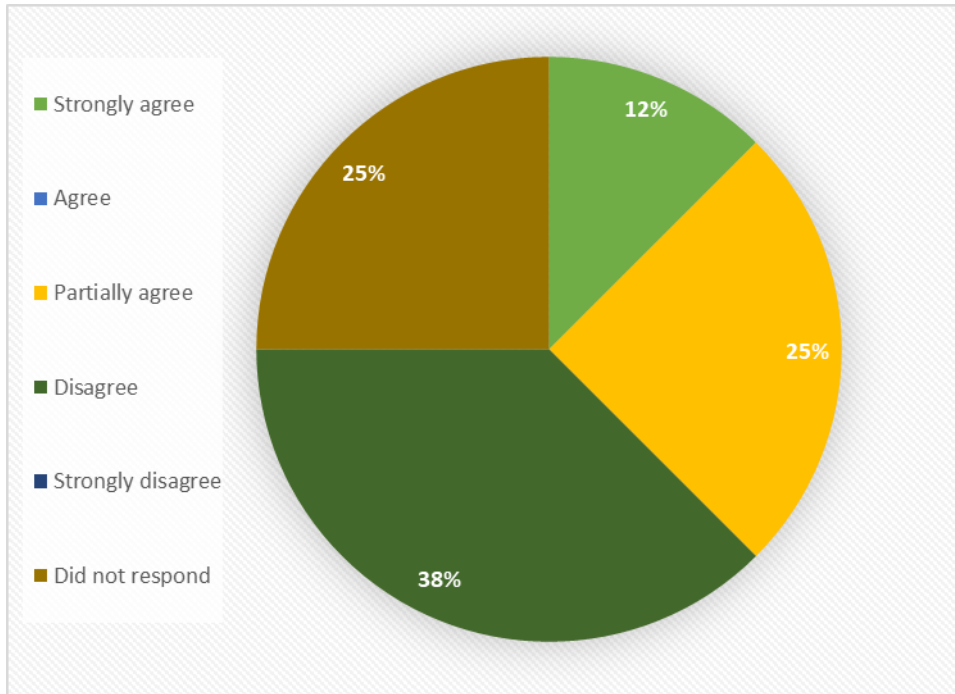


Figure 22 – Information is readily available - to what extent do you agree

- 237 Respondents had the following comments:
- (a) Two respondents stated that the objective of the proposals would be good, but elements of the proposals would require clarification (total allowed compensation, scope).

- (b) One respondent stated that the information required to implement the ED as drafted is not all currently available (e.g., tracking of assets under construction).
- (c) One respondent stated that the cost deferral method would bring less operational complexities, both at transition date and on a recurring basis.
- (d) One respondent stated a disagreement with the proposals on CWIP as it would not be in line with the standard's objective to provide relevant information that faithfully represents how regulatory income and regulatory expense affect the entity's financial performance and how regulatory assets and regulatory liabilities affect its financial position.

Survey question-What is your assessment of the overall cost-benefit resulting from your company's application of the proposals?

238 Some of the respondents (three or 37.5%) assessed a positive cost-benefit relationship. One respondent (12.5%) assessed a negative cost-benefit relationship. A respondent that assessed a positive cost-benefit relationship pointed out that the relationship could be unfavourable if the treatment of CWIP would be retained.

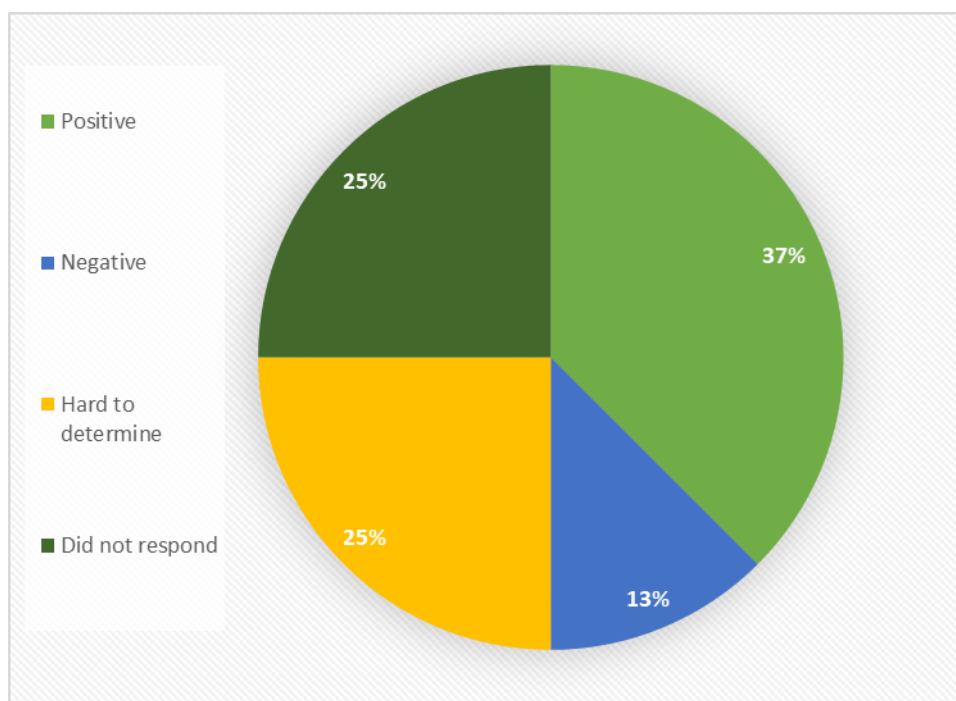


Figure 23 - Assessment of the overall cost-benefit from the application of the proposals

Comment letter analysis

Do you agree with the IASB's analysis of the likely effects of implementing the proposals on information reported in the financial statements and on the quality of financial reporting?

- 239 Most of the respondents did not respond to the specific question. Some agreed with the IASB's analysis whereas others had reservations about or only agreed partially on the implementation effects in the context of cost-benefits and financial information quality in their own assessment. Those that replied stated the following:
- (a) Two respondents noted that the proposals in B3-B9 and B15
 - (i) would not give users of financial statements a faithful insight into the entity's performance;
 - (ii) there may be an effect of reduced volatility in profit or loss.

- (b) One respondent agreed with the IASB analysis on quality of financial reporting while noting that the IASB would likely understate the proposals implementation cost.

Do you agree with the IASB's analysis of the likely costs of implementing the proposals?

240 Most of the respondents did not respond to the specific question. Some agreed to the IASB's analysis of costs and benefits whereas some did not agree on the IASB's analysis.

- (a) One respondent expressed the view that the adoption of the ED may be quite costly for entities as regulatory agreements and the application of the total allowed compensation concept may be complex and additional regulatory accounts would need to be maintained. Costs would also vary dependent on the jurisdiction influenced by the respective uncertainties.
- (b) One respondent only partly agreed with the Board's analysis about the likely costs of implementation as based on the respondent's view on the proposals user would have to also use other sources of information to understand the effects of regulation. The respondent expected considerable costs of applying the proposals, both on initial application and on an ongoing basis. Therefore, the respondent concluded that the costs to incur would not justify the user's benefits, leading to a negative cost-benefit relationship.
- (c) Another respondent stated implementing the proposals would be a significant accounting change, leading to the implementation of new processes or change the closing processes, which would be in contradiction to the IASB's assessment, which would appear a bit simplistic.
- (d) One respondent did not support the IASB's underlying assumption that entities would already gather all information needed for implementation. Data gathering throughout the year would be costly as interim year accounting would not be supported by regulatory accounting processes. The respondent also pointed out the significant workload required to implement the proposals and suggested to
 - (i) allow three years for implementation; and
 - (ii) require simplification of the proposals to the maximum extent.

EFRAG Secretariat's recommendations

241 Based on the feedback, the EFRAG Secretariat recommends the final comment letter retains the positive cost-benefit assessment made in the draft comment letter. The user outreach and effects analysis (this and the earlier-conducted effects analysis survey) show that positive benefits are expected. However, preparer responses to the effects analysis show that some of them may face significant implementation costs. As a result, the EFRAG final comment letter should highlight aspects of the proposed Standard where there noted significant implementation costs may arise (e.g., tracking regulatory returns related to individual assets- CWIP, disclosure, the retrospective transition requirements).

Question for EFRAG TEG

242 Does EFRAG TEG agree with the EFRAG Secretariat recommendation? If not, what alternative do you propose?

Question 13 - Other comments

Outreach events

- 243 Some participants from one jurisdiction noted that the proposals in the ED overlaid the treatment required under existing regulatory regimes. A suggestion was made to show regulatory numbers in line with regulatory guidance instead of calculating IFRS figures which would not fit with the actual compensation from the regulator. The accounting model proposed in the ED would create significant regulatory assets which would not be covered by the regulator.

Effect analysis

- 244 Not applicable.

Comment letters

- 245 Four responses to this question were received with the following comments and suggestions.

- (a) To re-expose the ED after taking into account the comments received
- (b) To provide real-world-based illustrative examples
- (c) To illustrate and clarify in the BC why general price regulations are not in the scope of this ED; to specify the initial recognition requirements for regulatory assets and liabilities and to explain in the BC how the IASB concluded that regulatory assets and regulatory liabilities were monetary items
- (d) Expressed reservations about the principle to identify the right or obligation arising from an **individual** difference in timing as the unit of account and suggested to consider **net of all** differences in timing arising from a regulatory agreement as a unit of account;
- (e) Noted that the assumption from paragraph BC116 that '*entities typically track separately the effects of each of the individual differences in timing*' does not apply in all cases (for example, in some regulations, where the specific return granted on CWIP is computed on their annual average amount). There is no specific regulatory need to track the return on each of these CWIP;
- (f) Questioned whether the exception to the principle on the unit of account, stated by paragraph 24, would apply when the various items encompassing the clawback account (e.g., differences between actual expenses and income, forecast expenses and income, financial outcome of performance incentives, capital gains on asset disposal, etc) are not subject to similar risks;
- (g) To create a TRG or to use the Consultative Group for Rate Regulation to help with transition issues.

EFRAG Secretariat's recommendations

- 246 Considering the feedback received, the EFRAG Secretariat recommends the following points be added to those raised in EFRAG response to Question 13 of the DCL:

- (a) To include more real-world-based illustrative examples;
- (b) To explain in the BC how the IASB concluded that regulatory assets and regulatory liabilities were monetary items when applying IAS 21 *The Effects of Changes in Foreign Exchange Rates*.

Question for EFRAG TEG

- 247 Does EFRAG TEG agree with the EFRAG Secretariat recommendation? If not, what alternative do you propose?