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## Regulatory assets and regulatory liabilities Issues Paper

### Objective

- 1 The purpose of this session is to seek EFRAG TEG/CFSS members' views on the recent IASB tentative decisions in Q1 and Q2 2023 on the 2021 Exposure Draft [Regulatory Assets and Regulatory Liabilities \(the ED\)](#). This input is sought in preparation for the ASAF discussion on 28 September 2023.
- 2 Questions to EFRAG TEG-CFSS members are in line with the question in the ASAF AP paper AP2. See paragraphs 134 and 135 of this paper.

### Agenda papers

- 3 This paper is supported by ASAF AP2, which is provided as a background paper – Agenda paper 04-02.

### IASB tentative decisions taken in Q1 and Q2 2023

- 4 The IASB tentative decisions addressed are:

#### *Total allowed compensation*

- (a) Total allowed compensation - Performance incentives;
- (b) Long-term performance incentives;

#### *Recognition*

- (c) The recognition threshold;
- (d) Interaction between enforceability and recognition;
- (e) Timing of initial recognition;

#### *Derecognition*

- (f) recovery of part/all of the regulatory asset or fulfilling part/all of the regulatory liability;
- (g) clarification that derecognise when a regulatory asset/liability ceased to meet the 'more likely than not' recognition threshold;
- (h) guidance when a regulatory asset/liability is settled by a regulator/designated body; and
- (i) other derecognition requirements when there is a no direct relationship.

#### *Measurement*

- (j) Estimation of uncertain cash flows.

- 5 For each of the IASB tentative decisions discussed in this paper, the following content is provided:
- (a) IASB tentative decisions;
  - (b) Proposals in the ED;
  - (c) Description and analysis of the issue; and
  - (d) Feedback received from constituents (including EFRAG).

## **TOTAL ALLOWED COMPENSATION**

### **Performance incentives-except long-term performance incentives**

#### *IASB tentative decision (February 2023)*

- 6 The IASB tentatively decided that:

The amounts relating to performance incentives should form part of or reduce the total allowed compensation for goods or services supplied in the period in which the entity's performance gives rise to the incentive. These amounts would include those that result from an entity's performance of construction work.

- 7 All 12 IASB members agreed with this decision in line with the IASB staff recommendations.

#### *Proposals in the ED*

- 8 Paragraphs B16–B18 of the ED proposed that amounts relating to a performance incentive form part of or reduce the total allowed compensation for goods or services supplied in the period in which an entity's performance gives rise to the incentive.

- 9 Paragraph B18 of the ED proposes the same treatment if the performance criteria test only an entity's performance of construction work. This means that amounts for performance incentives that test specified milestones while constructing an asset would form part of or reduce the total allowed compensation for goods or services supplied during construction.

- 10 In the Basis for Conclusions (BC103 – BC105), the IASB acknowledged that the proposed treatment of construction-related performance incentives would arguably not align with the principle underlying the model – which is to reflect the total allowed compensation for goods or services supplied as part of its reported financial performance for the period in which the entity supplies those goods or services.

- 11 However, the IASB explained that the proposals aim to reflect performance incentives in profit or loss in the period in which an entity's performance gives rise to the incentives, even for incentives for performing construction work, because that period is when the performance occurs. The IASB also argued that aligning the treatment of construction-related incentives with the treatment of all other performance incentives would provide useful information to users and reduce costs for preparers as entities would not need to develop and implement different policies and processes for different types of performance incentives.

#### *Description and analysis of the issue*

- 12 Most respondents (including EFRAG) agreed with the proposals for performance incentives, including the treatment for construction-related performance incentives noting that they aligned to the regulatory agreements.

- 13 One European preparer thought the assessment of whether rights and obligations are enforceable is challenging in some cases when the regulations are a bit vague and recommended the final Standard provide further guidance on this matter.

- 14 Many respondents, including EFRAG, pointed out an inconsistency between the proposed treatment of construction-related performance incentives and the proposed treatment of regulatory returns on an asset not yet available for use.
- 15 Regarding the point expressed by EFRAG and other respondents in paragraph 14, the IASB staff noted that the IASB's tentative decision in July 2022 aligned the treatment of the proposal for performance incentives for assets under construction with the accounting for regulatory returns on assets not yet in use. That tentative decision would require an entity to reflect regulatory returns on an asset not yet available for use in profit or loss during the construction period if the entity has an enforceable present right to these returns.
- 16 Based on the overall positive feedback received, the IASB staff recommended the IASB retain the ED's proposal.
- 17 The IASB staff acknowledged the challenges when assessing the enforceability of long-term incentives and decided to discuss these in a separate meeting – see below.
- 18 The feedback received and IASB staff analysis and recommendations were discussed with the IASB in its February 2023 meeting ([agenda paper 9D](#)).

*Feedback received so far*

*EFRAG RRAWG (July 2023)*

- 19 Members generally agreed with the IASB's tentative decision and welcomed consistency with a principle based on when an entity performed.
- 20 One member noted that as the amounts from performance incentives would not be significant compared to the whole revenue, he accepted it as a practical approach despite some diversity in estimation that could arise due to judgement being applied.

**Long-term performance incentives**

*IASB tentative decisions (April 2023)*

- 21 The IASB tentatively decided to retain the proposal in the ED to require an entity to estimate the amount of a long-term performance incentive, and to determine the portion of that estimated amount that relates to the reporting period using a reasonable and supportable basis.
- 22 Twelve of 14 IASB members agreed with this decision consistent with the IASB staff's recommendations.

*Proposals in the ED*

- 23 The ED proposed that:
  - (a) amounts relating to a performance incentive form part of or reduce the total allowed compensation for goods or services supplied in the period in which an entity's performance gives rise to the incentive (a bonus or a penalty—paragraph B17 of the ED).
  - (b) if the performance criteria test an entity's performance over a time frame that is not yet complete, the entity would estimate the amount of the performance incentive using the 'most likely amount' method or the 'expected value' method and then determine the portion of that estimate that relates to the reporting period. That portion forms part of or reduces the total allowed compensation for goods or services supplied in the reporting period. An entity should use a reasonable and supportable basis in determining that portion and apply that basis consistently (paragraph B19 of the ED).

*Description and analysis of the issue*

- 24 The IASB Staff conducted outreach with different stakeholders. This outreach identified a few long-term performance incentives that according to stakeholders—mainly preparers—are subject to significant outcome and measurement uncertainties:
- (a) long-term performance incentives that test an entity's efficiency when incurring capital and operating expenditures. These incentives are common in a few jurisdictions in Asia-Oceania and the United Kingdom. The significance of the performance incentives can vary. For example, in Australia, on average, the incentives could represent up to 2% of an entity's allowed revenue for a regulatory period. In the United Kingdom, long-term performance incentives represent approximately 1% of the entities' allowed revenue for a regulatory period.
  - (b) long-term performance incentives whose calculations depend on yearly average performances achieved during the performance period or on inputs related to the last year of the performance period. These incentives are common in Canada and Hong Kong.
- 25 In general, entities currently account for those long-term performance incentives in the period in which the related amounts are included in regulated rates charged.
- 26 During the outreach:
- (a) the IASB staff have not obtained evidence that long-term performance incentives subject to significant outcome and measurement uncertainties are widespread and represent a significant portion of the entities' allowed revenue (i.e., 2% of allowed revenue); and
  - (b) users of financial statements have expressed different views on the importance of information about amounts arising from long-term performance incentives. That is, credit analysts tend to place less value on information about amounts arising from long-term performance incentives and instead focus on more significant and highly predictable components of an entity's allowed revenue that have a greater effect on an entity's underlying credit ratios. On the other hand, equity analysts tend to place more value on information about amounts arising from long-term performance incentives because these amounts may have a significant effect on an entity's valuation over the long term.
- 27 The April 2023 IASB Staff paper 9A on long-term performance incentives can be found [here](#).

*Feedback received so far*

*EFRAG RRAWG (July 2023)*

- 28 Members were, in general, supportive of the tentative decisions.
- 29 One member indicated that long-term incentives relate to something major that is on top of the ordinary business while for allowable benchmark expenses, this relates to ordinary business. Therefore, this member did not see an issue with introducing a measurement constraint for allowable benchmark expenses while it is not the case for long-term incentives, looking at hybrid schemes<sup>1</sup>.

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<sup>1</sup> The IASB staff recommended that the final Standard should prohibit an entity from recognising a regulatory asset or regulatory liability arising from uncertain amounts until the uncertainty on the allowable benchmark expense is resolved. In February 2023, the IASB tentatively decided to require an entity to recognise a regulatory asset or regulatory liability—whose measurement depends on a regulatory benchmark determined after the financial statements are authorised for issue—when the regulator determines the benchmark.

- 30 Another member has not come across long-term incentives for example over five years. This member acknowledged that estimating the incentives would be challenging as it was not always possible to determine whether the entity had reached the target in time before publishing the financial statements. However, entities are used to determine the best estimate.
- 31 Members generally indicated that, currently, they see incentives related to operational efficiency but there may be incentives in the future relating to having a greener economy.

## **RECOGNITION**

### **The recognition threshold**

#### *IASB tentative decisions (February 2023)*

- 32 The IASB tentatively decided:
- (a) to retain the ED's proposal to require an entity to recognise a regulatory asset or a regulatory liability whose existence is uncertain if it is more likely than not that such an asset or liability exists;
  - (b) not to set a recognition threshold based on the probability of a flow of economic benefits;
  - (c) not to set a recognition threshold based on the level of measurement uncertainty, except for those regulatory assets and regulatory liabilities described in paragraph (e);
  - (d) to retain the ED's proposed symmetric recognition threshold for regulatory assets and regulatory liabilities; and
  - (e) to require an entity to recognise a regulatory asset or regulatory liability—whose measurement depends on a regulatory benchmark determined after the financial statements are authorised for issue — when the regulator determines the benchmark.
- 33 All 12 IASB members agreed with these decisions.
- 34 The IASB tentative decisions are in line with the IASB staff recommendations.

#### *Proposals in the ED*

- 35 The ED proposed that:
- (a) an entity should recognise all regulatory assets and all regulatory liabilities existing at the end of the reporting period (paragraph 25 of the ED)
  - (b) if it is uncertain whether a regulatory asset or a regulatory liability exists (existence uncertainty), an entity should recognise the regulatory asset or regulatory liability if it is more likely than not that it exists (paragraph 28 of the ED)
- 36 Paragraph 27 of the ED includes an indicative list of facts and circumstances that an entity would consider in determining whether a regulatory asset or a regulatory liability exists.
- 37 The ED did not propose a recognition exemption for allowable expenses based on benchmark expenses not known at reporting date.

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This February 2023 IASB tentative decision introduced a measurement constraint for allowable benchmark expenses, but the tentative decision in April 2023 has not done so for long-term performance incentives that may be highly uncertain.

*Description and analysis of the issue*

- 38 Most respondents, including EFRAG, agreed with the proposed recognition requirements, including the proposed 'more likely than not' recognition threshold that an entity would apply when it is uncertain whether a regulatory asset or a regulatory liability exists.
- 39 However, a few respondents, including some of EFRAG's stakeholders, disagreed with the recognition requirements mainly because of the perceived inconsistency with the *Conceptual Framework*<sup>2</sup> and because in some cases, there was a high existence uncertainty and measurement uncertainty for some regulatory assets and regulatory liabilities. For example, negotiations with the regulator on the recovery of specific costs and their respective amounts and instances when entities do not have sufficient insight on the amounts to be recognised as they are linked to sector averages or benchmark expenses. Another example would be underdeveloped regimes, which lack a track record of litigation/precedents. In cases where the existence uncertainty is significant in a particular regulatory regime, it may be complex to assess whether it is "more likely than not" that a regulatory asset or a regulatory liability exists.
- 40 These few respondents suggested that, in cases of high uncertainty, the final Standard should include a constraint on the measurement of regulatory assets and regulatory liabilities or disallow recognition and require disclosure instead.
- 41 Some respondents, including some of EFRAG constituents, reported that recognising regulatory assets and regulatory liabilities in instances where there is high existence and measurement uncertainty, would provide information that is not useful to users of financial statements. In some cases regulated rates based on sector averages were not known at the reporting period and might be difficult to estimate how much the entity was entitled to recover (compensate).
- 42 In reaching its recommendations to the IASB, the IASB staff focused on the following:
- (a) the "more likely than not" recognition threshold
  - (b) the symmetric recognition threshold for regulatory assets and regulatory liabilities
  - (c) allowable expenses based on benchmarks not known at reporting date.

More likely than not recognition threshold

- 43 The IASB staff acknowledged that applying a higher probability recognition threshold may reduce complexity and subjectivity. However, it may omit the recognition of some regulatory assets and regulatory liabilities. Overall, the IASB staff consider that entities would not need to exercise a high degree of judgement in the assessment of existence in most cases.
- 44 The IASB staff consider that, based on the evidence gathered during the research and consultation process, the probability of flows of economic benefits arising from regulatory assets or regulatory liabilities is generally high. However, the IASB staff acknowledge that there could be cases (for example, long-term performance incentives) where the probability of flows of benefits might be more difficult to assess.
- 45 The IASB staff noted that the overall feedback was positive and recommended that the IASB retain the ED proposal.

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<sup>2</sup> This view is predicated on the Conceptual Framework (1) not explicitly including a probability threshold in the recognition criteria and (2) specifies that recognition of a particular asset or liability may not always provide relevant information if its existence is uncertain. The IASB staff paper argues that the Conceptual Framework does not preclude the IASB from including a probability threshold when this will result in relevant information.

- 46 The IASB staff also observed that the IASB will discuss specific disclosures about recognised and unrecognised regulatory assets and regulatory liabilities that are subject to existence uncertainty at a future meeting.

Symmetric recognition

- 47 Some respondents suggested setting an asymmetric recognition threshold by applying a higher threshold to regulatory assets and a lower threshold to regulatory liabilities. They argued that such an approach would be prudent.
- 48 The IASB staff concluded that, based on the evidence gathered from their outreach, both regulatory assets and regulatory liabilities may be subject to similar levels of existence uncertainty and outcome or measurement uncertainty. This indicates that a symmetric recognition threshold for both regulatory assets and regulatory liabilities would result in useful information for users of financial statements. Therefore, the IASB staff recommend the IASB to retain the proposal.

Allowable expenses based on benchmarks not known at reporting date

- 49 Some respondents to the ED, including EFRAG, said that there would be significant measurement uncertainty associated with regulatory assets or regulatory liabilities that are based on benchmarks (expense based on submissions received from the peer group) that are not known at the time when an entity's financial statements are authorised for issue.
- 50 In such cases, the IASB staff concluded that the outcome and measurement uncertainties associated with actual benchmark expenses could be significant and any estimated amounts may not faithfully represent the regulatory asset or regulatory liability. Similar cases of uncertainty can exist in relation to variable consideration accounted for under IFRS 15 *Revenue from Contracts with Customers*. Paragraph 56 of IFRS 15 constrains the amount of variable consideration to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved.
- 51 For the above reasons, the IASB staff concluded that the final Standard should prohibit an entity from recognising a regulatory asset or regulatory liability arising from uncertain amounts until the uncertainty on the allowable benchmark expense is resolved.
- 52 During the IASB discussion, IASB members agreed in principle with the IASB staff recommendation to defer recognition of allowable benchmark expenses to when the allowable benchmark expense is known. This means that if it is known before the financial statements are authorised for issue, the entity must apply the requirements in IAS 10 *Events After the Reporting period*.
- 53 The feedback received and IASB staff analysis and recommendations were discussed with the IASB in its February 2023 meeting ([agenda paper 9B](#)).

*Feedback received so far*

*EFRAG RRAWG (July 2023)*

- 54 Members generally supported the tentative decisions including the exception made for recognition of regulatory assets and regulatory liabilities arising from allowable expenses based on benchmarks not known at the reporting date. On the latter, members agreed that in many cases companies do not know the amount that they are entitled to until it is communicated by the regulator. Members made the following additional comments:
- (a) One member observed that ongoing negotiations with the regulator or litigation may create a high level of uncertainty for such types of recoverable expenses and if it is recognised as a regulatory asset could result in a reversal of regulatory income in future periods.

- (b) Another member explained that there may be cases when negotiations are extended due to changes in the environment and that could pose challenges in assessing whether the underlying rights and obligations were enforceable.
  - (c) One member noted that entities may need to apply IAS 10 *Events After the Reporting Period* if the information became available before the financial statements were approved for release, meaning that in such cases regulatory assets and regulatory liabilities arising from benchmarks would be recognised.
- 55 However, another member while acknowledging that there could be uncertainty associated with allowable expenses based on benchmarks not known at the reporting date and judgement may be required, opined that the uncertainty could be addressed through disclosures as required by other relevant IFRS. Standards.
- 56 The IASB staff representative clarified that whenever regulatory assets or liabilities arose from allowable expenses based on benchmark information not known at the reporting date, there was no existence uncertainty as the regulator would address differences between the estimate and actual in the following year. Therefore, the entity would have certainty that it would have an asset or liability, but there was significant measurement uncertainty until the entity published its financial statements. The benchmarks in question were specific to situations when the entity did not have access to the benchmark information/know the applicable benchmark rate at the reporting period date. In other cases, benchmarks were published on a quarterly basis and an entity would have the ability to derive an estimate. The latter was a different issue. The drafting of the final Standard would need to be clear on what type of benchmarks the exception should be applied to.
- 57 Members did not identify other items with significant measurement uncertainty that should be treated in a similar manner to allowable expenses based on benchmark expenses not known at the reporting date.

### **Interaction between enforceability and recognition**

#### *IASB tentative decisions (February 2023)*

- 58 The IASB tentatively decided the following:
- (a) to reconfirm and clarify the proposed single assessment of the existence of enforceable present rights and enforceable present obligations in the Standard, for the individual regulatory assets or regulatory liabilities.
  - (b) to clarify in the final Standard that rights and obligations can be enforceable even if their existence is uncertain.
  - (c) to consider the principles in paragraph 35(c) of IFRS 15 *Revenue from Contracts with Customers* that relate to an entity's right to payment for performance completed to date in developing the Standard. These principles would be used to set the requirements for assessing the existence of enforceable present rights for regulatory returns on an asset not yet available for use, and for assessing the existence of enforceable present rights or enforceable present obligations for long-term performance incentives.
- 59 All 12 IASB members agreed with decisions (a) and (b) and eleven of 12 IASB members agreed with decision (c).
- 60 The IASB tentative decisions are in line with the IASB staff's recommendations.

#### *Proposals in the ED*

- 61 The ED required an entity to recognise all regulatory assets and regulatory liabilities that exist under the regulatory agreement.



- 62 The ED provided the following definitions:
- (a) A **regulatory agreement** is a set of enforceable rights and obligations that determine a regulated rate to be applied in contracts with customers.
  - (b) A **regulatory asset** is an enforceable present right, created by a regulatory agreement, to add an amount in determining a regulated rate to be charged to customers in future periods because part of the total allowed compensation for goods or services already supplied will be included in revenue in the future.
  - (c) A **regulatory liability** is an enforceable present obligation, created by a regulatory agreement, to deduct an amount in determining a regulated rate to be charged to customers in future periods because the revenue already recognised includes an amount that will provide part of the total allowed compensation for goods or services to be supplied in the future.
- 63 The ED stated that whether present rights and obligations in a regulatory agreement are enforceable is a matter of law. Regulatory decisions or court rulings may provide evidence about the enforceability of such rights and obligations. However, the ED did not specifically describe how to assess enforceability.
- 64 In its recognition proposals, the ED provided guidance for determining the existence of regulatory assets and regulatory liabilities which require an assessment of enforceability. Specifically, paragraph 27 of the ED outlined facts and circumstances that an entity should consider when determining whether a regulatory asset or a regulatory liability exists. Appendix 1 of this paper provides an extract of paragraph 27 of the ED.
- 65 Paragraph 28 of the ED proposed a single assessment of the existence of enforceable present rights and enforceable present obligations.

*Description and analysis of the issue*

- 66 Most respondents to the IASB who commented agreed with the proposed definitions of a regulatory asset and regulatory liability and with the proposed recognition requirements.
- 67 However, many respondents, including EFRAG, said that assessing whether rights and obligations are enforceable could be very challenging and they requested further guidance and illustrative examples. Difficulties can exist in the following cases:
- (a) in jurisdictions where the regulatory environment is not fully developed and there is no history of whether a specific right or obligation will be enforced
  - (b) when a regulatory agreement establishes a broad framework, but it may not be sufficiently detailed, or may be silent, on whether an entity would have a right to recover specific costs
  - (c) an entity's ability to include amounts in future regulated rates may be subject to the discretion of the regulator.
- 68 Respondents generally asked for further guidance on:
- (a) assessing enforceability and further guidance on determining the existence of regulatory assets and regulatory liabilities
  - (b) how the assessment of enforceability of rights and obligations interplays with the assessment of the existence of regulatory assets and regulatory liabilities
  - (c) whether the 'more likely than not' threshold was appropriate for an entity to assess whether a right or an obligation is enforceable.

- 69 Some respondents, including EFRAG, asked for additional guidance on the indicators provided in paragraph 27 of the ED about how an entity would determine whether a regulatory asset or a regulatory liability exists.
- 70 To address concerns from respondents, the IASB staff concluded that it would be helpful to include in the final Standard the principles underlying an entity's right to payment for performance completed to date in paragraph 35(c) of IFRS 15. This added guidance, together with the additional guidance on assessing enforceability proposed in paragraph 23 **Error! Reference source not found.** could help entities in assessing the existence of enforceable present rights or enforceable present obligations in relation to long-term performance incentives that are conditional upon future performance.
- 71 During the IASB discussion, IASB members acknowledged that having a higher threshold for regulatory returns on an asset not yet available for use and long-term performance incentives was appropriate and would help address feedback from respondents. For this reason, the IASB agreed with the IASB staff recommendation.
- 72 The feedback received and IASB staff analysis and recommendations were discussed with the IASB in its February 2023 meeting ([agenda paper 9C](#))

*Feedback received so far*

*EFRAG RRAWG (July 2023)*

- 73 Members generally supported the IASB's tentative decisions including that to maintain a single assessment for regulatory assets and regulatory liabilities. They noted it was important to link recognition to factors such as the regulation, regimes applicable in their jurisdiction and local law, and the IASB tentative decision allowed for judgement on the facts and circumstances.
- 74 One member suggested that there be a pre-requisite step that assessed the enforceability of the regulatory agreement to accommodate where the agreement was not sufficiently detailed. Another member noted that even when the agreement is sufficiently detailed, because of political influences or other factors, the end result might be different from what is stated in the regulatory agreement. However, these cases might be exceptional.

**Timing of initial recognition**

*IASB tentative decisions (May 2023)*

- 75 In May 2023, the IASB tentatively decided that the prospective Standard would retain the proposals in the 2021 Exposure Draft *Regulatory Assets and Regulatory Liabilities*:
- (a) to require recognition of all regulatory assets and all regulatory liabilities existing at the end of the reporting period; and
  - (b) to treat any regulatory assets or regulatory liabilities arising from regulated rates denominated in a foreign currency as monetary items when applying IAS 21.
- 76 All 14 IASB members agreed with these decisions. The IASB tentative decisions are in line with the IASB staff's recommendations.

*Proposals in the ED*

- 77 Paragraph 25 of the ED states:
- An entity shall recognise:
- (a) all regulatory assets and all regulatory liabilities existing at the end of the reporting period; and
  - (b) all regulatory income and all regulatory expenses arising during the reporting period.

78 Paragraph 45 of the ED states:

If regulated rates are denominated in a foreign currency, an entity shall treat any related regulatory assets or regulatory liabilities as monetary items when applying IAS 21 The Effects of Changes in Foreign Exchange Rates.

*Description and analysis of the issue*

*Timing of initial recognition*

79 Some respondents (including EFRAG) asked the IASB to clarify when a regulatory asset or a regulatory liability is initially recognised. Respondents indicated that paragraph 25 of the ED was unclear as to whether a regulatory asset or regulatory liability can be recognised before the end of the reporting period. They questioned whether there will be a need to assess existence for initial recognition throughout the reporting period<sup>3</sup> as done at the end of the reporting period.

80 A few accounting firms and European national standard-setters also commented on the application of IAS 21 to the recognition of regulatory assets and regulatory liabilities as follows:

- (a) the timing of initial recognition has implications for the application of IAS 21.
- (b) the regulatory assets and regulatory liabilities to which paragraph 45 of the ED refers might not always be monetary items.
- (c) the IASB should explain the rationale for the proposal in paragraph 45 of the ED.

81 The IASB Staff analysed the pros and cons of three options for determining the timing of initial recognition:

- (a) require that the recognition criteria be applied during the reporting period and that regulatory assets and regulatory liabilities be recognised at the earliest point that the recognition criteria are satisfied (that is, when the difference in timing arises) (Option A);
- (b) require that the recognition criteria be applied at the end of each reporting period, but permit earlier recognition (Option B); or
- (c) require that the recognition criteria be applied only at the end of each reporting period (Option C).

82 The IASB Staff recommended Option C because it would have the same outcome as Option A (in both the statement of financial position and the statement of financial performance) but lower compliance costs. Also, Option C would concentrate the need to gather data only at the end of reporting period and it would avoid an entity having to track changes between (i) when the difference in timing arose and (ii) the end of the reporting period.

83 However, the IASB had concerns with this recommendation and thought that it was overly restrictive especially given that the difference between recognising assets and liabilities during the period or at the end of the period only affects disclosures. They considered that entities could recognise regulatory assets and liabilities during the period if these could be tracked throughout the period.

*Application of IAS 21*

84 The proposal in paragraph 45 of the ED indicates that entities are to treat regulatory assets and regulatory liabilities as monetary items. This means that entities do not have to determine whether such regulatory assets and regulatory liabilities are monetary or non-

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<sup>3</sup> Reporting period means both interim reporting period and an annual reporting period.

monetary for the purpose of applying the subsequent measurement requirements in IAS 21.

- 85 The IASB Staff consider that the proposal in paragraph 45 of the ED above simplifies the application of the subsequent measurement requirements in IAS 21 because:
- (a) determining whether items are monetary or non-monetary can require judgement. The IASB Staff consider that when considering their nature, the regulatory assets and regulatory liabilities are closer to monetary items than to non-monetary items. The proposal in paragraph 45 of the ED avoids the potential for entities to make different determinations about similar items; and
  - (b) The proposal in paragraph 45 of the ED to treat these items as monetary items means that there is no need to determine whether to treat the proposed measurement basis as historical cost or fair value when applying IAS 21, or to amend IAS 21 to clarify its application to regulatory assets and regulatory liabilities.
- 86 In addition, the IASB Staff think treating regulatory assets and regulatory liabilities as monetary items leads to reasonable outcomes. There is likely to be little difference between the amounts reported if an item is treated as a monetary item (translated at the closing rate) or as a non-monetary item measured at fair value (translated using the closing rate when fair value was measured). This is because an entity would always reflect the fair value measurement of the non-monetary item at the end of the reporting period.
- 87 The IASB Staff also agreed with the respondents to explain in the final Standard the rationale for the proposal in paragraph 45 of the ED.
- 88 The May 2023 IASB Staff paper 9A on the timing of initial recognition can be found [here](#).

*Feedback received so far*

*EFRAG RRAWG (July 2023)*

- 89 Members were generally supportive of the tentative decisions.
- 90 One member indicated that if an entity derecognises/recognises at the end of the reporting date, then there would not be a need to create processes to monitor each regulatory asset or liability and that is a detriment to derecognition.

## DERECOGNITION

*Proposals in the ED*

- 91 The 2021 Exposure Draft Regulatory Assets and Regulatory Liabilities ('ED') did not have a separate section that deals explicitly with the derecognition of regulatory assets and regulatory liabilities.
- 92 Paragraph BC129 of the ED explained why the IASB considered a separate section on derecognition to be unnecessary. It indicates '*When an entity recovers part or all of a regulatory asset, or fulfils part or all of a regulatory liability, by adding or deducting an amount in determining future regulated rates (paragraphs BC50–BC51), the entity would derecognise that part of the regulatory asset or regulatory liability, and recognise regulatory expense or regulatory income accordingly (paragraph BC31). Furthermore, because the Board's measurement proposals would require an entity to update its estimates of future cash flows, measurement of regulatory assets and regulatory liabilities would be nil if estimated future cash flows were nil (paragraphs BC140-BC141)...'*
- 93 However, the ED does address derecognition in the context of cancellation of a regulatory agreement (in paragraphs B38 and BC153 of the ED).

IASB tentative decisions and Description and analysis of the issue

- 94 Some respondents including EFRAG and mainly accounting firms, considered that the final Standard should more explicitly address derecognition. In addition, clarity was requested on several aspects as follows:
- (a) whether regulatory assets or regulatory liabilities should be derecognised or remeasured if they no longer meet the more likely than not recognition threshold;
  - (b) whether the proposed derecognition of regulatory assets and regulatory liabilities in the context of cancellation of a regulatory agreement in paragraph B38 of the Exposure Draft would also apply to other situations that may occur during the term of the regulatory agreement—for example, if (partial) settlement takes place with parties other than customers;
  - (c) how to deal with the overall effects of discontinuing regulatory accounting; and
  - (d) whether an entity applies the derecognition requirements in IFRS 9 or follows some other approach when it transfers the right to the future cash flows arising from a regulatory asset to a third party (for example, on securitisation of regulatory assets).
- 95 The table below, which reflects the IASB’s tentative decisions and a summary of the IASB Staff analysis, is structured as follows:
- (a) general guidance on derecognition;
  - (b) “more likely than not” recognition threshold is no longer met; and
  - (c) derecognition of regulatory assets and regulatory liabilities ((i) examples identified by respondents and (ii) recovery of regulatory assets or fulfilment of regulatory liabilities through the regulatory capital base).
  - (d)

General guidance on derecognition	<p style="text-align: center;"><i>IASB tentative decisions</i></p> <p>96 The IASB tentatively decided that the prospective Standard would:</p> <ul style="list-style-type: none"> <li>(a) require an entity to derecognise: <ul style="list-style-type: none"> <li>(i) a regulatory asset as it recovers part or all of the regulatory asset by adding amounts to future regulated rates charged to customers; and</li> <li>(ii) a regulatory liability as it fulfils part or all of the regulatory liability by deducting amounts from future regulated rates charged to customers.</li> </ul> </li> <li>(b) explain that the derecognition of regulatory assets and regulatory liabilities, as described in paragraph (a) above, is the most common way in which regulatory assets and regulatory liabilities would be derecognised. Therefore, in applying the recognition and measurement requirements at the end of each reporting period, an entity would not be required to consider explicitly when and how its regulatory assets and regulatory liabilities should be derecognised.</li> </ul> <p>14 IASB members agreed with the tentative decisions.</p> <p style="text-align: center;"><i>IASB Staff analysis</i></p> <p>97 As the recovery of regulatory assets and fulfilment of regulatory liabilities are the most common ways in which regulatory assets and</p>
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	<p>regulatory liabilities are derecognised, the IASB Staff agreed that it would be helpful for this to be explicitly stated in the final Standard, alongside the recognition requirements.</p>
<p>More likely than not recognition threshold is no longer met</p>	<p><i>IASB tentative decisions</i></p> <p>98 The IASB tentatively decided that the prospective Standard would:</p> <p>(a) clarify that an entity would derecognise a regulatory asset or a regulatory liability if the asset or liability ceased to meet the ‘more likely than not’ recognition threshold.</p> <p>14 IASB members agreed with the tentative decision.</p> <p><i>IASB Staff analysis</i></p> <p>99 The proposal that an entity recognises all regulatory assets and all regulatory liabilities existing at the end of the reporting period means that regulatory assets and regulatory liabilities must continue to meet the recognition threshold each period. If changes in facts and circumstances mean that a regulatory asset or a regulatory liability ceases to meet the recognition threshold in a subsequent reporting period, this would trigger derecognition of the regulatory asset or regulatory liability.</p> <p>100 The IASB Staff do not consider that there would be unreasonable costs associated with assessing whether the recognition threshold is met at the end of each period. This is because, in most cases, the facts and circumstances supporting the initial assessment of existence will not have changed and reassessment will not be required.</p>
<p>Derecognition of regulatory assets and regulatory liabilities:</p> <p>Examples identified by respondents</p>	<p><i>IASB tentative decisions</i></p> <p>101 The IASB tentatively decided that the prospective Standard would:</p> <p>(a) include guidance on the derecognition of regulatory assets and regulatory liabilities settled by a regulator or another designated body. The guidance would also require an entity to recognise the difference between the derecognised regulatory asset or regulatory liability and any new asset or liability in profit or loss.</p> <p>14 IASB members agreed with the tentative decisions.</p> <p><i>IASB Staff analysis</i></p> <p>102 Respondents mentioned two cases whereby other than cancellation or termination of an agreement could lead to derecognition of regulatory assets and regulatory liabilities.</p> <p>(a) In some jurisdictions, regulatory agreements allow the regulator, or an entity acting on behalf of the regulator, to settle regulatory assets and regulatory liabilities directly with an entity.</p> <p>(b) A regulator might settle a regulatory asset by compensating the entity in some other way, such as by reducing the liability of the entity.</p> <p>103 In both cases mentioned by respondents, an entity would need to derecognise the regulatory assets or regulatory liabilities because they would no longer meet the definitions of regulatory assets and</p>

	regulatory liabilities in the ED. The relevant IFRS Accounting Standard would then apply to them.
<p>Derecognition of regulatory assets and regulatory liabilities:</p> <p>Recovery of regulatory assets or fulfilment of regulatory liabilities through the regulatory capital base</p>	<p><i>IASB tentative decisions</i></p> <p>104 The IASB tentatively decided that the prospective Standard would:</p> <p>(a) specify that if a regulatory asset or a regulatory liability is added to or deducted from an entity's regulatory capital base and the entity's regulatory capital base has no direct relationship with its property, plant and equipment, the entity would derecognise:</p> <p>(i) the regulatory asset and recognise any associated regulatory expense in profit or loss; and</p> <p>(ii) the regulatory liability and recognise any associated regulatory income in profit or loss.</p> <p>11 of 14 IASB members agreed with the tentative decisions.</p> <p>105 On this topic, the majority of IASB members agreed with the IASB Staff's recommendation (which is in line with the IASB tentative decision). However, some IASB members expressed a concern that the requirements were for a specific fact pattern that would be relatively rare, rather than the application of the general derecognition principles.</p> <p><i>IASB Staff analysis</i></p> <p>106 The following is feedback from a European preparer of a circumstance that could lead to derecognition. A regulator might change the recovery pace (most probably leading to an extension of the recovery period) of a regulatory asset by requiring the entity to include the outstanding amount of that regulatory asset in the entity's regulatory capital base. The entity would then recover the outstanding amounts of the regulatory asset through the depreciation of the regulatory capital base.</p> <p>107 If the December 2022 IASB tentative decisions<sup>4</sup> on the treatment of items (allowable expenses or performance incentives) included in an entity's regulatory capital base are applied consistently to the above issue, an entity would:</p> <p>(a) continue to recognise the regulatory asset if the entity's regulatory capital base and its property, plant and equipment have a direct relationship. The entity would update the estimates of future cash flows to reflect the new circumstance and consider whether it needs to use a different discount rate; and</p>

<sup>4</sup> At its December 2022 meeting, the IASB tentatively decided that:

(a) an entity is required to recognise a regulatory asset or a regulatory liability relating to an allowable expense or performance incentive included in its regulatory capital base when:

(i) the entity's regulatory capital base and its property, plant and equipment have a direct relationship; and

(ii) the entity has an enforceable present right (obligation) to add (deduct) the allowable expense or performance incentive to (from) future regulated rates.

(b) an entity is neither required nor permitted to recognise a regulatory asset or a regulatory liability relating to an allowable expense or performance incentive included in its regulatory capital base when the entity's regulatory capital base and its property, plant and equipment have no direct relationship.

	<p>(b) derecognise the regulatory asset if the entity's regulatory capital base and its property, plant and equipment have no direct relationship.</p> <p>108 The IASB Staff indicated that the derecognition of a regulatory asset in paragraph 107(b) above is counterintuitive because the regulator's decision does not affect the fact that the entity has an enforceable present right that is more likely than not to exist. However, the IASB Staff do not think this situation is different from the situation when a regulator decides, from inception, to include an allowable expense or a bonus to an entity's regulatory capital base that has no direct relationship with its property, plant and equipment. In this case, the entity also has an enforceable present right that is more likely than not to exist.</p> <p>109 In addition, a regulator could also change the period over which a regulatory liability is fulfilled by requiring that an entity deducts the regulatory liability from its regulatory capital base.</p> <p>110 The IASB Staff plan to discuss disclosures with the IASB at a future meeting, including whether to require disclosures when an entity derecognises previously recognised regulatory assets and regulatory liabilities in situations similar to those described above.</p>
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111 The April 2023 IASB Staff paper 9B on derecognition can be found [here](#).

*Feedback received so far*

*EFRAG RRAWG (July 2023)*

112 Members were, in general, supportive of the tentative decisions.

113 On securitisation:

- (a) Members were not aware of the securitisation of regulatory assets in their jurisdictions.
- (b) One member indicated that, in practice, there is a high hurdle to transfer all the risks and rewards as the performance risks remain with the entity that still has to perform to transform a regulatory asset into an IFRS 15 contract asset. Therefore, one could link derecognition to an entity's performance risk.

114 On the tentative decisions reflected in paragraph 104, this member indicated that if an entity was moving from a direct to a no-direct relationship between its regulatory capital base and its PPE, the entity should ascertain whether the regulation provides the entity with a buffer to maintain the rights that are recognised and if this is not the case, then the entity can derecognise.

## MEASUREMENT

### Estimation of uncertain cash flows

*IASB tentative decisions (June 2023)*

115 The IASB tentatively decided the following:

- (a) Estimating uncertain cash flows - retain the requirement proposed in the ED that an entity estimate uncertain future cash flows using whichever of the two methods - the 'most likely amount' method or the 'expected value' method - the entity expects would better predict the cash flows;



- (b) Reassessment- require an entity to reassess the method of estimating uncertain future cash flows only if there is a significant change in facts and circumstances such that the entity no longer expects the method to better predict the cash flows;
  - (c) Use of the 'expected value method' - clarify that when an entity uses the 'expected value' method to estimate uncertain future cash flows the entity should consider the entire range of outcomes, including those outcomes in which a regulatory asset or a regulatory liability would not exist, or would exist but produce no future cash flows; and
  - (d) No separate impairment test - retain the proposal in the ED not to require a separate impairment test for regulatory assets.
- 116 All 14 IASB members agreed with the decisions in (a) and (d). Thirteen of 14 IASB members agreed with the decisions in (b) and (c).
- 117 The IASB also tentatively decided that the final IFRS Standard would not provide additional guidance on circumstances in which the 'most likely amount' method might better predict uncertain future cash flows.
- 118 Twelve of 14 IASB members agreed with this decision.

*Proposals in the ED*

- 119 Paragraph 31 of the ED proposes that in measuring a regulatory asset or regulatory liability, an entity is required to include all estimated future cash flows arising from the regulatory asset or regulatory liability, and only those cash flows.
- 120 Paragraph 39 of the ED proposes to require that an entity estimates uncertain future cash flows using whichever of the following **two methods** the entity expects to better predict the cash flows:
- (a) the 'most likely amount' method—this method provides an estimate of the single most likely amount in a range of possible outcomes (that is, possible cash flow amounts). This method may better predict the uncertain cash flows if the possible outcomes are clustered around one outcome or if there are only two possible outcomes and they differ widely.
  - (b) the 'expected value' method—this method provides an estimate of the sum of probability-weighted amounts in a range of possible outcomes. This method may better predict the uncertain cash flows if there is a wide range of more than two possible outcomes.
- 121 Paragraph 42 of the ED proposes that an entity apply the chosen method for estimating uncertain future cash flows consistently from initial recognition to recovery or fulfilment.
- 122 The ED does not propose a separate impairment test for regulatory assets given that measurement is updated on an ongoing basis.

*Description and analysis of the issue*

- 123 Most respondents to the ED, including EFRAG, agreed with the proposals on estimating uncertain future cash flows,
- 124 Most respondents, including EFRAG, also supported the proposal to require an entity to estimate future cash flows arising from each regulatory asset and regulatory liability recognised, using either the most likely amount or the expected value method, depending on which approach provides more relevant information.
- 125 A few respondents raised the following concerns and made suggestions regarding the proposals for estimating uncertain cash flows:

- (a) raised concerns about using the expected value method when the probability of particular outcomes is low.
- (b) suggested the IASB requires the use of the expected value method for all regulatory assets and regulatory liabilities that have uncertain cash flows.
- (c) suggested the IASB provides more guidance on factors to consider in assessing which method of estimating uncertain future cash flows better predicts the cash flows.
- (d) suggested the IASB requires an entity to change the method selected at initial recognition when facts and circumstances change such that the method may not better predict the cash flows.
- (e) asked questions about the interaction between the existence uncertainty and the methods for estimating uncertain future cash flows in specific circumstances. These respondents said it is unclear whether an entity, when applying the methods for estimating uncertain future cash flows, should consider only those outcomes in which a regulatory asset or regulatory liability exists.

126 All respondents, except for one<sup>5</sup>, that commented on this question to the IASB agreed with not requiring an impairment test for regulatory assets.

127 To address some of the suggestions made by a few respondents, the IASB staff recommended the clarifications in 115(b) and 115(c) both of which were supported by the IASB.

128 The feedback received and IASB analysis and recommendations were discussed with the IASB in its June 2023 meeting ([agenda paper 9B](#)).

#### *Feedback received so far*

129 This topic will be discussed with the EFRAG RRAWG at a future meeting.

130 In its final comment letter, EFRAG supported the measurement proposals discussed by the IASB at its meeting in June 2023. The EFRAG Secretariat also thinks that the additional clarifications agreed by the IASB will be helpful to address the concerns raised by some respondents to the IASB.

131 The EFRAG Secretariat notes that one of EFRAG's main concerns regarding the measurement question in the ED is related to the boundary of the regulatory agreement. We understand that this topic will be discussed at a future IASB meeting.

#### **Next steps**

132 As noted in slide 6 of ASAF AP2, the topics still to be redeliberated by the IASB are:

- (a) Boundary of regulatory agreement;
  - (i) The staff will analyse feedback received on the boundary of a regulatory agreement and will provide corresponding recommendations for the IASB at a future meeting.
- (b) Measurement;
  - (i) Discount rate;
  - (ii) Items affecting regulated rates only when related cash is paid or received;
- (c) Presentation and disclosure;
- (d) Effective date and transition;

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<sup>5</sup> National standard-setter in Africa

- (e) Amendments to other IFRS Accounting Standards;
- (f) Other;
  - (i) Interaction between the model and IFRS 17 *Insurance Contracts*;
  - (ii) Analysis of responses received on the survey dealing with direct (no direct) relationship;
- (g) Expected effects of the final Standard.

133 The EFRAG RRAWG will meet again later this year to discuss the IASB tentative decisions taken in Q3 and Q4 2023, the responses to the survey on the direct (indirect) concept, and the IASB staff proposals on disclosure requirements.

**Questions for EFRAG FR TEG-CFSS members**

- 134 Do the tentative decisions on the following topics help address feedback from stakeholders in your jurisdiction:
- (a) total allowed compensation (paragraphs 6 and 21)
  - (b) recognition (paragraphs 32, 58 and 75)
  - (c) derecognition (paragraphs 96, 98, 101 and 104)
  - (d) measurement (paragraph 115)
- 135 Do you have any other comments on the progress so far or the next steps?