

## **‘Scope and Early-Stage Effects Analysis’ Outreach Issues Paper**

### **Objective**

- 1 The purpose of this paper is to discuss and obtain EFRAG TEG views on the ‘scope and early-stage effects analysis’ outreach plan (objectives, activities and timing) proposed by the EFRAG Secretariat.
- 2 These outreach activities are occurring prior to and after the issuance of the exposure draft (ED) on the accounting for regulatory assets and regulatory liabilities (the model). The ED is expected in December 2020.
- 3 The focus of the outreach is on assessing practical application issues of the model, which have been identified by the EFRAG RRAWG and EFRAG TEG (as summarised in Agenda paper 07-02), with a primary focus on the scope of application of the model. The outreach will also focus on the early-stage effects analysis (effects analysis) that will be incorporated into EFRAG’s comment letter to the IASB.
- 4 The outreach referred to in this paper is focused on impacts and it does not encompass the objectives of the type of outreach that will occur on issuance of the EFRAG comment letter (i.e. to ascertain whether or not stakeholders agree with EFRAG positions on the IASB proposals).
- 5 This outreach’s audience includes:
  - (a) European National Standard Setters (NSS);
  - (b) EFRAG RRAWG;
  - (c) Preparers; and
  - (d) Users of financial statements.
- 6 The sections below mainly describe the EFRAG Secretariat’s current plan for outreach on scope and effects analysis. However, there will likely be a need to explore collaboration with the IASB staff, once there is clarity on the IASB’s approach to effects analysis. The possible collaboration will aim to minimise the duplication of efforts and widen access to relevant stakeholders. Accordingly, as appropriate, this outreach plan might be modified at a later date.

### **‘Scope and effects analysis’ outreach plan**

- 7 The following sections outline key elements of the ‘scope and effects analysis’ outreach plan and include:
  - (a) objectives of the outreach (why);
  - (b) outreach activities and audience (what, how and who); and
  - (c) timeline for the outreach activities (when).

### Outreach objectives

#### *Assess implications of the scope of the model*

- 8 Paper 07-02 describes the model and summarises the areas that EFRAG TEG and EFRAG RRAWG members have pointed to as needing an enhanced understanding on the implications of the scope of the model. These areas include:

## Outreach Activities - Issues Paper

- (a) The sectors that are likely to be within the scope of the model.
- (b) Stakeholders' clarity on the scope of the model and the extent to which it meets their expectations.
- (c) The implications of a broad scope. There is need to identify the practical problems that may arise from too broad a scope, which was a concern expressed by EFRAG TEG.
- (d) Implications of self-regulation, specifically on whether there is a risk that the scope will capture self-regulation that should not be within the scope. This would only be an issue at individual financial statement level under IFRS and not for consolidated financial statements.
- (e) Should the scope be focused only on customers? EFRAG RRAWG members have suggested that the model should be independent of who pays for the services or goods delivered and observed that it is common practice in some jurisdictions (like Italy and Spain) for enforceable rights (obligations) to be recovered (fulfilled) by the regulator/government instead of the customer. The outreach will ascertain how widespread these arrangements are across EU jurisdictions.
- (f) Interaction with IFRIC 12 *Service Concession Arrangements*. The outreach will assess the interaction of the requirements under the model and IFRIC 12 to understand
  - (i) the differences that arise between the model and when an entity applies the financial asset model under IFRIC 12; and
  - (ii) whether the model captures everything that falls out of the scope of the intangible asset model under IFRIC 12.

### *Effects analysis*

- 9 The proposed outreach activities will be an input to the effects analysis that aims to identify the potential impact, expected benefits and costs of the model.
- 10 The IASB proposals will affect entities that have regulatory assets and regulatory liabilities (hereafter regulatory assets (liabilities)) as defined within the model. Currently, some European IFRS reporting entities do not recognise regulatory assets (liabilities). Other entities might already recognise regulatory assets (liabilities) in their IFRS financial statements. These entities would have developed an accounting policy under IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* that explains why they recognise regulatory assets (liabilities).
- 11 A key objective of the effects analysis will be to assess the anticipated impact of the model on financial statements for entities that have but are not currently recognising regulatory assets (liabilities) in their financial statements. Other financial statement impacts that could be assessed include:
  - (a) impact on presentation (e.g. split between items presented in profit or loss versus other comprehensive income-OCI);
  - (b) the effects of the proposed disclosure requirements;
  - (c) any initial application issues arising on transition.
- 12 The effects analysis will also assess possible economic consequences such as the potential impact on decision making (e.g. analytical impact and capital allocation by users), changes to contractual arrangements (e.g. loan covenants) and costs versus benefits of the model from a preparer and user perspective.

*Pre- ED issuance: Outreach activities and audience*

- 13 The outreach before issuance of the ED is targeted at NSS, RRAWG (mainly preparer members) and specialist users of financial statements covering rate-regulated entities (specialist users). To facilitate this outreach, the EFRAG Secretariat is in the process of developing different questionnaires tailored for the target audiences. In the coming weeks, we will seek written feedback from EFRAG TEG members on these questionnaires.

*Outreach to NSS*

- 14 The outreach activity to European NSS (EFRAG CFSS members) is already in motion, having been initiated by the EFRAG Secretariat in Q2 2020. The EFRAG Secretariat has already had phone discussions with some NSS representatives and exchanged emails with other NSS that expressed an interest in assisting with analysing the effects of the proposed scope. This outreach to NSS is mainly to understand whether the proposed scope is clear and whether it is likely to include any activities or items that would not have expected to be included and vice versa. The outreach also aims to identify jurisdiction-specific fact patterns of interest and a list of reporting entities that may be affected by the model. This outreach focuses on European NSS but, where needed, may be extended to the standard setters of a few non-EEA, IFRS reporting jurisdictions where rate regulated activities are prevalent. For instance, the Canadian Accounting Standard Setters Board (AcSB).
- 15 So far, due to the Covid-19 circumstances, the EFRAG Secretariat has only received feedback from a few European national standard setters. This feedback has been on the sectors affected including some or all of the utility sector (gas, electricity and water), transport sector (such as airports, railways and public transport more generally), and perhaps the real estate sector (when they are providing goods or services that fall under the scope of the model). The EFRAG Secretariat is currently following up on the other objectives of the outreach to NSS enumerated in paragraph 15.

*Outreach to EFRAG RRAWG*

- 16 The outreach to EFRAG RRAWG will be to elaborate on the implications of the scope of the model. For instance, at the June 2020 meeting, the EFRAG RRAWG agreed to share with the EFRAG Secretariat examples that may illustrate some of the initial difficulties observed with applying the model.
- 17 Another objective of the outreach to RRAWG will be to identify entities that will be impacted by the model. Also, we will ask the RRAWG members to help identify sell-side analysts covering their companies. Finally, the outreach will be to obtain from RRAWG preparers, a high-level analysis of the effects of the model on their respective entities' financial statements based on the IASB's tentative decisions. These will include effects on:
- (a) statement of financial position;
  - (b) profit or loss and performance;
  - (c) debt covenants and similar arrangements;
  - (d) presentation (e.g. split between P&L and OCI representation of regulatory income and expense line items); and
  - (e) costs and constraints associated with the proposed disclosures.

*Outreach to specialist users*

- 18 The outreach to specialist users will assess the usefulness and benefits of information on the effects of rate-regulated activities on the performance, position and prospects of reporting entities. The aim will be to ascertain users' information needs and whether the proposed accounting model meets their needs.

- 19 The intended outreach will build on past users' feedback from EFRAG outreach activities<sup>1</sup> held in 2014 (see related EFRAG [feedback statement](#) and EFRAG [user event report](#)) and on the user perspective highlighted in the AcSB research paper: *Exploring the decision-usefulness of financial information that reflects the economics of rate-regulated activities* ([the AcSB research paper](#)). The past EFRAG outreach (summary of key findings in Appendix 1) focused on users' information needs and sources and their views on the appropriate reporting for rate-regulated activities. This past feedback is still applicable as there is yet to be a change in the accounting requirements for rate-regulated activities.
- 20 The EFRAG Secretariat is in the process of identifying target specialist users from multiple sources (databases, websites). Similar to what has been done for other projects (e.g. IFRS 17 *Insurance Contracts*), we will consider issuing a news item in September, calling for specialist users to participate in the outreach. In addition, as noted in paragraph 17, we will reach out to RRAWG members to identify names of sell-side analysts covering their companies.
- 21 The outreach to specialist users is mainly occurring before the issuance of the ED. However, there may be a need to also consider conducting outreach to users after the issuance of the ED to assess their views on the model's presentation and disclosure requirements.

*Post -ED issuance: Outreach activities and audience*

*Outreach to preparers*

- 22 The outreach to preparers after issuance of the ED will be to understand the impact of the application of the model based on the detailed proposals of the ED.
- 23 As noted in paragraphs 14 and 17, the EFRAG Secretariat will engage with EFRAG CFSS and EFRAG RRAWG members to identify a list of entities interested in participating in the outreach. Another alternative to identify preparers will be to issue a news item shortly after the ED is published, calling for preparers to participate in the effects analysis outreach. This proposed call for preparer participation is similar to what has been done for other projects (e.g. IFRS 17).
- 24 As noted in paragraph 13, a preliminary questionnaire with high-level effects analysis questions is being prepared by the EFRAG Secretariat for conducting the pre-ED outreach to a subset of preparers (RRAWG members). There will be a need to develop updated and more detailed questions once the ED is published. Therefore, at a later date, the EFRAG Secretariat will seek EFRAG TEG members' feedback on an updated preparers questionnaire.

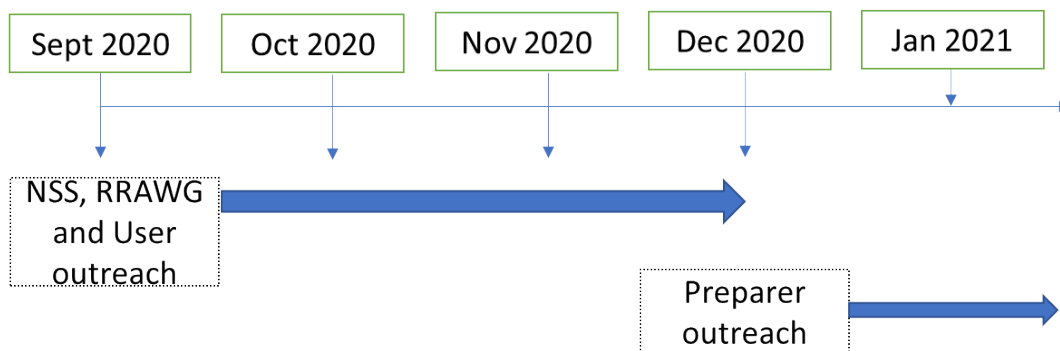
*Timeline for outreach activities*

- 25 The EFRAG Secretariat has prepared a proposed timeline to conduct the outreach activities (see below). As noted, the outreach activity to a wider set of preparers can only take effect once the ED has been released in order to formulate questions based on the detailed proposals:

---

<sup>1</sup> In 2014, as input to its response to the IASB Discussion Paper, EFRAG obtained outreach feedback from 19 analysts (13 equity analysts, 6 credit analysts) from seven jurisdictions including six EU jurisdictions covering the following industries: toll roads, airports, utilities (gas, electricity, and water), infrastructure, waste management and heating. In addition, in December 2014, EFRAG conducted a user outreach event with EFFAS and ABAF.

## Outreach Activities - Issues Paper



### Questions for EFRAG TEG

#### Objectives

- 26 Do TEG members agree with the broad focus of outreach on the practical effects of the proposals being on a) the implications of the scope; b) effects analysis? Are there any other areas that should be the focus of this outreach?
- 27 Do EFRAG TEG members have any further comments on the elements of assessment of implications of scope as detailed in paragraph 8?
- 28 Do EFRAG TEG members have any comments on the elements of effects analysis detailed in paragraphs 9 to 12?

#### Outreach Activities and Timing

- 29 Do EFRAG TEG members agree with the bifurcation of 'scope and effects analysis' outreach activities before and after the issuance of the ED, as reflected in the timeline depicted in paragraph 25?
- 30 Do EFRAG TEG members have any comments on the objectives, approaches (call for user participation, tailored questionnaires) and timing of outreaches to NSS, RRAWG and users before the issuance of the ED, as outlined in paragraphs 13 to 21?
- 31 Do EFRAG TEG members have any comments on the objectives, approaches (call for preparer participation, preparer questionnaire) and timing of outreach to preparers after the issuance of the ED, as outlined in paragraphs 22 to 24?
- 32 The outreach to specialist users has been planned to occur before the issuance of the ED. However, the effects analysis involving preparers will be considering the effects of disclosures. Do EFRAG TEG members have views on whether there should also be an outreach to users after the issuance of the ED with a focus on disclosure and presentation?

## Appendix 1: Summary of past EFRAG outreach feedback from users

- 1 This appendix provides a summary of the past (2014) EFRAG outreach feedback from users.

### *Analytical needs*

- 2 Users want to understand the driving forces of rate regulation, how transparent and predictable it is, the financial effects it creates, and how it impacts the business model and the risk profile of an entity that operates with activities subject to rate regulation. Furthermore, users need to understand the reasons why reported results differ from budgeted figures and how reported differences could be translated into adjustments to future tariffs and therefore cash flows for the entity.
- 3 Users need detailed information to assess the return on capital employed, an entity's ability to repay debts and to assess future cash flows.
- 4 Information on rate regulation is used mainly to estimate future cash flows, enterprise value and assess the financial stability and creditworthiness of the entity operating in a rate-regulated environment. In regimes where the regulatory asset base is used to assess the rate of return of entities operating rate-regulated activities, the regulatory asset base is the key indicator for users to develop their models.
- 5 The past EFRAG user outreach feedback on analytical needs (Appendix paragraphs 2 to 4), is consistent with the findings of the 2018 Canadian AcSB report, which highlights that users (debt and equity analysts, as well as credit rating agencies) assess utilities with regulated operations differently from non-regulated operations and that they adjust financial statements to compensate for the differences created by accounting standards (e.g. when the financial effects of rate regulation are not recognised in the financial statements).

### *User expectations on reporting of rate regulated activities*

- 6 Users who participated in the past EFRAG outreach broadly favoured the inclusion of the financial effects of rate-regulated activities in the primary financial statements. They expected that recognising the economic effects of rate regulation in the primary statements would: (a) result in a measure of performance that reflects what an entity is entitled to earn; (b) result in useful financial information to assess prospects of future cash flows; and (c) portray the economic reality of entities operating rate-regulated activities. They supported separate presentation of the effects of rate regulation on rate-regulated activities as they assess different risks profiles when entities also operate activities that are not rate-regulated.
- 7 However, some users noted that there were drawbacks to the recognition of these the effects of rate regulation mainly because most rate-regulated regimes are very complex and continually changing. In their view, recognition of the effects of rate regulation at the expense of reliability and relevance would increase complexity and therefore reduce the understandability of financial statements.
- 8 Where enforceable rights and obligations exist, users preferred having this information recognised in the primary financial statements where a certain level of reliability is ensured; but they would be concerned about recognition if the definition of elements (e.g. assets and liabilities) in the Conceptual Framework were not met.
- 9 Where recognition of regulatory items in the primary statements were considered, sufficient, supplementary qualitative and quantitative disclosures should be mandatory to let users understand how management has exercised judgement and what risks are attached to the regulatory items.