

This paper has been prepared by the EFRAG Secretariat for discussion at a public meeting of EFRAG TEG. The paper forms part of an early stage of the development of a potential EFRAG position. Consequently, the paper does not represent the official views of EFRAG or any individual member of the EFRAG Board or EFRAG TEG. The paper is made available to enable the public to follow the discussions in the meeting. Tentative decisions are made in public and reported in the EFRAG Update. EFRAG positions, as approved by the EFRAG Board, are published as comment letters, discussion or position papers, or in any other form considered appropriate in the circumstances.

Scope and definition of regulatory assets and liabilities

Issues Paper

Objective

- 1 The purpose of this paper is to obtain EFRAG TEG members views on the refined scope for defined rate regulation and updated definitions of regulatory assets and regulatory liabilities.

Scope

- 2 In March 2019, the IASB tentatively decided on the scope of the rate regulation accounting model, subject to some clarifications and refinements to the definition.
- 3 In June 2019, the IASB discussed [here](#) the refined definition and tentatively decided that the model for regulatory assets and regulatory liabilities should apply to defined rate regulation established through a formal regulatory framework that:
 - (a) is **binding** on both the entity and the regulator; and
 - (b) establishes a **basis for setting the rate** that gives rise to rights to add amounts to, and obligations to deduct amounts from, future rate(s) because of goods or services already supplied or because of amounts already charged to customers. That basis gives rise to those rights and obligations by determining when (i.e. in which periods) the **total allowed compensation** for specified goods or services supplied is included in the rate(s) charged to customers.
- 4 The reference to 'rate-adjustment mechanism' was removed because some IASB members thought this reference was causing confusion and made the scope less clear. Other changes to the definition proposed in March are intended to be consistent with the proposed refinements to the definitions of regulatory assets and liabilities (discussed below).

Defined Rate Regulation

- 5 In July 2019, the IASB discussed [here](#) the accounting model for defined rate regulation. It requires a formal regulatory framework which may take the form of a contractual licensing agreement or be imposed through statute. Regardless of its form, the regulatory framework is binding on both the rate regulated entity and the rate regulator and establishes enforceable rights and obligations for the entity.

Binding regulatory agreement

- 6 The binding nature of the regulatory framework is a necessary feature that **excludes self-regulation from the scope** of defined rate regulation as an entity cannot create enforceable rights and obligations with itself.

- 7 However, it is possible that the rate regulator and the entity are related parties because they are both controlled by the same entity. In such situations, the entity should consider the facts and circumstances to assess the enforceability of the regulatory agreement, including regulatory decisions and subsequent court rulings, to consider whether such a relationship is within the scope of the model.
- 8 Based on earlier IASB discussion, the planned application guidance could explain that the **binding** agreement includes:
- (a) the entity has a right to:
 - (i) supply specified goods or services; and
 - (ii) charge for those goods or services a rate(s) that is designed to compensate the entity for the goods or services it supplies to customers with the aim of making it viable for the entity to fulfil specified requirements for quality, quantity and availability of supply of the goods or services; and in exchange
 - (b) the entity is obliged to:
 - (i) fulfil the specified requirements for supplying goods or services; and
 - (ii) accept the basis established in the regulatory agreement for setting rates.

Basis for setting the rate

- 9 In defined rate regulation, the regulatory framework establishes both the presence of a **binding** regulatory agreement and a **basis for setting the rate** that gives rise to rights to add amounts to and obligations to deduct amounts from future rate(s) because of goods or services already supplied or because of amounts already charged to customers are both **necessary and sufficient** to give rise to regulatory assets and regulatory liabilities.
- 10 The existence of a **basis for setting the rate** within the regulatory agreement is a necessary feature for activities to be subject to defined rate regulation. However, on its own, it is not a sufficient feature to differentiate defined rate regulation from other types of rate regulation. In some cases, the existence of a basis for setting the rate affects only the rate per unit that an entity is permitted to charge for its goods or services. In these cases, the regulatory intervention is limited to establishing a cap price, but the entity's management is then free to manage the business in order to maximise its profitability. The IASB refers to this type of regulation as 'general price regulation'.
- 11 The **feature that distinguishes defined rate regulation from other forms of rate regulation** is that the basis for setting the rate gives rise to rights to add amounts to, and obligations to deduct amounts from, future rate(s) because of goods or services already supplied or because of amounts already charged to customers. These rights and obligations arise because the basis for setting the rate establishes not only the **amount of total allowed compensation** for goods or services supplied in a period but also determines when (i.e. in which periods) that total allowed compensation is included in the rate(s) charged to customers. Consequently, the regulatory agreement creates a **direct cause-effect relationship** between the supply of goods or services, the total allowed compensation for supplying those goods or services and the rate charged to customers.

Regulatory assets and regulatory liabilities

- 12 In defined rate regulation, when the total allowed compensation for goods and services already supplied differs from the amounts already included in the rates charged to customers, the regulatory agreement gives rise to incremental rights and incremental obligations that are not currently recognised using IFRS Standards.

- 13 The IASB tentatively decided that such incremental rights and obligations meet the definitions of assets and liabilities in the *Conceptual Framework*. The descriptions of these right and obligations have been refined and the updated definitions of regulatory assets and regulatory liabilities are the following:
- (a) Regulatory asset - the present right to add an amount to the rate(s) to be charged to customers in future periods because the total allowed compensation for the goods or services already supplied exceeds the amount already charged to customers.
 - (b) Regulatory liability - the present obligation to deduct an amount from the rate(s) to be charged to customers in future periods because the total allowed compensation for the goods or services already supplied is lower than the amount already charged to customers.
- 14 The updated definitions of regulatory assets and regulatory liabilities clarify:
- (a) the definition of the **past event** that gives rise to:
 - (i) an incremental right - when goods or services are supplied in the period, but the rate charged in the period does not reflect the whole amount of total allowed compensation for those goods or services; or
 - (ii) an incremental obligation - when the rate charged in the period includes an amount of total allowed compensation for goods or services not yet supplied;
 - (b) how the monetary amount of the right or obligation arising from the timing difference is determined – the difference between the right to the **‘total allowed compensation’** and the amount already charged to customers; and
 - (c) the obligation – to deduct an amount from the future rates rather than to provide goods or services.

EFRAG RRAWG comments on scope of defined rate regulation

- 15 At its meeting in October 2019, EFRAG RRAWG members generally agreed with the definition of the scope, however they noted that the new definition does not include the reference to rate-adjustment mechanism which could broaden the scope.
- 16 Some EFRAG RRAWG members also considered that one of the most important issues was the definition of the regulator as can avoid confusion for some contract options to enter within the scope.

EFRAG Secretariat analysis

- 17 The definition of defined rate regulation is key to the assessment of whether an activity is included or excluded from the scope of the project. The EFRAG Secretariat agrees with the IASB that to be in the scope of the accounting model the regulatory agreement must be **binding** and include a basis for setting the rate that gives rise to enforceable rights and obligations.
- 18 The ‘binding’ element is a necessary feature to exclude from the scope of the model activities subject only to self-regulation [because it cannot have a binding agreement with itself] or general regulation but has similar features as defined rate regulation. We agree that the combination of a binding agreement that creates enforceable rights and obligations is the core of defined rate regulation that give rise to regulatory assets and regulatory liabilities.

- 19 However, the EFRAG Secretariat considers that one of the important issues is the definition of the regulator. A broad definition could broaden the scope of RRA by including some intercompany agreements. The IASB has not yet defined regulator and we acknowledge the difficulties that the IASB could face in developing a definition.

Questions for EFRAG TEG members

- 20 Do you consider that the scope of defined rate regulation in paragraph 3 will capture the types of rate-regulated activities and regulatory enforceable rights and obligations that you think should be within the scope of the IASB project? If not, what changes would you suggest and why?
- 21 Do you have any comments or suggestions on the definition of regulatory assets and regulatory liabilities in paragraph 13?