

Report of the EFRAG RRAWG Chairman on the EFRAG RRAWG meeting on 8 October 2018

This paper is provided for background purposes only

Purpose

- 1 The purpose of this report is to inform EFRAG TEG of the feedback received from members of the EFRAG Rate-regulated Activities Working Group (EFRAG RRAWG) at a meeting held on 8 October 2018.

Agenda of the EFRAG RRAWG

- 2 The following topics were discussed at the meeting:
 - (a) Update on recent developments and next steps
 - (b) Scope of defined rate regulation
 - (c) Unit of account
 - (d) Recognition of regulatory assets and regulatory liabilities
 - (e) Measurement of regulatory assets and regulatory liabilities
 - (f) Presentation and disclosure
- 3 The agenda papers can be found [here](#).

Update on recent developments and next steps

- 4 The EFRAG Secretariat provided an update on the status of the IASB's project on the accounting for rate-regulated activities (the project).
- 5 One EFRAG RRAWG member asked about the timeline of the project. The IASB representative informed that the IASB would have made substantive decisions on the project by the end of 2018 and would be asked whether it should publish an exposure draft or a second discussion paper. If permission for an exposure draft was granted, it could be issued possibly in Q3 2019.
- 6 One EFRAG RRAWG member asked whether the IASB planned to test the elements of the definition of 'defined rate regulation' to see whether they worked in practice, referring in particular to the term 'binding'. The IASB representative informed that the key element of 'binding' was the focus on enforceable rights and obligations and the IASB would refine the definition as the project progressed.

Scope of defined rate regulation

- 7 EFRAG RRAWG members were asked whether the current description of defined rate regulation captured the types of activities they would expect to be included in the scope of the project.
- 8 EFRAG RRAWG members noted that the definition could allow arrangements to be included in the scope of defined rate regulation that were not the intention of the IASB. To address this, some members considered that the most important issue was the definition of the regulator.

- 9 One EFRAG RRAWG member mentioned that the definition should include indicators such as limitations of entry and exit into the market. However, the IASB representative stated that it was more important to include indicators to ensure a rate setting mechanism that resulted in enforceable regulation.
- 10 EFRAG RRAWG members noted that there would be timing differences between the regulatory model and the IFRS model (for example depreciation). The IASB representative stated that they were not looking for a full reconciliation between the two models.
- 11 The IASB representative added the main focus of the project had been to try to give a better estimate of the performance of the entity during the period. This would mean that the statement of financial position also needed to be considered.

Unit of account

- 12 Members of the EFRAG RRAWG were asked for views on the IASB's tentative decision to describe the unit of account for defined rate regulation as the individual timing differences arising from the rate-setting mechanism.
- 13 The IASB representative clarified that the IASB's intention was to consider that the natural grouping for recognition was items which had similar characteristics and were considered as a package by the regulator.
- 14 EFRAG RRAWG members generally agreed that the level of granularity would depend on the regulatory model and how the regulator identified timing differences to be considered in the rate. There could be instances when the regulator would consider timing differences as a group rather than individually. Rate-regulated entities would manage and track timing differences following the regulatory requirements.
- 15 Overall, EFRAG RRAWG members did not foresee any specific challenges regarding the application of the unit of account. Entities would be required to make judgements as the regulatory outcome was not always known by the time the entity published its financial statements.

Recognition of regulatory assets and regulatory liabilities

- 16 Members of the EFRAG RRAWG discussed the IASB's tentative decision to recognise regulatory assets and regulatory liabilities if it is 'more likely than not' that they exist.
- 17 All EFRAG RRAWG members agreed that 'more likely than not' referred to 50 percent or more. Some members were concerned that the suggested threshold would result in a significant change to current practice and observed that in some EU jurisdictions the practice was to recognise revenue only when it was virtually certain that the entity would earn the revenue. Other EFRAG RRAWG members thought that the tentative decision made sense in the context of the regulatory environment being considered and was consistent with the revised Conceptual Framework. The IASB representative noted that the revised Conceptual Framework focused on existence uncertainty for recognition, therefore an entity would not recognise regulatory assets and liabilities when their existence was uncertain.
- 18 The EFRAG RRAWG Chairman agreed that a more likely than not approach could create cultural challenges, but it remained relevant for a symmetrical approach to the recognition of regulatory assets and regulatory liabilities which, in his view, would be helpful for users of financial statements.

Measurement of regulatory assets and regulatory liabilities

- 19 The EFRAG RRAWG discussed the IASB tentative proposals on the measurement of regulatory assets and liabilities including estimating future cash flows, accounting for a significant financing component and applicable discount rate; and considering changes in estimates of future cash flows and discount rate.
- 20 When estimating future cash flows, most EFRAG RRAWG members preferred to apply the 'most likely amount' method. Members expressed concerns that in practice the expected value method could not be applied from a regulatory perspective as the timing differences had various parameters which needed to be considered. One member clarified that when there were multiple outcomes to be considered in the measurement of timing differences, then analogy with similar cases or preparer's best estimate was applied.
- 21 EFRAG RRAWG members generally agreed that the regulatory WACC was the appropriate rate to be used for discounting regulatory assets and liabilities. Usually, the regulatory agreement would provide an entity with explicit discount rates for both short-term and long-term timing differences. It was also common that an entity would use different discount rates (WACCs) for timing differences arising from different regulatory agreements.
- 22 A question was raised as to whether it was appropriate to use the discount rate for calculating the present value of a long-term provision and to use the same rate for discounting the corresponding regulatory asset. The IASB representative clarified that an entity should consider facts and circumstances and it would be reasonable to use the same discount rate if the costs would be recovered when paid in cash. Otherwise, the rate provided in the regulatory agreement would be the 'reasonable' rate to use. Generally, the WACC established in the regulatory agreement was specific for the entity as it was hard to find a market rate because it was not a competitive market.
- 23 Another member commented that there was no uniform definition of WACC and different regulatory agreements might include different components. Consequently, as the notion of WACC was not well defined, a suggestion was made that more guidance was needed, if the WACC was to be used in the new forthcoming standard.
- 24 EFRAG RRAWG members broadly agreed with the IASB tentative decision to apply the requirements in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* when accounting for changes in estimated cash flows and changes in the discount rate. One member raised a point that there could be significant litigations against the tariffs and that this constituted a high risk for the regulated entity. Although, the member did not disagree with the application of IAS 8, the member explained that the risk depended on the maturity of the regulation and the country profile, and it was important to consider this issue for first time application and transition purposes.

Presentation and disclosure

Presentation and disclosure objective for regulatory assets and liabilities

- 25 EFRAG RRAWG members discussed the recent IASB staff proposals (to be considered by the IASB at a future meeting) on presentation and disclosure for regulatory assets and liabilities and expressed the following views:
 - (a) Netting off regulatory assets against regulatory liabilities in the statement of financial position would not provide users of financial statements with relevant information as often entities had to comply with multiple regulations in different countries;

- (b) Concerns were raised about how and where the changes in regulatory assets and liabilities would be presented in the statement of financial performance. EFRAG RRAWG members expressed a preference for presenting regulatory income and expense separately from revenue recognised in accordance with IFRS 15.
- 26 The IASB representative clarified that the current IASB staff proposal on presentation and disclosures included separate presentation of regulatory assets and regulatory liabilities in the statement of financial position and a single line item for regulatory income/expense in the statement of financial performance which would be separate from the IFRS 15 revenue.

Level of aggregation of disclosures

- 27 With respect to the level of aggregation of disclosures, EFRAG RRAWG members commented that:
- (a) Some entities were already applying reasonable aggregation in local GAAPs which provided users with information about future cash flows;
 - (b) IFRS disclosures should be balanced as entities already prepare voluminous regulatory disclosures that users have access to in some jurisdictions;
 - (c) In certain countries the regulatory agreement may not be public and disclosing regulatory information would be difficult.
- 28 The IASB representative clarified that the current proposals on disclosures required a high-level breakdown of regulatory assets and regulatory liabilities with more details being disclosed for the origination of regulatory assets and liabilities and disclosures of subsequent reversals which would focus on a maturity analysis of the regulatory balances.

Other disclosure requirements

- 29 The EFRAG RRAWG members were generally supportive of the disclosure requirements for regulatory assets and liabilities as developed by the IASB staff. The IASB had only had an initial discussion on presentation and disclosure in July 2018 and further decisions on the topic would be taken at its upcoming November meeting.
- 30 One EFRAG RRAWG member suggested that disclosure requirements for entities with limited rate-regulated activities should be less burdensome than for those where the entire business was regulated.
- 31 The IASB representative noted that the disclosure requirements being developed for regulatory assets and regulatory liabilities followed the IASB project *Principles of Disclosure* and would be updated as that project progressed.

Question for EFRAG TEG members

- 32 Does EFRAG TEG have any comments on this report?