

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.

IASB project on accounting for regulatory assets and regulatory liabilities

Issues Paper – Sweep issues

Objective

- 1 The objective of this session is to discuss with EFRAG TEG the following sweep issues discussed by the IASB at its meeting in September 2020:
 - (a) Issue 1 - definitions of a regulatory asset and a regulatory liability;
 - (b) Issue 2 - regulatory returns on assets not yet available for use;
 - (c) Issue 3 - effective date; and
 - (d) Issue 4 - comment period.
- 2 The IASB expects to publish its exposure draft on the accounting for regulatory assets and regulatory liabilities in January 2021 with a 150-day comment period.
- 3 Questions for EFRAG TEG members are included after each issue. The EFRAG Secretariat notes that issues 1 and 2 have been discussed with EFRAG TEG in previous meetings.

Issue 1 - definitions of a regulatory asset and a regulatory liability

- 4 At its June 2019 meeting, the IASB tentatively decided to define:
 - (a) a regulatory asset as a *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*; and
 - (b) a regulatory liability as a *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*.
- 5 EFRAG TEG discussed the above definitions at its previous meetings. At the time, some EFRAG TEG members questioned whether the rights and obligations, as described in the definitions in paragraph 4, met the definitions of an asset and a liability under the *Conceptual Framework*.
- 6 In [agenda paper 9](#) of the IASB September 2020 meeting, the IASB staff explained that when drafting the forthcoming exposure draft using the definitions in paragraph 4, they encountered problems in explaining:
 - (a) the effects of using the phrase ‘amounts already charged to customers’; and
 - (b) how a regulatory liability arises.

- 7 Specifically, the phrase ‘amounts already charged to customers’ could create some confusion by appearing to result in double counting. The IASB staff therefore proposed to change the definitions as follows:
- (a) regulatory asset - *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***; and
 - (b) regulatory liability - *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***.

IASB staff analysis - Problems with double counting

- 8 Feedback on the previous wording reported that a double counting could result when an entity compares the total allowed compensation in a specified period with the amount invoiced to customers in that period, and the entity accounts for the ‘difference’ as a regulatory asset or a regulatory liability.
- 9 The issue is that an entity *will not* have a regulatory asset or regulatory liability when the total allowed compensation for goods or services supplied in that specific period has been fully reflected in revenue under IFRS 15 *Revenue from Contracts with Customers*. In the latter case, the entity will have no present right or present obligation as the total allowed compensation for the goods or service provided is already reflected in revenue under IFRS 15.
- 10 To overcome this problem, the updated draft of the definitions in paragraph 7 **refers to revenue recognised rather than to amounts charged to customers**. The IASB staff consider that referring to ‘revenue already recognised’ would work because of how the concepts of regulated rates, total allowed compensation and revenue are interrelated. They also think that the proposed changes should clarify but not change the intended outcome of the definitions agreed by the IASB in paragraph 4.

Example – provided in IASB agenda paper 9 (IASB September meeting)

Fact pattern

- 11 Entity A is entitled to **total allowed compensation of CU1,000** for the goods or services supplied to customers in 20X1. Entity A **has invoiced customers CU1,015** during 20X1, of which CU25 relates to goods or services to be supplied in 20X2. Entity A is yet to invoice customers CU10 for goods or services supplied (performance obligations satisfied) in 20X1. Entity A recognised revenue of CU1,000 for 20X1 applying IFRS 15. [CU1,015 – CU25 + CU10].

Analysis

- 12 Entity A recognises a contract liability of CU25 and a contract asset/receivable of CU10 at the end of 20X1 by applying IFRS 15.
- 13 Applying the definitions in paragraph 4, Entity A might have compared the total allowed compensation of CU1,000 for goods or services supplied in 20X1 with the amount of CU1,015 invoiced to customers and concluded that it has a regulatory liability of CU15. However, Entity A should have observed that the total allowed compensation of CU1,000 for goods or services supplied in 20X1 has been fully reflected in revenue and concluded that it has no regulatory asset or regulatory liability at the end of 20X1.

- 14 When an entity **satisfies its performance obligations to customers earlier or later than when it charges customers** at the regulated rate and the resulting asset or liability is a contract asset or contract liability (IFRS 15), that asset or liability is not a regulatory asset or regulatory liability.

IASB staff analysis - Problems with explaining how a regulatory liability arises

- 15 When applying the definition of a regulatory liability in paragraph 4, an entity would compare the total allowed compensation for goods or services already supplied with the amounts already charged to customers.
- 16 Feedback received on the previous wording reported that a regulatory liability is an obligation to reduce future regulated rates for goods or services **to be supplied in the future**. Therefore, it is confusing to word the definition by reference to total allowed compensation for goods or services already supplied. To remove that confusion, the IASB staff's proposed definition focuses on the facts that:
- (a) an amount has already been included in regulated rates charged to customer—and hence in revenue already recognised; and
 - (b) that amount will provide part of the total allowed compensation for goods or services to be supplied in the future.
- 17 The IASB staff consider that amending the definition of a regulatory liability in this way permits a close parallel with the definition of a regulatory asset. Both definitions focus firstly on the past event and secondly on the future consequence of that event. This is explained in the table below (taken from agenda paper 9 September IASB meeting):

	Right or obligation	Past event	Future consequence
Regulatory asset	right to add an amount in determining a future regulated rate	goods or services have already been supplied	part of the total allowed compensation for the goods or services already supplied will be included in revenue in the future
Regulatory liability	obligation to deduct an amount in determining a future regulated rate	revenue has already been recognised	that revenue will provide part of the total allowed compensation for goods or services to be supplied in the future

- 18 The IASB staff noted that they have tested the revised definitions against the library of examples they have considered during the project and have confirmed that the revision does **not change the intended outcomes** of applying the definitions. In

the IASB's staff's view, the revised definitions are simpler and easier to understand and implement in practice.

IASB discussion

- 19 Ten of 13 Board members agreed with the IASB staff recommendations to revise the wording of the definitions in paragraph 7. These members generally agreed that the IASB staff proposed **clarified that the price that customers pay does not reflect the goods or services provided**. This clarification helped to understand why there are regulatory assets and regulatory liabilities.
- 20 The IASB members that disagreed with the IASB staff recommendations, expressed concerns with the introduction of the word "revenue", and the possible tension it might cause with IFRS 15. These IASB members preferred that the definitions refer to "amounts chargeable" rather than "revenue".

EFRAG staff analysis

- 21 The EFRAG staff is of the view that reference to "the goods or services already supplied" made in the earlier definition of a regulatory liability (see paragraph 4b) resulted in a definition that could be misunderstood. This is because a regulatory liability arises when an entity will need to supply goods or services at a future date but has included some or all of the related total allowed compensation in the rates charged to customers during the current period (has recognised revenue for the current period under IFRS 15). The revised definition recommended by the IASB staff reflects this by now referring to "goods or services to be supplied in the future" instead of "goods or services already supplied" as was the case in the earlier definition. In terms of basic journal entries an entity would be:
 - (a) Debit: regulatory expense (a separate line item that offsets the IFRS 15 recognised revenue); and
 - (b) Credit: regulatory liability.
- 22 The EFRAG Secretariat had previously not considered the "double count" issue that could arise due to reference made to "amounts already charged to the customer" in the definitions of regulatory assets and regulatory liabilities. Nonetheless, the example provided in paragraphs 11 to 14 illustrates the potential issue.
- 23 The EFRAG Secretariat understand that, if the amounts charged to customers differ from the total allowed compensation, it ought not to necessarily mean that there are regulatory assets or regulatory liabilities. For example, this can be the case if amounts charged to customers includes amounts related to contract liabilities¹ under IFRS 15 (i.e. performance obligations are yet to be fulfilled, goods or services will be supplied in the future). The EFRAG Secretariat therefore support a revised definition as it can help to avoid the inappropriate recognition of regulatory assets and regulatory liabilities due to the "double count" issue.
- 24 However, in line with the concerns expressed by some IASB members, the EFRAG Secretariat think that referring to "revenue" might create some tension with IFRS 15 and would instead suggest using the phrase "amounts chargeable" to address the concerns with reference to "amounts charged to customers", which was recommended by some IASB members. This would not change the outcome but is likely to reduce any potential confusion that may arise from the mixing up of revenue

¹ Conversely, this can be the case if amounts charged to customers exclude amounts related to contract assets under IFRS 15 (i.e. the entity has performed and delivered but not charged the customer- as billing is conditional) and total allowed compensation for such goods and services has been included in the charge to customers (revenue has been recognised).

recognition under IFRS 15 and recognition of regulatory income/expense under the accounting model.

Question for EFRAG TEG members

- 25 Do EFRAG TEG members agree with the EFRAG Secretariat assessment that the revised definitions of regulatory assets and regulatory liabilities proposed by the IASB staff in paragraph 7 will result in better wording of the proposal? If not please explain why.

Issue 2 - Regulatory returns on assets not yet available for use

- 26 In March 2020, the IASB tentatively decided that regulatory returns on an asset not yet available for use (i.e. a construction work-in-progress base) included in the regulated rates charged to customers during the construction period forms part of the total allowed compensation for goods or services to be supplied once that asset becomes available for use.
- 27 In reaching this decision the IASB considered that regulatory returns on a construction work-in-progress asset included in the regulated rates charged to customers during the construction period form part of total allowed compensation **only during the period when the asset is in operation** and is being used to supply good or services.
- 28 When drafting the forthcoming exposure draft, the IASB staff observed that there is likely to be a follow-on question about whether the regulatory returns form part of the total allowed compensation for the goods or services supplied **over the useful life of that asset or over a different period**. To address this question, the IASB staff recommended that:
- (a) the return on a balance relating to an asset not yet available for use forms part of the total allowed compensation for goods or services supplied once the asset is available for use and **over the remaining periods in which the entity recovers the carrying amount of the asset through the regulated rates**; and
 - (b) the entity should use a reasonable and consistent basis in determining how to allocate the return on that balance over the period specified in subparagraph (a).

IASB staff analysis

- 29 Regulatory agreements may provide entities with regulatory returns on a base containing a balance relating to an asset not yet available for use for the supply of goods or services to customers. The IASB staff identified two approaches commonly used by regulatory agreements for regulatory returns on such balances:
- (a) Approach 1 - regulatory returns accumulate (and not immediately included in the regulated rates) while the asset is not yet available for use and are included in the regulated; and/or
 - (b) Approach 2 - regulatory returns are included in the regulated rates charged to customers during periods when the asset is not yet available for use.
- 30 The IASB staff noted that the issue about the period **arises only if the regulatory agreement uses Approach 2**. Under Approach 1 the regulatory returns form part of total allowed compensation for goods or services supplied over the period in which the asset is recovered through the regulated rates and are recognised over that period.

- 31 However, when the regulatory agreement applies Approach 2, it is **less clear in which period the regulatory returns should be recognised**. Two possibilities exist:
- (a) The regulatory period - the remaining period in which the asset is recovered through the regulated rates, once the asset is available for use; or
 - (b) The asset's useful life for IFRS purposes - the asset's useful life determined by applying IFRS Standards.
- 32 Although in some cases the regulatory period and the asset's useful life for IFRS purposes might be the same, in other cases the periods might be different.
- 33 The IASB staff proposed the use the regulatory period (paragraph 31(a)) which they noted is consistent with the IASB March 2020 decision on the accounting for returns on an asset not yet available for use (paragraph 26) – recognise once the asset is in operation.
- 34 A detailed IASB staff analysis of issue 2 is included in [agenda paper 9A](#) of the IASB September meeting.

IASB discussion

- 35 Eleven of 13 IASB members agreed with the IASB staff recommendation in paragraph 28. One IASB member was absent.
- 36 The IASB considered that allocation over the remaining useful life for IFRS purposes could be particularly complex if assets, or components of assets, have various useful lives. The IASB members that supported the staff recommendation did so also for cost-benefit reasons.

EFRAG staff analysis

- 37 The IASB staff recommendation is consistent with the IASB decision in paragraph 26 regarding the accounting for returns on assets that are not in use. Although we have not tested this IASB staff recommendation, our initial assessment is that recognition over the regulatory period (when it is different to the useful life of the related asset) will be less complex for companies to apply.

Question for EFRAG TEG members

- 38 Do EFRAG TEG members agree with the EFRAG Secretariat assessment that the recommendation proposed by the IASB staff in paragraph 28 regarding the period over which returns on assets not yet available for use should be recognised will result in improving the proposal? If not please explain why.

Issue 3 – Effective date

- 39 The IASB agenda paper explains that *Due Process Handbook* requires the mandatory effective date to be set so that jurisdictions have sufficient time to incorporate the new requirements into their legal systems and those applying the Standards have sufficient time to prepare for the new requirements.

IASB staff analysis and recommendation

- 40 The IASB staff consider that to a large extent, the proposed accounting model for regulatory assets and regulatory liabilities would use information that preparers are already expected to gather and process in determining regulated rates. On this basis the IASB staff recommended an implementation period of 18–24 months, which in their view is largely aligned with decisions made by the IASB for other IFRS Standards.

IASB discussion

- 41 Twelve of 13 IASB members agreed with the IASB staff recommendation in paragraph 40. One IASB member was absent.

EFRAG Secretariat analysis

- 42 The EFRAG staff considers that companies should have some/most of the information readily available so in principle a period of 18-24 months would allow sufficient time for companies to implement the new Standard. However, we have not discussed this question with EFRAG RRAWG members. We intend to do so in the coming days. So far, we have heard from EFRAG RRAWG members that although most of the information required by the IASB tentative proposals is available, it might be different for disclosure proposals. Many (most) EFRAG RRAWG have expressed a need to simplify the disclosures as they are not necessarily available in the same format and the same level of detail as the IASB tentative proposals.
- 43 The EFRAG Secretariat understands that with the timing imposed by the European agenda on transition to a green economy, there will be a growing volume of investments possibly within the scope of the forthcoming exposure draft.

Question for EFRAG TEG members

- 44 What are your views on the recommendation proposed by the IASB staff in paragraph 40 regarding the effective date of the forthcoming Standard?
- 45 Do you think that the timing imposed by the European initiatives on transition to a green economy should also play a role in defining the effective date?

Issue 4 – Comment period

- 46 At its July 2019 meeting, the IASB tentatively decided to set a comment period of 120 days for the forthcoming exposure draft.
- 47 At the supplementary IASB meeting in April 2020, the staff informed the IASB that, closer to the publication of the exposure draft, the staff would assess whether issues arising from covid-19 continue to affect our stakeholders, and whether the comment period should be extended to 180 days.

IASB staff analysis

- 48 In the IASB staff's view, a longer comment period would provide stakeholders with more time to provide the IASB with high-quality feedback, and give stakeholders more time to manage the effects and constraints, if any, of covid-19 on financial reporting priorities and annual financial reporting timelines.

IASB discussion

- 49 Seven of 13 IASB members agreed with the IASB staff recommendation for a longer period, but considered that 150 days would be sufficient given that the forthcoming exposure draft would only affect stakeholders in a particular sector and that many of these stakeholders had expressed an urgency to publish the exposure draft as soonest. If once the exposure draft was published, the IASB would consider extending the comment period further if needed. One IASB member was absent.

EFRAG Secretariat analysis

- 50 The EFRAG staff support a comment period of 150 days as decided by the IASB (instead of either 120 days as originally intended or 180 days as proposed by the IASB staff). For logistical/practical purposes, the EFRAG Secretariat consider that

receiving comments by June 2021 (before the European summer break) will be better than during the summer break.

Question for EFRAG TEG members

51 Do EFRAG TEG members agree with the IASB decision for an extension of comment period to 150 days instead of 120 days? If not please explain why.