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## **Disclosure objectives and disclosure requirements for defined rate regulation Issues Paper**

### **Objective**

- 1 The objective of this paper is to obtain EFRAG TEG and EFRAG CFSS views on identifying disclosure objectives and related disclosure requirements for defined rate regulation. The feedback received will be presented at the October 2018 meeting of the Accounting Standards Advisory Forum (ASAF).

### **Background**

- 2 At its July meeting, the IASB had an initial discussion on a high-level presentation and disclosure objective for regulatory assets and regulatory liabilities created by defined rate regulation. The IASB was not asked to make decisions and only preliminary views were expressed. In line with those views the IASB staff developed the presentation and disclosure objectives as set out in this paper.
- 3 Agenda paper 14-03 contains background information about the accounting model being developed for defined rate regulation (the model) and a summary of the IASB tentative decisions on the model to date.

### **Initial views on presentation requirements**

- 4 Due to its distinct nature, regulatory assets and regulatory liabilities do not fit into the defined categories of assets and liabilities accounted for using existing IFRS Standards. Consequently, the IASB staff is proposing presentation of additional line items beyond those required by IAS 1 *Presentation of Financial Statements*. As a minimum, the following separate line items are proposed:
  - (a) In the **statement of financial position**:
    - (i) regulatory assets;
    - (ii) regulatory liabilities;
  - (b) In the **profit or loss section** of the statement of profit or loss and other comprehensive income, regulatory income or regulatory expense recognised in profit or loss (possibly just as a single net amount).
  - (c) In the **other comprehensive income section** of the statement of profit or loss and other comprehensive income, regulatory income or regulatory expense recognised in other comprehensive income (possibly with income netted against expenses) and presented in separate lines to distinguish:
    - (i) items that will be reclassified subsequently to profit or loss when specified conditions are met; and
    - (ii) items that will not be reclassified subsequently to profit or loss.

### Initial views on disclosure objectives

- 5 At its July 2018 meeting, the IASB discussed the disclosure objective for defined rate regulation and expressed the following views:
- (a) the disclosure objective should not be too broad to avoid any unintentional disclosure overload;
  - (b) it should convey a key feature of the model, being a 'supplementary' model; and
  - (c) it should focus more on understanding what future rate adjustments refer to activities carried out to date, the uncertainties associated with them, how they were measured and the expected timing of their reversal.
- 6 The IASB staff also considered the following guidance when developing the overall disclosure objective for defined rate regulation:
- (a) **user information needs** - users of financial statements need information about the origination and reversal of timing differences created by the operation of the rate-adjustment mechanism. This information helps to distinguish fluctuations in revenue and expenses compensated for through the rate-adjustment mechanism from fluctuations for which there is no compensation. The information also helps users to predict the amounts, timing and uncertainty of future cash flows arising from regulatory assets and regulatory liabilities. Any additional information about the regulatory environment and the relationship with the regulator will only enhance users' understanding of the model.
  - (b) **the disclosure objective in IFRS 14 Regulatory Deferral Accounts** – under the IFRS 14 disclosure objective, an entity shall disclose information which enables users to assess the nature and risks associated with the rate regulation and the effects on its financial position, financial performance and cash flows; and
  - (c) **guidance in the Conceptual Framework for Financial Reporting** – under the Conceptual Framework, the financial statements should provide financial information about the reporting entity's assets, liabilities, equity, income and expense that is useful to users of financial statements in assessing:
    - (i) the prospects for future net cash inflows to the reporting entity; and
    - (ii) the management's stewardship of the entity's economic resources.
- 7 Consequently, based on the objective of financial statements and the views expressed by the IASB, the disclosure objectives and disclosure requirements for defined rate regulation need to focus on the effects that the transactions or other events that give rise to regulatory timing differences have on the entity's financial performance and financial position.
- 8 As a result, the IASB staff is proposing the following **overall disclosure objective**:
- (a) An entity shall disclose information that helps users of financial statements to understand how the origination and reversal of regulatory timing differences affect the entity's financial performance and financial position.
  - (b) This information will be useful because it will help users to assess the entity's financial performance trends and the amounts, timing and uncertainty of its future cash flows.
- 9 To provide a more granular application of the overall disclosure objective, the IASB staff suggests three **specific disclosure objectives**:

- (a) **Financial performance** - an entity shall disclose information about the effect of regulatory timing differences on the entity's revenues, regulatory income and regulatory expense recognised during the period and the relationship of those effects with the expenses recognised during the period. This information will help users to distinguish between:
  - (i) fluctuations in revenue and expenses compensated for through rate-adjustment mechanisms; and
  - (ii) fluctuations in revenue and expenses for which there is no compensation.
- (b) **Amount, timing and uncertainty of future cash flows from regulatory assets and regulatory liabilities** - an entity shall disclose information about:
  - (i) the remaining time interval over which it expects to recover the carrying amounts of the regulatory assets and regulatory liabilities; and
  - (ii) uncertainties about the amount or timing of future cash flows from regulatory assets and regulatory liabilities.
- (c) **Changes in the carrying amounts of regulatory assets and regulatory liabilities** - an entity shall disclose information that shows how the carrying amounts of regulatory assets and regulatory liabilities have changed from the beginning to the end of each reporting period presented.

#### Questions for EFRAG TEG and EFRAG CFSS

- 10 Do EFRAG TEG and EFRAG CFSS think the overall disclosure objective in paragraph 8 and specific disclosure objectives in paragraph 9 are appropriate and would result in information that is useful for the users of the financial statements? Do you think that those disclosure objectives would facilitate judgement by entities in deciding what information to disclose?
- 11 Do EFRAG TEG and EFRAG CFSS suggest any modifications to the overall disclosure objective and the specific disclosure objectives? Have you identified any other specific disclosure objectives that should be considered?

#### Level of aggregation of disclosures

- 12 The IASB staff has considered the following guidance when developing the aggregation criteria<sup>1</sup> for presentation and disclosure for defined rate regulation:
  - (a) **the Conceptual Framework** – under the Conceptual Framework, assets, liabilities, equity, income or expenses are classified for presentation and disclosure purposes based on their shared characteristics such as the nature of the item, its role (or function) and how it is measured. The classification is applied to the unit of account selected for an asset or liability. For presentation and disclosure purposes, items may need to be aggregated or separated into components, however, balance needs to be found so that relevant information is not obscured either by a large amount of insignificant detail or by excessive aggregation;
  - (b) **other IFRS Standards** – some IFRS Standards provide guidance about the level of disaggregation needed by identifying criteria that an entity could use, such as nature, characteristics and use; risks and degree of uncertainty and how the item is measured;

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<sup>1</sup> The IASB tentatively decided that the accounting model for defined rate regulation will use as its unit of account the individual timing differences.

- (c) **the disclosure objective in IFRS 14** – IFRS 14 requires disclosures about recognised amounts for each type of rate-regulated activity and for each class of regulatory balance.

*Initial views on level of aggregation*

- 13 Considering the existing guidance on presentation and disclosure (paragraph 12 above), the IASB staff is proposing that entities apply judgement when assessing how to aggregate regulatory assets and regulatory liabilities into groups of like items. When assessing the level of aggregation, an entity should also consider materiality. Additionally, it may be appropriate to use different levels of aggregation for meeting different specific disclosure objectives.
- 14 For the statement(s) of financial performance, the IASB staff is recommending that entities should present the following line items:
- (a) regulatory income or regulatory expense recognised in profit or loss (possibly just as a single net amount); and
  - (b) regulatory income or regulatory expense recognised in other comprehensive income (possibly with income netted against expenses).
- 15 Furthermore, to help users understand how and when regulatory timing differences affect revenue and expenses reported in the statement(s) of financial performance, entities should be required to disaggregate the regulatory income/(expense) line items into the following components, if material:
- (a) amounts that an entity has a right to include in rates in a future period(s) as a result of rate-regulated activities carried out in the current period (ie origination of regulatory assets);
  - (b) amounts already included in revenue in the current period for rate-regulated activities that the entity will carry out in a future period(s) (ie origination of regulatory liabilities);
  - (c) amounts included in revenue relating to rate-regulated activities carried out in previous period(s) (ie recovery of regulatory assets);
  - (d) amounts included in regulatory income as a result of rate-regulated activities carried out in the current period for which the entity had already charged customers in previous period(s) (ie fulfilment of regulatory liabilities); and
  - (e) changes in the carrying amount of regulatory assets and regulatory liabilities due to changes in accounting estimates.
- 16 If an entity applies IFRS 8 *Operating Segments*, it should be required to disaggregate the regulatory income/(expense) line item for each reportable segment.

**Questions for EFRAG TEG and EFRAG CFSS**

- 17 Do EFRAG TEG and EFRAG CFSS members agree that the regulatory income/(expense) line item(s) should be disaggregated into: (a) originations of regulatory assets and of regulatory liabilities; (b) recoveries of regulatory assets and fulfilments of regulatory liabilities and (c) changes in estimates?
- 18 Do EFRAG TEG and EFRAG CFSS members think that an entity should be allowed to apply judgement to determine the level of aggregation of regulatory assets and regulatory liabilities needed to satisfy the disclosure objectives? If not, what criterion would you propose to determine the level of aggregation required?

## **Disclosure requirements**

- 19 The disclosure requirements for defined rate regulation have been developed by associating each disclosure requirement with specific disclosure objectives to help entities apply judgement as to whether the information is material to their financial statements and whether it meets user information needs. The IASB staff initial views on disclosure requirements are as follows:

### *Disclosure requirement 1*

- 20 An entity shall consider disclosing:
- (a) a breakdown of the regulatory income/(expense) line item(s) in the statement(s) of financial performance including the items identified in paragraph 15;
  - (b) the breakdown in 20(a) for each reportable segment disclosed; and
  - (c) the reasons for the changes in estimates in the carrying amount of regulatory assets and regulatory liabilities.

### *Disclosure requirement 2*

- 21 An entity shall consider disclosing:
- (a) a maturity analysis showing the remaining time intervals over which the entity expects to recover the carrying amount of regulatory assets or to fulfil the carrying amount of regulatory liabilities. The entity is expected to use judgement to determine an appropriate number of time bands;
  - (b) how the future recovery of regulatory assets or the future fulfilment of regulatory liabilities is affected by risks and uncertainty such as regulatory risk and demand risk.

### *Disclosure requirement 3*

- 22 An entity shall consider disclosing:
- (a) the discount rate or ranges of discount rates used to discount the estimated cash flows reflected in the carrying amounts of regulatory assets and regulatory liabilities at the end of the period;
  - (b) any differences between the rate or range of rates used to discount any regulatory assets or regulatory liabilities and the interest or return rate or range of rates approved by the regulator to compensate or charge the entity for the time lag between the origination and recovery of regulatory assets or the origination and fulfilment of regulatory liabilities, and the reason for such differences.

### *Disclosure requirement 4*

- 23 An entity shall consider disclosing a reconciliation of the carrying amount of regulatory assets and regulatory liabilities at the beginning and the end of the period. The entity shall apply judgement in deciding the level of detail provided, however, it should consider disclosing:
- (a) the amount(s) included in the regulatory income/(expense) line item(s) in the statement(s) of financial performance; and
  - (b) other amounts, separately identified, that affect the carrying amounts of regulatory assets and regulatory liabilities, such as items acquired or assumed in a business combination, items disposed of, or the effect of changes in foreign exchange rates.

*Disclosure requirement 5*

- 24 An entity shall disclose the judgements used by management, in accordance with IAS 1, that have the most significant effect on the amounts of regulatory assets, regulatory liabilities, regulatory income and regulatory expense recognised in the financial statements.
- 25 Agenda paper 14-05 illustrates some of the disclosure requirements described in paragraphs 20-24 through a case study. The case study contains examples of originations and reversals of various timing differences.

**Questions for EFRAG TEG and EFRAG CFSS**

- 26 Do EFRAG TEG and EFRAG CFSS members think the disclosure requirements are clear, complete and balanced (ie would result in useful information to users and would not result in disclosure overload)?
- 27 Do EFRAG TEG and EFRAG CFSS members consider that the disclosure requirements are drafted in a way that is intended to emphasise the use of judgement and to use less prescriptive language than the drafting style currently used in disclosure requirements in IFRS Standards. Do you think the drafting achieves this objective?

**Agenda Papers**

- 28 In addition to this issues paper, agenda papers for this session are:
- (a) Agenda paper 14-02 – ASAF 04 RRA Cover paper - for background only;
  - (b) Agenda paper 14-03 – ASAF 04A RRA Background and decisions to date -for background only;
  - (c) Agenda paper 14-04 – ASAF 04B RRA Disclosure objectives and requirements – for background only; and
  - (d) Agenda paper 14-05 – ASAF 04C RRA Case study - for background only.