**EFRAG Board and TEG meeting
07 September 2021
Paper 05-06
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Regulatory Assets and Regulatory Liabilities

Effects Analysis – Preparer and User Outreach feedback August 2021

Objective

1 To assess the effects of IASB's ED *Regulatory assets and Regulatory Liabilities* (ED) that was published at the end of January 2021, EFRAG conducted an analysis of the effects of the proposed Standard. This was done through surveying both preparers of rate-regulated entities and users of financial statements of rate-regulated entities (herein referred to as Effects Analysis).

2 The findings of the Effects Analysis are presented in this paper and is intended to be a background paper for the 7 September EFRAG TEG-Board meeting. The key findings of the Effects Analysis are summarised in agenda paper 05-02.

Overview

3 An initial Effects Analysis1 set of separate surveys for preparers and users was distributed before the ED was published and the results (see early-stage analysis preparers and early-stage analysis users) were reflected in the EFRAG draft comment letter. A follow-up set of separate surveys for preparers and users was distributed after the ED was issued. The latter set of surveys were open from early June to the end of July 2021.

4 The pre-ED and post-ED preparer and users surveys conducted for Effects Analysis focused on the effects of the ED with a focus on the following aspects:

(a) Clarity on the scope of the proposed Standard for preparers;

(b) Effects of CWIP (construction work in progress) regulatory returns as part of the total allowed compensation from a preparer and user perspective;

(c) Effects of the discounting proposals for preparers and users;

(d) Clarity on interaction with IFRIC 12 *Service Concession Arrangements* for preparers;

(e) Effects of disclosure and presentation for users;

(f) Transition requirements for preparers;

(g) Implementation costs for preparers and cost-benefit analysis from a preparer perspective.

5 The effects analysis highlights the expected consequences of the ED's proposals on rate-regulated entities.

6 In this paper, the following terms are used to describe the extent of responses.

Term	Extent of response
Most	80% - 100%

[1] Previously referred to as Early-stage effects analysis.

Many	50% - 80%
Some	25% - 50%
A few	more than one to 25% of respondents

7 The rest of the paper is structured as follows:

(a) **Executive summary**;

(b) **Detailed findings** with a distinction between preparer and user respondents' findings; and

(c) **Appendix** (with more details on respondents)

Executive summary

Clarity on the scope of proposed Standard for preparers

8 Most respondents were clear, but a few were not clear whether they are in scope. A few of the respondents made suggestions for the refinement of scope (e.g., need to define regulatory agreement).

Effects of CWIP regulatory returns as part total allowed compensation from a preparer and user perspective

9 Some preparers indicated that they are not obliged to refund the regulatory returns granted and charged to customers during construction indicating that the CWIP regulatory returns are compensation for a fulfilled performance obligation. Many respondents indicated they foresee implementation challenges as a result of the ED's CWIP proposals.

10 Many users indicated that they would need to make analytical adjustments if the ED's CWIP proposals were adopted. They considered that the ED's CWIP proposals would understatement of profitability during the construction phase.

*Effects of the discounting proposals for preparers and u*sers

11 Many preparer respondents replied that applying the discounting proposals would result in using a regulatory interest rate. Some said it would result in using the minimum interest rate. Consequently, it seems that the application of the minimum interest rate does not only occur under exceptional circumstances.

12 Many preparers answered noted that they would find the discounting concept difficult to implement (in particular estimating the minimum discount rate) and that the concept would therefore create challenges for preparers. Many preparers supported to include a practical expedient not to have to discount if the effects of time and risks were not significant. Such expedient could simplify the model in the long run.

13 A majority of users stated that they consider the present value of regulatory cash flows in their analysis. It seems that discounting is important for users, but only to the extent that it creates useful information and only some of the users said that the discounting proposal enhances analysis.

Clarity on interaction with IFRIC 12 Service Concession Arrangements for preparers

14 On IFRIC 12, some of the preparer respondents stated that they did not find any aspects of the interaction of the proposed model with IFRIC 12 problematic for practical application purposes, but some found it difficult to apply and requested more guidance.

Effects of disclosure for preparers and users and presentation for users

15 Many of the preparer respondents indicated that the disclosure requirement would be difficult to implement as required information under the model was only partly available or not readily available in their accounting systems, e.g., assets under construction would not be tracked separately.

16 Many users generally expressed support for the proposed disclosure requirements, especially related to reconciliations and a breakdown of regulatory income which was supported by most of the respondents.

17 Although many users agreed on the presentation proposals and that it would enhance the analysis of financial statements, few respondents expressed concern about the lack of comparability relative to US GAAP.

*Tr*ansition requirements for preparers

18 Many preparer respondents highlighted implementation challenges in connection with a full retrospective application of the Standard (e.g., due to CWIP proposals).

Implementation costs for preparers and cost-benefit analysis from a preparer perspective

19 Some respondents (three) agreed to the IASB's analysis of likely costs. Some (two) did not agree with the analysis or had reservations/agreed only partly. One respondent expressed the view that the adoption of the ED may be quite costly for entities.

20 In summary, some preparer respondents assessed a positive cost-benefit relationship although there are some implementation concerns. A few expected a negative cost-benefit relationship. Many respondents expected: minimal to moderate implementation costs; and positive benefits from applying the model (e.g., reduced volatility of performance).

Detailed findings

Scope

Preparer survey (eight respondents)

Have you identified any other situation/s in which the proposed scope would affect entities that should not be subject to the standard? (Question 8)

21 Most respondents (88%) had not come across situations during their assessment of the standard and its application to their business model, where entities would be affected that should not be in the scope of the standard.

Are the proposals on scope clear enough to determine whether a regulatory agreement gives rise to regulatory assets and regulatory liabilities?

22 As shown in the pie chart (Figure 1 below), the feedback received from the preparer survey indicated that it was not always clear to preparers what was within the scope of the proposed Standard.

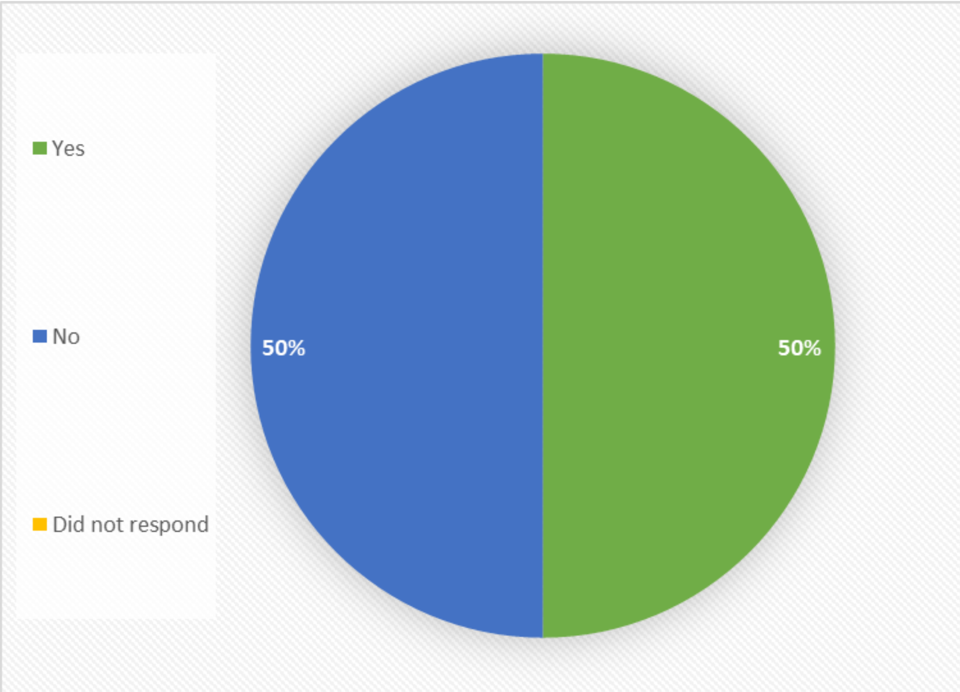

Figure 1 - Application of the concept, whether regulatory agreement gives rise to regulatory assets and liabilities, is clear enough

23 The preparer respondents made the following suggestions for the IASB to consider related to the scope:

(a) To further clarify the definition of a regulatory agreement giving rise to regulatory assets and regulatory liabilities. The definition could be tightened along the lines of a 'specified regulatory agreement'. To specify whether a regulatory framework could give rise to regulatory assets and regulatory liabilities when a regulatory agreement per se did not exist;

(b) To provide examples of scope exclusions, i.e., what was not intended to be covered by the scope such as price cap arrangements;

(c) To introduce a definition of a 'regulator' to prevent self-regulation from falling within scope. The regulator could be defined as an independent third party such as a government or the state and was not necessarily a regulatory body;

(d) to provide guidance on the use of the term 'customers' in the ED because the concept of 'customers' in the ED was different from the definition of a customer in IFRS 15 *Revenue from Contracts with Customers*;

(e) to clarify whether the recovery/ settlement of total allowed compensation by third parties other than the customer fell within the scope;

(f) to clarify if amounts charged to customers and settled by third parties can be in scope.

Are you aware of situation/s where rate adjustments related to service concessions arrangements result in enforceable rights/obligations but are not in scope of IFRIC 12 and could be within scope of the ED?

24 Many respondents (63%) did not encounter these situations in their assessment, but some of the respondents (37%) referred to specific fact patterns that would not fall within the scope of IFRIC 12 but potentially fall within the scope of the ED (see Figure 2 below).

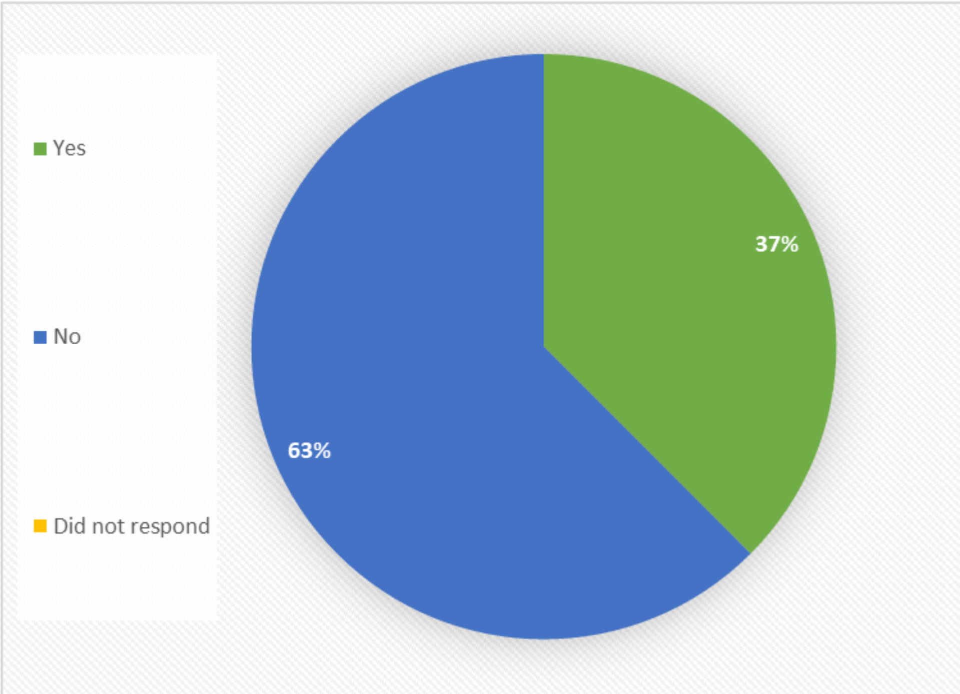

Figure 2 - *Concession arrangement not in scope of IFRIC 12, but in scope of the ED*

25 As described by the respondents, such fact patterns probably include situations

(a) in the portable water business: under the respective arrangement the operator does not bear the volume risk for the delivery of water. The grantor set a future tariff based on the estimated volume and the tariff will be adjusted for variances based on precedents and regulation requirements.

(b) under the hybrid model and the financial model, where it seems unclear if future increase of tariff should adjust the estimated future cash flow of the financial asset under IFRIC 12 or be accounted according to the ED.

Are you aware of situation/s that are not within the scope of the proposed model but in your view should be?

26 Most respondents (88%) were not aware of:

(a) parts of their regulated business model that were supposed to fall within the scope, would not fall within the scope of the proposed model, or

(b) that probably other business models, that currently seem not to be within the scope of the ED, should fall within the scope.

27 A few respondents (12%) answered affirmatively but did not elaborate.

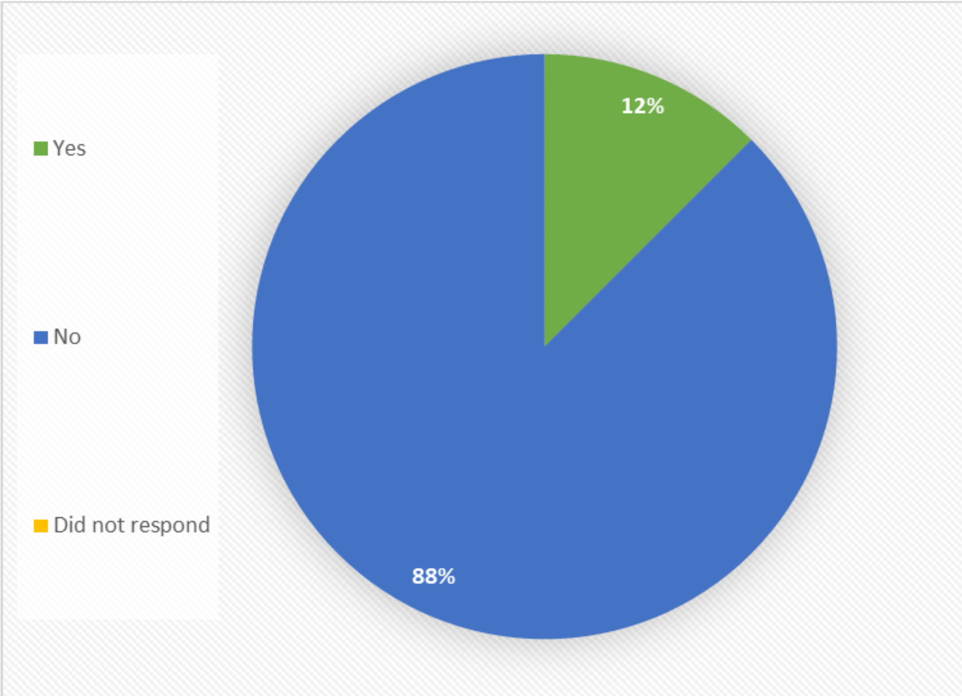

Figure 3 - Business models not in the scope, that should be in the scope of the ED

28 In summary, there was uncertainty whether certain circumstances fell within the scope of the proposed Standard or IFRIC 12 *Service Concessions Arrangements* (e.g., in IFRIC 12 under the hybrid model and the financial asset model it was not clear if future tariff increases should adjust the estimated future cash flow of the financial asset or be accounted according to the ED).

Have you identified any situation/s in which the proposed scope would include self-regulation?

29 Some of the respondents (37%) concluded that self-regulation would be in the scope of the ED (see Figure 4).

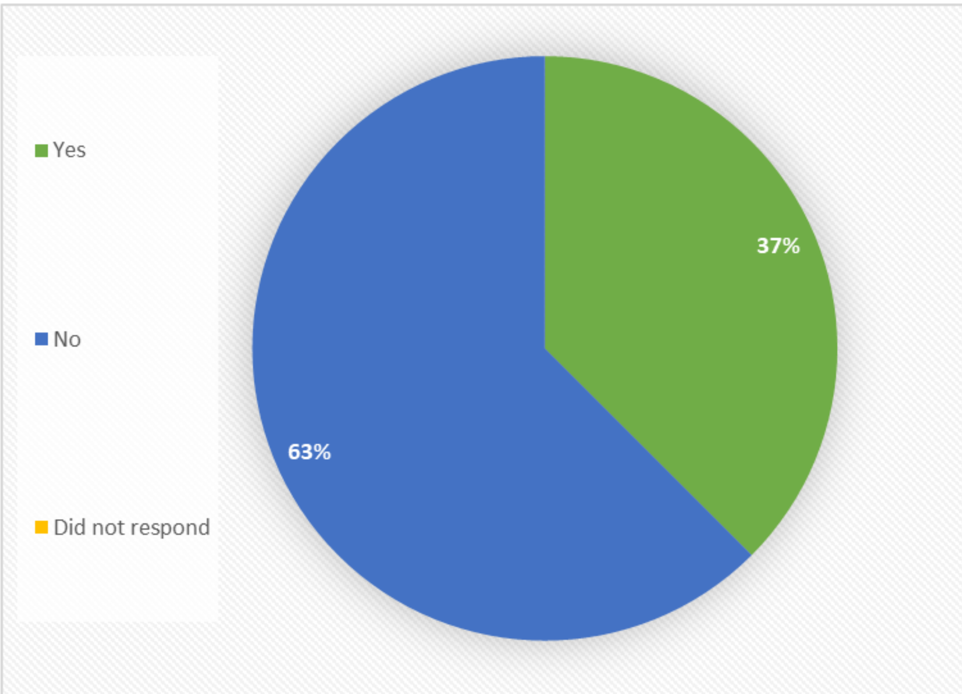

Figure 4 - Proposed scope includes self-regulation

30 Not every respondent had practical experiences with self-regulation. Nevertheless, those that expressed the view that self-regulation would be within scope, argued from a theoretically perspective (one respondent). If an entity appoints

(a) an entity as a regulator into its group structure, or

(b) outside the group structure (while effectively being controlled by the group).

31 More specifically, one respondent pointed out that intercompany service contracts could lead to a situation where self-regulation could exist.

32 One expressed the view that certain criteria should be added, e.g., the requirement that the regulator should be an independent third party. In this case, the independent third party could be a regulatory body or government-related entity (or state agency).

<u>Earlier surveys</u>

33 In the earlier survey, with regards to the scope of the proposed model, many respondents were clear on the scope of the model, but some respondents highlighted activities that they were uncertain fell within scope.

34 The picture on the clarity of scope is similar to the earlier survey. Also, the effects analysis shows that the proposals, in general, are not always clear enough to determine whether a regulatory agreement gives rise to regulatory assets and regulatory liabilities.

Total allowed compensation

<u>*Preparer survey (eight respondents)*</u>

In your jurisdiction/ company, how does the regulator compensate for regulatory returns for CWIP when determining total allowed compensation?

35 The respondents (eight) replied as follows (several answers were possible):

(a) regulatory returns on CWIP included in *total allowed compensation* during the CWIP phase: six of eight respondents

(b) regulatory returns on CWIP included in total allowed compensation when the asset is available for use: four of eight

(c) regulatory returns on CWIP are granted: one of eight

(d) Did not respond: one of eight

If CWIP is incomplete, does the regulator oblige the entity to refund the regulatory return charged to customers during construction?

36 As shown in the pie chart in Figure 5, 50% of the preparer respondents (four of eight respondents) stated that the regulator would not oblige them to refund the regulatory return charged to customers, if the asset construction project is never completed. This finding shows that, at least for some entities, when the regulatory returns are granted during construction by the regulator, it relates to a fulfilled performance obligation. Some preparer respondents (two of eight respondents – 25%) stated that the regulation would oblige them to refund the return on failure to complete projects.

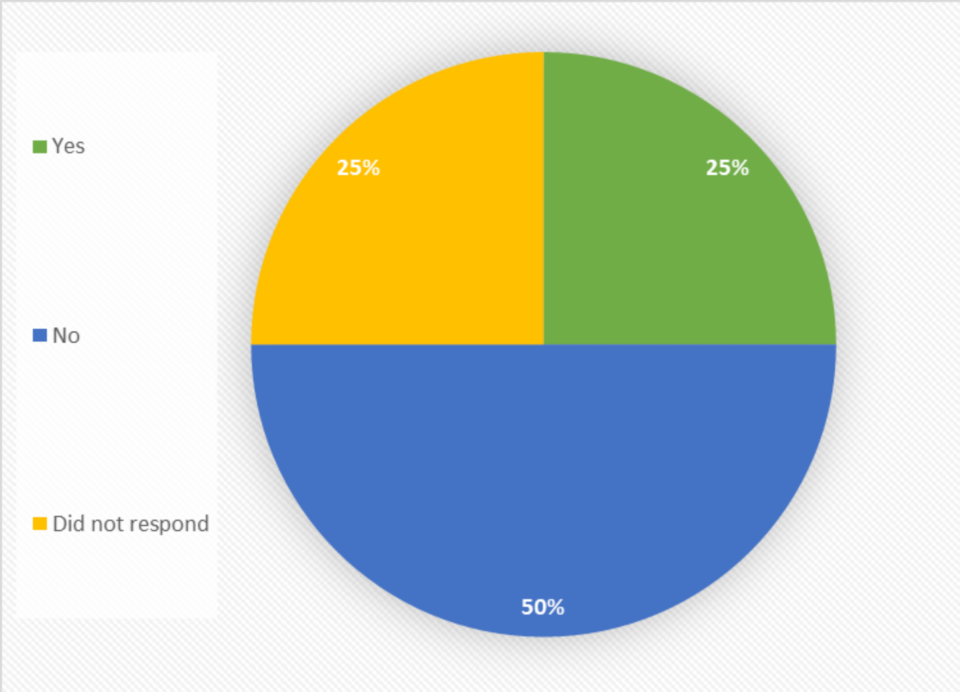

Figure 5 - Obligation to refund the regulatory return charged to customers during construction when the constructed asset is not completed

Do you link the delivery of goods or services to being compensated for regulatory returns on CWIP?

37 Some respondents [three of eight respondents – 37%] indicated they do not link the compensation for regulatory returns on CWIP to delivery of goods and services to customers and that it compensates for something different (e.g., the delivery of public services), as shown in the following Figure 6.

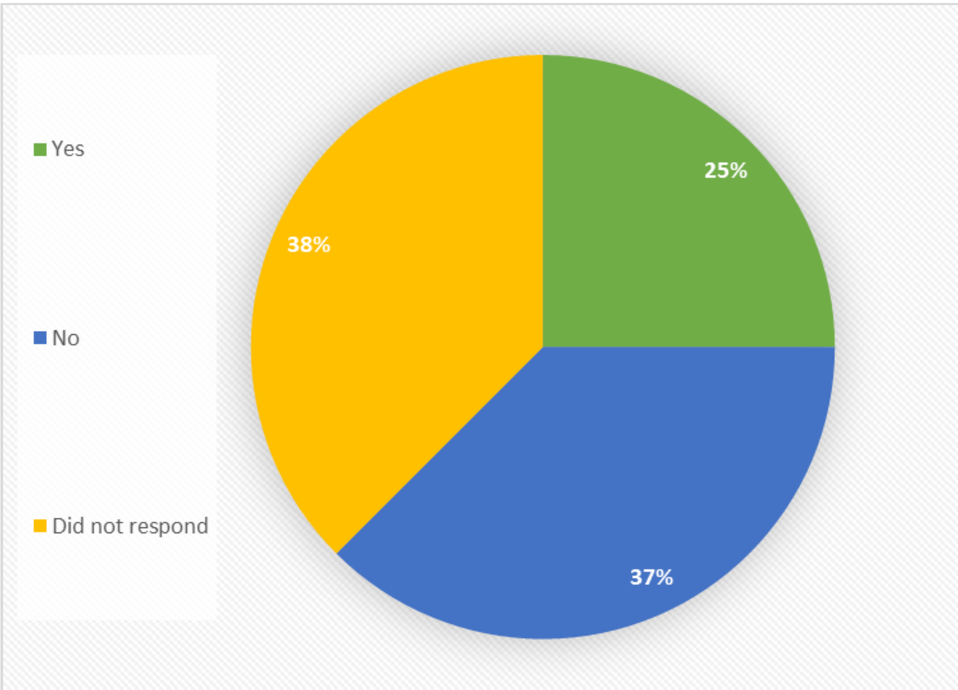

Figure 6 - Link between the delivery of goods or services and compensation for regulatory returns on CWIP

For the latest reporting period, please state the regulatory return on CWIP charged as a proportion of either total allowed compensation or revenue?

38 As shown in Figure 7, some respondents (four of eight respondents - 50%) indicated that regulatory return on CWIP as a proportion of either total allowed compensation

or revenue was either moderate (three of eight respondents - 37.5%) or significant (one of eight respondents - 12.5%). This finding shows that regulatory returns on CWIP can be material for some entities and the chosen accounting approach will have a material impact for these entities.

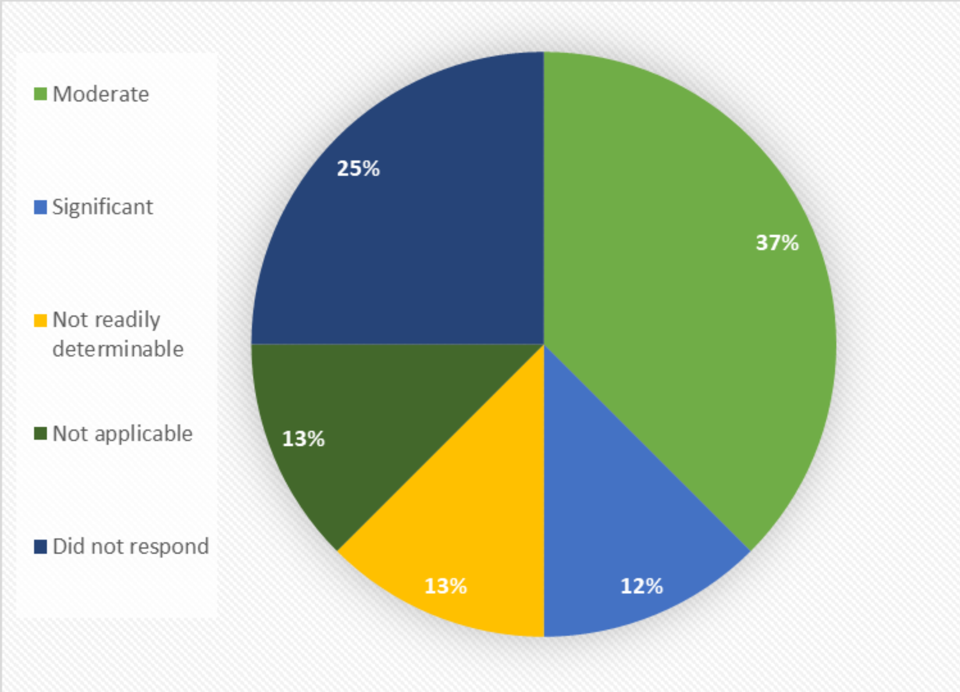

Figure 7 - Regulatory return on CWIP charged as a proportion of either total allowed compensation or revenue

Do you foresee any implementation challenges in identifying regulatory returns related to a regulatory asset base including CWIP or linking revenue to particular assets?

39 Many respondents [five of eight respondents – 63%] indicated they would foresee implementation challenges in identifying the regulatory return related to assets under construction (shown in Figure 8 below). Some respondents [two of eight respondents – 25%] did not see any challenges and one preparer did not respond.

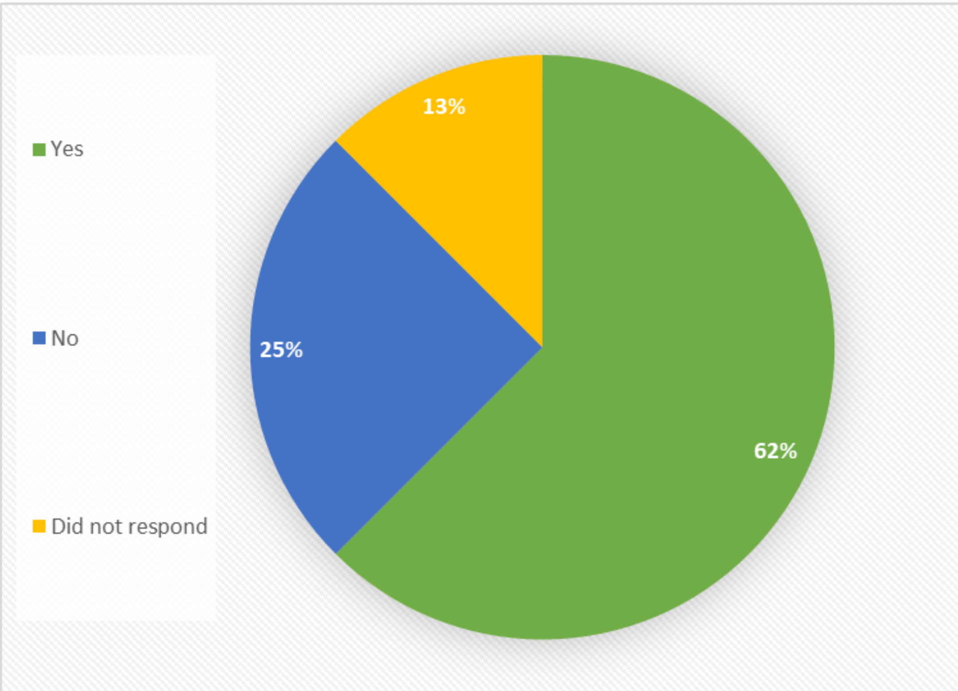

Figure 8 - Implementation challenges in identifying regulatory returns related to a regulatory asset base including CWIP or linking regulatory returns to a particular asset

Have you identified challenges in using a reasonable and supportable basis to determine how to allocate the return over the remaining periods?

40 Many respondents [five of eight respondents – 63%] expected challenges in using a reasonable and supportable basis to determine how to allocate the return over the remaining period (shown in Figure 9 below). Some respondents [two of eight respondents – 25%] did not see challenges and one preparer did not respond to that question. Those that responded and expected implementation challenges stated the following:

(a) One preparer stated that as regulatory returns are made based on a homogenous regulatory base, it would be difficult to carve this out into individual assets that may unwind over different periods.

(b) Another preparer stated that this would mean rolling back up to 2 years and quantifying restatements for each of the individual relevant projects and the incurred cost would far exceed the benefits.

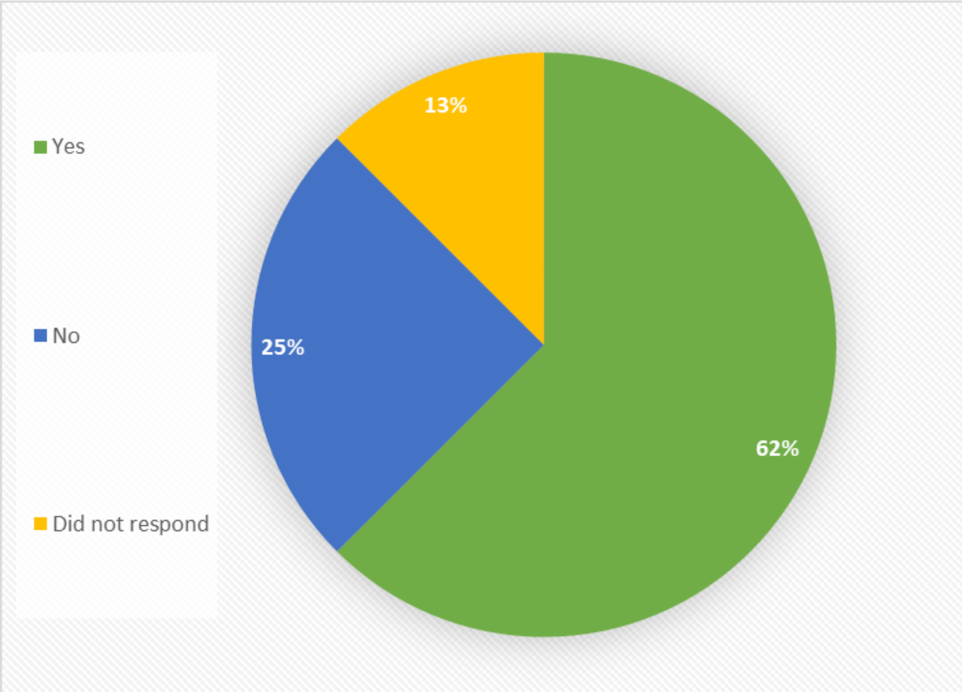

Figure 9 - Identification of challenges in using a reasonable and supportable basis to determine how to allocate the return over the remaining periods

<u>*User survey (seven respondents)*</u>

Any need to adjust analytical model?

41 A majority of user respondents [four of seven respondents – 57%] stated that they would be required to adjust their analytical models when regulatory returns would be deferred into future periods (shown in Figure 10). The users that would adjust their models gave the following reasons:

(a) One user responded that cash flows would differ from profit or loss, and this would understate the profitability of the project as it would seem the company receives no remuneration during construction.

(b) Another user responded that where regulatory regimes allow companies to earn a return during the construction of an asset, this return should be reflected in the performance reported during construction and not deferred to the operational period. The respondent noted that the regulated entity is remunerated for the construction risk and creating additional capacity.

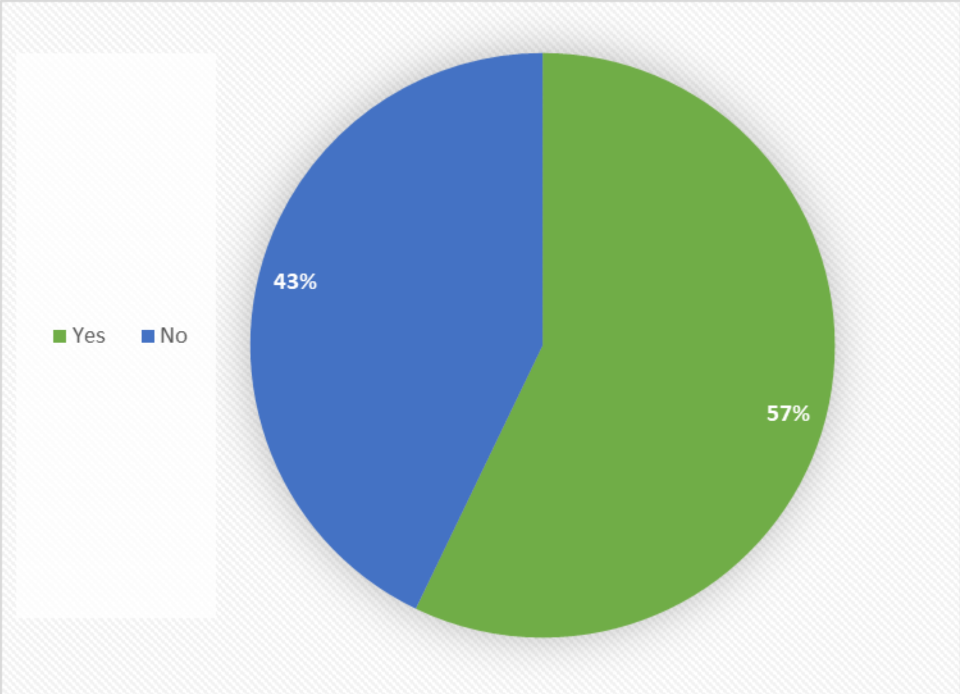

Figure 10 - Need to adjust analytical models

Are particular business models affected?

42 A majority of users [four of seven respondents – 57%] stated that they were not aware of particular business models that would be affected by the proposed requirements for CWIP (shown in Figure 11). The three respondents [43%] that were aware of particular business models impacted had the following comments:

(a) One user stated that especially affected would be fully regulated companies such as electricity transmission companies where the CAPEX over RAB ratio is high.

(b) One user stated that especially affected would be electricity networks and some regulated gas transport assets.

(c) One user stated that large single-asset investment projects, which receive returns during construction, or companies exposed to sizeable multi-year construction projects would be affected.

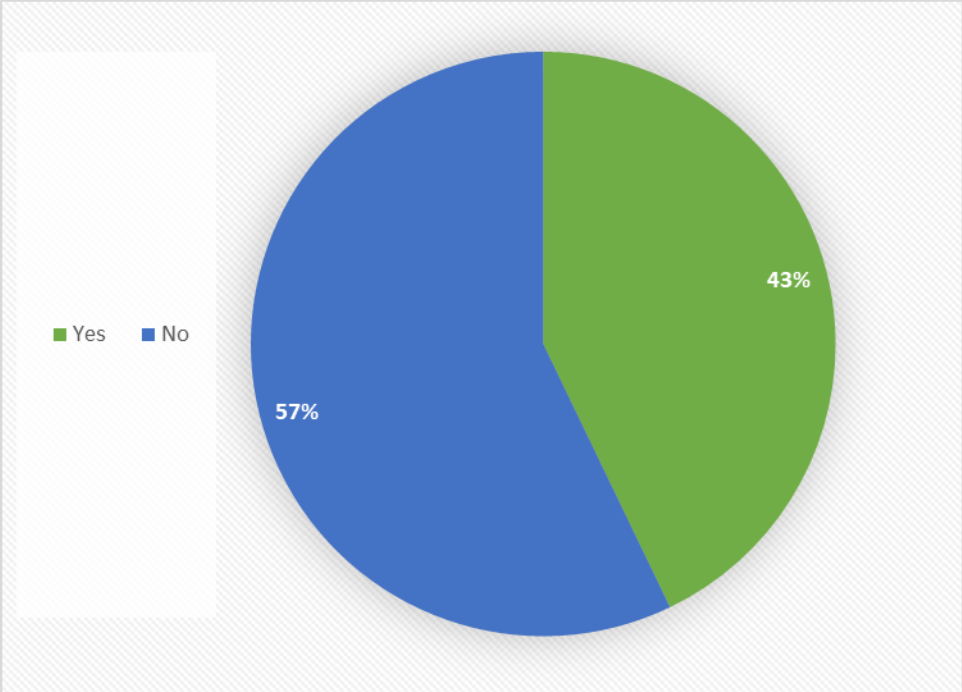

Figure 11 - Are particular business models affected?

Does the CWIP treatment lead to material impacts on the financial statement and non-GAAP metrics?

43 As shown in *Figure 12*, some users [three of seven respondents – 42%] did not expect material impacts on financial statements or non-GAAP metrics. But one user [one of seven respondents – 14%] responded that he would not be able to trust the profit or loss, and this would have to make an assumption on the cash flows received from assets under construction and reduce numbers from profit or loss.

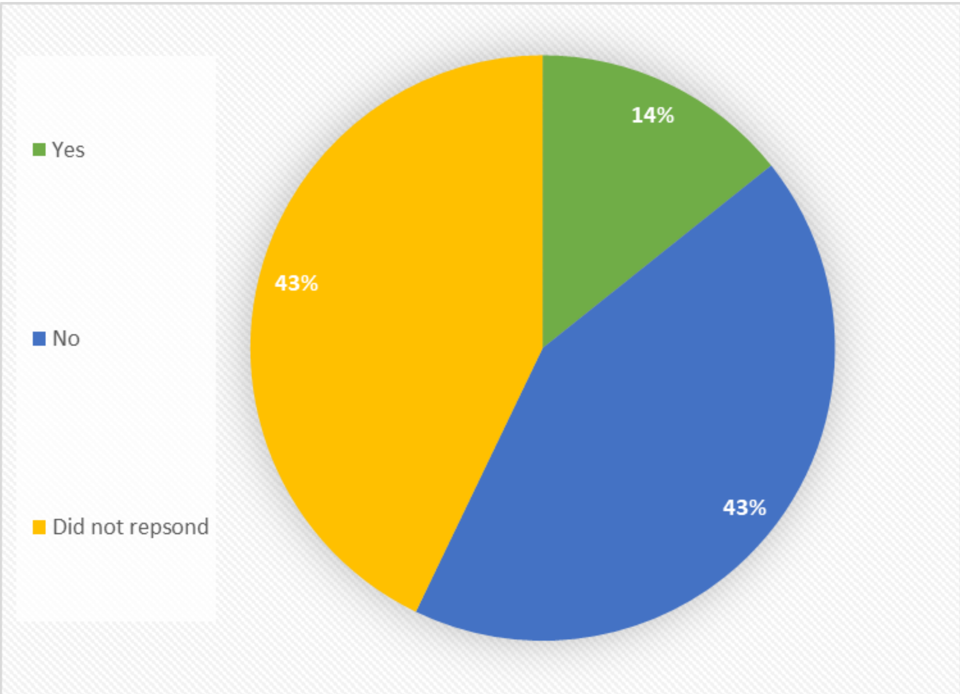

Figure 12 - Material impacts on financial statements or non-GAAP metrics from the proposed treatment of CWIP

Measurement: discounting and discount rate

<u>Preparer survey (eight respondents)</u>

In your jurisdiction, what does the regulatory interest rate compensate for?

44 Many preparer respondents noted that the regulatory interest rate compensates for the time value of money and other factors such as business risks. One preparer noted that there is no regulatory interest rate clearly indicated in the regulatory agreement. Based on an initial analysis, this respondent expressed difficulty identifying the regulatory interest rate within the mechanism provided by the regulator. And noted that further analysis of whether WACC is used in the calculation of regulatory returns on asset base contains an element relating to compensation for the time lag is required.

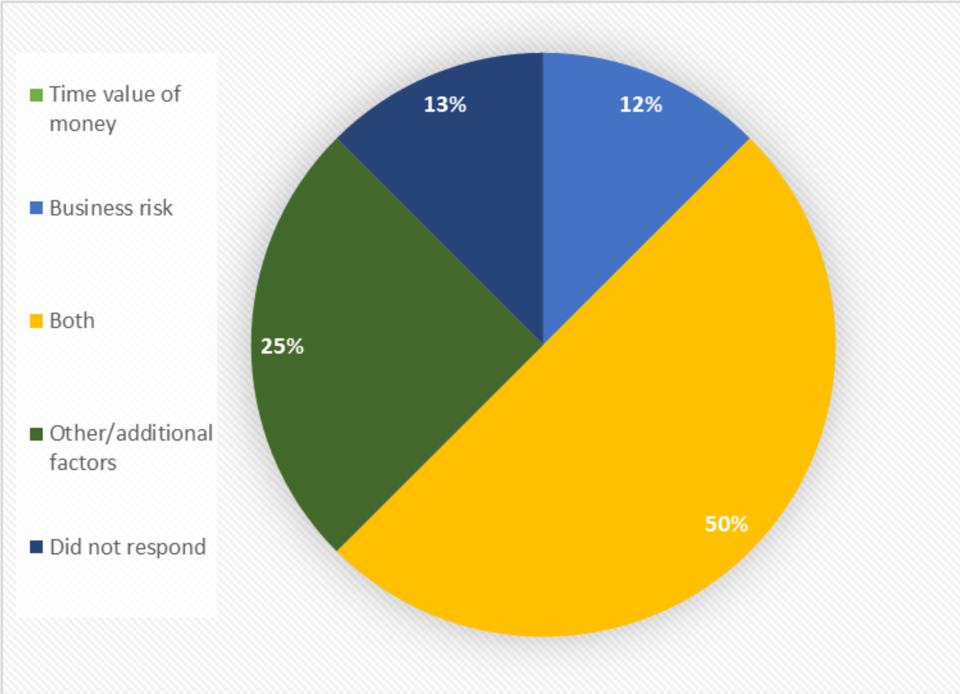

Figure 13 - What does the regulatory interest rate compensate for in your jurisdiction?

Based on your regulation, what will discounting cash flows by applying a minimum interest rate for regulatory assets result in?

45 In response to the question, three respondents (37.5%) stated they used regulatory interest rate, two respondents (25%) used the minimum rate. (Figure 14).

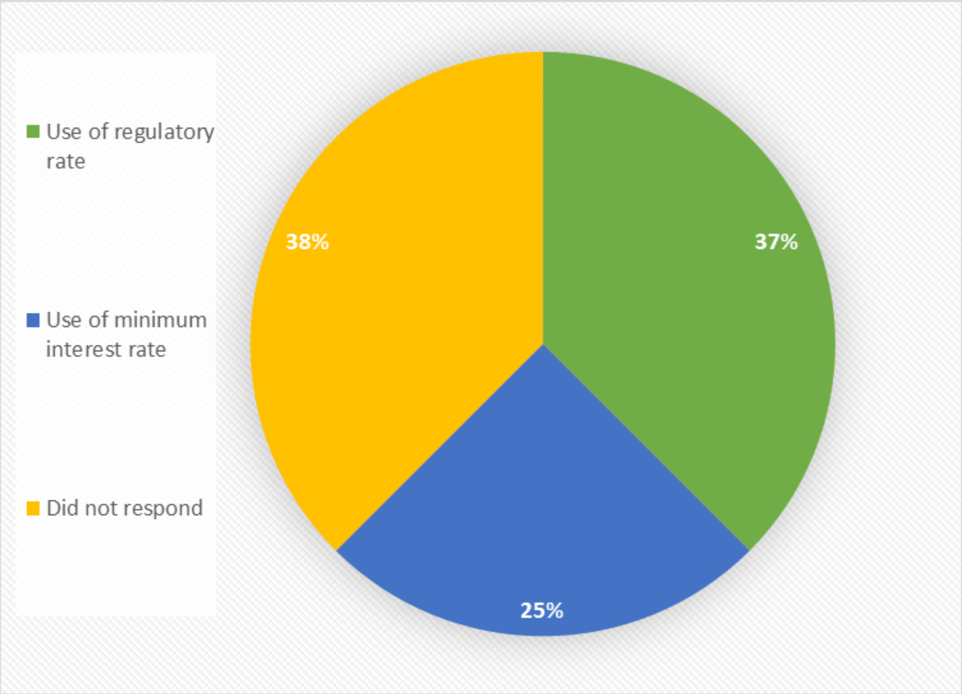

Figure 14 - What is the outcome of applying the minimum interest rate to regulatory assets

Would you face implementation issues with the proposals for discounting and specifically with estimating the minimum interest rate when insufficient?

46 Five preparers answered regarding the question of implementation challenges with applying the discounting proposals, particularly estimating the minimum discount rate [seven out of eight answered] that it would result in implementation challenges (see Figure 15).

(a) One preparer said that believed that in every case making estimates and judgements may result in some implementation issues;

(b) Another respondent highlighted that the proposal could create implementation challenges because it is highly judgmental to determine if the regulatory rate is insufficient and that the regulatory WACC is generally defined by the regulator considering adequately the time value of money. In fact, the regulatory interest rate (or WACC) is subject to negotiation with the regulator and already represents the rate at which a regulated entity recovers (fulfils) a regulatory asset (liability). Furthermore, estimating a minimum interest rate when the regulatory one is deemed to be insufficient would be very complex and open to a high degree of judgement, subject to agreement's issues with auditors. Also, it would result in a misalignment with the measurement of regulatory liabilities, for which the estimation of a minimum interest rate is not required, where generally the regulatory agreement provides the same rate for assets and liabilities.

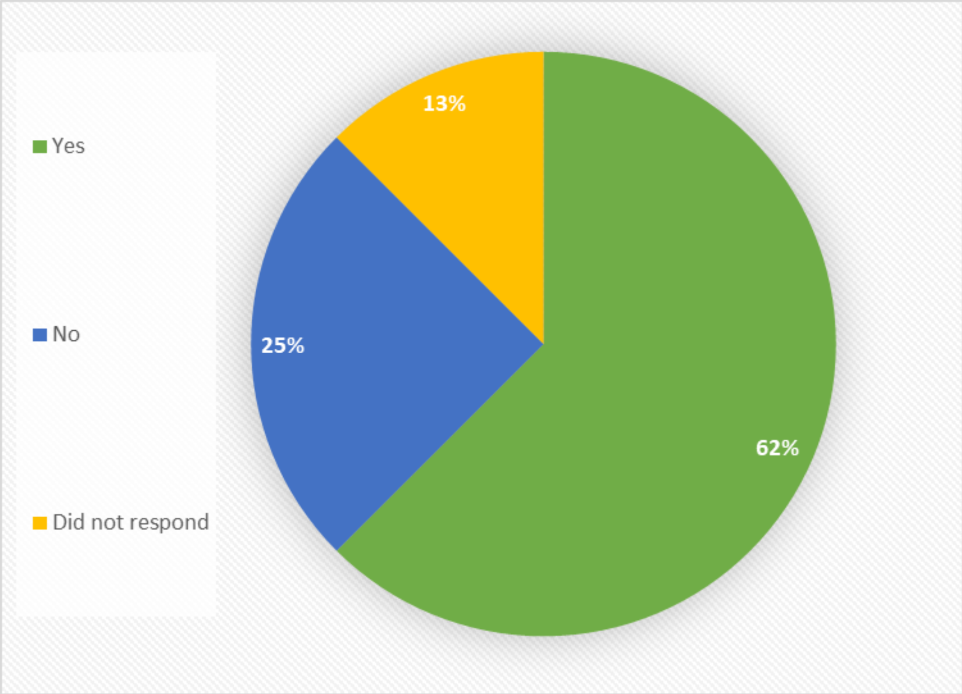

Figure 15 – Do you expect implementation issues with the proposals for discounting and specifically with estimating the minimum interest rate when insufficient?

Based on the proposals, do you foresee any implementation challenges to determine a single discount rate when the regulatory interest rate is uneven?

47 Three of the preparers answering the question regarding implementation challenges to determine a single discount rate when the regulatory interest rate is uneven [seven out of eight answered] replied that they did not identify implementation challenges and four respondents did (see Figure 16).

(a) One preparer noted that there are recurring situations whereby regulatory assets are subject to a time lag of between 6 months and 2 years until they are included in the rates. And there are thousands of individual regulatory assets with different maturities, especially resulting from the allocation of corporate and regional overheads to individual components of PP&E. Consequently,

(i) the regulated entity first computes an estimated effective regulatory interest rate and measures the related regulatory asset when it obtains an enforceable right to obtain increases in tariffs.

(ii) Second, the regulated entity updates these computations when the regulator determines the actual return and actual period over which the entity is entitled to bill increased tariffs.

(iii) Third, the regulated entity regularly updates the computations, because the regulator often changes the nominal regulatory interest rate over the long life of the regulatory assets. The regulatory assets may have maturities of up to 50 years (e.g., corporate overheads allocated to civil works and included in Water treatment plants).

(b) This respondent suggested the use of a cost deferral approach, which provides a fair representation of the intentions of the parties in the US water regulations. Alternatively, the use of a practical expedient that would enable to apply an approach similar to the approach used in IAS12 *Income Taxes* to measure regulatory assets resulting from the allocations of overheads. In this scenario, the listed companies that apply the practical expedient would disclose this fact and would disclose the carrying value of the related regulatory assets.

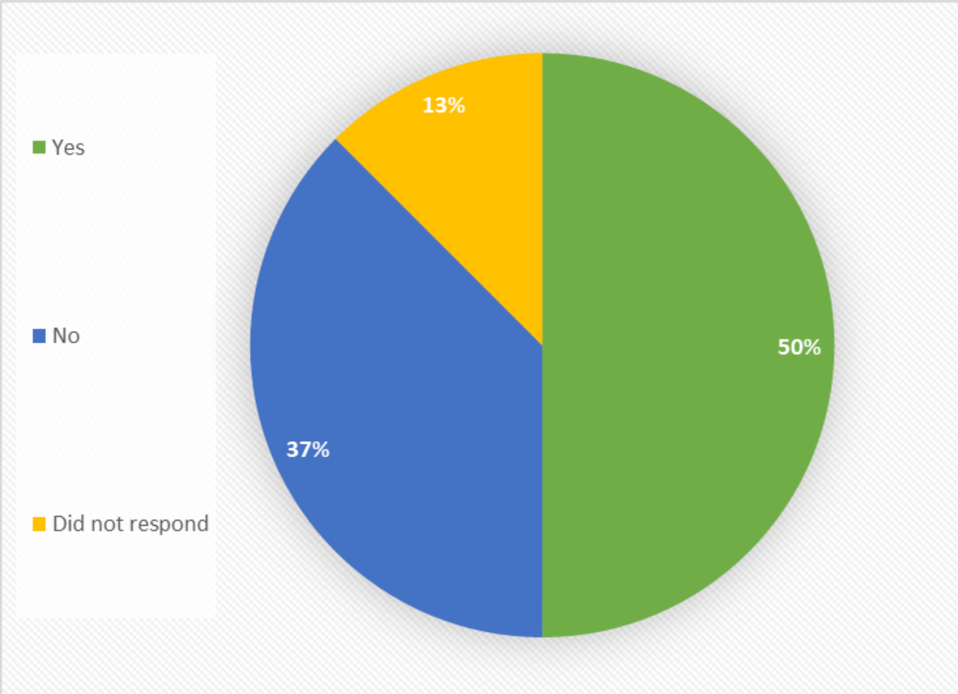

Figure 16 - Do you foresee any implementation challenges to determine a single discount rate when the regulatory interest rate is uneven?

Should a practical expedient not to discount, if the effects of time and risks were not significant, be incorporated in the proposals?

48 Regarding the above question, five preparers [seven out eight answered], five answered ’yes’ and two answered “no”.

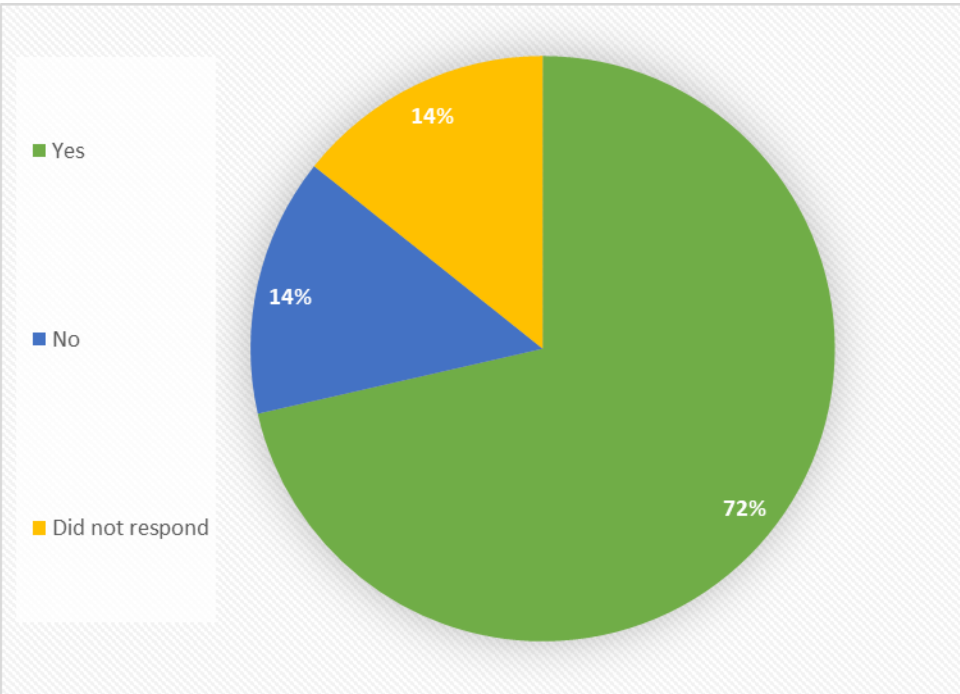

Figure 17 - Incorporation of a practical expedient not to discount, if the effects of time and risks were not significant, required?

User survey (seven respondents)

Present value of regulatory cash flows considered?

49 In the user survey, four users said that they consider the present value (PV) of regulatory cash flows and the other three did not.

Proposal enhances analysis?

50 Three users had no opinion whether ED's discounting proposal enhances analysis, two said 'no' and two said 'yes'. The users that said "no" did not elaborate. The users that said yes, explained that:

(a) One user understood that the ED's proposals for discounting differ from US GAAP. Since they rate companies globally this user prefers converged accounting solutions and would recommend the IASB considers aligning the proposals for discounting with the well-established US GAAP solution.

(b) The other user noted that additional disclosure may be required to explain what interest rate applied; interest rate makes sense for short term recoverable amounts; regulator may allow a specific rate for these amounts or cost of debt allowance could be applied; needs to be clear that interest cost does not refer to the overall rate of return (i.e., WACC).

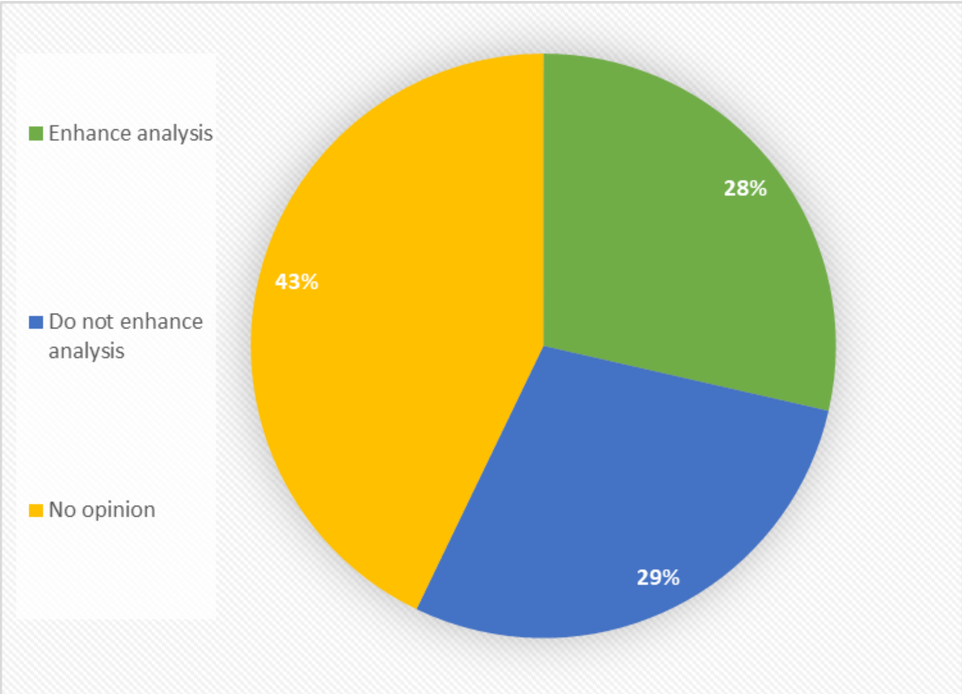

Figure 18 - Proposals enhance analysis

<u>Earlier survey</u>

51 The current survey`s findings confirm the earlier survey`s findings regarding implementation challenges applying the proposals for discounting, which are quite similar (general challenges in determining the discount rates, that will lead to a lengthy discussion with the auditor).

Presentation in the statement(s) of financial performance

<u>User survey (seven respondents)</u>

Presentation will enhance the analysis of entities?

52 As shown in Figure 19, many users agreed that the IASB proposals on presentation would enhance the analysis of financial statements of rate-regulated entities.

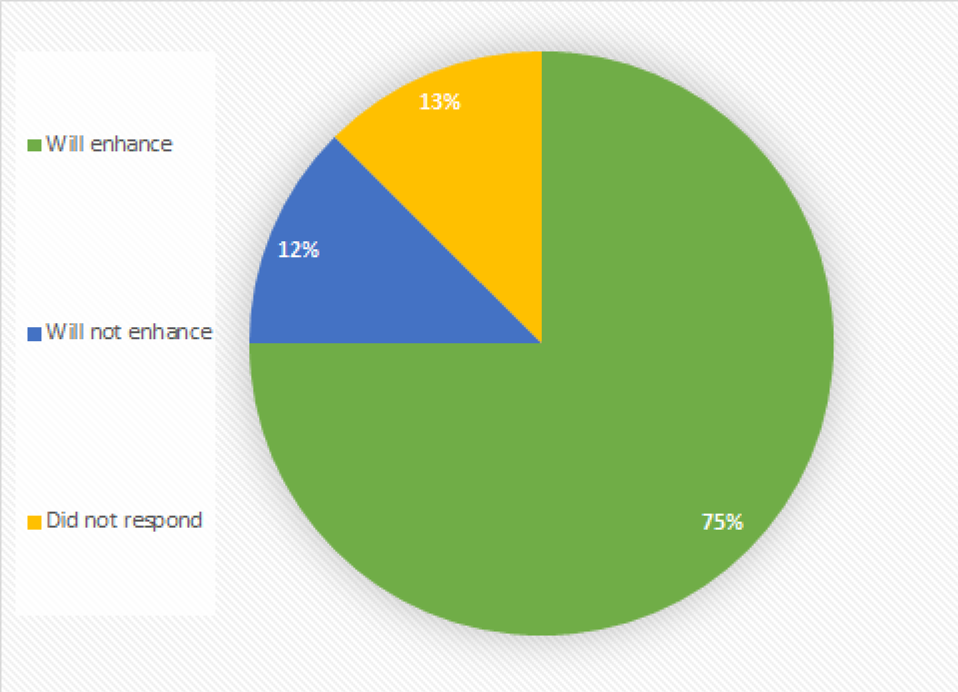

Figure 19 - Presentation enhances analysis

53 One respondent, although expressing general support, noted that differences between US GAAP and IFRS treatments would result in differences in ratios that will negatively impact comparability. This user recommended a more converged solution with existing US GAAP.

Interaction with other standards

Preparer survey (eight respondents)

What will be the impact of the proposals on goodwill/gain on acquisition arising on the business combination which includes regulatory assets/liabilities?

54 Only one preparer respondent commented on the impact of the IASB proposals on IFRS 3 *Business Combinations* and IFRS 1 *First-time Adoption of International Financial Reporting Standards* on goodwill balances stating that the IASB proposals will result in the increase of goodwill balances.

Are there any aspects of the interaction of the proposed model with IFRIC 12 Service Concession Arrangements that you find problematic for practical application purposes?

55 On IFRIC 12, half of the preparer respondents stated that they did not find any aspects of the interaction of the proposed model with IFRIC 12 problematic for practical application purposes.

56 Another half (3) mentioned the following points:

(a) It was not clear how an operator under the financial asset model would have additional unrecognised amounts that should be recognised as regulatory assets and regulatory liabilities. This being the case, one respondent recommended excluding these types of contracts from the scope of the proposed standard.

(b) There was no clarity where concession arrangements fall under the scope of the proposed model or IFRC 12, for example under the hybrid and the financial asset model it is not clear if future increase of tariffs should adjust the estimated future cash flows of the financial asset under IFRIC 12 or be accounted according to the ED.

(c) The need for additional guidance and illustrative examples to determine what are enforceable rights and obligations in concession arrangements, especially in foreign countries where the regulation is not mature.

<u>*Earlier survey*</u>

57 Many respondents of the earlier survey (66.7%) expected that the exemption of acquired regulatory assets and regulatory liabilities from the IFRS 3 requirements would have unintended consequences and one respondent noted that it could influence the recognised goodwill. In the current survey, only one respondent answered the question and expected an increase in goodwill.

Disclosures

<u>*Preparer survey (eight respondents)*</u>

For preparing the proposed disclosures, do you have all information readily available?

58 As shown in the below pie chart (Figure 20), half of the preparer respondents indicated that the information required under the model was only partly available.

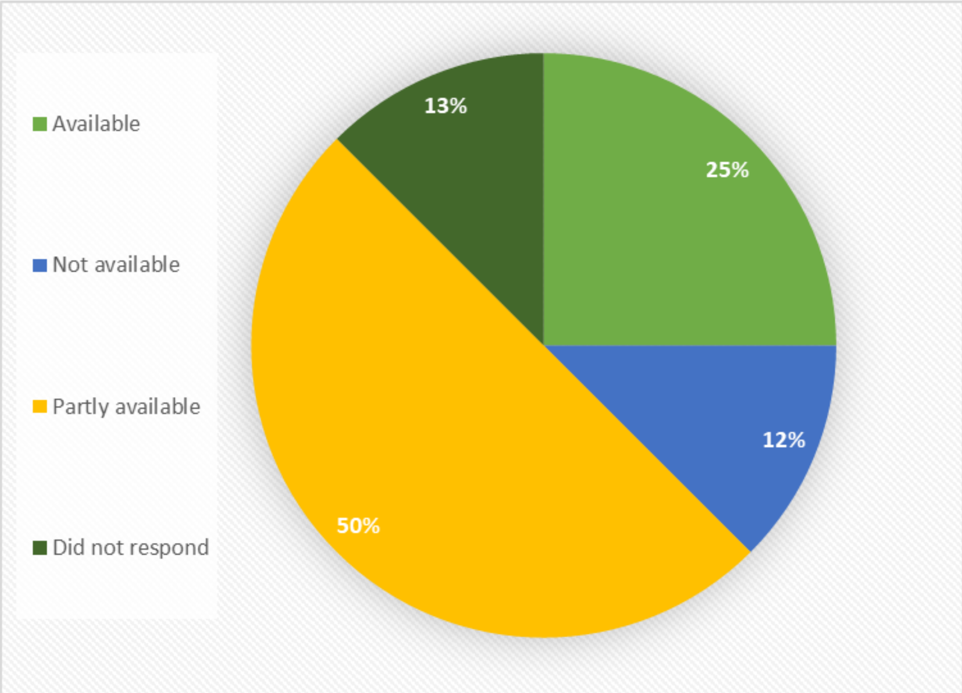

Figure 20 - Preparers disclosures – is the information needed for disclosures available?

59 Some preparers commented that for most of the disclosures required under paragraphs 78, 80 and 83 of the ED, there was no information readily available in their accounting systems. In particular, disclosures under paragraph 78 would be complex to provide as the regulated entity would have to disclose changes in all estimates included in the measurement of regulatory assets and regulatory liabilities.

Are there any other constraints to providing the proposed disclosures?

60 Some preparer respondents (three; 38% of respondents) stated that they would expect other constraints, whereas three did not expect such. Respondents expecting constraints also commented on those (see paragraph 61 on responses to disclosures).

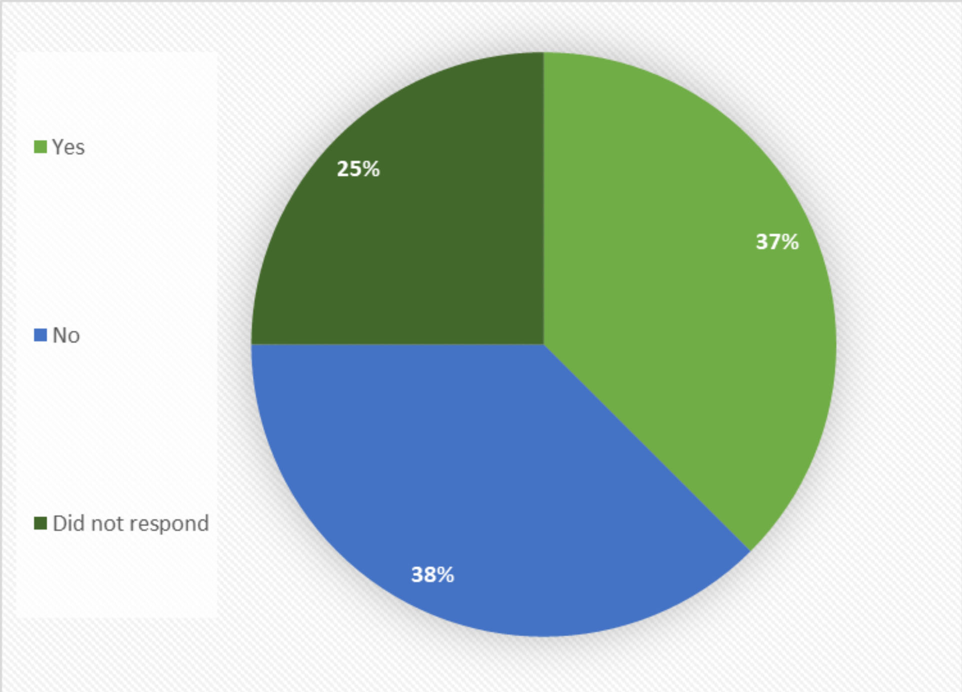

Figure 21 - Do you expect other constraints to providing the proposed disclosures?

61 Furthermore, the required disclosures were not always meaningful on a stand-alone basis, i.e., some regulatory assets generated nominal returns higher than the local WACC, however, the overall returns granted by the regulator guaranteed the financial viability of the regulated entity. Additionally, the recognition of regulatory assets depended to a great extent on the maturity of the regulatory regime.

62 A suggestion was made that it might be useful to consider the approach identified in the ED *Disclosure Requirements in IFRS Standards – A Pilot Approach* moving from a 'checklist' approach to identifying information that is relevant for each specific disclosure objective.

User survey (seven respondents)

Do you disagree/agree that disclosure enhances analysis?

63 Users that participated in the user survey indicated that having more transparency on non-current regulatory items and their reconciliation would allow a better understanding of regulated revenues, although this would not materially change the way regulated entities were being analysed.

64 Users generally expressed support for the disclosure requirements proposed in the ED. From the rating of the relative importance of four categories of specific disclosures shown in the chart below (Figure 1), it can be inferred that from a weighted-average perspective, the user respondents consider the reconciliation of asset/liability balances (paragraph 78) and the breakdown of regulatory income (paragraph 83) to be more important than discount rates (paragraphs 80-b and c) and maturity analysis breakdown (paragraphs 80-a and 81). This finding is consistent with the feedback from the user outreach webinar.

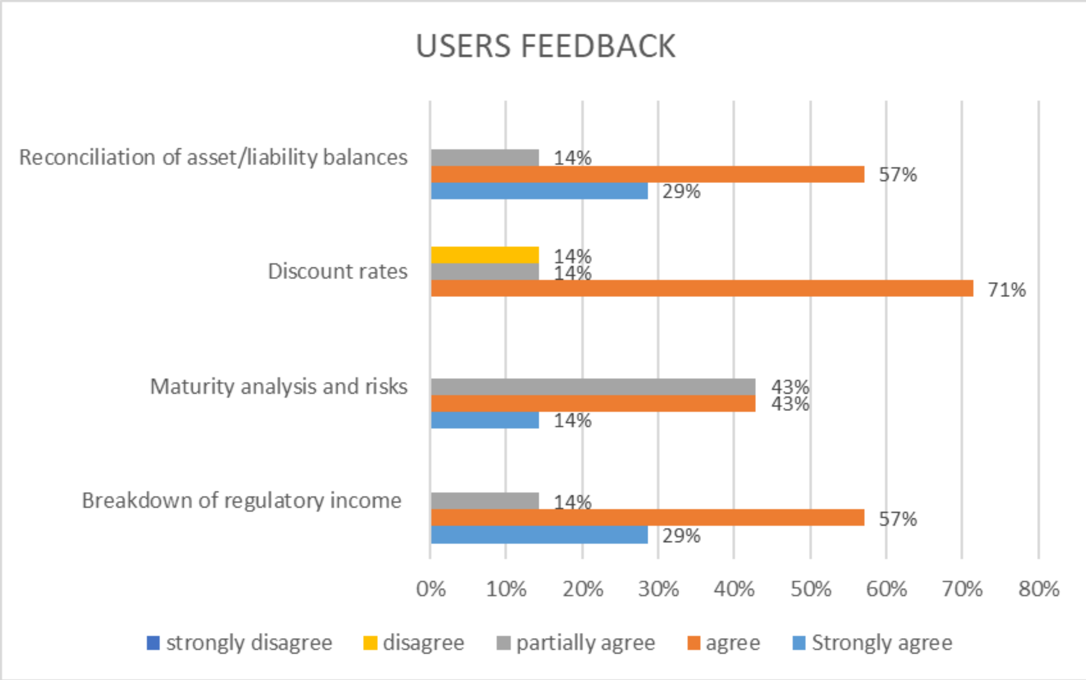

Figure 22 - Users feedback on disclosures

65 Furthermore, users commented that:

(a) maturity analysis and risks were more related to credit analysis; and

(b) discount rates were already disclosed by regulated companies.

<u>Earlier survey</u>

66 Consistent with the earlier survey it was indicated in both that information would be available whereas the focus in the current survey was on readily available information for implementing the disclosures requirements. In this respect, it needs to be differentiated between the information available, e.g., on local GAAP, and information required for ED purposes. Respondents to the effects analysis stated that such unavailable information would include disclosures under paragraphs 78, 80 and 83 of the ED, e.g., like time bands for regulatory assets and regulatory liabilities.

Transition

<u>Preparer survey (eight respondents)</u>

Are there any implementation challenges arising from the ED`s transition requirements?

67 Many respondents (four out of six) preparers who responded to this question, mentioned the important implementation challenges related to the full retrospective approach (see Figure 23), such as:

(a) to account for regulatory returns on an asset-by-asset basis would be extremely onerous as regulatory returns on specific assets are not required to be tracked within our industry and by our regulator. Sourcing the information and unpicking how it interacts with the regulatory model in this way would be problematic as returns are made on the regulatory base as a whole;

(b) high volumes of transactions to be restated and additional deferred taxes on these additional restatements;

(c) different regulations in different countries resulting in different types of restatements. Consequently, two sets of accounts and forecasts would need to be prepared which would require significant updates of processes, controls and IT tools. It would also result in misalignment with regulator accounting and rate-making processes; etc.

(d) retrospective application on CWIP regulatory returns will be particularly difficult.

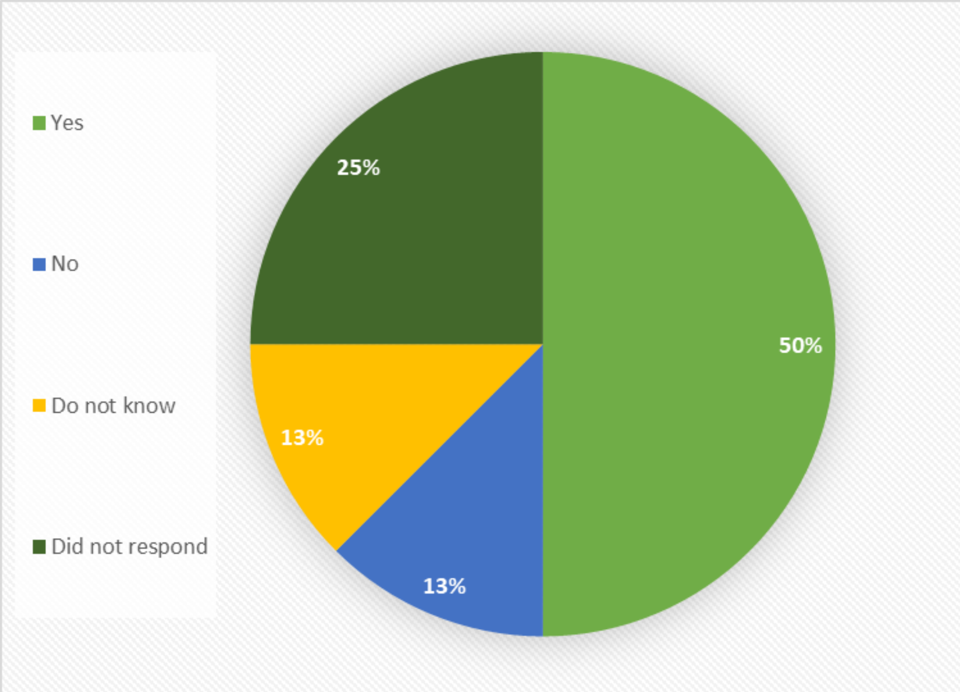

Figure 23 - Implementation challenges arising from transition requirements?

68 One preparer noted that IFRS 3 exception for past business combinations (i.e., that regulatory assets/liabilities acquired in a business combination are not measured at fair value but recognised and measured according to the proposed Standard requirements of a cash-flow-based measurement technique) will not simplify the transition. This respondent supported EFRAG's draft comment letter proposal to charge to retained earnings, the adjustments to regulatory assets/liabilities instead of goodwill as it would result in a real simplification for the past business combinations.

Earlier survey

69 In both surveys, many respondents indicated the presence of implementation challenges and other initial application issues on transition. Both survey`s respondents pointed to specific issues that would make implementation more difficult:

(a) Retrospective application and rolling up of historical information (far into the past);

(b) Proposals for the accounting of regulatory returns on CWIP;

(c) IT systems that lack certain capabilities.

Likely effects on financial statements and cost-benefit relationship

Preparer survey

(a) Likely effects

What do you anticipate will be the impact of the proposals on the 2020 balance sheet?

70 On aggregate, many of the respondents regarding the question about the impact of the proposals on the 2020 balance sheet [five of eight respondents – 63%] replied that the impact on the balance sheet would be moderate at least whereas three

[38%] expected a significant impact. Few [one of eight – 13%] expected only a minimal impact, as shown in the following Figure 24.

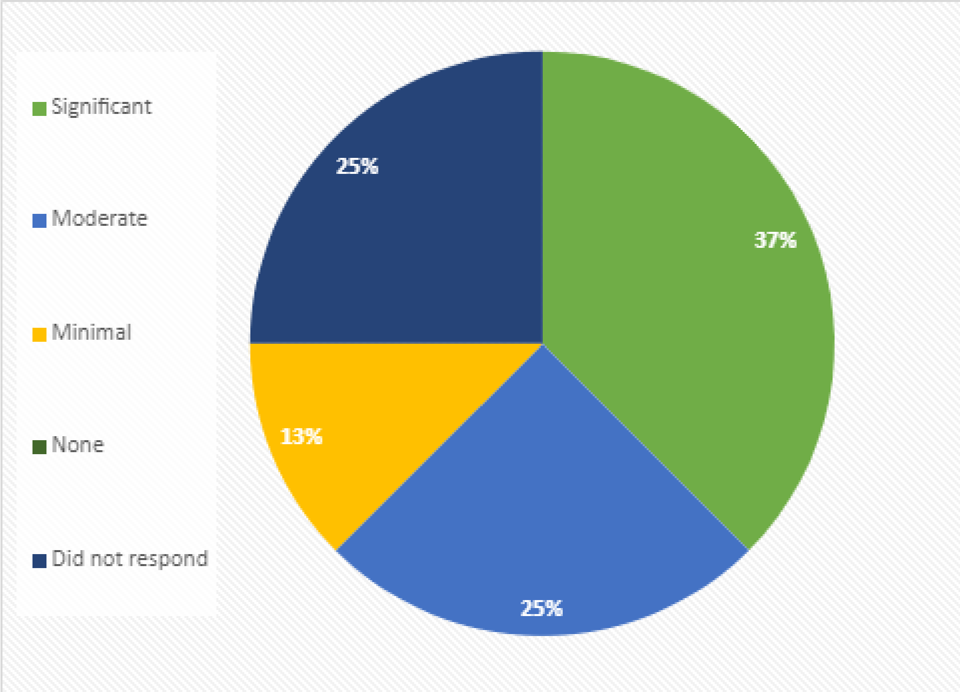

Figure 24 - Impact of the proposals on the 2020 balance sheet?

71 With regard to the effects on the balance sheet, one respondent explained that the main factors that drive the significance would be incentives and penalties not yet recovered, tax positions (like deferred taxes in some jurisdictions) and the long-term nature of regulatory returns on the regulatory asset base. Another respondent explained that also the magnitude of the regulatory asset base (based on the different components included by the regulatory regime) would be important for the effects on regulatory assets and regulatory liabilities.

What do you anticipate will be the impact of proposals on your profit or loss and performance?

72 On aggregate, many of the respondents [five of eight – 63%] assessed that the impact on the profit or loss would be moderate at least. Three [38%] highlighted that they would expect a moderate impact and only two [25%] would expect a significant impact. All other respondents did not reply to the question (see Figure 25). Two respondents stated that in year income would probably be moderate as many regulatory assets and liabilities would be long term and therefore reduce volatility in profit or loss.

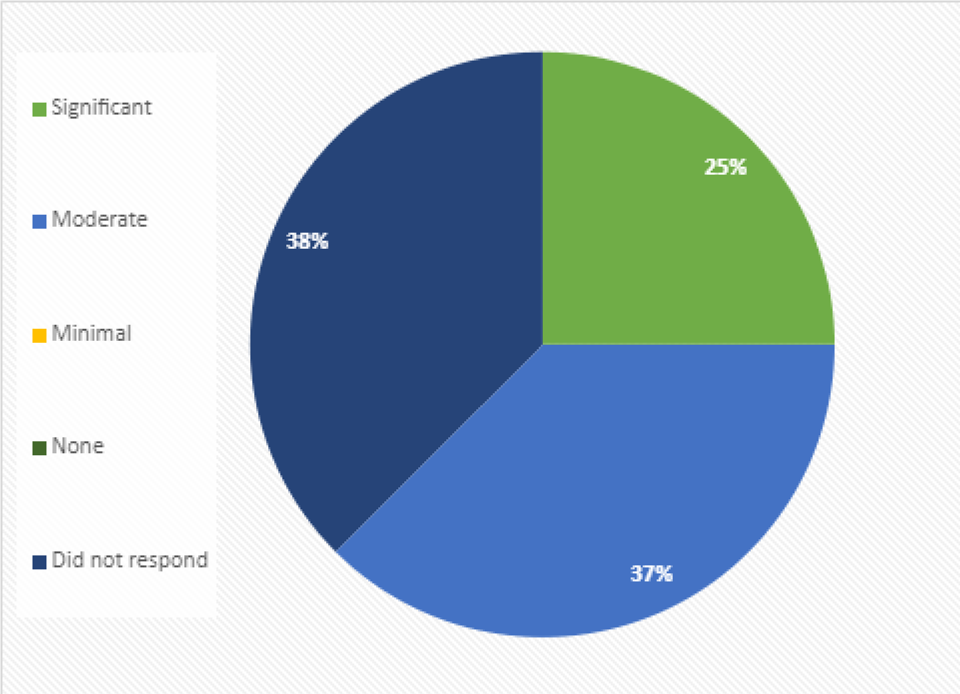

Figure 25 - Impact of proposals on your profit or loss and performance?

73 One respondent argued that income over the years would be less affected given that regulatory assets and regulatory liabilities have a long-term nature. Based on the principles of the proposals another respondent stated that he would expect a less volatile profit or loss over the years, but for a clear assessment, more extensive calculations would be required.

<u>Earlier survey</u>

74 Most respondents of the earlier survey expected either a significant or moderate impact of the proposed model on the statement of financial position. In the current survey on aggregate, respondents indicated similar expectations (52% in total). The reasons of those referred to more general factors like the magnitude of the regulatory asset base or unrecovered incentives and penalties. The answers in the earlier survey were more generic (e.g., differences between local GAAP and IFRS).

75 Many respondents from the earlier survey (53%) expected a moderate impact, four (26.7%) expect a significant impact, and the rest expected either minimal or no impact. The current survey corroborates the earlier results.

(b) Cost-benefit relationship

What do you anticipate will be the level of costs to incur to implement the proposals for accounting for regulatory assets and liabilities?

76 On aggregate, many of the survey respondents [four of eight – 50%] assessed that the level of costs incurred to implement the proposals would be moderate, while three respondents [37%] – as shown in Figure 26 -expected significant costs.

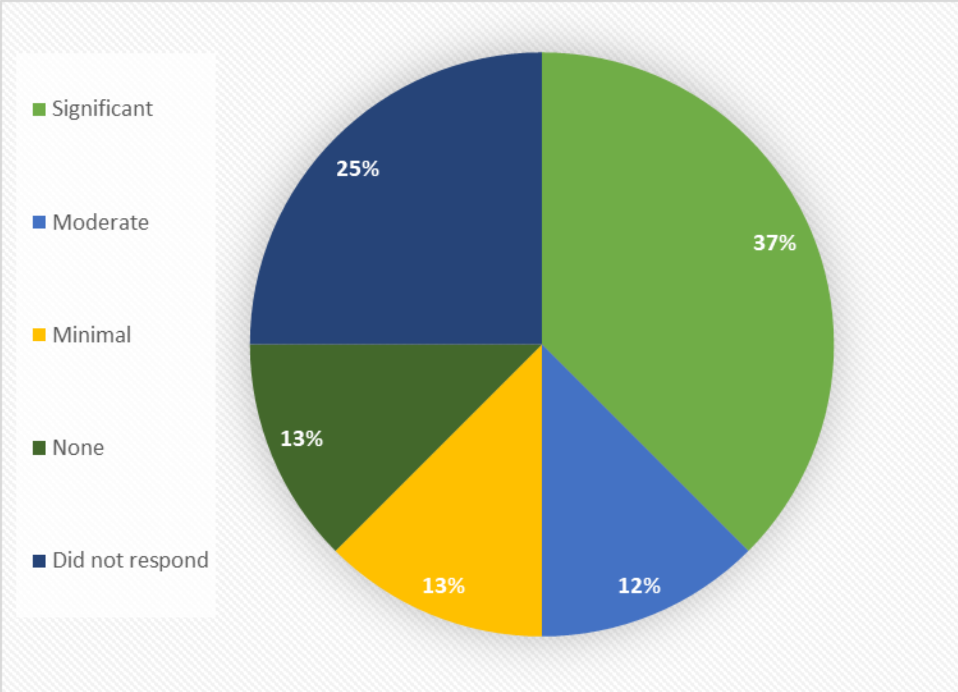

Figure 26 - Level of costs to incur to implement the proposals?

77 The respondents had the following comments:

(a) Two respondents [two of eight – 25%] commented that the costs would be highly significant if the entity would be required to allocate the regulatory returns on an asset-by-asset basis to determine the regulatory returns on CWIP that are to be deferred until assets come into use.

(b) One respondent commented that a negative cost-benefit will arise due to: the proposals to determine effective and minimum interest rates; recurring remeasurements of individual regulatory assets and regulatory liabilities; burdensome disclosures; and full retrospective transition requirements.

(c) One respondent commented that the one-off implementation costs might be limited due to similarities between their current regulatory accounting and the proposed Standard. However, the respondent stated that he would imagine that preparers not experienced in the proposed accounting model in other jurisdictions would face significantly higher implementation costs. In the respondents view varying aspects may lead to significant one-off or ongoing implementation costs:

(i) Guidance on CWIP will require companies to establish tools to comply with this proposed guidance;

(ii) Providing a breakdown of the positions considered as regulatory assets/liabilities and monitoring changes on this granular level involves high ongoing administrative costs.

If you replied to the earlier survey of the early-stage effects analysis, have you changed your view on the anticipated level of costs?

78 Only four of the respondents [four of eight – 50%] had participated in the earlier survey and could answer the question of whether they would have changed their assessment of the proposals' impact. Two of them [25%] increased their estimate of implementation costs made in the earlier survey, the other two [25%] did not change their previous assessment of the expected cost level.

Do you agree/disagree: The ED supports preparers' efforts to provide users of financial statements with relevant information?

79 On aggregate, many of the respondents [five of eight – 63%] agreed with the statement that the ED would support the efforts to provide relevant information.

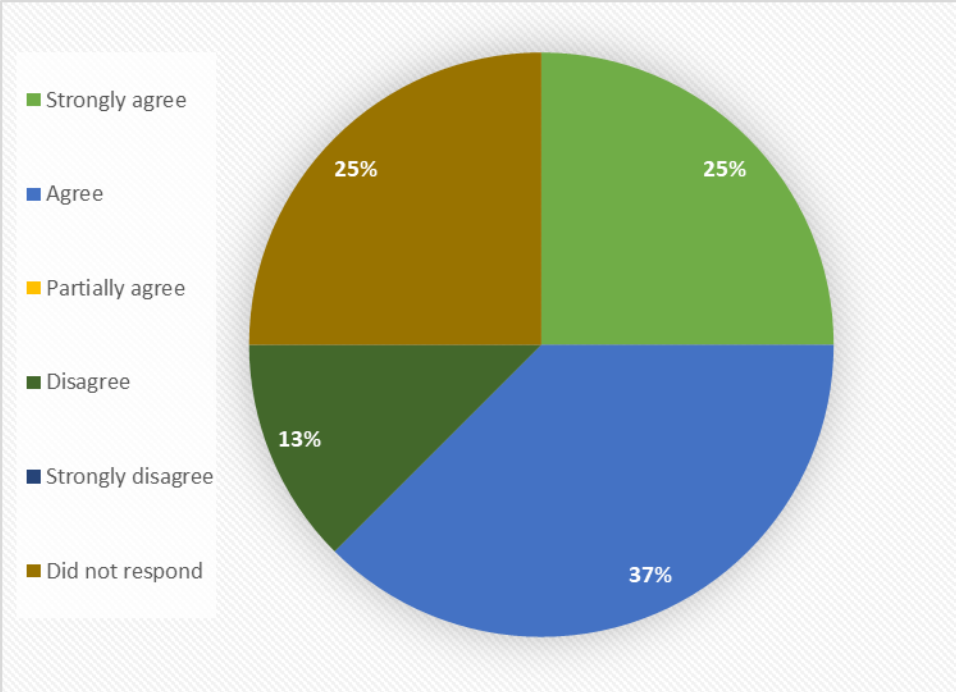

Figure 27 - ED supports preparers' efforts to provide relevant information - to what extent do you agree?

Do you agree/disagree: The ED appropriately reflects the complexity of existing rate-regulation regimes?

80 On aggregate, some of the respondents [three of eight – 38%] partially agreed to the statement that the ED would appropriately reflect the complexity of their regulatory regime and two respondents [two of eight – 25%] agreed to the statement. No one agreed strongly, but one respondent disagreed, as indicated in Figure 28. The outcome is based on the fact that some preparers oppose the proposed guidance on the recognition of regulatory returns on construction work in progress (see chapter total allowed compensation). This was highlighted by different two respondents.

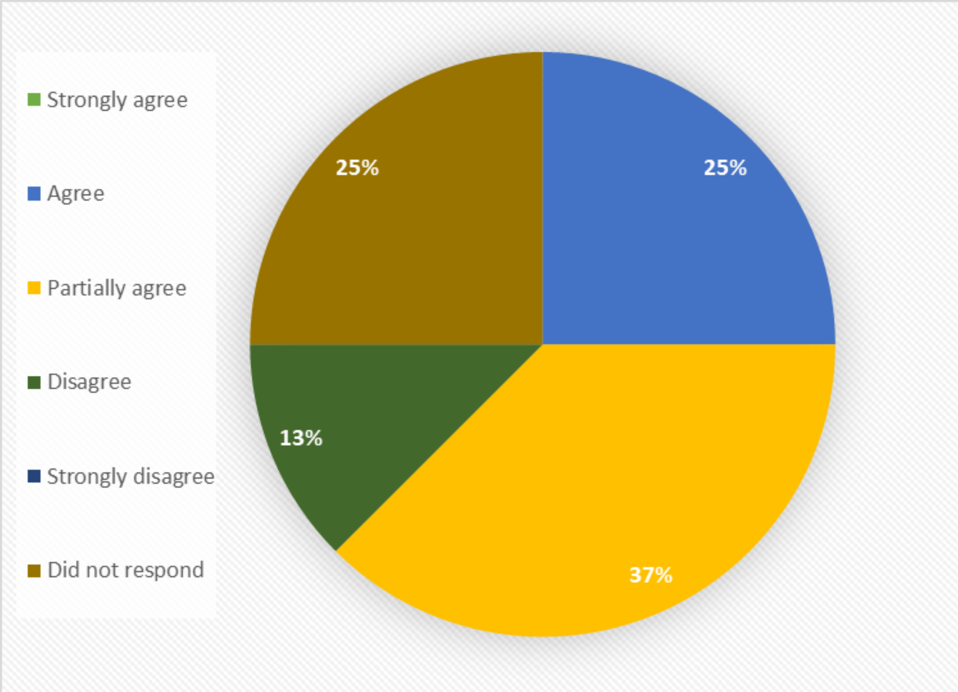

Figure 28 - ED appropriately reflects regulatory complexity - to what extent do you agree?

Do you agree/disagree: The information needed to implement the ED requirements is readily available?

81 Many of the respondents [five of eight – 63%] only partially agreed [two of eight – 25%] or disagreed [three of eight – 38%] with the statement that the information needed to implement the ED would be readily available. One respondent strongly agreed, and two respondents did not respond to this statement.

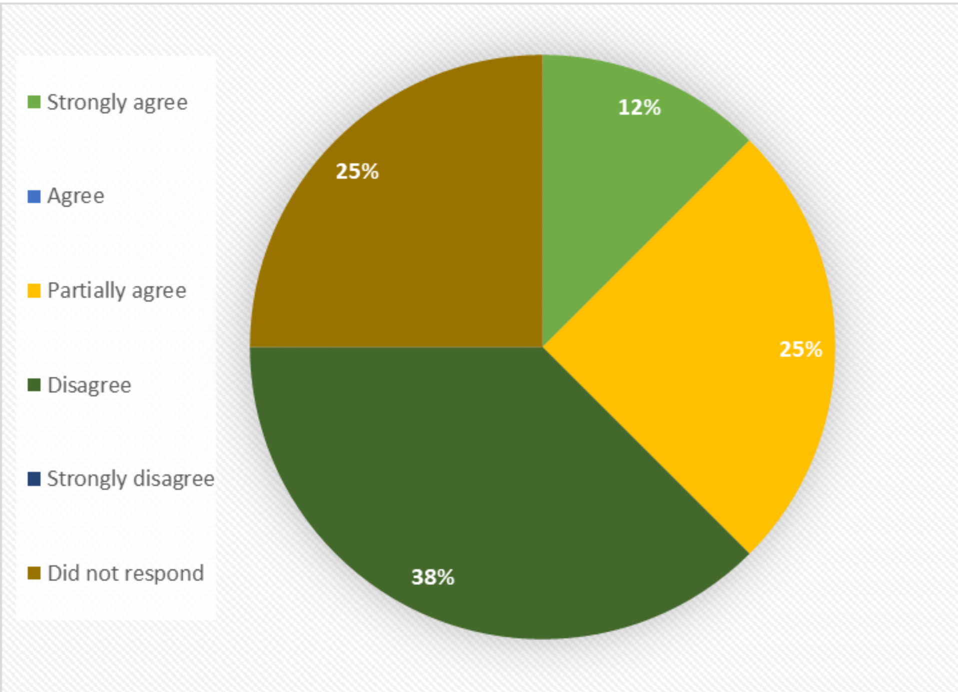

Figure 29 - Information is readily available - to what extent do you agree?

82 Respondents had the following comments:

(a) Two respondents stated that the objective of the proposals would be good, but elements of the proposals would require clarification (total allowed compensation, scope).

(b) One respondent stated that the information required to implement the ED as drafted is not all currently available (e.g., tracking of assets under construction).

(c) One respondent stated that the cost deferral method would bring less operational complexities, both at transition date and on a recurring basis.

(d) One respondent stated a disagreement with the proposals on CWIP as it would not be in line with the standard's objective to provide relevant information that faithfully represents how regulatory income and regulatory expense affect the entity's financial performance and how regulatory assets and regulatory liabilities affect its financial position.

What is your assessment of the overall cost-benefit resulting from your company's application of the proposals?

83 As shown in Figure 30, some of the survey`s respondents [three of eight – 38%] assessed a positive cost-benefit relationship. Few [one of eight – 13%] assessed a negative cost-benefit relationship, and some responded that it would be hard to determine [two of eight – 25%]. One of those that found it hard to determine and one respondent that assessed a positive cost-benefit relationship pointed out that the relationship could be unfavourable if the treatment of CWIP would be retained.

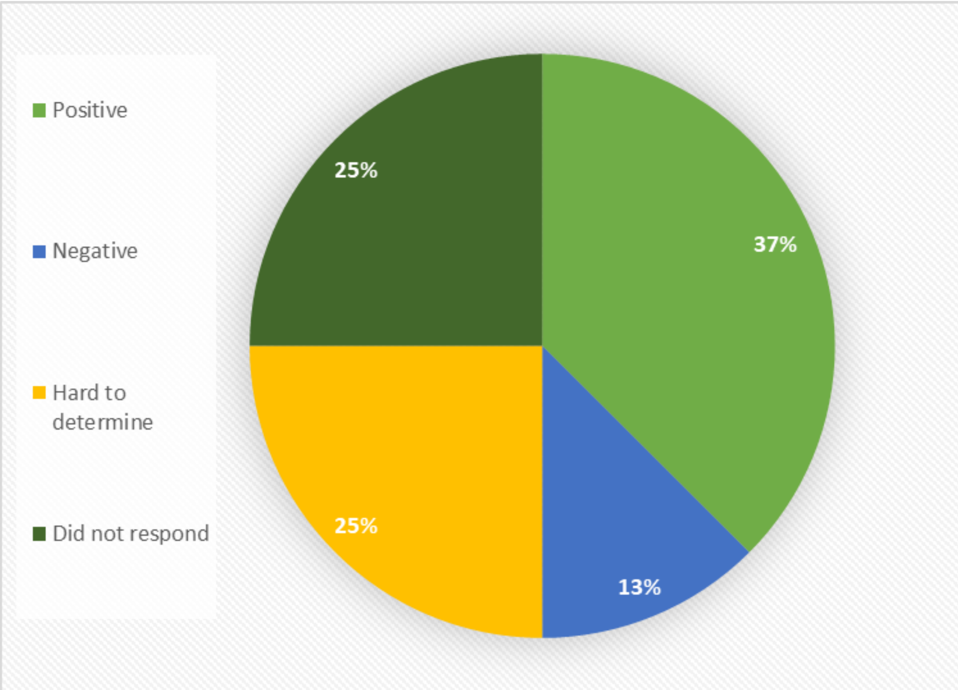

Figure 30 - Assessment of the overall cost-benefit from the application of the proposals?

Earlier survey

84 The findings from both surveys on the anticipated cost level are similar, although the percentage of those that expected only a minimal impact has decreased from 26% to 13%. In general respondents in both surveys state, that cost will depend on

(a) the application of the retrospective application;

(b) the application of the proposals on regulatory returns on CWIP; and

(c) the need for improved IT systems.

Furthermore, respondents of the current survey are even more specific stating that implementation cost would also be caused by the proposals on the discount rates, recurring remeasurements; burdensome disclosures; and full retrospective transition requirements.

85 Half of the respondents that participated in the earlier survey [four of eight – 50%] have changed their assessment of the proposals' impact

(a) Two of them [25%] increased the estimate of implementation costs;

(b) Two [25%] did not change their previous assessment.

86 Many of the respondents in the earlier survey (60%) noted that their initial cost-benefit relationship will be positive, some (33.3%) indicated that it is hard to determine. One (6.7%) expected a negative cost-benefit relationship. In the current survey, the situation has slightly changed due to several ED`s proposals where respondents expected implementation issues related to high-cost levels, especially with regard to regulatory returns on CWIP. But still many respondents of the current survey (52%) see a positive cost-benefit relationship or find it hard to determine. Some of those that stated it would be hard to determine also stated that, if certain proposals would be changed (e.g., treatment of CWIP), they would expect a positive cost-benefit relationship as well.

Appendix 1: Profile of respondents

Introduction

87 This appendix provides the general information of users that respondent to the outreach activity. Eight participants responded to the preparer survey and seven participants responded to the user survey.

The details

In which sector do you operate?

88 Respondents to the survey included the following (by sector, whereas several answers were possible):

Preparer		**User**	
Utilities	7	Utilities	6
Transport	1	Transport	3

In which regions do you operate?

89 The following table shows preparer respondents by operating area, whereas other markets include (North/South) America, Asia, Africa etc.:

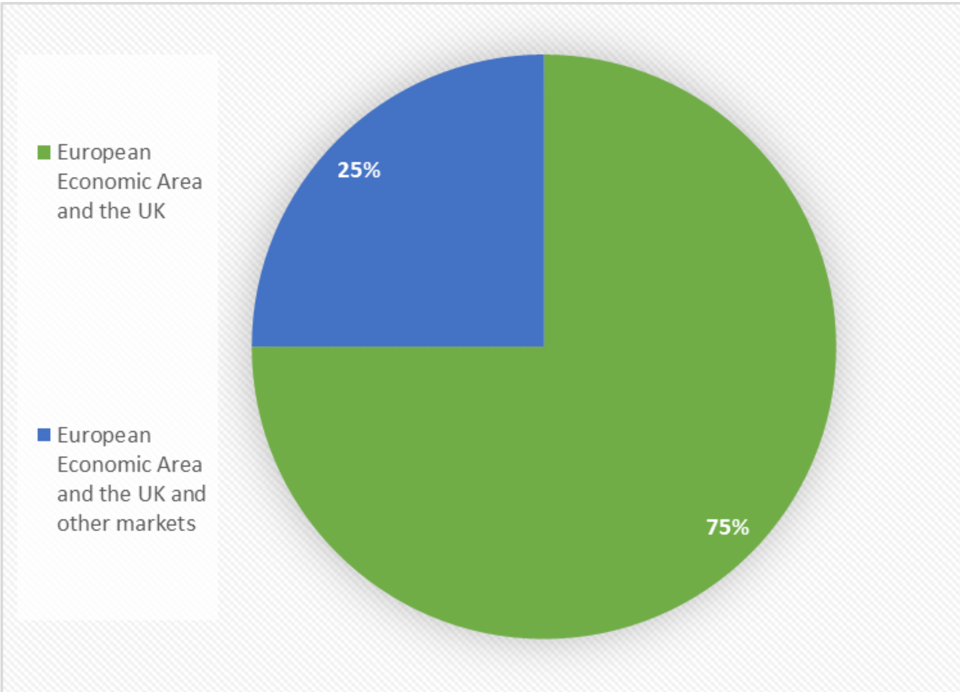

Figure 31 - Preparer by operating area

90 The user respondents covered mostly Europe (six respondents) and one user covered global markets.

Please specify whether your financial reporting is in accordance with IFRS Standards or whether the companies you cover apply IFRS?

91 All preparer respondents indicated that they prepare their financial statements under IFRS. All user respondents indicated that the companies they would cover prepare financial statements under IFRS.

Asset classes covered by user

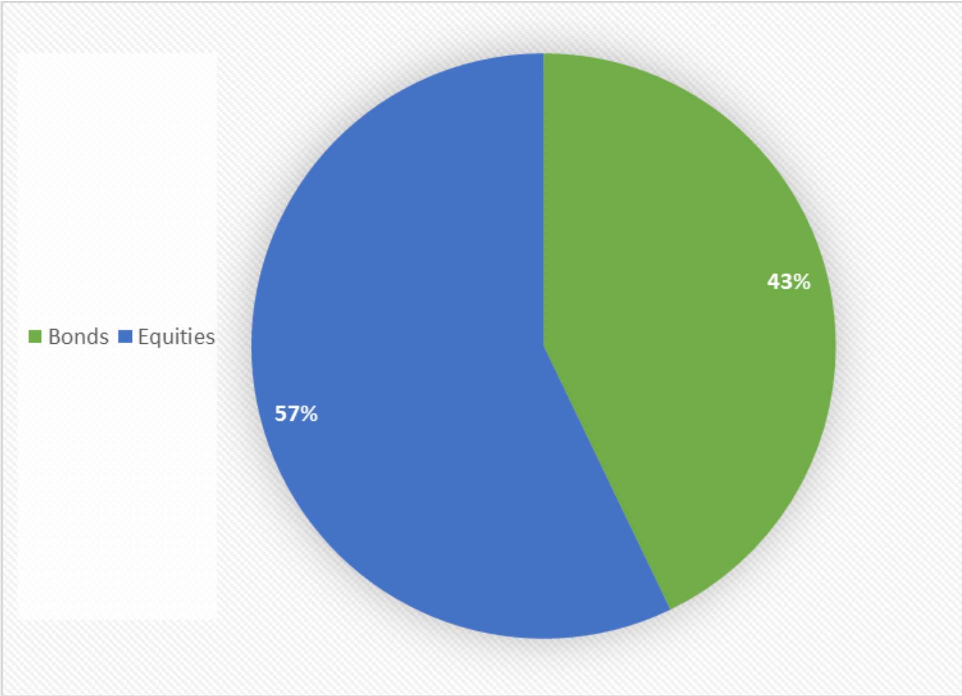

Figure 32 - Asset classes covered

For preparer - What is the amount of your total consolidated assets as per the latest reporting period?

92 The amount of consolidated total assets as per the latest reporting period varied between respondents and ranged from €163m to €35bn