

This paper has been prepared by the EFRAG Secretariat for discussion at a public meeting of EFRAG FR TEG-CFSS. 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 FR Board or EFRAG FR TEG-CFSS. 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 FR Board, are published as comment letters, discussion or position papers, or in any other form considered appropriate in the circumstances.

## Regulatory assets and regulatory liabilities Cover Note

### Introduction and Objective

- 1 The objective of the session is to obtain views from EFRAG FR TEG-CFSS members on whether the IASB's tentative decisions, taken from September to December 2022, on scope and total allowed compensation help address stakeholders' concerns about the proposals. This is in preparation for the ASAF meeting that will take place on 27-28 March 2023.
- 2 EFRAG FR TEG-CFSS members were provided with the ASAF paper 08-03, which includes links to the relevant IASB papers, in an email sent by the EFRAG Secretariat on 2 March 2023 in preparation for this session.
- 3 The IASB's tentative decisions relevant for the EFRAG FR TEG-CFSS discussion relate to:
  - (a) Scope - Interaction with IFRIC 12 *Service Concession Arrangements*;
  - (b) Total allowed compensation which includes:
    - (i) Proposed definition of allowable expense and benchmark expenses;
    - (ii) Regulatory assets and regulatory liabilities arising from differences between the regulatory recovery period and the assets' useful lives;
    - (iii) Capitalised borrowing costs;
    - (iv) Inflation adjustment to the regulatory capital base; and
    - (v) Other items included in the regulatory capital base.
- 4 The questions to EFRAG FR TEG-CFSS members are in Agenda paper 08-02.

### Background

- 5 On 28 January 2021, the IASB published Exposure Draft ED/2021/1 *Regulatory Assets and Regulatory Liabilities* (the ED) with a comment period of 180 days and a comment deadline of 30 July 2021.
- 6 EFRAG published its [final comment letter](#) on the ED on 10 September 2021 and a [Feedback Statement](#) in October 2021.
- 7 The IASB started to discuss respondents' feedback on the ED at its October and November 2021 meetings. The appendix provides a summary of the IASB's tentative decisions to date.

### EFRAG discussions taken place to date

- 8 In February 2023, EFRAG RRAWG discussed the November and December IASB tentative decisions relating to the accounting for total allowed compensation.

- 9 In December 2022, the EFRAG FRB received an update on the IASB tentative decisions from May 2022 – September 2022 (scope and aspects of the accounting for total allowed compensation).
- 10 In December 2022, EFRAG FR TEG received a presentation from the IASB staff on the two main regulatory regimes present in Europe and beyond – namely cost-based and incentive-based regimes.
- 11 On 8 November 2022, EFRAG met with the RRAWG to discuss the IASB tentative decisions on scope and several aspects of total allowed compensation (including the topics that will be presented at the meeting today).
- 12 In September 2022, EFRAG FR TEG and EFRAG CFSS discussed the IASB's tentative decisions taken in May, July, and September 2022 on scope and total allowed compensation (components of total allowed compensation and regulatory returns on assets not yet in use).
- 13 In July 2022, EFRAG FR TEG received an update on the IASB tentative decisions on scope and total allowed compensation. At that meeting, EFRAG FR TEG members briefly discussed the 'differences between regulatory recovery pace and assets' useful lives', and it was then agreed that an education session would be useful as a prerequisite to a detailed discussion on total allowed compensation.
- 14 In April 2022, EFRAG met with its Rate-regulated Activities Working Group (RRAWG) to discuss the IASB tentative decisions on scope and the outcome of the IASB outreach to its Consultative Group in March 2022.
- 15 Between December 2021 and April 2022, EFRAG FR TEG, EFRAG CFSS and EFRAG FRB received updates on the IASB redeliberation plan and tentative decisions on the scope of the final Standard. In December 2021, EFRAG FR TEG and EFRAG FRB received education sessions on the features of regulatory schemes.

### **Next steps**

- 16 So far, the IASB has redeliberated and made tentative decisions on most aspects of scope and total allowed compensation. The remaining topic for redeliberation on scope is the interaction with IFRS 17 *Insurance Contracts*.
- 17 The IASB staff is also currently undertaking outreach on direct (no direct) relationship. In addition, the IASB have started redeliberating proposals on recognition in its February 2023 meeting. The other proposals on measurement, presentation, disclosure and interaction with other IFRS Standards will be redeliberated in 2023.
- 18 The EFRAG Secretariat will continue to update EFRAG RRAWG, EFRAG FR TEG, EFRAG CFSS and EFRAG FRB as the project progresses.

### **Agenda Papers**

- 19 In addition to this cover note, agenda papers for this session are:
  - (a) Agenda paper 08-02 – Issues paper;
  - (b) Agenda paper 08-03 – ASAF paper on scope and total allowed compensation (links to the relevant IASB papers are provided in this paper); and
  - (c) Agenda paper 08-04 – EFRAG Secretariat paper on an overview of the direct (no direct) relationship concept – for background information.

## Appendix - Summary of the IASB tentative decisions

- 1 The table below provides an overview of IASB discussions and tentative decisions so far. This table was prepared based on the information published in the IASB Updates.

Topic	Decisions reached	IASB Meeting Date
<p><b>Recognition and Total allowed compensation</b></p>	<p><b>The recognition threshold</b></p> <p>The IASB tentatively decided:</p> <ul style="list-style-type: none"> <li>• to retain the proposal to require an entity to recognise a regulatory asset or a regulatory liability whose existence is uncertain if it is more likely than not that such an asset or liability exists;</li> <li>• not to set a recognition threshold based on the probability of a flow of economic benefits;</li> <li>• not to set a recognition threshold based on the level of measurement uncertainty, except for those regulatory assets and regulatory liabilities described in paragraph (e);</li> <li>• to retain the proposed symmetric recognition threshold for regulatory assets and regulatory liabilities; and</li> <li>• to require an entity to recognise a regulatory asset or regulatory liability—whose measurement depends on a regulatory benchmark determined after the financial statements are authorised for issue—when the regulator determines the benchmark.</li> </ul> <p>All 12 IASB members agreed with these decisions.</p> <p>The IASB will discuss the proposed recognition and measurement requirements for regulatory assets and regulatory liabilities arising from long-term performance incentives at a future IASB meeting.</p> <p><b>Enforceability and recognition</b></p> <p>The IASB tentatively decided:</p> <ul style="list-style-type: none"> <li>• to reconfirm and clarify the proposed single assessment of the existence of enforceable present rights and enforceable present obligations in the Standard, for the individual regulatory assets or regulatory liabilities.</li> <li>• to clarify in the Standard that rights and obligations can be enforceable even if their existence is uncertain.</li> <li>• to consider the principles in paragraph 35(c) of IFRS 15 Revenue from Contracts with Customers that relate to an entity’s right to payment for performance completed to date in developing the Standard. These principles would be used to set the requirements for assessing the existence of enforceable present rights for regulatory returns on an asset not yet available for use, and for assessing the existence of enforceable present rights or enforceable present obligations for long-term performance incentives.</li> </ul> <p>All 12 IASB members agreed with these decisions.</p> <p><b>Total allowed compensation—Performance incentives</b></p>	<p><b>February 2023</b></p>

Regulatory assets and regulatory liabilities – Cover Note

Topic	Decisions reached	IASB Meeting Date
	<p>The IASB tentatively decided to reconfirm in the Standard the proposed requirement relating to performance incentives. The requirement would be that amounts relating to performance incentives should form part of or reduce the total allowed compensation for goods or services supplied in the period in which the entity's performance gives rise to the incentive. These amounts would include those that result from an entity's performance of construction work.</p> <p>All 12 IASB members agreed with this decision.</p>	
<p><b>Total allowed compensation</b></p>	<p><b><i>Inflation adjustments and accounting for allowable expenses or performance incentives included in an entity's regulatory capital base</i></b></p> <p><u>Inflation adjustments</u></p> <p>The IASB tentatively decided that the Standard specify that an entity is neither required nor permitted to recognise as a regulatory asset inflation adjustments to the regulatory capital base.</p> <p>All 12 IASB members agreed with this decision</p> <p><u>Other allowable expenses or performance incentives</u></p> <p>The IASB tentatively decided that the Standard specify that:</p> <ul style="list-style-type: none"> <li>• an entity is required to recognise a regulatory asset or a regulatory liability relating to an allowable expense or performance incentive included in its regulatory capital base when: <ul style="list-style-type: none"> <li>○ the entity's regulatory capital base and its property, plant and equipment have a direct relationship; and</li> <li>○ the entity has an enforceable present right (obligation) to add (deduct) the allowable expense or performance incentive to (from) future regulated rates.</li> </ul> </li> <li>• an entity is neither required nor permitted to recognise a regulatory asset or a regulatory liability relating to an allowable expense or performance incentive included in its regulatory capital base when the entity's regulatory capital base and its property, plant and equipment have no direct relationship.</li> </ul> <p>All 12 IASB members agreed with this decision.</p> <p>At the December 2022 meeting, the IASB also discussed the advice from the Consultative Group for Rate Regulation on the topics discussed in the December meeting; and the use of the direct (no direct) relationship concept in the IASB's redeliberations of the proposed model</p>	<p><b>December 2022</b></p>
<p><b>Total allowed compensation</b></p>	<p><b><i>Interaction between regulatory returns on an asset not yet available for use and an entity's capitalisation of borrowing costs incurred to construct that asset.</i></b></p> <p>In November 2022 the IASB discussed the interaction between the IASB's tentative decision on regulatory returns on an asset not yet available for use and an entity's capitalisation of borrowing costs incurred to construct that asset.</p>	<p><b>November 2022</b></p>

*Regulatory assets and regulatory liabilities – Cover Note*

Topic	Decisions reached	IASB Meeting Date
	<p>The IASB tentatively decided that when an entity's regulatory capital base and its property, plant and equipment have a direct relationship and the entity capitalises its borrowing costs:</p> <ul style="list-style-type: none"> <li>• if the regulatory agreement provides the entity with both a debt and an equity return on an asset not yet available for use—to require the entity to reflect only those returns in excess of the entity's capitalised borrowing costs in the statement of financial performance during the construction period; and</li> <li>• if the regulatory agreement provides the entity with only a debt return on such an asset—to prohibit the entity from reflecting the return in the statement of financial performance during the construction period.</li> </ul> <p>All 11 IASB members agreed with these decisions.</p>	
<b>Total allowed compensation</b>	<p><b><i>Proposed definition of allowable expense and treatment of allowable expenses based on benchmarks</i></b></p> <p>The IASB tentatively decided that the Standard:</p> <ul style="list-style-type: none"> <li>• retain the proposed definition of allowable expense;</li> <li>• clarify that a regulatory agreement may determine the amount that compensates an entity for an allowable expense using a basis different from the basis the entity uses to measure the expense in accordance with IFRS Accounting Standards; and</li> <li>• clarify the treatment of allowable expenses based on benchmarks and include examples to help entities identify differences in timing in those cases.</li> </ul> <p>All 11 IASB members agreed with these decisions.</p>	<b>October 2022</b>
<b>Total allowed compensation</b>	<p><b><i>Regulatory assets and regulatory liabilities arising from differences between the regulatory recovery period and the assets' useful lives</i></b></p> <p>The IASB tentatively decided that the Standard:</p> <ul style="list-style-type: none"> <li>• provide guidance to help an entity determine whether its regulatory capital base and its property, plant and equipment have a direct relationship;</li> <li>• retain the proposals for an entity to account for regulatory assets or regulatory liabilities arising from differences between the regulatory recovery period and the assets' useful lives if the entity has concluded that its regulatory capital base and its property, plant and equipment have a direct relationship; and</li> <li>• require an entity that has concluded that its regulatory capital base and its property, plant and equipment have no direct relationship to provide disclosures to enable users of financial statements to understand the reasons for its conclusion.</li> </ul> <p>All 11 IASB members agreed with these decisions.</p>	<b>October 2022</b>
<b>Total allowed compensation</b>	<b><i>Components of total allowed compensation</i></b>	<b>July 2022</b>

*Regulatory assets and regulatory liabilities – Cover Note*

Topic	Decisions reached	IASB Meeting Date
	<p>The IASB tentatively decided that in the Standard, the application guidance focus on:</p> <ul style="list-style-type: none"> <li>• helping entities to identify differences in timing instead of specifying the components of total allowed compensation; and</li> <li>• the most common differences in timing that could arise from various types of regulatory schemes.</li> </ul> <p>All 10 IASB members agreed with this decision.</p>	
<p><b>Total allowed compensation</b></p>	<p><b>Regulatory returns on an asset not yet available for use</b></p> <p>The IASB tentatively decided that the Standard specify that when an entity has an enforceable present right to regulatory returns on an asset not yet available for use, those returns would form part of the total allowed compensation for goods or services supplied during the construction period of that asset. The Standard will provide guidance for entities to assess whether their rights to these regulatory returns are enforceable.</p> <p>Eight of nine IASB members agreed with this decision. One IASB member was absent.</p>	<p><b>July 2022</b></p>
<p><b>Scope</b> <b>Including interaction with other IFRS Standards</b></p>	<p><b>IFRIC 12 Service Concession Arrangements.</b></p> <p>The IASB tentatively decided that the Standard:</p> <ul style="list-style-type: none"> <li>• clarify the intended interaction between the Standard and IFRIC 12. That is, an entity would apply IFRIC 12 first and then apply the requirements of the Standard to any remaining rights and obligations to determine if the entity has regulatory assets or regulatory liabilities.</li> <li>• include examples to illustrate that interaction.</li> </ul> <p>All 11 IASB members agreed with this decision.</p>	<p><b>September 2022</b></p>
<p><b>Scope</b> <b>Including interaction with other IFRS Standards</b></p>	<p><b>Scope—Customers</b></p> <p>The IASB tentatively decided to clarify in the Standard that, for a regulatory asset or a regulatory liability to arise, it is necessary that differences in timing originate from, and reverse through, amounts included in the regulated rates that an entity accounts for as revenue in accordance with IFRS 15 Revenue from Contracts with Customers. This is the case even when:</p> <ul style="list-style-type: none"> <li>• an entity charges the regulated rates to its customers indirectly through another party.</li> <li>• the origination and reversal of differences in timing occur in different revenue streams through regulated rates charged to different groups of customers.</li> </ul> <p>All 10 IASB members agreed with this decision.</p> <p><b>Scope—Financial instruments within the scope of IFRS 9</b></p> <p>The IASB tentatively decided:</p> <ul style="list-style-type: none"> <li>• not to exclude from the scope of the Standard regulatory assets or regulatory liabilities related to financial instruments within the scope of IFRS 9.</li> </ul>	<p><b>May 2022</b></p>

*Regulatory assets and regulatory liabilities – Cover Note*

Topic	Decisions reached	IASB Meeting Date
	<ul style="list-style-type: none"> <li>• to explain in the Basis for Conclusions on the Standard that the regulation of interest rates is typically limited to setting a cap or floor on interest rates. This type of regulation is not expected to give rise to differences in timing.</li> </ul> <p>All 10 IASB members agreed with this decision.</p>	
<b>Scope</b>	<p><b><i>Determining whether a regulatory agreement is within the scope of the proposals</i></b></p> <p>The IASB tentatively decided to:</p> <ul style="list-style-type: none"> <li>• reconfirm the proposals in the Exposure Draft on:               <ul style="list-style-type: none"> <li>○ requiring an entity to apply the Standard to all its regulatory assets and regulatory liabilities.</li> <li>○ requiring the Standard to apply to all regulatory agreements and not only to those that have a particular legal form.</li> <li>○ the conditions necessary for a regulatory asset or a regulatory liability to exist.</li> </ul> </li> </ul> <p>Eleven of 12 IASB members agreed with these decisions.</p> <ul style="list-style-type: none"> <li>• not explicitly to specify in the Standard which regulatory schemes would be within or outside its scope. All 12 IASB members agreed with this decision.</li> <li>• to clarify in the Standard that:               <ul style="list-style-type: none"> <li>○ a regulatory agreement may include enforceable rights and enforceable obligations to adjust the regulated rate beyond the current regulatory period.</li> <li>○ regulatory agreements that create either regulatory assets or regulatory liabilities, but not both, are within its scope.</li> <li>○ a regulatory agreement that causes differences in timing when a specified regulatory threshold is met creates regulatory assets or regulatory liabilities.</li> <li>○ a regulatory agreement is not required to determine a regulated rate using an entity's specific costs for the regulatory agreement to create regulatory assets or regulatory liabilities.</li> </ul> </li> </ul> <p>All 12 IASB members agreed with these decisions.</p> <p><b><i>Scope—Definition of a regulator</i></b></p> <p>The IASB tentatively decided that the Standard will:</p> <ul style="list-style-type: none"> <li>○ self-regulation is outside the scope of the Standard.</li> <li>○ a situation in which an entity or its related party determines the rates, but does so in accordance with a framework that is overseen by a body empowered by law or regulation, is not self-regulation for the purposes of the Standard.</li> </ul>	<b>February 2022</b>

*Regulatory assets and regulatory liabilities – Cover Note*

<b>Topic</b>	<b>Decisions reached</b>	<b>IASB Meeting Date</b>
	All 12 IASB members agreed with this decision.	
<b><i>Project plan</i></b>	The IASB discussed and agreed on a plan for redeliberating the proposals in its Exposure Draft Regulatory Assets and Regulatory Liabilities.	<b>December 2021</b>
<b><i>Feedback received on DP</i></b>	At its meetings in October and November 2021, the IASB discussed the feedback received in comment letters and outreach events on its proposals in the ED.	<b>October and November 2021</b>