Regulatory assets and regulatory liabilities

Issues Paper – IASB tentative decisions Q3 2024

Objective

1 The purpose of this session is to seek EFRAG FR TEG/CFSS members' views on the IASB tentative decisions in July 2024 on the redeliberations of the 2021 Exposure Draft *Regulatory Assets and Regulatory Liabilities* (the ED). This input is sought in preparation for the ASAF meeting in December 2024.

2 The tentative decisions discussed in this paper, which are also included in agenda paper 05-02 ASAF paper provided as background material, deal with feedback from constituents on the following topics:

(a) Topic 1 - extending the measurement proposals in paragraphs 61 of the ED;

(b) Topic 2 - extending the presentation proposals in paragraphs 69 of the ED; and

(c) Topic 3 - transition and effective date.

3 Also included are the **Next Steps** and **Questions to EFRAG FR TEG-CFSS members** which are in line with the questions in the related ASAF paper (background paper – IASB Agenda paper 05-02).

Topics 1 - Extending the measurement proposals in paragraphs 61 of the ED

4 The IASB discussed requests from respondents to extend the measurement proposals in paragraph 61 of the ED for items affecting regulated rates only when related cash is paid or received (on a cash basis) to items affecting regulated rates on **other bases.** IASB agenda paper 9 A of the July 2024 IASB meeting provides a detailed analysis of the feedback received and examples of the concerns reported by respondents to the IASB's ED on this issue.

5 Paragraph 59 of the ED states in some cases, a regulatory asset or regulatory liability arises because a regulatory agreement treats an item of expense or income as allowable or

chargeable in determining the regulated rates **only once an entity pays or receives the related cash, or soon after that**, instead of when the entity recognises that item as expense or income in its financial statements by applying, for example, IAS 12 *Income Taxes*, IAS 19 *Employee Benefits* or IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

6 Paragraph 61 of the ED states that an entity shall measure the regulatory asset and regulatory liability described in paragraph 59 by:

(a) using the measurement basis used in measuring the related liability or related asset by applying IFRS Accounting Standards; and

(b) adjusting the measurement of the regulatory asset or regulatory liability to reflect any uncertainty present in it but not present in the related liability or related asset.

7 An entity ceases to apply paragraph 61 when the entity pays (receives) cash to settle the liability (recover the asset).

Feedback on ED proposals

8 A few respondents[1] asked whether the measurement 'exemption' in paragraph 61 of the ED could be also applied to regulatory assets and regulatory liabilities that arise:

(a) **an accrual basis** - for example, a regulator provides compensation for provisions or defined benefit (pension) obligations based on when the related liability is recognised as an expense or income in accordance with IFRS Accounting Standards or the local GAAP.

(b) **a basis analogous to the cash basis** - for example, a regulator provides compensation for credit risk when an amount is determined to be irrecoverable - such as when all available means of recoverability have been exhausted.

9 These respondents noted significant difficulties in discounting regulatory assets and regulatory liabilities that arise from differences in timing in the above situations, particularly for long-term obligations. Applying paragraph 61 of the ED would have the same effect as an exemption from discounting. Appendix B and C of agenda paper 9A of the IASB July 2024 meeting provides examples of the concerns reported.

IASB tentative decisions

10 The IASB tentatively decided that the prospective Accounting Standard would:

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[1] An accounting firm, an accountancy body in Asia-Oceania, a few preparers in North America and Europe, and a national standard-setter in Europe

(a) **not extend the application of the measurement requirement** proposed in paragraph 61 of the ED to items affecting regulated rates on other bases;

(b) **exempt an entity from discounting** the estimates of future cash flows arising from a regulatory asset or regulatory liability if:

(i) the regulatory asset or regulatory liability arises from an item of expense or income that relates to liabilities or assets measured on a present value basis and that affects regulated rates on an accrual basis; and

(ii) the entity, having considered all reasonable and supportable information that is available without undue cost or effort, is unable to estimate the amount and timing of those future cash flows.

(c) require an entity that chooses to apply the exemption described in (b) to disclose that fact and also to disclose the carrying amounts at the end of the reporting period of regulatory assets and regulatory liabilities to which the entity has applied that exemption; and

14 IASB members agreed with decision (a), eight of 14 IASB members agreed with decision (b) and 12 of 14 IASB members agreed with decision (c).

(d) include - as another example to which the proposed requirement in paragraph 61 of the ED can be applied - expected credit losses that affect regulated rates only once the regulator determines that there is no reasonable expectation of the entity receiving the related cash.

11 Seven of 14 IASB members agreed with decision (d). The Chair used his additional casting vote, making the vote eight - seven in favour of the decision.

EFRAG RRAWG feedback on IASB tentative decisions

12 EFRAG RRAWG will discuss this issue at a future meeting.

EFRAG Secretariat analysis

13 The IASB discussed in July 2024 was split into two parts:

(a) Items affecting regulated rates on an accrual basis (using IFRS Accounting Standards and on an accrual basis using local GAAP)

(b) Items affecting regulated rates on a basis analogous to the cash basis.

Items affecting regulated rates on an accrual basis

14 The EFRAG Secretariat agrees with not extending paragraph 61 of the ED to other items not affecting regulated rates on a cash basis.

15 However, we disagree with **introducing an exemption to discounting in the cases noted**. We note that the IASB has concluded that regulatory assets and regulatory liabilities should be discounted, as this results in useful information for users. We also consider that estimating and discounting future cash flows is a core aspect of the RRA model and which is present in many other aspects of IFRS Accounting Standards which can be equally challenging (for example cash flow estimates when performing impairment tests and estimating decommissioning liabilities).

16 Overall, we consider that adding exemptions to the general measurement principles for these limited cases would add complexity and reduce the understandability of reported information.

Items affecting regulated rates on a basis analogous to the cash basis

17 In some cases, an entity has an enforceable right to regulatory compensation for credit risk. Depending on the regulatory agreement, an entity may or may not reflect the cash flows it expects to receive from that compensation in the loss allowance for expected credit losses applying IFRS 9 *Financial Instruments.* If the cash flows from the regulatory compensation for credit risk are not included in the calculation of the loss allowance, a difference in timing may arise from that compensation.

18 The EFRAG Secretariat does not agree with the IASB tentative decision. In our view, the recommended example is stretching the justification that cash inflows are a replica of cash outflows. That is, for this specific fact pattern, there are no actual cash outflows.

TOPIC 2: Extending the presentation proposals in paragraph 69 of the ED

19 The IASB discussed requests to extend the presentation proposals in paragraph 69 of the ED for items affecting regulated rates on a cash basis to items affecting regulated rates on other bases.

20 In the case of an item that affects regulated rates on a cash basis, paragraph 61 of the ED proposes that an entity measures a regulatory asset or regulatory liability using the basis used in measuring the related liability or related asset.

21 Paragraph 69 of the ED proposes that when an entity remeasures a regulatory asset or regulatory liability applying paragraph 61, the entity presents the resulting regulatory income or regulatory expense in other comprehensive income (OCI) to the extent that the regulatory income or regulatory expense results from remeasuring the related liability or related asset through OCI.

22 Some remeasurements of the underlying related liability or related asset are presented in OCI. BC185 explained that presenting that component of regulatory income or regulatory expense in profit or loss would mean that the same underlying remeasurement would lead to two opposite effects: one in profit or loss for the regulatory asset or regulatory liability and the other in OCI for the related liability or related asset

Feedback on ED proposals

23 A few respondents - preparers in North America, an accounting firm and a national standard-setter in Europe - expressed the view that the presentation in OCI proposed in paragraph 69 of the ED should apply to **all** regulatory income and regulatory expenses that arise from a remeasurement of the related liability or related asset through OCI (not be limited to items that a regulatory agreement treats as allowable or chargeable on a cash basis).

24 According to these respondents, the presentation would be more understandable to users of financial statements consistent with previous conclusions reached by the IASB in IFRS 14 *Regulatory Deferral Accounts.*

IASB tentative decisions

25 The IASB tentatively decided that the Standard will **extend the application of the presentation requirement** for items affecting regulated rates on a cash basis to items affecting regulated rates on other bases.

26 Seven of 14 IASB members agreed with this decision. The Chair used his additional casting vote, making the vote eight–seven in favour of the decision.

27 The IASB Staff recommended in AP9B Extending presentation proposals regulated rates cash basis **not extending** the use of presentation proposals because it might:

(a) Challenge the objective of the accounting model which is to supplement the information provided by IFRS 15;

(b) Result in having less relevant information and a less faithful representation of the entity's financial performance;

(c) Dilute the benefits of presenting equal but opposite amounts in OCI if the measurement exception included in paragraph 61 of the ED applies; and

(d) add complexity to the presentation requirements.

RRAWG discussions

28 The RRAWG will discuss this topic at a future meeting. However, when discussing the measurement and presentation exceptions related to items affecting regulated rates on a

cash basis, members generally agreed with the presentation exception. One member disagreed on the basis that regulatory income is complementary to IFRS 15 and it should always be presented in the statement of profit and loss to provide indications of future revenue regardless of how the underlying item is presented. Another member supported extending the presentation exception to other items.

EFRAG Secretariat analysis

29 Since the IASB already tentatively agreed to present some regulatory income/expense in OCI to avoid having two opposite effects (one in profit and loss and another in OCI) we agree with this tentative decision as it will result in consistent presentation requirements on items affecting regulated rates on a basis other than cash. We disagree with the IASB Staff reasoning in paragraph 27 above to recommend not extending the use of presentation proposals as most of the arguments provided could also apply to items affecting regulated rates on a cash basis.

TOPIC 3: Transition and effective date

30 The ED proposed that an entity apply the prospective RRA Standard retrospectively in accordance with IAS 8 (to adjust the opening balance of each affected component for each period presented as if the new accounting policy had always been applied), apart from an exemption for past business combinations.

31 The ED did not propose any transition reliefs apart from the proposed relief for past business combinations.

32 The ED proposed that an entity apply the prospective RRA Standard retrospectively in accordance with IAS 8 to a past business combination, unless the entity elects not to apply it retrospectively and instead apply the simplified approach described in paragraph C4 of the ED.

Feedback on ED proposals

33 Considering the feedback received on its 2021 ED, the IASB tentatively decided to provide entities with the choice whether to use a full retrospective approach or apply a modified retrospective approach when transitioning to the future RRA standard.

34 Many respondents have indicated that a full retrospective approach would involve undue cost and effort, in particular, when accounting for:

(a) regulatory assets and regulatory liabilities arising from differences between regulatory recovery period and assets' useful lives; and

(b) regulatory liabilities arising from regulatory returns on assets not yet available for use included in regulated rates charged during the construction period.

35 The IASB also tentative decided to provide some transition reliefs when transitioning to IFRS X to alleviate stakeholders concerns related to:

(a) a full retrospective approach would involve undue cost and effort when applying the requirements for regulatory returns on assets not yet available for use;

(b) some respondents indicated that it would be difficult to apply some of the ED proposals retrospectively without the use of hindsight such as determining whether it is more likely than not that a regulatory asset or a regulatory liability existed;

(c) some respondents considered helpful to avoid an entity having to consider multiple regulatory interest rate changes when assessing whether previous regulatory interest rates provided sufficient compensation for the time value of money and uncertainty in the future cash flows or a single discount rate should be computed under the uneven regulatory interest rate requirement;

(d) granting relief from paragraph 28(f)[2] of IAS 8 would avoid an entity from having to run parallel systems to generate the information required about the effect on the current period.

36 The IASB tentatively decided to remove the requirement for an entity to elect to apply the retrospective or simplified approach to regulatory assets acquired or regulatory liabilities assumed in a past business combination for the following reasons:

(a) some adjustments may be unrelated to the goodwill recognised at the acquisition date;

(b) to avoid the need for entities to differentiate between regulatory assets acquired and regulatory liabilities assumed in a past business combination and those that have not;

(c) to address concerns raised by a few stakeholders about the proposals to take the net adjustments to goodwill such as adjusting retained earnings would be consistent with the requirements in other IFRS Accounting Standards and would avoid unintended consequences; and

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[2] Paragraph 28(f) of IAS 8 requires an entity to disclose for the current period and each prior period presented, to the extent practicable, the amount of the adjustment for each financial statement line item affected.

(d) to align with recently issued Standards (such as IFRS 17).

37 Most respondent who commented on the effective date proposal in the ED asked for a longer transition period (at least 24 - 36 months) as some entities would apply IFRS 1 and the prospective RRA Standard at the same time and will need to discuss with the regulator how to align the requirements in their regulatory agreements with the requirements in IFRS 1 and the prospective RRA Standard.

IASB tentative decisions on transition

38 The IASB tentatively decided that the Standard will permit an entity already applying IFRS Accounting Standards to apply the Standard retrospectively either in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* or by using a modified retrospective approach. Regardless of which transition approach an entity elects, the Standard will:

(a) require the entity to restate comparative information for the period immediately preceding the period in which the Standard is first applied (the comparative period); and

(b) permit the entity either to restate comparative information or to present unadjusted comparative information for any earlier periods presented and, if the entity presents unadjusted comparative information, to require the entity to identify clearly the comparative information that has not been adjusted, disclose that the comparative information has been prepared on a different basis and explain that basis.

39 Thirteen of 14 IASB members agreed with these decisions.

40 The IASB also tentatively decided to amend IFRS 1:

(a) to permit a first-time adopter to use a modified retrospective approach in applying the Standard;

(b) retain the proposal in the ED to require a first-time adopter to present comparative information in accordance with the requirements in IFRS 1 (and the definition of the date of transition to IFRSs [IFRS Accounting Standards] in IFRS 1); and

(c) retain the amendments proposed in the ED:

(i) to align the terminology and requirements in the deemed cost exemption in paragraph D8B of IFRS 1 with the Standard; and

(ii) to delete paragraph 39V[3] of IFRS 1.

41 All 13 IASB members present agreed with these decisions. One member was absent.

IASB tentative decisions on transition reliefs

42 The IASB tentatively decided to provide the following transition reliefs for entities applying the modified retrospective approach:

(a) require an entity using the modified retrospective approach to state that fact, disclose which transition reliefs it has applied and, where appropriate, describe how it has applied them;

(b) permit an entity using the modified retrospective approach whose regulatory capital base has a direct relationship with its property, plant and equipment to limit the application of the requirements for regulatory returns on assets not yet available for use to assets that are not yet available for use at the beginning of the comparative period; and

(c) permit an entity using the modified retrospective approach:

(i) to use hindsight; and

(ii) to use the regulatory interest rate at the beginning of the comparative period as the regulatory interest rate for the purpose of applying the requirements for discounting estimates of future cash flows, including the minimum interest rate and the uneven regulatory interest rate requirements.

43 The IASB tentatively decided for entities, regardless of which transition approach they elect to use (full retrospective under IAS 8 or modified retrospective approach):

(a) to require the entity to disclose the quantitative information required by paragraph 28(f) of IAS 8 for the comparative period; and

(b) to permit, but not require, the entity to disclose the quantitative information required by paragraph 28(f) of IAS 8 for the current period or for any earlier periods presented.

44 The IASB also tentatively decided to amend IFRS 1:

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[3] Paragraph 39V of IFRS 1 is an effective date paragraph related to IFRS 14 *Regulatory Deferral Accounts* that is no longer required.

(a) to permit a first-time adopter to apply any of the transition reliefs in the future RRA Standard, except that a first-time adopter that applies the exemption in paragraph D8B of IFRS 1:

(i) is not permitted to apply the transition relief for regulatory returns on assets not yet available for use; and

(ii) is required instead to apply prospectively the requirement to account for a regulatory asset arising from regulatory returns on assets not yet available for use.

(b) to require a first-time adopter applying any transition reliefs in the future RRA Standard to disclose which reliefs it has applied and, where appropriate, describe how it has applied them.

45 Regarding past business combinations, the IASB tentatively decided:

(a) not to include the requirement proposed in the ED for an entity to apply the retrospective or simplified approach to regulatory assets acquired or regulatory liabilities assumed in a past business combination, but instead to require the entity to apply the transition requirements of the prospective RRA Standard to these regulatory assets and regulatory liabilities;

(b) to require an entity applying the transition requirements of the prospective RRA Standard to take the net adjustment to retained earnings (or another category of equity, as appropriate), including adjustments related to regulatory assets acquired and regulatory liabilities assumed in a past business combination; and

(c) to omit the proposal in the Exposure Draft to amend paragraph C4 of IFRS 1 to specify how a first-time adopter accounts for the derecognition of goodwill-related regulatory balances.

46 All 14 IASB members agreed with these decisions.

IASB tentative decision on effective date

47 The IASB tentatively decided to require an entity to apply the prospective RRA Standard for annual periods beginning on or after 1 January 2029, with earlier application permitted.

48 Seven of 14 IASB members agreed with this decision. The IASB Chair used his additional casting vote, making the vote eight–seven in favour of the decision.

EFRAG Secretariat analysis

49 EFRAG Secretariat notes that based on feedback received from respondents, including EFRAG's recommendations in its comment letter to the IASB, the initial ED's proposals on transition were reconsidered and amended to accommodate the various concerns expressed during the consultation. These amendments include introducing a modified retrospective approach for entities to apply when transitioning to the requirements of the prospective RRA standards.

50 The modified retrospective approach would require an entity to restate comparative information for the first year immediately preceding the year of initial application and present adjusted or unadjusted comparative information for any earlier periods. This transition relief will give entities the flexibility to apply the new standard in a simpler and cost-efficient way. Allowing a first-time adopter under IFRS 1 to also use a modified retrospective approach when transitioning to the new standard will alleviate the burden of preparers having to apply both IFRS 1 and the prospective RRA standard at the same time.

51 Additionally, the IASB tentatively decided to provide several transition reliefs which were not part of the initial ED to reduce the burden on reporting entities when transitioning to the prospective RRA standard.

52 EFRAG Secretariat agrees with the IASB decision to provide a long transition period (at least 24 - 36 months) before the new RRA standard becomes effective. This will give entities more time to prepare and adjust their reporting system to meet the requirements of the new standard as well as allow sufficient time to apply IFRS 1, if the entity is a first-time adopter.

53 EFRAG Secretariat agrees with the IASB tentative decisions on past business combinations which are in line with EFRAG's recommendations in its comment letter.

EFRAG RRAWG feedback on IASB tentative decisions

54 EFRAG RRAWG will hold its meeting on 27 November 2024 where the transition and effective date tentative decisions will be discussed and the EFRAG Secretariat will provide a verbal update on the views expressed.

NEXT STEPS

55 At the July 2024 meeting, the IASB completed its redeliberations on the ED. The IASB has finalised its redeliberation proposals. The IASB expects to issue the prospective RRA Standard in the second half of 2025.

56 The IASB staff is currently conducting additional fieldwork on the likely effects of the prospective Standard. In tandem, the EFRAG Secretariat has kickstarted the preparatory endorsement work and will be distributing a questionnaire to preparers.

QUESTIONS FOR EFRAG FR TEG-CFSS MEMBERS

57 Do the IASB's tentative decisions on the following topics help address feedback from stakeholders in your jurisdiction:

(a) extending the measurement and presentation proposals in paragraphs 61 and 69 of the ED (paragraphs 4 to 29)?

(b) transition and effective date (paragraphs 30 to 54)?

58 Do you have any further comments?