Unit of account and offsetting

Issues Paper

Objective

1 The purpose of this paper is to discuss with EFRAG FR TEG the IASB tentative decisions following the feedback to the IASB Exposure Draft ED/2021/1 *Regulatory Assets and Regulatory Liabilities* ('the ED') related to the proposals on the unit of account and offsetting to be included in the future standard *Regulatory Assets and Regulatory Liabilities* ('RARL standard'). As noted at the February 2025 EFRAG FR meeting, these tentative decisions have not been discussed at an EFRAG FR TEG meeting.

2 Based on the mixed feedback received from the EFRAG RRAWG and concerns raised by a few other national standard setters, after consulting EFRAG FR TEG in September 2024, the EFRAG Secretariat included the unit of account as one of the focus areas for preparatory work for the endorsement advice on the upcoming RARL standard. As a result, this topic has been included in the EFRAG survey to preparers along with a question on regulatory regimes that could inform on their implications for the unit of account determination. Similarly, as highlighted in the February 2025 EFRAG FR meeting, the EFRAG Secretariat assessed the unit of account as being of ***medium*** concern. Depending on the feedback to EFRAG's preparer survey, the assessment of this topic may be revised and deemed as being of high concern.

3 The IASB discussed unit of account and offsetting during its December 2023 meeting. The related IASB agenda paper [9A Unit of account and offsetting] is provided for background information only.

Structure of the issues paper

4 This issues paper contains the following sections:

(a) ED proposals

(b) Feedback from constituents

(c) IASB Staff analysis

(d) The IASB's tentative decisions on the topics

(e) EFRAG RRAWG, EFRAG CFSS and ASAF feedback on the tentative decisions

(f) The EFRAG Secretariat analysis

ED proposals

5 The IASB's initial proposal on the unit of account for the model for regulatory assets and regulatory liabilities is contained in paragraph 24 of the ED:

'*An entity shall account for the right or obligation arising from each individual difference in timing described in paragraph 12(a) as a separate unit of account. However, if rights, obligations, or rights and obligations arising from the same regulatory agreement have similar expiry patterns and are subject to similar risks, they may be treated as arising from the same individual difference in timing.'*

6 The IASB's decision in the ED to use the right or obligation arising from an *individual difference in timing* as the unit of account was based on:

(a) The feedback received during the preparation of the ED that it was feasible to obtain this information at a reasonable cost; and

(b) It would provide more useful information about the expected timing and pattern of recovery or fulfilment of the right or obligation than treating the net of all differences in timing as a single unit of account.

7 The IASB also concluded that grouping rights and/or obligations arising from the same regulatory agreement which have similar expiry patterns and are subject to similar risks, would provide information that is as relevant as the information provided by treating each right or obligation as a separate unit of account.

8 In the ED the IASB notes that the unit of account would not determine how best to predict uncertain cash flows by applying either the most likely amount method or the expected value method as proposed in paragraph 39 of the ED.

9 In paragraph 40 of the ED, the IASB proposes:

'In assessing which of the methods described in paragraph 39 better predicts the uncertain cash flows, an entity shall also assess whether a better prediction will result from considering ***each regulatory asset and each regulatory liability separately****, or from considering* ***any of them together*** *with other regulatory assets or regulatory liabilities.'*

10 The IASB reasoning for this proposal is based on the argument that when a source of uncertainty affects more than one unit of account in the same period in a similar manner,

a better prediction of uncertain cash flows may result from considering together all units of account that are affected by the same source of uncertainty.

11 In addition, paragraph 71 of the ED permits an entity to offset regulatory assets and regulatory liabilities that form separate units of account only if the entity:

(a) has a legally enforceable right to offset those regulatory assets and regulatory liabilities by including them in the same regulated rate; and

(b) expects to include the amounts resulting from the recovery or fulfilment of those regulatory assets and regulatory liabilities in the same regulated rate for goods or services supplied in the same future period.

Feedback to the ED

12 Following the consultation on its ED, the IASB received the following feedback:

(a) Unit of account - a few respondents (mainly preparers and national standard-setters):

(i) asked how paragraph 24 of the ED would be applied to some regulatory accounts that include items that are subject to different risks, however, are netted and recovered over the same period;

(ii) asked for more guidance on applying the proposal on the unit of account. In particular, how the unit of account proposal interacts with the proposal in paragraph 40 of the ED (which considers whether a better prediction of the cash flows would result from considering units of account separately or from considering any of them together). In their view, the fact that an entity may consider a group of regulatory assets or regulatory liabilities as the unit of account for measurement purposes appears to contradict the requirement in unit of account proposal (account for the right or obligation arising from each individual difference in timing as a separate unit of account);

(iii) expressed concerns about the interaction between the proposed unit of account and other proposals in the ED - such as regulatory returns on an asset not yet available for use and the accounting for regulatory assets and regulatory liabilities arising from differences between the regulatory recovery period and the assets' useful lives. In their view, the IASB's proposal may be onerous to apply in practice because an entity may need more granular information than that currently used in setting regulated rates;

(iv) *EFRAG comment letter position* - in its comment letter on the IASB ED, EFRAG also recommended the IASB clarify the unit of account for disclosure purposes. EFRAG noted that it might be difficult for entities having several regulatory agreements to determine which agreement is more prominent to meet the proposed disclosure requirements. Specifically, whether the disclosures should be presented per regulation or in aggregate for several operations or subsidiaries and whether it is meaningful to provide disclosures on a stand-alone basis.

(b) Offsetting - regarding the proposal on offsetting regulatory assets and regulatory liabilities (paragraph 71 of the ED), a national standard-setter commented that it was unclear how the proposed conditions for offsetting would interact with the proposal on the unit of account. Some other respondents suggested to:

(i) permit offsetting based on only the first proposed condition (that is, an entity has a legally enforceable right to offset regulatory assets and regulatory liabilities by including them in the same regulated rate); or

(ii) permit offsetting based on conditions similar to those specified in IAS 12 *Income Taxes* or IAS 32 *Financial Instruments: Presentation*;

(iii) *EFRAG position* – in its comment letter, EFRAG supported the offsetting of regulatory assets and regulatory liabilities in the statement of financial position. However, expressed concerns that the requirements of paragraph 71(b) of the ED could make offsetting balance sheet positions more complicated. EFRAG suggested the IASB to consider:

- aligning the offsetting conditions with the requirements of paragraph 42 of IAS 32 *Financial Instruments: Presentation* (being the existence of legally enforceable right to settle and intent to settle on a net basis) or the requirements of IAS 12 for deferred tax assets and liabilities where expected simultaneous settlement in the future is not a requirement;
- explaining in the Basis for Conclusions the reasons for permitting instead of requiring offsetting (like in IAS 32 and IAS 12) of regulatory assets and regulatory liabilities in paragraph 71 of the ED.

IASB Staff analysis

13 The IASB Staff considered the feedback received from respondents and made the following recommendation to the IASB:

(a) Unit of account – based on the feedback from respondents, entities would only track differences in timing using the same level of aggregation as the regulator has used for determining an adjustment to the future regulated rates. Requiring more granular information would give rise to costs that may outweigh any benefits. Paragraph 24 of the ED, however, proposes that an entity may treat a group of rights and/or obligations as arising from an individual difference in timing if those rights and/or obligations arise from the same regulatory agreement, have similar expiry patterns and are subject to similar risks. Therefore, the IASB Staff recommended the IASB to clarify the definition of the unit of account and redrafted paragraph 24 for greater clarity in the final Standard as well as to include an illustrative example on this topic.

(b) Offsetting – following respondents' feedback, the IASB Staff considered the interaction of paragraph 24 of the ED (unit of account) and paragraph 71 of the ED (offsetting requirement) and:

(i) established that the proposal on the unit of account considers *similar expiry patterns* while the proposal on offsetting considers the *same timing of recovery or fulfilment*;

(ii) noted that a regulator may decide that some differences in timing should be netted and treated as a single adjustment when determining the future regulated rate;

(iii) additionally, paragraph 32 of IAS 1 *Presentation of Financial Statements* prohibits offsetting of assets and liabilities or income and expenses, unless required or permitted by an IFRS Standard.

As a result, even if paragraph 71 of the ED is removed, entities would be prohibited from inappropriately offsetting regulatory assets and regulatory liabilities. Consequently, the IASB Staff recommended the IASB that the final Accounting Standard exclude paragraph 71 from the ED.

14 During the IASB discussion, all 14 IASB members agreed with these proposals.

The IASB's tentative decisions on the topic

15 At its December 2023 meeting, the IASB considered the feedback received on the ED's proposals on unit of account and offsetting and tentatively decided:

(a) to clarify that the unit of account is **the right or obligation arising from a difference in timing or from a group of differences in timing**. The differences in timing included in that group would:

(i) be created by the same regulatory agreement;

(ii) have similar expiry patterns; and

(iii) be subject to similar risks.

(b) to omit the proposal in paragraph 71 of the ED that would have permitted an entity to offset regulatory assets and regulatory liabilities in the statement of financial position.

16 All 14 IASB members agreed with these decisions.

EFRAG RRAWG, EFRAG CFSS and ASAF feedback on the tentative decisions

Unit of account

EFRAG RRAWG feedback on IASB ED unit account and higher unit of account under UKEB top-down model

Views on IASB ED unit of account

17 Some members supported the IASB's tentative decision to clarify that the unit of account is the right or obligation arising from a difference in timing or from a group of differences in timing when these differences meet certain criteria. The proposal to group timing differences would work also well for 'clawback' accounts (accounts including various items of revenue and expenses) and allow them to recognise regulatory assets and regulatory liabilities.

18 Some members considered the unit of account to be quite theoretical and asked for the IASB to consider providing examples. Furthermore, members made the following comments/suggestions:

(a) it was unclear whether the revised definition of the unit of account was aimed at accommodating the way the items were grouped by the regulator;

(b) it was proposed to have a higher level of unit of account which should not affect the recognition of regulatory assets and regulatory liabilities because there was no real symmetry between RA and RL.

19 A question was also raised as to why a unit of account at an individual asset level was warranted. It could be argued that if the unit of account at a higher level did not create problems for the recognition and measurement of regulatory assets (liabilities), then having it at a detailed level as proposed would likely create more costs than benefits for entities.

20 In summary, EFRAG RRAWG members' feedback indicated that there were still challenges in understanding the applicability of the unit of account concept.

EFRAG RRAWG feedback on the higher unit of account under the UKEB top-down approach

21 At its May 2024 meeting, EFRAG RRAWG received a presentation on the UKEB top-down approach[1], which is based on applying a higher unit of account than the one proposed by the IASB in its exposure draft to determine the differences in timing between RCB and PPE (i.e., the aggregate difference between RCB and reported PPE).

22 One EFRAG RRAWG asked whether trying to compare the PPE to RCB in the UKEB top-down approach would not create differences that were not differences in timing (i.e., permanent differences[2]) and would therefore need to be explained in the disclosures. This would increase costs to preparers.

23 In response, the UKEB representative explained that the IASB proposals already included various disclosures regardless of whether an entity had a direct or no direct relationship. Furthermore, there was an analogy to be made to tax accounting under IAS 12 where permanent differences also needed to be excluded. Entities had learned to work with IAS 12.

[1] The UKEB top-down model was developed as a possible supplement to the IASB model relating to the concept of no direct relationship between the PPE and RCB of regulated entities. It would allow the recognition of certain regulatory assets (liabilities) that would be excluded under the IASB's proposed model.

[2] The same point on challenges that would be faced to address permanent differences in timing was raised at the April 2024 IFASS meeting item 11A page 39 (audience response to panel discussion involving OIC-Italy, ASCG-Germany and UKEB).

EFRAG CFSS feedback

24 One member commented that setting up the unit of account at the right level was critical for the RRA project. Since there were no different recognition and measurement criteria for regulatory assets and regulatory liabilities, having a very detailed unit of account was not necessary. Therefore, the unit of account could be established at a higher level than currently proposed under the IASB tentative decisions confirming the ED proposals.

25 One member observed that the unit of account when considering credit risk is at the level of each regulatory asset and each regulatory liability separately, or from considering any of them together with other regulatory assets or regulatory liabilities.

26 Other suggestions made on the unit of account were a) to use a top-down approach like IFRS 17 for establishing the unit of account at a higher level where timing differences with similar risks are managed together; or b) to manage regulatory assets and regulatory liabilities together like IAS 12 *Income Taxes*.

27 In summary, there were still challenges to understanding the applicability of the unit of account concept. It was seen as important to simulate the unit of account concept before the IASB finalises its deliberations on this topic. If the unit of account does not create problems for recognition purposes, having it at a detailed level would create more costs than benefits for the entities.

ASAF feedback

28 Some ASAF members welcomed the IASB's tentative decisions on the unit of account and offsetting. However, the EFRAG representative said that some stakeholders in their jurisdiction found the unit of account decisions too prescriptive. This member and the UKEB representative asked the IASB for more clarification and education on the unit of account to ease the application of the prospective Accounting Standard.

Offsetting

EFRAG RRAWG feedback

29 Some members generally agreed with the proposal to omit the requirement on offsetting in paragraph 71 of the ED.

30 One member questioned whether this tentative decision was necessary considering the modification made to the definition of the unit of account in relation to the grouping of timing differences. The requirement in paragraph 71 of the ED was providing a possibility for preparers to group regulatory assets and regulatory liabilities meeting certain criteria and was not a requirement. In his view, as long as paragraph 71 was not inconsistent with the requirements in IAS 32 and IAS 12, this requirement would be good to have.

EFRAG CFSS feedback

31 Some CFSS members considered it useful to retain paragraph 71 of the ED to apply the concepts in the RARL standard.

EFRAG Secretariat's analysis and views

Unit of account

32 The EFRAG Secretariat notes that though the general feedback has been supportive, several points of attention on the unit of account have been raised in EFRAG RRAWG, TEG-CFSS and ASAF meetings as noted above. These include questions on whether a detailed unit of account is necessary and whether a higher unit of account would be appropriate. As noted, the EFRAG survey to preparers is gathering feedback that will shed further light on the practicability of the IASB proposals related to the unit of account.

33 Based on our current understanding, the EFRAG Secretariat is of the view that the IASB tentative decisions clarifying[3] the unit of account are useful for certain regulatory schemes (i.e., cost-based schemes[4]). However, for other schemes (i.e., incentive-based or hybrid models[5]) it is more difficult to establish a workable unit of account. For the latter schemes, the allowed revenue usually includes depreciation of the RCB (which is not aligned with the depreciation of the PPE because RCB is constructed on a different basis from the PPE), returns on RCB, operating expenses, incentives (bonuses or penalties), other items (i.e., tax, inflation). In such schemes establishing the unit of account (individual or group) can be challenging because there is a disconnect between allowed revenue and actual costs incurred by entities.

34 Consequently, entities operating under incentive-based schemes can typically establish the unit of account at a higher level (i.e., line of business) than the one required by the ED's

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[3] '*the right or obligation arising from a difference in timing or from a group of differences in timing when the differences in timing included in that group are created by the same regulatory agreement, have similar expiry patterns and are subject to similar risks*'

[4] In cost-based schemes, regulatory accounting and reporting requirements are usually aligned to the IFRS Accounting Standards. This means that any differences in timing (individual or group of differences) can be separately tracked as the components of assets recoded, measurement basis, capitalisation policies and depreciation rates are aligned. In general, the rate setting aims to create direct links between an entity's expenses with its allowed revenue and rates charged to customers

[5] Incentive-based schemes aim at optimising processes and increase profits by reducing costs and the regulated rate is more focused on targeted outputs (i.e., quality/quantity of provided services to customers) rather than on a set of inputs (i.e. various input costs).

proposals and the differences in timing between RCB and IFRS figures can be recognised as regulatory assets and regulatory liabilities without tracing individual timing differences. However, as noted in the views of RRAWG members expressed in paragraph 22, the unit of account could capture permanent timing differences (i.e., items such as borrowing costs or assets pre-funded by customers) which need to be excluded from the RCB as they are not allowable expenses under the RRA model or have already been recovered from customers.

Offsetting

35 The EFRAG Secretariat acknowledges the limited views expressed by EFRAG RRAWG and EFRAG CFSS to retain paragraph 71 of the ED (permitting an entity to offset regulatory assets and regulatory liabilities in the statement of financial position) to help entities apply the concepts in the RARL standard. However, EFRAG Secretariat supports the IASB's tentative decision to omit this proposal because the requirements in IAS 1.32 would provide the necessary guidance for entities to consider.

Questions for EFRAG FR TEG

36 Does EFRAG FR TEG agree with the IASB tentative decision to clarify that the unit of account is the right or obligation arising from a difference in timing or from a group of differences in timing when the differences in timing included in the group would be created by the same regulatory agreement; have similar expiry patterns; and be subject to similar risks?

37 Considering paragraphs 32-34343234, what are your views on establishing the unit of account on a higher level than proposed by the Rate-regulated Activities model?

38 Does EFRAG FR TEG have any recommendations for improving the definition of the unit of account and making it better when applied in practice?

39 Does EFRAG FR TEG agree with the IASB tentative decision to omit the proposal in paragraph 71 of the ED that would have permitted an entity to offset regulatory assets and regulatory liabilities in the statement of financial position?