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Recognition and derecognition of regulatory assets and regulatory liabilities

Issues Paper

Objective

1. The objective of this agenda paper is to discuss the IASB's tentative decisions on the recognition and derecognition of regulatory assets (RA) and regulatory liabilities (RL) that will be reflected in the upcoming IFRS Accounting Standard *Regulatory Assets and Regulatory Liabilities* (prospective IFRS Standard).

Structure of this paper

2. This paper is structured as follows:
 - (a) Recognition of RA and RL
 - (b) Derecognition of RA and RL
 - (c) Appendix 1: IASB proposals on recognition and derecognition included in the 2021 exposure draft ('the ED')
 - (d) Appendix 2: Feedback to the ED

Recognition of RA and RL

IASB tentative decisions (February and May 2023)

3. In February and May 2023, based on the feedback received, the IASB redeliberated the ED's proposals on recognition of RA and RL (see Appendix 1 for ED proposals) and made the tentative decisions included in the table below.

Recognition threshold

The IASB tentatively decided:

- (a) to retain the ED's 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;
- (b) not to set a recognition threshold based on the probability of a flow of economic benefits;
- (c) 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);
- (d) to retain the proposed symmetric recognition threshold for regulatory assets and regulatory liabilities; and
- (e) 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.

Interaction between enforceability and recognition

The IASB tentatively decided to:

- (f) 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.
- (g) clarify in the Standard that rights and obligations can be enforceable even if their existence is uncertain.
- (h) 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.

Timing of initial recognition

The IASB tentatively decided to retain:

- (i) the proposal to require recognition of all regulatory assets and all regulatory liabilities existing at the end of the reporting period.

Feedback on the IASB tentative decisions

EFRAG RRAWG feedback

4. EFRAG RRAWG members generally supported the IASB's tentative decisions on the recognition threshold including deferring the recognition of RA and RL for allowable expenses based on benchmarks not known at the reporting date until the regulator determines the benchmark.
5. Regarding recognition of RA and RL for allowable expenses based on regulatory benchmarks, members expressed the following concerns:
 - (a) A few members considered that ongoing negotiations with the regulator or litigation may create a high level of measurement uncertainty for such types of recoverable expenses which if recognised as regulatory assets could be reversed in future periods, or it could pose challenges in assessing whether the underlying rights and obligations were enforceable. Another member suggested that the uncertainty could be addressed through disclosures as required by other relevant IFRS Accounting Standards.
 - (b) One member noted that entities may need to apply IAS 10 *Events After the Reporting Period* if the information became available before the financial statements were approved for release - meaning that in such cases regulatory assets and regulatory liabilities arising from benchmarks would be recognised.
6. In response to the concern in paragraph 5(a), the IASB staff representative clarified that there was no existence uncertainty when an entity would recognise RA and RL arising from allowable expenses based on benchmark information because the regulator would address differences between the estimates and actuals in the following year. However, there was significant measurement uncertainty until the regulator published the regulatory benchmarks. Furthermore, it was noted that the IASB's tentative decision to defer the recognition of RA and RL on benchmarks until the regulator determines the benchmark rate was related to specific situations when the entity did not know/have access to the benchmark information at the reporting period date. In cases when benchmarks were

published on a quarterly basis and an entity would have the ability to derive an estimate, this exception should not be applied by entities.

7. EFRAG RRAWG members supported the IASB's tentative decisions on the interaction between enforceability and recognition including for entities to maintain a single assessment of the existence of enforceable present rights and enforceable present obligations. They noted it was important to link recognition to factors such as the regulatory regimes applicable in their jurisdiction and local law. In addition, the IASB tentative decision allowed for an entity's judgement depending on its facts and circumstances.
8. EFRAG RRAWG members supported the IASB's tentative decisions on the timing of initial recognition of RA and RL.

EFRAG TEG-CFSS feedback

Recognition threshold

9. EFRAG FR TEG-CFSS members generally agreed with the IASB's tentative decisions on the recognition of RA and RL. They also supported the IASB's tentative decisions to not include a recognition threshold based on the probability of a flow of economic benefits and to retain the symmetric recognition threshold for RA and RL.
10. Regarding the recognition threshold, a few members indicated a concern that the "more likely than not" threshold could impose significant uncertainty in estimating amounts due to the nature of regulatory agreements in their jurisdictions (e.g., Italy). These stakeholders called for a "highly probable" threshold akin to that applied to constrain the recognition of variable consideration under IFRS 15.
11. EFRAG FR TEG-CFSS members did not object to the IASB's tentative decision on recognition of RA and RL whose measurement depends on a regulatory benchmark. However, a few members sought clarity on the timing of recognition (i.e., when is it reasonably estimable or precisely known), especially in situations where the benchmark expenses only became clear after the reporting period (e.g., two years later).

Interaction between enforceability and recognition

12. EFRAG FR TEG-CFSS members did not object to the IASB's tentative decisions on the interaction between enforceability and recognition. One member asked for illustrative examples of the application of the enforceability assessment.

Timing of initial recognition

13. EFRAG FR TEG-CFSS members were supportive of the IASB's tentative decision on the timing of initial recognition.

ASAF discussion (September 2023)

14. ASAF members generally supported the IASB's tentative decisions and provided the following comments:
- (a) *Recognition threshold* – one ASAF member commented that in accounting for regulatory assets and regulatory liabilities subject to high outcome uncertainty, there could be some confusion between the proposed recognition threshold of 'more likely than not' and the 'highly probable' threshold used in IFRS 15 to constrain the measurement of variable consideration. Another ASAF member asked for more guidance on the judgement of 'more likely than not'.
 - (b) *Enforceability and recognition* - a few ASAF members asked for further guidance on the assessment of enforceability. One member suggested that the IASB should include guidance on enforceability based on some of the clarifications suggested in the [IASB staff paper](#) on this topic.
 - (c) *Timing of initial recognition* - a few ASAF members said the timing of recognition might be unclear, for example, if:
 - (i) an entity's financial reporting period is not aligned with its regulatory reporting period and the entity is entitled to receive an amount that accumulates beyond the financial reporting period; or
 - (ii) a regulatory asset or regulatory liability arises from items included in an entity's regulatory capital base and that base has no direct relationship with the entity's property, plant and equipment.

EFRAG Secretariat analysis

15. The EFRAG Secretariat concurs with the general support (or non-objection) from EFRAG RRAWG and EFRAG FR TEG-CFSS members for the IASB's tentative decisions on the recognition of RA and RL. We note that the IASB's tentative decisions address an area of concern raised in EFRAG's comment letter (i.e. by confirming the circumstances under which the recognition of allowable expenses based on benchmark rates will occur). That said, as noted in the EFRAG TEG-CFSS meeting and feedback to the ED (see Appendix 2), some stakeholders would prefer a higher recognition threshold to cater for underdeveloped regulatory regimes. The EFRAG Secretariat will assess the findings of EFRAG's survey to preparers to ascertain if there are any identified fact patterns where there would be a cause for concern in applying the IASB's proposed requirements for a 'more likely than not' recognition threshold.

16. The EFRAG Secretariat also agrees that a single assessment of enforceability on the level of individual regulatory assets and regulatory liabilities will suffice and there is no practical benefit to assessing enforceability at the level of the regulatory agreement first. As noted by some IASB Board members during the discussion, a two-step approach would be inconsistent with other IFRS Accounting Standards. Moreover, we note that the guidance on enforceability will be strengthened by the IASB's tentative decision to incorporate into the final standard the principles in paragraph 35(c) of IFRS 15 that relate to an entity's right to payment for performance completed to date (i.e. for assessing enforceable rights for long-term performance incentives, regulatory returns for assets not yet available for use).

Derecognition of RA and RL

IASB tentative decisions (April 2023)

17. The ED (see Appendix 1) did not have a separate section dealing explicitly with the derecognition of regulatory assets and regulatory liabilities.
18. Some respondents, including EFRAG, recommended the IASB to address more explicitly derecognition and provide guidance on some aspects.
19. In April 2023, the IASB took the following tentative decisions on derecognition of regulatory assets and regulatory liabilities:

Derecognition of RA and RL

The IASB tentatively decided that the prospective Standard would:

- (a) require an entity to derecognise:
 - (i) a regulatory asset as it recovers part or all of the regulatory asset by adding amounts to future regulated rates charged to customers; and
 - (ii) a regulatory liability as it fulfils part or all of the regulatory liability by deducting amounts from future regulated rates charged to customers.
- (b) explain that the derecognition of regulatory assets and regulatory liabilities, as described in paragraph (a), is the most common way in which regulatory assets and regulatory liabilities would be derecognised. Therefore, in applying the recognition and measurement requirements at the end of each reporting period, an entity would not be required to consider explicitly when and how its regulatory assets and regulatory liabilities should be derecognised.

- (c) clarify that an entity would derecognise a regulatory asset or a regulatory liability if the asset or liability ceased to meet the 'more likely than not' recognition threshold.
- (d) include guidance on the derecognition of regulatory assets and regulatory liabilities settled by a regulator or another designated body. The guidance would also require an entity to recognise the difference between the derecognised regulatory asset or regulatory liability and any new asset or liability in profit or loss.
- (e) specify that if a regulatory asset or a regulatory liability is added to or deducted from an entity's regulatory capital base and the entity's regulatory capital base has no direct relationship with its property, plant and equipment, the entity would derecognise.
 - (i) the RA and recognise any associated regulatory expense in profit or loss.
 - (ii) the RL and recognise any associated regulatory income in profit or loss.

Feedback received on the IASB tentative decisions

EFRAG RRAWG feedback

- 20. EFRAG RRAWG members supported the IASB's tentative decisions.
- 21. On the tentative decisions related to the recovery of regulatory assets or fulfilment of regulatory liabilities through the regulatory capital base, one member indicated that if an entity is moving from a direct to a no-direct relationship between its regulatory capital base and its PPE, the entity should ascertain whether the regulation provides the entity with a buffer to maintain the rights that are recognised and if this is not the case, then the entity can derecognise.

EFRAG TEG-CFSS feedback

- 22. EFRAG TEG-CFSS members supported the IASB's tentative decisions.

ASAF discussion (September 2023)

- 23. ASAF members supported the IASB's tentative decisions.

EFRAG Secretariat analysis

- 24. The EFRAG Secretariat observes that, in its tentative decisions, the IASB has responded to the call for guidance on derecognition that EFRAG (in its FCL) and other stakeholders made in response to the ED. We also note the general support for the IASB's tentative decisions at the EFRAG RRAWG and EFRAG TEG-CFSS meetings.

Questions for EFRAG FR TEG

25. Do EFRAG FR TEG members agree with and/or have any questions/comments on the IASB tentative decisions related to the recognition of RA and RL (paragraph 3)?
26. Do EFRAG FR TEG members agree with and/or have any questions/comments on the IASB tentative decisions related to the derecognition of RA and RL (paragraph 19)?

Appendix 1: IASB proposals on recognition and derecognition included in the 2021 ED

ED proposals on recognition

- 1 The ED proposed that:
 - (a) an entity should recognise all regulatory assets and all regulatory liabilities existing at the end of the reporting period (paragraph 25 of the ED);
 - (b) if it is uncertain whether a regulatory asset or a regulatory liability exists (existence uncertainty), an entity should recognise the regulatory asset or regulatory liability if it is more likely than not that it exists (paragraph 28 of the ED).
- 2 Paragraph 27 of the ED includes an indicative list of facts and circumstances that an entity would consider in determining whether a regulatory asset or a regulatory liability exists.
- 3 The ED did not propose a recognition exemption for allowable expenses based on benchmark expenses not known at the reporting date.

ED proposals on derecognition

- 4 The 2021 ED did not have a separate section that deals explicitly with the derecognition of regulatory assets and regulatory liabilities.
- 5 Paragraph BC129 of the ED explained why the IASB considered a separate section on derecognition to be unnecessary. It indicates *'When an entity recovers part or all of a regulatory asset, or fulfils part or all of a regulatory liability, by adding or deducting an amount in determining future regulated rates (paragraphs BC50–BC51), the entity would derecognise that part of the regulatory asset or regulatory liability and recognise regulatory expense or regulatory income accordingly (paragraph BC31). Furthermore, because the Board's measurement proposals would require an entity to update its estimates of future cash flows, measurement of regulatory assets and regulatory liabilities would be nil if estimated future cash flows were nil (paragraphs BC140-BC141)...'*.
- 6 However, the ED does address derecognition in the context of cancellation of a regulatory agreement (in paragraphs B38 and BC153¹ of the ED).

¹ *"...The Exposure Draft proposes that an entity derecognise the part of the regulatory asset or regulatory liability that no longer exists, and apply the applicable IFRS Standard in recognising and measuring the financial asset or financial liability, recognising any resulting difference in profit or loss."*

Appendix 2: Feedback to the ED

Feedback on Recognition

Feedback on recognition threshold

- 7 Most respondents, including EFRAG, agreed with the proposed recognition requirements, including the proposed ‘more likely than not’ recognition threshold that an entity would apply when it is uncertain whether a regulatory asset or a regulatory liability exists.
- 8 However, a few respondents, including some of EFRAG’s stakeholders, disagreed with the recognition requirements for the following reasons:
- (a) The perceived inconsistency of the proposed requirements with the *Conceptual Framework for Financial Reporting* (which does not include probability threshold in the recognition criteria); and
 - (b) In some cases, there is a high existence uncertainty and measurement uncertainty for some regulatory assets and regulatory liabilities. For example, negotiations with the regulator on the recovery of specific costs and instances when entities do not have sufficient insight on the amounts to be recognised as they are linked to sector averages or benchmark expenses. Another example of existence uncertainty would arise for underdeveloped regulatory regimes, which lack a track record of regulatory decisions and litigation/precedents upon which the enforceability of regulatory agreements can be ascertained. In cases where the existence uncertainty is significant in a particular regulatory regime, it is complex and challenging to assess whether it is “more likely than not” that a regulatory asset or a regulatory liability exists.
- 9 These respondents suggested that, in cases of high measurement uncertainty, the final Standard should include a constraint on the measurement of regulatory assets and regulatory liabilities or disallow recognition and require disclosure instead.
- 10 Some respondents, including some EFRAG stakeholders, were of the view that recognising regulatory assets and regulatory liabilities in instances where there is high existence and measurement uncertainty, would result in information that is not useful to users of financial statements. In some cases, regulated rates based on sector averages were not known at the reporting period and might be difficult to estimate how much the entity was entitled to recover (compensate).
- 11 The IASB staff analysis and recommendations in response to the feedback to the ED were discussed with the IASB in its February 2023 meeting ([agenda paper 9B](#)).

Feedback on interaction between enforceability and recognition

- 12 Most respondents to the IASB who commented agreed with the proposed definitions of a regulatory asset and regulatory liability and with the proposed recognition requirements.
- 13 However, many respondents, including EFRAG, said that assessing whether rights and obligations are enforceable could be very challenging and they requested further guidance and illustrative examples. Difficulties can exist in the following cases:
- (a) in jurisdictions where the regulatory environment is not fully developed and there is no history of whether a specific right or obligation will be enforced;
 - (b) when a regulatory agreement establishes a broad framework, but it may not be sufficiently detailed, or it may be silent, on whether an entity would have a right to recover specific costs;
 - (c) an entity's ability to include amounts in future regulated rates may be subject to the discretion of the regulator.
- 14 Respondents generally asked for further guidance on:
- (a) assessing enforceability and further guidance on determining the existence of regulatory assets and regulatory liabilities;
 - (b) how the assessment of enforceability of rights and obligations interplays with the assessment of the existence of regulatory assets and regulatory liabilities;
 - (c) whether the 'more likely than not' threshold was appropriate for an entity to assess whether a right or an obligation is enforceable.
- 15 Some respondents, including EFRAG, asked for additional guidance on the indicators provided in paragraph 27 of the ED about how an entity would determine whether a regulatory asset or a regulatory liability exists.
- 16 The IASB staff analysis and recommendations in response to the feedback to the ED were discussed with the IASB in its February 2023 meeting ([agenda paper 9C](#)).

Feedback on timing of initial recognition

- 17 Some respondents (including EFRAG) asked the IASB to clarify when a regulatory asset or a regulatory liability is initially recognised. Respondents indicated that paragraph 25 of the ED was unclear as to whether a regulatory asset or regulatory liability can be recognised before the end of the reporting period. They questioned whether, for initial recognition, there will be a need to assess existence throughout the reporting period as done at the end of the reporting period.

- 18 The IASB staff analysis and recommendations in response to the feedback to the ED were discussed with the IASB in its May 2023 meeting ([agenda paper 9A](#)).

Feedback on derecognition

- 19 The ED did not have a separate section dealing explicitly with the derecognition of regulatory assets and liabilities.
- 20 Paragraph BC129 of the Basis for Conclusions states that when an entity recovers part or all of a regulatory asset, or fulfils part or all of a regulatory liability, by increasing or decreasing the regulated rates, the entity would derecognise that (part of the) regulatory asset or regulatory liability and recognise regulatory expense or regulatory income accordingly.
- 21 However, the ED addressed derecognition in the context of the cancellation of a regulatory agreement (B38 and BC 153). If a right of cancellation has been exercised, so that a right to receive (or obligation to pay) cash arises, the entity derecognises the regulatory asset (or regulatory liability) and recognises and measures the financial asset (or the financial liability) by applying the relevant IFRS Standard, recognising any resulting difference in profit or loss.
- 22 Some respondents, including EFRAG, recommended the IASB should provide further guidance in the final Standard on the derecognition of regulatory assets and liabilities and requested clarifications, as follows:
- (a) whether regulatory assets or regulatory liabilities should be derecognised or remeasured if they no longer meet the “more likely than not” recognition threshold;
 - (b) whether the proposed derecognition of regulatory assets and regulatory liabilities in the context of cancellation of a regulatory agreement in paragraph B38 of the ED would also apply to other situations that may occur during the term of the regulatory agreement - for example, if (partial) settlement takes place with parties other than customers;
 - (c) how to deal with the overall effects of discontinuing regulatory accounting; and
 - (d) whether an entity applies the derecognition requirements in IFRS 9 or follows some other approach when it transfers the right to the future cash flows arising from a regulatory asset to a third party (for example, on securitisation of regulatory assets).