IFRS

STAFF PAPER

November 2021

IASB® meeting

Project	**Rate-regulated Activities**
Paper topic	Feedback summary—Likely effects and other comments

CONTACT(S)	Zicheng Wang	zwang@ifrs.org
	Raghava Tirumala	rtirumala@ifrs.org

Objective

1. This paper analyses:

   (a) the feedback from comment letters and outreach events on the Board's analysis of the likely effects of the proposals, set out in paragraphs BC214–BC251 of the Basis for Conclusions on the Exposure Draft *Regulatory Assets and Regulatory Liabilities* (Question 12 of the Invitation to Comment); and

   (b) other comments from comment letters and outreach events (Question 13 of the Invitation to Comment).

Introduction

2. The Board's overall assessment is that the benefits of more useful information to users of financial statements would outweigh the costs to users and preparers of implementing the proposals. The effects of the proposals are likely to be more significant for companies that currently do not recognise regulatory balances.[1] For companies that currently recognise regulatory balances, the effects would depend on how they currently account for such balances.

[1] Paragraph 218(b) of the Basis for Conclusions defines regulatory balances as the effects of rate regulation that an entity recognises as assets or liabilities.

Key messages

3. Overall, most respondents believed that the benefits the proposals would bring to the users of financial statements would exceed the costs of implementing the proposals for preparers.

4. Most respondents agreed with the analysis of the likely effects of implementing the proposals on information reported in the financial statements and on the quality of financial reporting. A few respondents said that applying some of the proposals would not improve the quality of financial reporting because these proposals do not reflect the economic substance of regulatory agreements.

5. Many respondents agreed with the Board's analysis of the likely costs of implementing the proposals. However, some respondents disagreed with the Board's analysis. These respondents included some national standard-setters, some accounting firms, and many preparers. The main reason for disagreement is that entities would need to incur significant costs to develop systems to track regulatory assets and regulatory liabilities. Some of these respondents said that these costs would be passed onto customers through increased future regulated rates.

Structure of the paper

6. This paper is structured as follows:

   (a) Question 12(a)—Likely effects on information reported and on the quality of financial reporting (paragraphs 7–14);

   (b) Question 12(b)—Likely costs of implementing the proposals (paragraphs 15–24);

   (c) Question 12(c)—Other comments on likely effects (paragraphs 25–26); and

   (d) Question 13—Other comments on the Exposure Draft (paragraphs 27–29)

Question 12(a)—Likely effects on information reported and on the quality of financial reporting

Summary of the Board's analysis

7. Paragraphs BC222–BC229 contain the analysis of the likely effects of implementing the proposals on information reported in the financial statements. The Board concluded that the application of the proposals would result in a coherent, prominent and understandable presentation of information about regulatory assets and regulatory liabilities. In the statement of profit or loss, all regulatory income minus all regulatory expense would be presented immediately below revenue. In the statement of financial position, regulatory assets and regulatory liabilities would be presented separately. The proposals would not affect the cash flows entities report in the statement of cash flows.

8. Paragraphs BC230–BC244 contain the analysis of the likely effects of implementing the proposals on the quality of financial reporting. The Board concluded that applying the proposals would:

   (a) give users of financial statements a better understanding of the relationship between an entity's revenue and expenses by providing information about the effects of differences in timing associated with regulatory assets and regulatory liabilities;

   (b) provide users of financial statements with useful information focusing on the incremental future cash flows that result from regulatory assets and regulatory liabilities; and

   (c) improve the comparability of financial information across entities because all entities would use a single set of principles in reporting all regulatory assets and regulatory liabilities.

Comment letter and outreach feedback

9. The Board asked stakeholders whether they agree with the analysis, and if they disagree, with which aspects of the analysis do they disagree.

10. Most respondents who commented agreed with the analysis.

11. A few respondents, mainly European preparers, said that applying some of the proposals would not improve the quality of financial reporting, and potentially result in entities using non-GAAP metrics that ignore the effects of applying those proposals. They said that applying those proposals does not reflect the economic substance of regulatory agreements. For example:

    (a) reflecting regulatory returns on assets not yet available for use in financial performance for the period after the asset becomes available for use;

    (b) recognising regulatory assets and regulatory liabilities arising because the regulatory recovery period is longer or shorter than the useful life of an asset; and

    (c) recognising regulatory assets or regulatory liabilities associated with the difference between the way an item of income or expense is accounted for applying IFRS Standards and the way that item is treated applying the regulatory agreement.

    (See Agenda Paper 9C *Feedback summary—Total allowed compensation* of the October 2021 meeting for further discussion of these concerns)

12. A national standard-setter from Asia-Oceania said that the high level of subjectivity in making the judgements and estimates required by the proposals would adversely affect the quality of financial reporting. This respondent suggested that the Board seek further feedback from users of financial statements on the effects of the proposals.

13. A European preparer said the focus of the proposals on matching the timing of revenue with that of expense recognition applying IFRS Standards does not provide useful information to the users of financial statements. According to this respondent, such matching does not reflect the underlying regulatory agreements and the regulatory assets or regulatory liabilities arising from such matching do not always represent adjustments to the future regulated rates.

14. A European preparer with rate-regulated activities in the United States said the cost-deferral model provides a better representation of how the regulations work in their business.

Question 12(b)— The likely costs of implementing the proposals

Summary of the Board's analysis

15. Paragraphs BC245–BC250 contain the analysis of the likely costs of implementing the proposals. The Board concluded that:

    (a) the availability of better information about differences in timing in the financial statements would decrease costs incurred by the users of financial statements for gathering information from other sources; and

    (b) entities are not expected to incur significant costs in applying the proposals because their application would mainly require inputs that entities already need to gather and process in determining regulated rates.

Comment letter and outreach feedback

16. The Board asked stakeholders whether they agree with the analysis, and if they disagree, with which aspects of the analysis do they disagree.

17. Many respondents who commented agreed with the Board's analysis.

18. Some respondents across stakeholder types disagreed with the Board's analysis of the likely costs of implementing the proposals. They said that applying the proposals would be costly and complex both on initial application and on an ongoing basis. Many of these respondents commented in particular on the costs of implementing the proposals listed in paragraph 11. (See Agenda Paper 9C *Feedback summary—Total allowed compensation* of the October 2021 meeting and paragraph 14 of Agenda Paper 9C *Feedback summary—Effective date and transition* of this meeting.) A few preparers said that the cost of applying the proposals would eventually be charged to customers through increased future regulated rates.

19. A few preparers from North America said that entities that currently recognise regulatory balances may incur significant administrative costs arising from the need to reconcile the regulatory balances with the regulatory assets and regulatory liabilities reported in the financial statements.

20. A few national standard-setters said that some entities that are subject to some form of rate regulation may have to incur costs to assess whether they have regulatory assets and regulatory liabilities, only to conclude that no such assets and liabilities exist or that those assets and liabilities that do exist are immaterial. (See Agenda Paper 9A *Feedback summary—Objective and Scope* of the October 2021 meeting.)

21. Some respondents said recognising regulatory assets or regulatory liabilities may affect financial covenants or credit metrics, which may necessitate amendments to financing documents and create legal and compliance costs. (See Agenda Paper 9B *Feedback summary—Regulatory assets and regulatory liabilities* of the October 2021 meeting.)

22. In relation to the discounting proposals:

    (a) a few respondents said the cost to implement discounting for regulatory assets and regulatory liabilities that attract regulatory interest would outweigh the benefits because the proposals would result in similar measurements to those that would be obtained using an approach that does not discount estimates of future cash flows.

    (b) most respondents said the assessment of whether the regulatory interest rate is sufficient for a regulatory asset and the determination of the minimum interest rate for that regulatory asset would be very costly and complex.

    (See Agenda Paper 9F *Feedback summary—Discount rate* of the October 2021 meeting.)

23. In relation to the disclosure proposals:

    (a) some respondents said the cost of disclosing all the proposed components of regulatory income or regulatory expense outweigh the benefits to the users of financial statements;

    (b) some respondents said disclosing the quantitative information about expected recovery of regulatory assets and fulfilment of regulatory liabilities would be costly for preparers as it would require significant judgement when determining the time bands and the amounts; and

(c) a few respondents said the disclosure in the notes of the financial effects of regulatory assets and regulatory liabilities without recognition would be a cost-effective approach to providing useful information to the users of financial statements.

(See Agenda Paper 9B *Feedback summary—Disclosure* of this meeting.)

24. To reduce the costs of implementing the proposals, a European national standard-setter suggested the Board clarify that an entity should identify its performance obligations based on the regulatory agreement and not just the obligation to supply goods or services to its customers.

Question 12(c)—Other comments on likely effects

25. The Board asked stakeholders whether they have any other comments on how the Board should assess whether the likely benefits of implementing the proposals outweigh the likely costs of implementing them or on any other factors the Board should consider in analysing the likely effects.

26. A few respondents said the Board should further study the costs and benefits of the proposals to entities other than utilities.

Question 13—Other comments

27. The Board asked stakeholders whether they have any other comments on the proposals in the Exposure Draft or on the Illustrative Examples accompanying the Exposure Draft.

28. A few accounting firms and preparers encouraged the Board to include in the Basis for Conclusions on the Standard an analysis of the differences between the proposals and US GAAP.

29. A few accounting firms and national standard-setters recommended the Board constitute a Transition Resource Group to support implementation of the Standard.

Question for the Board
Does the Board have any questions or comments on the feedback discussed in this paper? Specifically: a. Is there any feedback that is unclear? b. Are there any points you think the Board did not consider in developing the Exposure Draft but should consider in the re-deliberations? c. Are there any points you would like staff to research further for the re-deliberations?