Meeting Notes—Consultative Group for Rate Regulation

The Consultative Group for Rate Regulation (CGRR) held a virtual meeting on 4 March 2022. These notes are prepared by the staff of the International Accounting Standards Board (IASB) and summarise the discussion.[1]

About this meeting

1. The purpose of the meeting was to explore possible courses of action the IASB may consider in responding to the feedback and in redeliberating its proposal on regulatory returns on construction work-in-progress (CWIP).

2. Meeting participants:

Name	***Organisation***	***Country/Region***
Giorgio Acunzo	Ernst & Young	Italy
Eric Chan	CLP Power Hong Kong Limited	Hong Kong
Leonardo George de Magalhães	Companhia Energética de Minas Gerais (Cemig)	Brazil
Jesús Herranz Lumbreras	Ferrovial SA	Spain
John Leotta	Deloitte Touche Tohmatsu	Australia
Richard McCabe	Consultant for Electricity Canada	Canada
Christopher McCusker	National Grid	USA
Sureta Moolman	Eskom Holdings SOC Ltd	South Africa
Pascale Mourvillier	PAM Expertise	France
Tim Murray	RBC Capital Markets, Royal Bank of Canada	Canada
Michel Picard	KPMG	Canada
Christina Scharf	TenneT Holding B.V.	Germany
Michael Timar	PricewaterhouseCoopers	United Kingdom
Stefanie Voelz (observer)	Moody's Investors Service Ltd	United Kingdom
	European Financial Reporting Advisory Group (EFRAG) (observer)	Europe

3. Meeting notes structure:

   a. background (paragraphs 4–8);

   b. goods or services supplied (paragraphs 9–10);

[1] The papers discussed with the Consultative Group for Rate Regulation can be found here. A full recording of the meeting is available on the IFRS Foundation® website.

c. courses of action 1 and 2 (paragraphs 11–13);

d. course of action 3 (paragraph 14);

e. courses of action 4 and 5 (paragraphs 15–16);

f. other comments (paragraphs 17–19); and

g. next steps (paragraph 20).

Background

4. The staff summarised Agenda Paper 2 and possible courses of action the IASB could take in relation to its proposal on regulatory returns on construction work-in-progress (CWIP).

5. Paragraph B15 of the Exposure Draft *Regulatory Assets and Regulatory Liabilities* (Exposure Draft) proposes that:

   a. regulatory returns on CWIP should form part of the total allowed compensation for goods or services supplied:

      i. once the asset is available for use; and

      ii. over the remaining periods in which the entity recovers the carrying amount of the asset through the regulated rates; and

   b. an entity should use a reasonable and supportable basis to determine how to allocate the return on that asset over these remaining periods and apply that basis consistently.

6. The IASB concluded that the proposal in paragraph B15 is consistent with the principle underlying the model because no goods or services are supplied using an asset before it is available for use.[2]

7. The IASB's possible courses of action are :

   a. course of action 1—expand the scope of the Standard to include rights and obligations that are not regulatory assets and regulatory liabilities;

   b. course of action 2—broaden the notion of 'goods or services supplied' to include satisfying service requirements specified by a regulatory agreement;

   c. course of action 3—remove paragraph B15 of the Exposure Draft, which specifies the required treatment for regulatory returns on CWIP;

[2] The underlying principle of the model in the Exposure Draft *Regulatory Assets and Regulatory Liabilities* is that an entity shall reflect the total allowed compensation for goods or services supplied as part of its reported financial performance for the period in which those goods or services are supplied.

d. course of action 4—confirm the proposal; and

e. course of action 5—narrow the proposal so it applies only to long-duration construction projects.

8. The staff asked members whether staff:

a. have correctly analysed the pros and cons of each course of action;

b. should be aware of any implementation issues; and

c. should consider any other potential courses of action.

Goods or services supplied

9. Many members said that during the construction period regulated entities are providing services, such as:

a. designing, building, maintaining and expanding the infrastructure;

b. making the infrastructure available at all times; and

c. financing—returns represent reimbursement for funding costs incurred during construction.

10. A few members added that:

a. the goods or services are not limited to the commodity supplied—services of the types described in paragraph 9 are provided even before an asset comes into operation;

b. entities' entitlement to returns on CWIP does not depend on whether the construction of the assets is completed—that is, the finalisation of the construction of the asset is not a condition for an entity's right to receive returns on CWIP. This supports the recognition of returns on CWIP during the construction period and not during its operation.

Courses of action 1 and 2

11. Members of the CGRR preferred these courses of action. Paragraphs 12–13 summarise the comments on both courses.

12. Course of action 1—some members said this course of action would address concerns raised by respondents to the Exposure Draft and could, therefore, be a workable solution. However, a few members said:

a. expanding the scope of the Standard could have unintended consequences that could take time to identify and understand.

b. expanding the scope of the Standard would be unnecessary because, during the construction period, the regulator would have approved the returns on CWIP to which an entity was entitled. Entities subject to regulatory schemes that allow an entity to include such returns in the rates charged while the entity operates the asset, already have an enforceable present right that fulfils the definition of a regulatory asset.

c. this course of action may reduce the understandability of an entity's performance. This reduced understanding could occur because this course of action would introduce a new type of income arising from the right to accrue regulatory returns on CWIP. This new item of income would need to be considered with the revenue and regulatory income minus regulatory expense line items, when assessing an entity's performance.

d. course of action 1 could cause implementation issues because entities would need to accrue regulatory returns on an individual asset basis during the construction period of each asset. According to this member, this accrual would require more effort than including returns on CWIP in the statement of profit or loss during the construction period.

13. Course of action 2—members said this course of action would also address the concerns raised by respondents to the Exposure Draft and could, therefore, be a workable solution. As mentioned in paragraph 9, to many members, building, maintaining, expanding and making the infrastructure available are services regulated entities provide during the construction period. A few members also said:

a. the recognition of regulatory returns on CWIP during construction would better reflect an entity's performance in accordance with the regulatory agreement than would the proposals in the Exposure Draft.

b. course of action 2 would align with the IASB's decision, when developing IFRS 15 *Revenue from Contracts with Customers,* to avoid using an activity-based model for revenue recognition in the absence of a contract with customers (see paragraphs BC16–BC24 of IFRS 15). This member said that, over the construction period, the regulator could be viewed as entering into a regulatory agreement on behalf of the 'customer base', whereby the entity is required to build infrastructure. Consequently, during the construction period, the entity provides services to that customer base. During construction, an individual customer cannot enter into a contract with the entity and demand the fulfilment of the construction promise. However, in the operating phase, the individual customer can enter into a contract with the entity. The disadvantage of this member's suggestion is that it would require the IASB to develop the notion of 'customer base'.

c. course of action 2 should provide no opportunities for preparers to manage income recognition because regulatory agreements are typically clear about the nature of an entity's rights and obligations.

d. in developing this approach, the IASB would need to consider whether expanding the notion of 'goods or services supplied' would be consistent with the performance obligation concept in IFRS 15.

Course of action 3

14. Many members said that course of action 3 is a workable solution. However, some members also said:

    a. they were concerned this course of action would lead to various outcomes depending on whether regulators allowed entities to include returns on CWIP in rates charged during the construction period or during the operating period. These members said that, for course of action 3 to be a workable solution, it would require the notion of 'goods or services' to include goods or services supplied during the construction period.

    b. the proposed requirement in paragraph B15 of the Exposure Draft should be redrafted to allow entities to reflect returns on CWIP in profit or loss during the construction period (instead of prohibiting entities from doing so).

    c. for entities that are only allowed to include returns on CWIP in the rates charged during the operating period, this course of action would result in outcomes inconsistent with the proposed treatment of construction-related performance incentives.

Courses of action 4 and 5

15. No members of the CGRR agreed with proposed courses of action 4 or 5. Members stated that these courses of action would not respond to respondents' main concerns about the proposals for returns on CWIP.

16. A few members said that course of action 5:

    a. would not address the concerns of entities with long-term construction projects.

    b. could create two types of regulated entities: those that mainly do short-term construction projects and those that mainly do long-term construction projects. According to this member, this could have unintended consequences—for example, would an entity doing short-term construction projects avoid long-term construction projects because of the accounting consequences? This course of action could also result in a lack of comparability between these two entity types and provide opportunities for earnings management.

Other comments

17. A member commented that regulated entities are significantly different from commercial entities. Regulated entities carry out social responsibilities and their earnings are limited; however, they also enjoy some financial protection. This member said that trying to apply accounting concepts developed for commercial entities to regulated entities may not work.

18. A few members said the Exposure Draft considered assets under construction on an individual basis. However, assets under construction should be considered on a portfolio basis (that is, they form part of a wider network of assets). Consequently, returns on CWIP are based on a portfolio of assets, not on assets considered on an individual basis.

19. A few members also said:

a. the Standard should require information about performance that reflects the substance of regulatory agreements. This member also suggested the Standard use similar performance reporting principles to those in IFRS 15.

b. it is important that the Standard provides guidance for entities to report movements in regulatory assets and regulatory liabilities in the statement of cash flows so that this is done in a consistent and comparable manner.

c. when customers pay for the regulated goods or services, they are paying not only for the goods or services they receive but also for the promise the regulated entity would keep providing goods or services in the future. This is an important difference between regulated entities and non-regulated entities that, according to this member, would support the recognition of revenue for regulated entities during the construction period.

d. the issued Standard would generate information that could hide directors' stewardship and accountability responsibility because, during the construction period, the entity would incur losses regardless of whether it is complying with the regulatory agreement.

Next steps

20. At a next meeting, the staff plan to discuss with the CGRR the proposed accounting for regulatory assets or regulatory liabilities arising from differences between the regulatory recovery period and assets' useful lives (paragraphs B3–B9 of the Exposure Draft and Illustrative Examples IE2B and IE2C accompanying the Exposure Draft).