ED on Regulatory Assets and Liabilities

Accounting for RAs and RLs arising from differences between the regulatory recovery pace and assets' useful lives

Presentation to the IASB Consultative Group's meeting of March 28, 2022

With you today

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Agenda

- Entities surveyed
- General comments
- Responses to Q1 to Q5

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Entities surveyed

- UK (11), Australia (2) and Canada (1)
  - 2 regulators
  - 1 investor
  - 6 energy entities
  - 5 water entities

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General comments

- No unintended consequences identified for the Canadian utilities as there is normally a direct link between RAB and PPE, including depreciation
  - Regulatory requirements to reconcile the two bases
- UK and Australia support action 1 as the link between the RAB and PPE is weak
- Some (UK and Australia) believe that the differences between RAB and PPE do not meet the definition of RA or RL
- Users are against recognition of RAs and RLs for non-cash timing differences as they would back them out from their EBITDA calcs
- Disclosures for action 1 should be minimal (UK and Australia)

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Q 1: Pros and cons of each course of action

My view: What would happen is that within a country/regime, the relevant players would typically apply the same approach and the risks is actually differences between countries that have similar arrangements.

Course of action 1: Pros

— Avoids the creation of an artificial link between regulatory depreciation and accounting depreciation where one does not exist, therefore providing more relevant information

Course of action 1: Cons

— "Application by analogy" – Disagree to restrict it. if there is no direct link then the principle remains that it would not be providing decision useful information

— "Determining whether there is a direct relationship" – Would be mitigated by ensuring that the indicators are correctly identified

— Both of the cons raised could be overcome through carefully worded application guidance and illustrative examples

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Q 1: Pros and cons of each course of action

Courses of action 2 and 3: Pros

— Not convinced that the "pros" for actions 2 and 3 re. comparable information would be true

— Actions 2 and 3 would both be infeasible, complex and add more confusion to the accounts rather than making them helpful to the end users

— Could be a challenging / time consuming exercise

Courses of action 2 and 3: Cons

— Add: Would require alternative performance measures (APMs) to back out the impact of RAs and RLs which would add an additional burden to preparers

— It is not a case of being operationally challenging and complex - the two values are simply not reconcilable

— Proposals will NOT result in consistent outcomes for all entities. The proposals are complex and require judgements to be made about future inflation and returns which are likely to lead to entities taking different approaches.

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Q 2: Implementation issues for action 1

My view: Indicators are clear. No issue if it is only qualitative disclosure.

Comments from the UK

— Many agree with the proposed disclosure

— Agree that the costs would not outweigh the benefits when the link is weak, therefore they support disclosure

— Unclear whether the disclosure would require quantification

— Difficulty to implement the ED due to availability of the required granular information (e.g. some assets are 80 years old and have been acquired from through privatisation of previously nationalised assets)

— In the water sector, users have access to additional information about their performance, including a calculation of shadow RCV, as required by the regulator

— Regulation differs across regions. Therefore IG would be required to ensure consistent reporting by groups within a region and within a group across regions.

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Q 2: Implementation issues for action 2

My view: Action 2 represents a significant simplification – a beneficial practical expedient – but would still require significant work, subjectivity and judgment

— Unconvinced that this is really a feasible option given the lack of linkage

— Any attempt to reconcile the two bases would be highly subjective, hugely complex and expensive, and would be confusing to users

— Would still require a significant level of work in order to unpick what has gone into the RAB of many years and is likely to involve significant judgement in reaching a final timing difference

— Would involve a lot of subjectivity as they would need to uncouple inflation, performance incentives awards, infrastructure renewal accrual/prepayment, etc. Furthermore, upon privatisation, the RCV was determined based on presumed market value at that time. Therefore, would require significant assumptions

— Would be problematic in cases where a business was acquired under M&A

— Would need to develop a way and system that enables us to link RCV to PPE that doesn't currently exist

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Q 3: Indicators

My view: The indicators appear reasonable

- The indicators noted are deemed reasonable
- Based on the indicators listed, most utilities in UK would conclude there is no link
- Add: The ability to adjust a tariff in a future period
  - As depreciation does not allow, it demonstrates that there is no linkage
- Add: Inclusion of comments from regulators as an indicator
  - The regulator in UK has expressly communicated that the RAB is an esoteric economic construct which attempts to make no link to an entity's PPE
- Add: Indexation of RCV that is not included in PPE
- How to define "significant" in the 1st indicator (especially in situations where the underlying RAB components predominantly consist of PPE)
- It is unclear whether the phrase in the 3rd indicator "…not possible…" equates to being "costly" or "impractical"

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Q 3: Disclosure

- Most believe that since there is no link then detailed disclosures is not relevant
  - Disclose a brief explanation of the (lack of a) relationship
- Disclosure of information should be limited to an explanation of the reasons why it is not appropriate to recognise RAs / RLs in respect of regulatory depreciation
  - Having established that RAB and PPE are not comparable values, any requirement to compare regulatory and accounting depreciation would be contradictory and confusing and be of no value to the users
- Add: RAB value with information about the main reasons for the difference between RAB and PPE
- Add: Regulated life and weighted average accounting life;

  provide an explanation of how the regulator/company determined the regulatory depreciation life; and

  note the key reasons for any difference (user surveyed)

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Q 4: Other potential courses of action

- Course of Action 1 with no, or very limited, disclosure
- The Standard could either exclude these proposals or specifically set out that they do not apply to the regulated entities in the UK
- Should (re)consider whether or not the difference between RAB and PPE actually creates an asset/liability
- Remove 'non-cash' timing differences from the definition of a RA and RL
- Should consider that if there is no link between RAB/PPE, then by extension this should also apply to AFUDC
- Should also consider a modified retrospective approach, where the cumulative effect of initial application is recognized in opening retained earnings in the year of initial application

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Q 5: Rates recover assets under construction

My View: Not common in Canada to recover assets under construction (a few cases)

— Common fact pattern in the UK, whereby they begin recovering costs of constructing an asset one year after they've begun incurring expenditure

And typically, regulatory recovery period is shorter than IFRS useful life

— One regulator surveyed would not allow an RCV run off rate which resulted in companies running down their RCV too quickly and which left them in a position where the RCV was fully written down before the costs of the assets had been fully paid

— Revenue collected during the construction is deferred in the accounts in line with current Standards. No additional info should be disclosed

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Q 5: Disclosure

- Disclose the fact that the recovery of the RAB has started during the construction of the assets and disclose the linkage issue
- Where RAB recovery period is shorter than useful life, disclose that information along with an explanation
- If there is no link, they don’t believe any further information would be useful
- While not directly comparable, the amendment to IAS 16 - “Proceeds before Intended Use' is quite similar to proceeds received during construction of an asset
  - The amendment is ceasing the 'balance sheet accounting' for pre-commissioning revenue, whereas the ED is proposing to 'balance sheet account' for the rates received during construction
  - Regulator allows construction costs to be included in the rate setting and therefore meets the definition of revenue under IFRS 15
  - 'Reversal' of this revenue through recognition of a RL contradict two other Standards

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