

## Meeting Notes—Consultative Group for Rate Regulation

The Consultative Group for Rate Regulation (CGRR) held a virtual meeting on 28 March 2022. These notes are prepared by the staff of the International Accounting Standards Board (IASB) and summarise the discussion.<sup>1</sup>

### About this meeting

- The purpose of the meeting was to explore how the IASB might respond to feedback on its proposals on the accounting for regulatory assets and regulatory liabilities arising from differences between the recovery pace of the regulatory asset base<sup>2</sup> and the assets' useful lives.
- Meeting participants:

<b>Name</b>	<b>Organisation</b>	<b>Country/Region</b>
Giorgio Acunzo	Ernst & Young	Italy
Eric Chan	CLP Power Hong Kong Limited	Hong Kong
Anil Kumar Gautam	NTPC Ltd	India
Leonardo George de Magalhães	Companhia Energética de Minas Gerais	Brazil
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
Tim Murray	RBC Capital Markets, Royal Bank of Canada	Canada
Michel Picard	KPMG	Canada
Christina Scharf	TenneT Holding B.V.	Germany
Silvia Blanco Sánchez <sup>3</sup>	Ferrovial SA	Spain
Michael Timar	PricewaterhouseCoopers	United Kingdom
Yeshvir Singh	Fitch Ratings	United Kingdom
Stefanie Voelz (observer)	Moody's Investors Service Ltd	United Kingdom
	European Financial Reporting Advisory Group (observer)	Europe

<sup>1</sup> 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's® website.

<sup>2</sup> The Exposure Draft referred to the 'regulatory asset base' as the 'regulatory capital base'. Other common terms are 'regulatory asset value' or 'regulatory capital value'.

<sup>3</sup> Replacing Jesús Herranz Lumbreras at this meeting.

3. Meeting notes structure:
  - a. background (paragraphs 4–8);
  - b. the regulatory asset base and an entity's assets (paragraphs 9–10);
  - c. course of action 1 (paragraphs 11–16);
  - d. courses of action 2 and 3 (paragraphs 17–21);
  - e. other comments (paragraphs 22–24); and
  - f. next steps (paragraph 25).

## Background

4. The staff summarised [Agenda Paper 1](#) and possible courses of action the IASB could take in relation to its proposal on accounting for regulatory assets and regulatory liabilities arising from differences between the regulatory asset base's recovery pace and the assets' useful lives.
5. Paragraph B7 of the Exposure Draft *Regulatory Assets and Regulatory Liabilities* proposes that:

*... IAS 16 Property, Plant and Equipment specifies how to allocate the depreciable amount of an item of plant on a systematic basis over its useful life. If a regulatory agreement allows an entity to recover the cost of an asset through the regulated rates charged to customers, the depreciation expense recognised in a period, by applying IAS 16, is an allowable expense and the amount that recovers that depreciation expense forms part of the total allowed compensation for goods or services supplied in the same period. That is the case even if, under the terms of the regulatory agreement, the recovery of the depreciation expense occurs in a different period—for example, if the regulatory agreement uses a longer or shorter period of recovery than the asset's useful life [emphasis added].*
6. Agenda Paper 1 also included an overview of the comments received from respondents to the Exposure Draft. Some comments from respondents are relevant to discussions on the possible courses of action, for example:
  - a. the Exposure Draft proposes that differences between the regulatory asset base's recovery pace and the assets' useful lives would give rise to differences in timing that would be accounted for as regulatory assets or regulatory liabilities. These differences in timing would not represent adjustments to future rates. Some respondents referred to these differences in timing as 'non-cash differences in timing'. Some respondents said these regulatory assets or regulatory liabilities would not result in useful information.
  - b. respondents subject to incentive-based schemes said an entity's regulatory asset base cannot be linked or reconciled to the fixed asset register the entity uses for accounting. These respondents said the recognition of the regulatory depreciation (that is, the regulatory compensation to recover the regulatory asset base) should be based on the regulatory agreement, instead of when accounting depreciation is recognised.
7. The possible courses of action available to the IASB include:
  - a. *course of action 1*—to consider the relationship between regulatory depreciation and accounting depreciation. This course of action would require that an entity determine

whether there is a direct relationship between the regulatory compensation (regulatory depreciation) and the underlying expense (depreciation expense). If the entity were to conclude there is no direct relationship, the entity would not be required to account for regulatory assets or regulatory liabilities but to disclose specific information.

- b. *course of action 2*—to make an overall calculation based on comparable regulatory and accounting bases. This course of action would be aimed at identifying differences in timing by comparing the regulatory asset base and the entity's total assets.
  - c. *course of action 3*—to confirm the proposals.
8. The staff asked members:
- a. whether the staff has correctly analysed the pros and cons of each course of action.
  - b. whether any implementation issues might arise if the IASB took courses of action 1 or 2.
  - c. whether the indicators suggested for course of action 1 are appropriate.
  - d. whether the suggested disclosures are appropriate for entities that do not account for regulatory assets or regulatory liabilities in accordance with course of action 1.
  - e. whether the staff should consider any other potential courses of action.
  - f. how common it is for a regulatory agreement to allow an entity to include amounts in rates charged during the construction of an asset that recover part of the carrying amount of the asset. The staff also asked members whether any information resulting from this fact pattern would be useful for users of financial statements.

### **The regulatory asset base and an entity's assets**

9. A few members from jurisdictions where entities are subject to incentive-based schemes noted that it is unusual for the entity's asset base to have a direct relationship with the regulatory asset base. Consequently, comparisons between these two bases may not be meaningful. For these members, recognising regulatory assets and regulatory liabilities for differences between the regulatory recovery pace and the assets' useful lives would not result in useful information.
10. A few members from jurisdictions where entities are subject to regulatory schemes that are cost-based or similar to cost-based schemes commented on the relationship between the regulatory asset base and an entity's assets. They said that typically, the regulatory asset base is directly related to an entity's assets and that, therefore, the regulatory depreciation is directly related to the accounting depreciation. These members said entities in those jurisdictions are generally required to reconcile accounting and regulatory fixed asset registers regularly.

### **Course of action 1**

11. Almost all members preferred course of action 1. Some members said course of action 1:
  - a. is consistent with a principles-based approach that can be applied to different regulatory schemes.
  - b. is aligned with the concept of differences in timing, which is at the core of the model and:
    - i. would not create links between the regulatory compensation (regulatory depreciation) and an item of expense (depreciation expense) when none existed. They said that

when regulatory compensation is unrelated to accounting depreciation, disclosures would provide useful information.

- ii. would result in information about the differences between the regulatory asset base's recovery pace and the assets' useful lives when there is a direct relationship between regulatory depreciation and accounting depreciation. Entities taking this course of action would be required to account for the corresponding regulatory assets and regulatory liabilities.
12. A few members, including members that are users of financial statements, said that users' analyses focus on the impact of rate regulation on future cash flows (that is, cash differences in timing). For users it is important to know the amount of the regulatory depreciation that has flowed into revenue and will turn to cash flows and how that amount differs from the accounting depreciation. One of those members preferred that an entity should be required to account for regulatory assets or regulatory liabilities arising from cash differences in timing only.
13. A member preferring course of action 1 said this course of action would not necessarily address the root cause of the problem, which is the way total allowed compensation is described in the proposed application guidance. According to this member, the Exposure Draft assumes that all regulatory regimes aim to entitle entities to recover their costs and, consequently, that the recovery of cost is directly related to revenue. However, some regulatory schemes give entities an allowed revenue that does not guarantee the recovery of costs while other regulatory schemes are hybrid schemes (that is, schemes that give the entity an allowed revenue and pass-through costs). For this member, focusing only on whether there is a direct relationship between regulatory depreciation and accounting depreciation may not address the root cause of the problem because that relationship might be just one of many problematic issues in the proposed application guidance. This member suggested the guidance state that total allowed compensation comprises allowable expenses and target profit or allowed revenue for the provision of goods or services for a specified period. Entities would then need to apply judgment to determine which components of total allowed compensation are relevant to them for the purposes of identifying differences in timing.
14. A few members commented on the indicators that course of action 1 suggest entities could use to determine when linking regulatory depreciation to accounting depreciation. They said:
  - a. the indicators are reasonable and that entities can use them to determine that there is no direct relationship between regulatory depreciation and accounting depreciation.
  - b. the descriptions of the indicators raise some questions. For example, it is unclear what is meant by the italicised words in the phrases 'the regulatory asset base departs *significantly*

- from the assets' and '*not possible* for items in the regulatory asset base to be reconciled to audited financial statements'.
- c. the indicators could be supplemented with additional guidance, including specific examples of indicators such as inflation and efficiency adjustments to the regulatory asset base, and different measurement bases between the regulatory asset base and an entity's assets.
15. A few members commented on the information an entity should disclose when it does not account for a regulatory asset or a regulatory liability. They said:
- a. the entity should be required to disclose qualitative information only. When there is no direct relationship between regulatory depreciation and accounting depreciation, it would be very complex and costly to provide quantitative information that reconciles regulatory depreciation to depreciation expense. Quantitative information about links between the regulatory compensation and the accounting depreciation would not be useful for users of financial statements.
  - b. examples of useful qualitative information include:
    - i. a description of the regulatory schemes and the recovery mechanism for the regulatory asset base disclosed separately for each jurisdiction in which an entity operates.
    - ii. an explanation for the lack of a direct relationship between regulatory depreciation and accounting depreciation, the main differences between the value of the regulatory asset base and the carrying amount of the assets, and the key regulatory and accounting assumptions.
    - iii. how the regulatory asset base's recovery pace is determined, whether the recovery pace has changed during the period and, if so, the underlying reasons for the change.
    - iv. if the regulatory depreciation has not been fully recovered, information about the recoverable amount and any regulatory approval required for the true-up adjustment to the future rates.
16. A few members commented on the pros and cons of course of action 1. They said:
- a. this course of action should also be followed for any other items of expense for which there is no direct relationship between the regulatory compensation and those items of expense.
  - b. entities could reach different conclusions about whether there is a direct relationship between regulatory depreciation and accounting depreciation based on the same or similar fact patterns or situations. A few members said:
    - i. the IASB could mitigate this risk by providing the right indicators and additional guidance or examples in the Standard.
    - ii. if an entity did not account for the related regulatory assets or regulatory liabilities, the information the entity would be required to disclose could mitigate a potential lack of comparability.
    - iii. whether a direct relationship exists between regulatory depreciation and accounting depreciation will depend on the regulatory regime—it is largely a matter of fact rather than judgment. Consequently, opportunities to apply judgment to achieve a preferred accounting outcome would be limited. One member said that in their jurisdiction, entities are subject to cost-based regulatory schemes. The assets' regulatory recovery

period is subject to a rigorous independent review process. Entities maintain separate regulatory and accounting records of individual assets and submit reconciliations of regulatory assets and accounting assets as part of their regulatory reporting.

### Courses of action 2 and 3

17. No members supported course of action 3. Only one member said course of action 2 might be feasible as it requires the reconciliation between the regulatory asset base and an entity's assets to be done at an aggregate level rather than at an asset level. However, this member was concerned about the auditability of the assumptions and the information used when applying this course of action.
18. Many members said both courses of action would require entities to account for regulatory assets and regulatory liabilities even when there is no direct relationship between regulatory depreciation and accounting depreciation. As mentioned in paragraph 15(a), these members said:
  - a. a reconciliation of regulatory depreciation to depreciation expense would be very complex and costly; and
  - b. the reported regulatory assets and regulatory liabilities would not constitute useful information for users of financial statements.
19. In relation to course of action 2 a few members said:
  - a. making the two bases (that is, the regulatory asset base and an entity's total assets) comparable would be complex and costly because:
    - i. new variances between the value of the regulatory asset base and the carrying amount of the assets would arise on an ongoing basis, which an entity would need to track.
    - ii. following course of action 2 could require an entity to obtain information at a more detailed level than that maintained for regulatory purposes (for example, information aggregated by asset classes and high-level reconciliations). This could be the case even in cases where regulatory depreciation is directly related to accounting depreciation. These members were also concerned about the ease of auditing information at that level of detail.
  - b. it is unclear:
    - i. why the recovery or fulfilment period of the regulatory asset or regulatory liability should be based on the assets' weighted average useful lives. One member said the resulting regulatory expense or regulatory income is intended to supplement the revenue information, but there is no clear linkage between revenue recognition and the assets' weighted average useful lives.
    - ii. how an entity would treat items such as adjustments for inflation and measurement differences that would form part of an entity's total allowed compensation but that would need to be removed to make the bases comparable.
20. Members said course of action 3 would not respond to respondents' concerns and would fail to reflect regulatory schemes other than cost-based schemes. They said the proposed model

assumes a direct relationship between the regulatory compensation and the accounting depreciation, but that this is not always the case.

21. A member said, in addition to the identified disadvantages of courses of action 2 and 3, that entities subject to incentive-based schemes might need to present alternative performance measures reflecting the regulatory compensation.

### Other comments

22. A member surveyed 14 stakeholders (preparers, regulators and a user) from the United Kingdom, Australia and Canada and presented the results of the survey.<sup>4</sup> The comments in the paragraphs above also include feedback on the survey. The main messages from the survey were that:
  - a. stakeholders based in the United Kingdom and Australia generally supported course of action 1 because, in their view, the relationship between the regulatory asset base and an entity's assets is weak. In addition, some stakeholders in these jurisdictions said the assets or liabilities arising from differences between the regulatory asset base's recovery pace and the assets' useful lives would not meet the definitions of a regulatory asset or a regulatory liability. These stakeholders also said the disclosures for course of action 1 should be minimal and should be qualitative rather than quantitative.
  - b. courses of action 2 and 3 did not receive much support from stakeholders from the United Kingdom and Australia because they are complex to apply and could confuse users of financial statements.

### *Recovery of assets' carrying amounts through rates charged during construction*

23. A few members said the fact pattern in which rates charged during the construction of an asset recover part of the carrying amount of the asset is:
  - a. common in the regulatory schemes of a jurisdiction in Europe, in which there is no direct relationship between regulatory depreciation and accounting depreciation; and
  - b. uncommon in the regulatory schemes of two jurisdictions in North and South America in which there is a direct relationship between regulatory depreciation and accounting depreciation.
24. A member suggested the accounting for a regulatory liability and the related regulatory expense relating to an asset's carrying amount recovered during construction would be inconsistent with the requirements in *Property, Plant and Equipment: Proceeds before Intended Use* (Amendments to IAS 16). Those amendments require an entity to recognise in profit or loss the proceeds from selling and the cost of any items produced while bringing an asset to the location and condition necessary for its intended use. According to that member, if part of the asset's carrying amount recovered during construction was recognised in revenue as a result of goods or services already supplied, in accordance with IFRS 15 *Revenue from Contracts with*

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<sup>4</sup> The presentation from this member of the CGRR can be found [here](#).

*Customers*, it was unclear why the entity should be required to defer recognising the effects of that amount in profit or loss by recognising a regulatory liability.

### **Next steps**

25. The staff will analyse the feedback received from the members of the CGRR on the topics discussed at the meeting held on 4 March 2022 and at this meeting. The staff may also consult the CGRR or individual members of the CGRR on specific matters.