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Re: ED/2021/1 Regulatory Assets and Regulatory Liabilities

Dear Mr Barckow,

We are pleased to have the opportunity to provide our comments on the EFRAG Draft Comment Letter on the Exposure Draft *Regulatory Assets and Regulatory Liabilities* issued by the IASB in January 2021 (the ED).

In general, we support the ED and the IASB's efforts to address the accounting for regulatory assets and regulatory liabilities. We believe that a new Standard on regulatory assets and liabilities is needed to enhance comparability of information for users of financial statements and to better represent the performance of rate-regulated entities.

We provide below our comments on the IASB's proposals.

Objective and scope

We support the IASB's overall objective to develop an accounting model for regulatory asset and regulatory liabilities.

We see the merits of a principle-based definition of the scope of the new standard and we support this approach. However, we note that the ED does not provide a definition of "customers". We think that a definition of "customers" would help entities in applying the accounting model proposed by the IASB. This is because, the ED focuses on increases/decreases in future regulated rates that are charged to customers because of goods or services already supplied to those customers. Therefore, in our view, the recovery and settlement of total allowed compensation by parties other than customers (for example a government agency or the regulator) should not be within the scope of this ED, as it should be considered a receivable already in the scope of another standard (for example IFRIC 12).

We also believe that a definition of customers is needed, because the concept of customers in the ED is different from the definition of customer in IFRS 15. If the concept of customer in this standard is probably wider and should probably meant as community, this should be explicited in the standard.

Recognition

We agree that an entity should recognise all its regulatory assets and regulatory liabilities existing at the end of the reporting period. However, we have some concerns on paragraph 28 of the ED that specifies that: "if it is uncertain whether a regulatory asset or a regulatory liability exists, an entity shall recognise the regulatory asset or regulatory liability if it is more likely than not that it exists."

We think that in some circumstances it may be very complex to assess whether it is more likely than not that an asset exists. Consequently, we recommend the IASB to consider an higher threshold for the recognition of a regulatory item when it is uncertain whether it exists. To this end the "highly probable" threshold used in paragraph 56 of IFRS 15 (ie Constraining estimates of variable consideration) would result in more reliable information.

Regulatory returns on construction work in progress

According to the ED regulatory returns related to assets not yet in use (ie construction work in progress – 'CWIP') are not included in the total allowed compensation for goods or services supplied before the asset is available for use.

In some cases the regulatory agreement allows to charge to customers the returns on CWIP during the construction phase. We believe that in this case, these returns should be included in profit or loss during the construction phase (and not only when the asset is in use as proposed in the ED) for the following reasons:

- This IASB's proposal is not aligned with the objective of the regulatory agreement. Usually, the regulator allows to charge to customers these returns during the construction phase in order to incentive the regulated entity to complete the construction of the asset as soon as possible. They are very similar to performance incentives, that according to the ED are included in the total allowed compensation.
- It may be complex to defer the part of the revenue that relates to these returns, because entities would be required to allocate the revenues to the single asset under construction and these assets may be numerous.

Measurement

Reliability

We support the proposed cash flow measurement technique; however, we have been informed that in some cases it may be very challenging to reliably estimate the future cash-flows of a regulatory asset or liability, either using "the expected value method" or "the most likely amount method". For example, in Italy, in some sectors the future regulated rates are determined by the regulator on the basis of the costs incurred by all the entities operating in a specific sector. This means that a single entity may not be able to reliably estimate its regulatory assets or liabilities, because the future rates depend also by the costs incurred by other entities (and the entity does not have this information).

For this reason, we suggest the IASB to consider to specify in the new standard that regulatory assets and regulatory liabilities that cannot be estimated in a reliable manner should not be recognised.

Credit risk

We agree that an entity should consider all sources of uncertainty affecting the future cash flows, including the credit risk that it bears. However, we have been informed that in some cases this estimation may be very challenging. For example, an entity might not be able to identify who will be the customer (and thus it cannot estimate its credit risk) when it initially recognises and measures a regulated asset.

For this reason, we suggest the IASB to clarify in the new standard whether and how an entity should estimate the credit risk that it bears when the customer is "unknown" when a regulated asset is initially recognised.

Discount rate

The ED requires to measure a regulatory asset or a regulatory liability discounting the future cash flows using the regulatory interest rate. However, only for regulatory assets, the ED requires to assess if this rate is sufficient to compensate the entity for the time value of money and for uncertainty in the amount and timing of the future cash flows. If the regulatory interest rate is insufficient to provide this compensation, an entity shall estimate the minimum interest rate and use this higher rate to discount the future cash flows.

We disagree with this proposal. We believe that an entity should always use the regulatory interest rate as a proxy of the discount rate for all its regulatory assets and liabilities when it is clear that the regulatory interest rate is negotiated with the regulator and it represents the actual rate that the entity is entitled to recover.

Moreover, we note that the regulatory interest rate is unbiased, while the minimum interest rate is judgmental and may be difficult to estimate.

We also suggest the IASB to specify in the new standard that entities are not required to discount future cash flows if the effects of discounting are not material.

Interaction with other IFRS Standards

We generally agree with the IASB proposals addressing the interactions with other IFRS Standards, however we have the following concerns:

- IFRS 3: we do not agree with the proposed exception to IFRS 3 (ie regulatory assets and liabilities acquired in a business combination are not measured at fair value but continue to be measured at modified historical cost). In our view, this proposed exception could increase the amount of goodwill recognised in the financial statements of the acquirer and further complicate the impairment test.
- IFRIC 12: according to paragraph B47 of the ED, it seems that regulatory assets included in the assets within the scope of IFRIC 12 should be reclassified in the regulatory assets within the scope of the ED. We disagree with this proposal when the financial model of IFRIC 12 is applied. In that case, as mentioned above, there is no reason to apply this standard. When the intangible model is applied then it should be clarified that this standard applies only to the assets from operations and not from construction and that the entity should avoid any risk of double counting between the two.

Should you need any further information, please do not hesitate to contact us.

Yours sincerely,
Angelo Casò
(Chairman)