

28 July 2021

Dr Andreas Barckow
Chairman
International Accounting Standards Board
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Via website: www.ifrs.org/projects/open-for-comment/

Dear Dr Barckow

Submission on Exposure Draft ED/2021/1: Regulatory Assets and Regulatory Liabilities

As the representatives of over 280,000 professional accountants in Australia, New Zealand and around the world, CPA Australia and Chartered Accountants Australia and New Zealand (CA ANZ) thank you for the opportunity to provide feedback on the above Exposure Draft ("the ED").

CPA Australia and CA ANZ support the objective of the proposals on the basis that they will lead to establishing consistent reporting requirements for entities subject to regulatory agreements. However, we highlight below some areas that we believe should be given further consideration in developing the proposals further.

Allowable expenses – recovery of the cost of assets

We believe there are challenges associated with applying the proposals to some types of accounting expenses, such as depreciation, envisaged as part of "amounts that recover allowable expenses minus chargeable income" (para B3-B9). Many are practical challenges associated with a lack of alignment between the record of assets maintained for accounting purposes and the record of assets maintained in order to recover costs as part of a regulatory agreement.

Transitional provisions

The ED proposes retrospective application of the proposals. Feedback we have received from our members and stakeholders indicates that there will be many entities that fall within the scope of these proposals that do not currently adopt accounting practices similar to those proposed in the ED, particularly as the accounting standard IFRS 14 *Regulatory Deferral Accounts* allows entities a choice as to how they account for such regulatory agreements in their financial statements.

We understand such entities may have to make significant changes to their accounting systems and processes to accommodate the changes proposed in the ED. To assist such entities with a smooth transition to the proposed new requirements, we suggest including an optional modified transitional approach that simplifies the prior-year accounting requirements associated with full-retrospective application.

The **Attachment** to this letter contains our responses to some of the specific questions raised in the ED where we feel we can add the most value. If you have any questions about our submission, please contact either Ram Subramanian (CPA Australia) at ram.subramanian@cpaaustralia.com.au or Amir Ghandar (CA ANZ) amir.ghandar@charteredaccountantsanz.com.

Yours sincerely

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Attachment

Question 1—Objective and scope

We support the proposed objective set out in the ED. For the reasons stated in the cover letter and reiterated below, we believe further consideration should be given to the components of total allowed compensation including allowable expenses:

We believe there are challenges associated with applying the proposals to some types of accounting expenses, such as depreciation envisaged as part of “amounts that recover allowable expenses minus chargeable income” (para B3-B9). Challenges include:

- There is no link between the asset register maintained for accounting purposes and the records maintained of such assets for regulatory cost recovery purposes. A reconciliation between the accounting depreciation and regulatory recovery of costs is impracticable in such circumstances.
- Entities subject to regulatory agreements may carry their assets at fair value, which can exacerbate the practical challenges of matching accounting depreciation to regulatory cost recovery. Carrying assets at fair value is a common practice amongst Australian and New Zealand public sector entities that may fall within the scope of the proposals.
- Regulatory agreements may not compensate the entity for individual assets but may do so for a pool of assets that are employed in the provision of a specific service subject to the regulatory agreement, which creates further challenges of reconciliation.
- Regulatory agreements may compensate for the provision of uninterrupted service, including components related to the recovery of the cost of assets and costs associated with replacing assets. These elements of compensation may not always be separately identifiable within the regulatory agreement.

To address the above challenges, we suggest consideration be given to revising the proposals to include in total allowed compensation only, allowable expenses that can be matched and reconciled with expenses recognised for financial reporting purposes.

In some instances, it may be challenging to identify the enforceable rights and obligations that give rise to a regulatory agreement. For example, in Australia, a regulatory agreement could either be a standalone arrangement or subsumed within a regulatory framework established by a government to provide certain utilities. Although the Application Guidance in Appendix B provides guidance on the boundary of a regulatory agreement in the context of determining the time period of a regulatory agreement, we believe further guidance on the types of enforceable rights and obligations that may constitute a regulatory agreement would also be useful. This would assist both preparers and auditors in applying judgement to, not only the boundary of a regulatory agreement, but also what enforceable rights and obligations are associated with such an agreement.

Question 2—Regulatory assets and regulatory liabilities

Subject to our comments in response to Q1 above, we agree with the definition of the terms “regulatory assets” and “regulatory liabilities”.

Question 3—Total allowed compensation

In addition to our comments in response to Q1 above, we offer further comments on matters, that in our view, should be addressed in finalising the definition of the term “total allowed compensation”.

Para B15 precludes from inclusion in target profit, a regulatory return amount relating to an asset not yet in use. We do not agree with this exclusion as it is possible that the regulator expects to compensate the entity as an asset is being constructed, and therefore, total compensation allowed should include relevant amounts whilst the asset is being constructed. Although the justification given for this exclusion is on the basis of para BC30, that is, that total allowable compensation should be for goods or services supplied for the period, this appears to contradict the proposed inclusion in total allowable compensation of certain performance incentives in para B18, relating to assets under construction.

We appreciate the proposal in para B15 seeks to align with the objective in para 2(a) of establishing a relationship between total allowed compensation and the goods or services relating to that total allowed compensation in a particular year. However, para B18 does not appear to align with this objective. Furthermore, we believe that recognising such inflows of resources from the regulatory agreement relating to the construction of assets would benefit users’ understanding of the future cashflows relating to that asset under construction. Therefore, it should be recognised in the year received. However, if the IASB decides to proceed with the proposal as set out in the ED, we suggest consideration be given to how to account for the resources received for assets under construction as part of the regulatory agreement.

Question 4—Recognition

Subject to our response to Q1 above, we agree with the proposals for recognition of regulatory assets and regulatory liabilities.

We also agree with the proposal that, where there is uncertainty whether a regulatory asset or regulatory liability exists, any entity should recognise such an asset or liability if it is more likely than not that it exists. However, we suggest developing and providing further guidance around how an entity can determine that it is “more likely than not” that a regulatory asset or regulatory liability exists when there are uncertainties surrounding their determination (for example, an entity may incur a cost that it expects to recover in a future period, but the regulator has not yet agreed to include these costs in the regulated rate).

Question 5—Measurement

We agree with the proposed measurement basis using a cashflow based approach.

Similar to the approach to estimating variable consideration in IFRS 15 *Revenue from Contracts with Customers* (IFRS 15), it is proposed that an entity estimates uncertain future cashflows using the “most likely amount” method or the “expected value” method. However, unlike IFRS 15, there is no requirement to apply a constraint to the estimated cashflows. We suggest that a constraint, similar to that applied to variable consideration under IFRS 15 also be applied to the estimates relating to uncertain future cashflows. If the IASB believes there are valid reasons for not imposing such a constraint when estimating future cash flows under these proposals, we suggest articulating these reasons in the Basis for Conclusions.

Question 10—Effective date and transition

As stated in the cover letter, feedback we have received from our members indicates that there will be many entities that fall within the scope of these proposals that do not currently adopt accounting practices similar to those proposed in the ED, particularly as the accounting standard IFRS 14 *Regulatory Deferral Accounts* allows entities a choice as to how they account for such regulatory agreements in their financial statements.

We understand such entities may have to make significant changes to their accounting systems and processes to accommodate the changes proposed in the ED. To assist such entities with a smooth transition to the proposed new requirements, we suggest including an optional modified transitional approach that simplifies the prior-year accounting requirements associated with full-retrospective application.