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Consultation Exposure Draft ED/2021/1 Regulatory Assets and Regulatory Liabilities Comments by Oesterreichs Energie

Dear Madam,
Dear Sir,

Oesterreichs Energie, the Association of Austrian Electricity Companies, welcomes the opportunity to comment on the Exposure Draft ED/2021/1 Regulatory Assets and Regulatory Liabilities. Oesterreichs Energie represents more than 140 energy companies active in generation, trading, transmission, distribution and sales which in total cover more than 90 per cent of the Austrian electricity generation and the entire distribution.

Generally, we agree with the ED's proposals, nevertheless we would like to comment on the consultation questions 3, 5/6, 10 and 11 as follows:

Question 3—Total allowed compensation

Paragraphs B3–B27 of the Exposure Draft set out how an entity would determine whether components of total allowed compensation included in determining the regulated rates charged to customers in a period, and hence included in the revenue recognised in the period, relate to goods or services supplied in the same period, or to goods or services supplied in a different period. Paragraphs BC87–BC113 of the Basis for Conclusions explain the reasoning behind the Board's proposals.

(a) Do you agree with the proposed guidance on how an entity would determine total allowed compensation for goods or services supplied in a period if a regulatory agreement provides:

(i) regulatory returns calculated by applying a return rate to a base, such as a regulatory capital base (paragraphs B13–B14 and BC92–BC95)?

(ii) regulatory returns on a balance relating to assets not yet available for use (paragraphs B15 and BC96–BC100)?

(iii) performance incentives (paragraphs B16–B20 and BC101–BC110)?

<u>Response to Q3 (a) (ii) Proposed guidance on determination for regulatory returns on a balance relating to assets not yet available for use:</u>

1. A regulated rate is a price for goods or services, charged to customers in the period when the regulated entity supplies those goods or services and fulfils its regulatory obligations.

   Although some parts of the total allowed compensation are closely linked to individual assets of the regulated entity, the performance obligation of these regulated entities goes far beyond operating a single asset.

2. An individual single asset never will be able to fulfil a performance obligation. It is not only one or more similar assets that are needed, it is a system of various resources and substantive processes that are needed to generate the outputs of a regulated business (therefore mostly the companies are called Transmission System Operators or Distribution System Operators, and not: Transmission Asset Operators or Distribution Asset Operators). These systems undergo a steady renewal process with myriads of individual investment projects within a relatively short construction period.

3. According to most regulatory agreements, the regulatory compensation for these financing costs is granted in the construction phase, and not over the useful life time of the assets.
   The compensation for those interests is mostly calculated based on the carrying amount of the construction work in progress. Compensations for borrowing costs of assets under construction are very small in relation to compensation for interests of assets in operation.
   As the companies have a legally enforceable right to receive these compensations, these amounts related to construction working progress meet the criteria of an asset.

4. Borrowing costs that are directly attributable to the construction of qualifying assets form part of the cost of that asset. Due to the characteristics and multitude of the assets under construction, only very few or almost none of the companies' related borrowing costs are directly attributable to single assets and eligible for capitalisation.
   Therefore they are recognised as an expense. As far as expenses for borrowing costs are not eligible for capitalisation, also related income should not be deferred.

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5. According to IFRIC 12 it is not uncommon to recognize revenue during the construction period.

6. In any case, we suggest to follow the regulatory methodologies and regulatory decisions, and to recognize and present expenses and income relating to construction work in progress in the same periods.

7. Any further accruals for interests relating to construction working progress will probably lead to no further clarifications and certainly to administrative burdens.

Response to Q3 (a) (iii) Proposed performance incentives (paragraphs B16–B20 and BC101–BC110):

The current regulatory regime in Austria for electricity and gas transmission and distribution covers aspects of an incentive regulation.

In applying the proposed requirements of the ED with respect to potential regulatory assets/liabilities resulting from performance incentives, we find it difficult at times to assess at which point(s) in time rights stemming from regulatory agreements can be deemed enforceable. This is particularly true if the regulatory authority (acting on the basis of legal requirements that are somewhat vague) exerts discretion as to how efficiency increases/decreases from performance incentives are measured, determined, and attributed to individual entities in its official decisions. The general description in para. 9 of the ED (that basically states that enforceability is a matter of law and court rulings can be indicative) is, from our perspective, too broad in scope to provide sufficient assistance for the practical application. Hence, we would suggest that circumstances under which enforceable rights linked to performance incentives are to be identified are discussed in greater detail.

Other than that, we generally agree with the proposed guidance on performance incentives according to the paragraphs B16-B20 in the ED.

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Question 5—Measurement

Paragraph 29 of the Exposure Draft specifies the measurement basis. Paragraphs 29–45 of the Exposure Draft propose that an entity measure regulatory assets and regulatory liabilities at historical cost, modified by using updated estimates of future cash flows. An entity would implement that measurement basis by applying a cash-flow-based measurement technique. That technique would involve estimating future cash flows— including future cash flows arising from regulatory interest—and updating those estimates at the end of each reporting period to reflect conditions existing at that date. The future cash flows would be discounted (in most cases at the regulatory interest rate—see Question 6). Paragraphs BC130–BC158 of the Basis for Conclusions describe the reasoning behind the Board's proposals.

(a) Do you agree with the proposed measurement basis? Why or why not? If not, what basis do you suggest and why?

(b) Do you agree with the proposed cash-flow-based measurement technique? Why or why not? If not, what technique do you suggest and why?

If cash flows arising from a regulatory asset or regulatory liability are uncertain, the Exposure Draft proposes that an entity estimate those cash flows applying whichever of two methods—the 'most likely amount' method or 'expected value' method—better predicts the cash flows. The entity should apply the chosen method consistently from initial recognition to recovery or fulfilment. Paragraphs BC136–BC139 of the Basis for Conclusions describe the reasoning behind the Board's proposal.

(c) Do you agree with this proposal? Why or why not? If not, what approach do you suggest and why?

Question 6—Discount rate

Paragraphs 46–49 of the Exposure Draft propose that an entity discount the estimated future cash flows used in measuring regulatory assets and regulatory liabilities. Except in specified circumstances, the discount rate would be the regulatory interest rate that the regulatory agreement provides. Paragraphs BC159–BC166 of the Basis for Conclusions describe the reasoning behind the Board's proposals.

(a) Do you agree with these proposals? Why or why not? If not, what approach do you suggest and why?

Paragraphs 50–53 of the Exposure Draft set out proposed requirements for an entity to estimate the minimum interest rate and to use this rate to discount the estimated future cash flows if the regulatory interest rate provided for a regulatory asset is insufficient to compensate the entity. The Board is proposing no similar requirement for regulatory

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liabilities. For a regulatory liability, an entity would use the regulatory interest rate as the discount rate in all circumstances. Paragraphs BC167–BC170 of the Basis for Conclusions describe the reasoning behind the Board's proposals.

(b) Do you agree with these proposed requirements for cases when the regulatory interest rate provided for a regulatory asset is insufficient? Why or why not?

(c) Have you identified any other situations in which it would be appropriate to use a discount rate that is not the regulatory interest rate? If so, please describe the situations, state what discount rate you recommend and explain why it would be a more appropriate discount rate than the regulatory interest rate.

Paragraph 54 of the Exposure Draft addresses cases when a regulatory agreement provides regulatory interest unevenly by applying a series of different regulatory interest rates in successive periods. It proposes that an entity should translate those rates into a single discount rate for use throughout the life of the regulatory asset or regulatory liability.

(d) Do you agree with the proposal? Why or why not? If not, what do you recommend and why?

<u>Response to Q5 & Q6: Measurement and Discounting:</u>

1. The concept of discounting is a fundamental part of general IFRS requirements where the effects of the time value of money are significant.
   We appreciate the proposal's goal to reduce complexity and skip discounting in cases where the differences in timing or value are not significant.

2. "Time lag" means the time between a regulatory asset (RA) / regulatory liability (RL) is originated and the time until that RA/RL is recovered / fulfilled. For that time lag the regulatory agreement provides/charges the entity with an interest rate.
   The regulatory agreement entitles an entity to charge a total allowed interest rate on RA/RL, including 1.) a compensation for time lag and 2.) a risk premium, depending on equity/debt ratios.
   The (allowed) return on equity and the (allowed) return on debt are part of the total allowed interest rate, which compensates shareholders and lenders for their capital investment. In many regulatory agreements the total allowed interests are based on the capm / wacc – methodology.

3. The ED acknowledges that the interest rate an entity is provided / charged may vary between zero to a rate that approximates to the WACC (para BC163 (b)).

   The ED says that the decision on the interest rate would be typically tied to the duration of the RA/RL. Using the regulator's interest rate as the discount rate (regardless what

that rate is) allows an entity to basically measure the regulatory asset at the initial nominal amount of the difference in timing. This is explained in para 49 of the ED: 'if the regulatory interest rate is also the discount rate, the present value of the estimated future cash flows equals the sum of the estimated future cash flows excluding the cash flows from regulatory interest.' The rationale behind this may have been that the benefits of requiring entities to determine the discount rate that would accurately reflect the characteristics of the cash flows would be unlikely to outweigh the costs and complexity. Para BC164 explains this and adds: 'Thus, the Board proposes that an entity use the regulatory interest rate as the discount rate, except when the regulatory interest rate for a regulatory asset is insufficient […]'.

4. However, the term 'time lag' as well as the term "regulatory interest rate" are vague, need individual judgement and will lead to additional complexity, intransparency and will likely lead to disputes among preparers, auditors and enforcement bodies.
   Unequal treatment of regulatory assets and regulatory liabilities will lead to further discrepancies.
   In the end, uniformity and comparability are not supported by these proposals of ED.

5. Despite careful assumption of the planning parameters, the actual results are exposed to various random influences: e.g. hours of sun or wind, use of power plants in one's own network or the import of energy from upstream networks cannot be controlled by the company. Assumptions about the timing of the compensation therefore remain subject to a high degree of uncertainty.

6. The proposal of using the regulatory interest rate as the discount rate seeks simplification but gives rise to the possibility of inappropriate judgement related to the complexity described above.
   In many cases the reliable determination of RA and RL on a discounted basis is impracticable or highly complex.

7. Therefore, it is inappropriate to require or permit discounting of RA and RL.
   As a consequence, we suggest to follow the methodology of IAS 12 in measuring RA and RL.

8. If discounting of RA and RL was indispensable from the Board's perspective, we would strongly suggest the following:
   The company should have the right of choice whether to apply the interest rate proposed by the regulator or to apply the minimum interest rate. This option should be applicable to both, regulatory assets and regulatory liabilities.

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Question 10—Effective date and transition

Appendix C to the Exposure Draft describes the proposed transition requirements. Paragraphs BC203–BC213 of the Basis for Conclusions describe the reasoning behind the Board's proposals.

(a) Do you agree with these proposals?

(b) Do you have any comments you wish the Board to consider when it sets the effective date for the Standard?

Response to Q10(a): Effective date and transition/first use in combination with Q11:

When a new standard is applied for the first time, IAS 8 provides the procedure and we agree on that.

Especially as the last major changes to IFRS standards, IFRS 15 and IFRS 16, provided no divergent specific transitional provisions.

As consequence the accounting difference have to be fully retrospectively recognized one-off directly in equity when the standard is applied for the first time. The revenue reserves can be used for offsetting.

We are fine with the proposed timing for the effective date.

Question 11—Other IFRS Standards

Paragraphs B41–B47 of the Exposure Draft propose guidance on how the proposed requirements would interact with the requirements of other IFRS Standards. Appendix D to the Exposure Draft proposes amendments to other IFRS Standards. Paragraphs BC252–BC266 of the Basis for Conclusions describe the reasoning behind the Board's proposals.

(a) Do you have any comments on these proposals? Should the Board provide any further guidance on how the requirements proposed in the Exposure Draft would interact with any other IFRS Standards? If yes, what is needed and why?

(b) Do you have any comments on the proposed amendments to other IFRS Standards?

Response to Q11 Interaction with requirements of other IFRS Standards:

In contrast to the Austrian Commercial Code (UGB), the Exposure Draft Rate Regulated Activities (see Scope) does not contain any options (e.g. for extraordinary expenses and

revenues). Deferred taxes occur when there are timing differences between (local) tax law and IFRS that will be offset in future periods. Since there is an option in the local GAAP for some extraordinary expenses and revenues, there may occur timing differences between tax law and IFRS if this is exercised differently in the UGB (and therefore also in the local Tax law) than would correspond to the provision in IFRS. In our view, the exposure draft does not reveal any specifics in connection with IAS 12. Deferred taxes must be recognised for temporary differences between IFRS and tax law.

Thank you for considering our comments. If you have any further questions, please do not hesitate to contact us.

Yours sincerely,

Mag. Dr. Michael Strugl
President

Dr. Barbara Schmidt
Secretary General