August 2009

Exposure Draft

Snapshot: Rate-regulated Activities

This snapshot is a brief introduction to a proposed IFRS on *Rate-regulated Activities*.

It provides a non-technical, high level overview of the core proposals presented by the International Accounting Standards Board (IASB) in the exposure draft.

Project objectives:	The proposals clarify in what circumstances regulated entities should recognise assets or liabilities as a result of rate regulation. The proposed IFRS defines regulatory assets and regulatory liabilities, sets out criteria for their recognition, specifies how they should be measured and requires disclosures about their financial effects.
Project stage:	The exposure draft was published in July 2009.
Comment deadline:	20 November 2009.
Next steps:	Comment letters received during the consultation process will be published on the IASB's website. The IASB will discuss the feedback received in public board meetings. The IASB expects to issue the envisaged IFRS in 2010.

International Accounting Standards Board®

Why is the IASB undertaking the project?

Rate regulation is a restriction on the setting of prices that can be charged to customers for services or products.

In many jurisdictions the charges that particular entities can demand from their customers are set by regulatory bodies or governments. Typically such an entity (a 'rate-regulated entity') has a monopoly or a dominant market position that gives it excessive market power.

In some jurisdictions rate-regulated entities account for regulatory assets and regulatory liabilities by reference to the relevant US standard. The amounts recognised can be substantial.

This project is important because some of those jurisdictions are in the process of converging with IFRSs. However, IFRSs do not currently provide guidance on how entities should account for the effects of rate regulation.

The project addresses these issues. In particular it aims to establish:

- the criteria for recognising assets and liabilities as a result of rate regulation;
- the measurement of regulatory assets and regulatory liabilities;
- the disclosures required to enable users to understand the nature and financial effects of rate regulation on an entity's activities.

What is the scope of the project?

A number of regulatory methodologies exist and their application can vary by regulator, the entity being regulated and the particular circumstances.

The proposed IFRS addresses only those rate-regulated activities that meet the following two criteria:

- an authorised body is empowered to establish rates that bind customers; and
- the price established by regulation (the rate) is designed to recover the specific costs the entity incurs in providing the regulated goods or services and to earn a specified return.

This form of regulation is often referred to as 'cost-of-service' or 'return on rate base' regulation.

The IASB's project to create a standard on rate-regulated activities affects only those entities that are subject to 'cost-of-service' regulation.

What is the IASB proposing?

The underlying principle of the proposed standard is that cost-of-service regulation results in the creation of assets and liabilities.

The IASB concluded that the rights and obligations arising from activities within the scope of the proposed IFRS satisfy the definitions of assets and liabilities in the *Framework*.

A regulatory asset exists because:

- the entity obtains from the regulator the present right to set rates at a level that will ensure the entity recovers its previously incurred costs by receiving cash flows from its aggregate customer base.

A regulatory liability arises from:

- a present obligation enforced by the regulator to return previously collected amounts to the aggregate customer base by reducing rates.

No recognition threshold

The IASB proposes that if rate-regulated activities satisfy the proposed scope criteria, the actions of a regulator provide reasonable assurance that the economic benefit from the regulated activities will flow to or from the entity.

In addition, regulatory assets and regulatory liabilities relate to specifically identifiable amounts, therefore they can be measured reliably.

This would mean a change of practice in those jurisdictions that currently account for rate-regulated activities by reference to the US standard in which a recognition threshold applies.

Establishing requirements for accounting for rate-regulated activities would make it easier for preparers to understand how to account for those activities and would ensure consistency in application and better comparability for users.

...continued

The proposed measurement approach is consistent with current guidance in IFRSs.

The exposure draft proposes measuring regulatory assets and regulatory liabilities at their expected present value on initial recognition and at the end of each subsequent reporting period.

The measurement of regulatory items should take into account both the probability that the entity will recover or refund cash flows and the probability that the regulator will allow the entity to include a specific cost in the determination of future rates.

This approach is consistent with the guidance in IAS 36 *Impairment of Assets*, IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, IAS 38 *Intangible Assets* and IFRIC 12 *Service Concession Arrangements*.

The intended effects of the proposed IFRS are:

Increased consistency in the recognition of assets and liabilities...

In the IASB's view, it is more efficient to develop an IFRS than to require each entity to reach its own conclusions on how the *Framework* and existing standards apply to its activities.

...for minimal costs

The IASB thinks that preparers of financial statements would not incur significant additional costs – in most instances the necessary information is already required for reporting to the regulator.

What happens now?

The exposure draft includes questions related to the IASB's proposals. Please send us your comments on any or all of those questions and on any other issue you think the IASB should consider in finalising the proposals.

The IASB's deliberations will, as usual, take place in public board meetings as announced on the IASB website.

The deadline for comments on the exposure draft is 20 November 2009.

To view the exposure draft and submit your comments, visit the 'Open for Comment' section on www.iasb.org.

Notes

International Accounting Standards Committee Foundation (IASC Foundation)

30 Cannon Street | London EC4M 6XH | United Kingdom
Telephone: +44 (0)20 7246 6410 | Fax: +44 (0)20 7246 6411
Email: iasb@iasb.org | Web: www.iasb.org

For further information about the IASC Foundation, IASB, copies of International Financial Reporting Standards, International Accounting Standards, exposure drafts and other publications, including details of IASB subscription services, please contact our Publications Department on telephone: +44 (0)20 7332 2730 or email: publications@iasb.org

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