Project **Rate-regulated Activities**

Topic **Summary comment letter analysis** (Revised 5 Feb 2010*)

Purpose of this agenda paper

1. This agenda paper summarises the staff's analysis of the comment letters received on the exposure draft *Rate-regulated Activities* (ED) published in July 2009. This paper includes:

   (a) **background** of the issue;

   (b) summary analysis of the **respondent demographics**;

   (c) summary of primary **technical issues**;

   (d) **logistical considerations** impacting this project, **project timetable and potential paths forward**; and

   (e) **questions for the Board**.

Background

US GAAP

2. In December 1982, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 71 *Accounting for the Effects of Certain Types of Regulation* (FAS 71). 'This Statement provides guidance in preparing general-purpose financial statements for most public utilities. Certain other companies with regulated operations that meet specified criteria are also covered.'

* Following feedback received from respondents, paragraphs 15, 19, 80(c), 83 and Appendices A-F have been revised.

This paper has been prepared by the technical staff of the IASCF for discussion at a public meeting of the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IASB.

Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRIC or the IASB can make such a determination.

The tentative decisions made by the IASB at its public meetings are reported in IASB *Update*. Official pronouncements of the IASB, including Discussion Papers, Exposure Drafts, IFRSs and Interpretations are published only after it has completed its full due process, including appropriate public consultation and formal voting procedures.

3. Since 1982, several other jurisdictions have adopted, either directly or indirectly, the provisions of FAS 71.

IFRIC 2004-2005

4. In the midst of the European Union's adoption of IFRSs, individual jurisdictions that had previously recognised regulatory assets and regulatory liabilities in accordance with their national GAAP were unsure of their ability to continue this practice in accordance with International Financial Reporting Standards (IFRSs). In 2004, a European entity sent the issue to the International Financial Reporting Interpretations Committee (IFRIC) for consideration. The August 2005 IFRIC Update states:

> **IAS 38 Regulatory asset**
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> The IFRIC considered a request for guidance for operations subject to price regulation. The request concerned situations in which a regulatory agreement allowed the entity to increase its prices in future years to recover outflows of economic resources during the current or previous years. The IFRIC was asked whether US SFAS 71 *Accounting for the Effects of Certain Types of Regulation* could be applied under the hierarchy in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* for selection of an accounting policy in the absence of specific guidance in IFRSs.
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> The IFRIC observed that it had previously discussed whether a regulatory asset should be recognised in the context of service concession arrangements, either as deferred costs or as an intangible asset to reflect an expectation that the entity will recover these costs as part of the price charged in future periods. It had concluded that entities applying IFRSs should recognise only assets that qualified for recognition in accordance with the IASB's *Framework for the Preparation and Presentation of Financial Statements* and relevant accounting standards, such as IAS 11 *Construction Contracts*, IAS 18 *Revenue*, IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*.
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> The IFRIC had noted that SFAS 71 required entities to recognise regulatory assets when certain conditions were met. However, the IFRIC had concluded that the recognition criteria in SFAS 71 were not fully consistent with recognition criteria in IFRSs, and would require the recognition of assets under certain circumstances which would not meet the recognition criteria of relevant IFRSs. Thus the requirements of SFAS 71 were not indicative of the requirements of IFRSs.
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> Since it already had concluded that the special regulatory asset model of SFAS 71 could not be used without modification, the IFRIC noted that expenses incurred in performing price-regulated

activities should be recognised in accordance with applicable IFRSs and decided not to add a project on regulatory assets to its agenda.

5. The staff are not aware of the common practice of recognition of regulatory assets and regulatory liabilities in jurisdictions applying IFRSs. However, while accounting results of regulated entities continue to be consistent with the August 2005 IFRIC agenda decision, many regulated entities continue to support the ability to recognise regulatory assets and regulatory liabilities in accordance with IFRSs. All of the four largest international accounting firms' current guidance in their formal publications and websites is consistent with the IFRIC agenda decision. PricewaterhouseCoopers Financial reporting in the utilities industry: International Financial Reporting Standards (April 2008)[1] states in section 1.2.3 *Regulatory assets and liabilities* (emphasis added):

> Complete liberalisation of utilities is not practical because of the physical infrastructure required for the transmission and distribution of the commodity. Privatisation and the introduction of competition is often balanced by price regulation. Some utilities continue as monopoly suppliers with prices limited to a version of cost plus margin overseen by the regulator.
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> The regulatory regime is often unique to each country. The two most common types of regulation are incentive-based regulation and rate-based regulation. The regulator governing an incentive-based regulatory regime usually sets the 'allowable revenues' for a period with the intention of encouraging cost efficiency from the utility. A utility entity operating under rate-based regulation is usually permitted the recovery of an agreed level of operating costs, together with a return on assets employed.
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> Any regulatory type asset or liability recognised under IFRS needs to be a financial asset, an intangible asset or a financial liability in its own right, as there are no special recognition requirements for regulatory assets or liabilities under IFRSs.

6. Additional technical literature provided by the largest international accounting firms is provided in the Technical issues section of this paper.

[1] Document available at http://www.pwc.com/gx/en/utilities/reporting-regulatory-compliance/publications-utilities-industry-international-financial-reporting-standards.jhtml

National Standard Setters 2007

7. While no significant divergence existed in practice in jurisdictions applying IFRSs, advocates of the ability to recognise regulatory assets and regulatory liabilities continued to discuss the ability to recognise these assets and liabilities in accordance with current IFRSs. 'At the March and September 2007 meetings of a group of National Standard Setters (NSS), the NSS considered whether to publish an NSS discussion paper on this topic, as a potential contribution towards the initial development of international guidance in this area. However, there was general agreement that the first priority should be to put the issues before the IFRIC, with a view to obtaining IFRIC's views. The NSS believe that resolution of the issue is an urgent matter, particularly in those jurisdictions about to adopt IFRSs as their primary basis for financial reporting. The NSS are concerned about inconsistent practices developing in this area.'[2]

IFRIC 2008-2009

8. In January 2008, the European Commission submitted a request to the IFRIC which stated, in part:

> [O]n 18 October 2007, the EU Roundtable on consistent application of IFRS identified the issue of "Regulatory liabilities in certain regulated industry sectors" as being an area of concern…
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> The Roundtable further noted that this issue is widespread, has practical relevance and that there is divergence in practice with significant effects. It was mentioned that diverging practices are also observed outside the European Union, e.g. in Canada and India. As a consequence the Canadian and Indian standard setters, possibly together with other national standard setters, are also looking into this specific issue and are in the process of preparing a proposal to the IASB. This seems to underline the importance of the issue and the broad interest to find a solution.

9. The issue was deliberated at the May 2008 IFRIC meeting where the IFRIC decided to add the issue to its agenda for review and deliberation at future meetings. The November 2008 IFRIC Update includes a Tentative Agenda Decisions on this issue that states:

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[2] Excerpt from IASPlus at http://www.iasplus.com/ifric/ias38regulatoryasset.htm

> **IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*/IAS 38 *Intangible Assets*—Regulatory assets and liabilities**
>
> The IFRIC received a request to consider whether regulated entities could or should recognise a liability (or an asset) as a result of rate regulation by regulatory bodies or governments.
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> At the IFRIC meeting in November 2008 the IFRIC considered detailed background information, an analysis of the issue and an assessment of the issue against its agenda criteria. The IFRIC noted that:
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> - rate regulation is widespread and significantly affects the economic environment of regulated entities;
> - divergence does not seem to be significant in practice;
> - resolving the issue would require interpreting the definitions of assets and liabilities set out in the *Framework* and their interaction with one or more IFRSs;
> - although the issue is not specifically being considered in an active Board project, it relates to more than one active Board project.
>
> The IFRIC concluded that the agenda criteria were not met, mainly because divergence in practice does not seem to be significant. Therefore, the IFRIC [decided] not to add the issue to its agenda.

Board project 2008-2010

10. Subsequent to the November 2008 IFRIC meeting, the staff presented this issue to the Board for their consideration as a separate Board project. At the December 2008 Board meeting, the staff presented Agenda Paper 12. At that meeting (emphasis added):

> The Board decided to add to its agenda a project on *Rate-regulated Activities*. The issue is whether regulated entities could or should recognise an asset or liability as a result of rate regulation imposed by regulatory bodies or governments.
>
> Although a specific standard on accounting for the effects of rate regulation exists in US generally accepted accounting principles (GAAP), it has no counterpart in IFRSs. However, rate regulation is widespread and significantly affects the economic environment of rate-regulated entities. Many billions of dollars of 'regulatory' assets and liabilities are currently recognized in jurisdictions that refer to US GAAP. Some of these jurisdictions are already converging to IFRSs. Clarifying the treatment of assets and

liabilities arising from rate regulation in IFRSs is therefore important.[3]

11. The Board deliberated the project at the February 2009, April 2009, May 2009 and June 2009 Board meetings. These deliberations resulted in the publication of an exposure draft for public comment.

Respondent demographics

12. A total of 155 comment letters were received on the ED published on 23 July 2009 with a 120-day comment period that ended on 20 November 2009. Of those comment letters, 35 were received after the comment letter deadline.

13. The respondents include accountancy bodies, accounting firms, preparers (and preparer representative groups), regulators, standard setters and others. They represent the major regions of the world including Africa, Asia-Pacific, Europe, North America, South America and international organisations.

14. Over half of the respondents are classified as 'preparers' with the vast majority of those preparers coming from the utility industry and the vast majority of preparers broadly supportive of the recognition of regulatory assets and regulatory liabilities. Approximately sixty percent of the respondents are classified as 'North American' with a majority of the North American respondents being utility preparers or utility industry associations.

15. Seven international accounting firms submitted comment letters on the ED. All firms were supportive of the IASB's efforts to address differences in practice regarding the recognition of regulatory assets and regulatory liabilities. All comment letters addressed a broad range of issues and concerns and provided recommendations for the Board's consideration. For several of these comment letters, the staff found it difficult to ascertain whether or not the respondent was supportive of the key issue for this project of whether regulatory assets and regulatory liabilities should be recognised in accordance with the current *Framework* and consistent with current other IFRSs. Several of these letters

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[3] Excerpt from the IASB's *Rate-regulated Activities* project page at http://www.iasb.org/Current+Projects/IASB+Projects/Rate+regulated+activities/Summary.htm

noted mixed views within the respondent's organisation. The comment letters for BDO, Deloitte, Ernst & Young, Grant Thornton, KPMG, Mazars and PricewaterhouseCoopers can be viewed in their entirety (along with all other comment letters received) on the IASB's public website. Additionally, fifteen standard setters and eleven accountancy bodies submitted comment letters on the ED. Overall, the staff found the comment letters received from the standard setters and accountancy bodies provide clearer insight into the respondents' views of the key issue. However, like the comment letters received from several of the accounting firms, a few of the letters received from the standard setters and accountancy bodies were difficult to ascertain whether or not the respondent was supportive of the recognition of regulatory assets and regulatory liabilities in accordance with the current *Framework* and consistent with current other IFRSs.

16. Additional demographic information is included in Appendices A–E of this paper:

    (a) Appendix A – List of Comment Letter Respondents

    (b) Appendix B – Respondent Summary by Type and Geography

    (c) Appendix C – General Agreement or Disagreement with ED by Respondent Type

    (d) Appendix D – General Agreement or Disagreement with ED by Geography

    (e) Appendix E – Matrix of Respondent Type by Geography by General Agreement or Disagreement

17. Of all respondents in support of the project, the vast majority also provided recommended changes from the ED. Additionally, several of the respondents that do not support the overall project nonetheless provided recommended changes from the ED in the event the Board decided to proceed with the project. The recommended changes are not limited to a small area of the ED, but rather impact all major aspects of the ED. Those recommended changes as well as other issues analysed by the staff are summarised in the Technical issues section of this paper.

18. In addition to comments received through the receipt of formal comment letters, the staff performed significant outreach to constituents. The outreach efforts included direct meetings with individual preparers, regulators, standard setters and accounting firms. It included webcasts sponsored by the IASB as well as external organisations. It also included conference calls with individual preparers, securities regulators, utility industry regulators, standard setters, and accounting firms. The direct meetings and conference calls covered constituents classified as European, North American and International.

Technical issues

Key issue

19. The key issue identified in many comment letters is:

> Do regulatory assets and regulatory liabilities exist in accordance with the current *Framework for the Preparation and Presentation of Financial Statements* and consistent with current other IFRSs?

20. This key issue affects the scope, recognition and measurement aspects of this project.

21. Regulatory systems most frequently occur in jurisdictions that have little internal competition. The transactions that create regulatory assets and regulatory liabilities would otherwise be recognised in the statement of comprehensive income in the period in which the transaction occurred. This may create significant volatility period over period. Absent the regulations and rate-making process, the entity would most certainly pass along the current period volatility to customers in the current or immediately following billing period. The effect of the rate-making process creates a smoothing of rates invoiced to customers as a means to significantly reduce short-term rate volatility to the customers.

22. Many respondents who support the project maintain that regulations create an environment that is different from the environment in which non-regulated entities operate. That environment provides the reporting entity with rights to future benefits (increased rates) and obligations to reduce future benefits (reduced rates). The rights and obligations recognised are the accounting impact representing the economic impacts from rate regulation that acts as a pricing

'buffer' between the customer and the short-term volatility in the cost of providing the goods/ services. Most respondents supporting this project believe that it is imperative that regulatory assets and regulatory liabilities are recognised to ensure that the economic reality of the rate-making process is captured in the financial statements.

23. Many of the respondents that disagree with the project believe that pricing mechanisms that set future rates are common to most entities. If a 'widget maker' incurs increased costs in the current period, for whatever reason, they will likely increase the unit price of a 'widget' next year. However, absent a contractual agreement permitting it, the entity is not permitted to invoice an additional amount to prior customers to increase the ultimate amount of revenue collected on the past transaction. Rather, the entity can only receive the increased unit price from future customers and the incremental increase should only be recognised in the future period when that unit is sold. Those respondents that disagree with the project typically disagree that the effect of regulation creates such assets and liabilities.

24. One of the main concerns cited by those challenging the recognition of regulatory assets and regulatory liabilities is the concept of control. They comment that entities subject to rate regulation cannot require customers to purchase goods/ services in a future period and thus do not have the necessary **control** over the future economic benefits associated with an increase in rates. Typically such respondents are not persuaded by the **aggregate customer** base argument set out in the ED.

Cross-cutting issues

25. When commenting on this key issue of whether or not assets and liabilities exist, many respondents drew comparisons with the guidance in **IFRIC 12** ***Service Concession Arrangements*** and the current developments in the ***Emissions Trading Schemes*** project. Respondents highlighted those projects as involving an external body (frequently linked a governmental agency) that determines future rates that an entity may charge or that provides the entity directly with a future economic benefit, respectively. In both of those situations when an asset is initially recognised, the other half of the transaction is usually the recognition

of a liability/ deferred income (and not a credit to the statement of comprehensive income as proposed in the ED).

Scope

26. The scope of this project links closely with the key issue concerning whether it is appropriate to recognise regulatory assets and regulatory liabilities in accordance with IFRSs. The vast majority of respondents commented on the scope of this project. Many of the respondents, when proposing changes to the scope, focused on their desired outcome of what types of regulation should be in or out of the scope of the ED rather than a core principle. Many of those comments referred to their existing practices and regulatory regimes when supporting their views (and whether regulatory assets and regulatory liabilities were recognised in that GAAP).

Support for narrow scope

27. Most respondents that are accustomed to using FAS 71 believe that the scope should be more closely mirrored with FAS 71. One of the benefits of aligning this project more closely to the scope of FAS 71 is that practice and other non-authoritative guidance has formed over the past 27 years to aid its application. They believe that a narrower and well defined scope will ensure only the appropriate entities with a 'cost of service' model will be able to recognise regulatory assets and regulatory liabilities.

28. The 'cost of service' model provides that the actual costs incurred by the entity will be ultimately charged to customers. This requires 'linkage' between past events or transactions and future rate changes and is the underlying rationale supporting recognition of regulatory assets and regulatory liabilities.

Support for broad scope

29. Many of the respondents that have not historically applied FAS 71 or similar local guidance believe that the scope distinction separating entities as either 'cost of service' or 'incentive based' is not appropriate. Some of those respondents commented that the distinction was an (arbitrary) rule. Others noted that the qualitative characteristics set out in the ED in support of

recognising regulatory assets and liabilities in the context of cost of service regulation applied equally in the context of incentive based regulation. Those respondents argue that they are still subject to regulations that create a regulatory environment in which the rates they charge are set by an authorised body.

30. One alternative suggested is to broaden the scope to permit all entities with prices subject to a regulator to be within the scope of this project and also introduce recognition criteria. The suggested approach would permit only transactions/ activities that have a 'linkage' between the past event/ transaction would be eligible for recognition as a regulatory asset or regulatory liability of the incremental amount that would otherwise be recognised in the statement of comprehensive income in the current period. However, the key issue of whether the definition within the *Framework* of assets and liabilities is met would still need to be addressed.

Disagreement with scope and recognition of regulatory assets/ regulatory liabilities

31. Respondents that broadly disagree with this project cite the following common themes to support their argument:

    (a) Many regimes started out as traditional cost of service but **regulatory regimes and practices have evolved over time**. FAS 71 was issued in December 1982 at a time when many regulatory environments were more simplistic and where most entities would be considered 'cost of service'. Over time informal practice has been created whereby most of these entities continue to describe themselves 'cost of service' despite changes in their rate structure from pure 'cost of service' towards 'incentive based' with many entities more properly classified as 'hybrids'. This ensures that the costs for which the entity does have some level of control are being appropriately managed and the true end costs paid by the customer in rates is as low as reasonably possible, but breaks the linkage to past events required by the ED.

    (b) Some believe that pure 'cost of service' regulation is probably 'going the way of the dodo', so there is not much point in writing a standard for something that will disappear. Further, given the size and variation

in jurisdictions to which IFRSs apply, the variations on the cost of service and incentive-based (including hybrid regimes) mean that the most difficult question about this project will continue to be whether an entity is in scope.

(c) Some respondents question whether entities having **monopolistic features** can apply, by analogy, the provisions in the ED. As an example, a 'widget maker'(not involved in a 'rate-regulated activity' as defined in the ED) that is a dominant market participant having some monopolistic features believes it incurred too many raw material costs in the current period. The entity may make the business decision to increase the price for transactions beginning next year. The question is whether it is appropriate to recognise the incremental increase in sales price multiplied by the expected volume of sales for next year given that the link/ reason the dominant market participant increased its price was because this year's costs were too high (and therefore this year's 'reasonable profit' expected by equity holders was not achieved).

(d) Many jurisdictions currently recognising regulatory assets and regulatory liabilities involve regulatory rate review structures whereby if an entity's rates are reviewed and changed, either up or down, that change will be enforced on a prospective basis only. For example, assume the regulator had set a 'specified return' for the entity at 8% and the entity had been earning an actual rate of 10% with this actual 10% having been earned for the current and several prior periods. As is common in many jurisdictions, a 'rate case' to review the appropriateness of the entity's operations is only performed if asked for (by the entity, regulator or a third-party constituent). When a formal rate case was reviewed and the regulator determined the prior rate earned of 10% was in excess of the regulator's target of 8%, the entity's **rates would be prospectively adjusted** to the original target rate of 8% and charged prospectively to customers. The incremental return of 2% (10% - 8%) the entity received in excess of the regulator's target rate would be kept by the entity. Further, in many jurisdictions, specific

laws prevent 'retrospective rate-making' and formally preclude the regulator from requiring a refund of the incremental return of 2%.

Recognition criteria

32. Many respondents believe that the Board should include **explicit recognition criteria** within the project consistent with paragraphs 82-91 of the current *Framework*, specifically paragraph 85 of the *Framework* that deals with the notion of probability. Additionally, while the *Conceptual Framework* project is still in process, the Board has already integrated several broad concepts (including a lack of explicit recognition criteria) into recent exposure drafts on the replacement of IAS 37, IAS 12, etc.

33. These constituents believe implementation of a standard without any recognition threshold may be onerous and lead to the recognition of regulatory assets and regulatory liabilities for which there is a low probability of occurring.

Measurement

34. The measurement model included in the ED that uses the expected present value of the probability weighted future cash flows of the regulatory asset or regulatory liability, discounted at the entity-specific rate appropriate for the specific regulatory asset or regulatory liability. This measurement is required to be performed at each reporting date.

35. Many respondents commented that the requirement to determine different **probability** scenarios for each regulatory asset and regulatory liability would be onerous. Many respondents prefer a 'management's best estimate' approach.

36. Many respondents also commented that the requirement to measure regulatory assets and regulatory liabilities at each reporting period would be onerous. Several respondents asked for alternative models that determined the value only at initial recognition with no **remeasurement** in subsequent periods.

37. Some respondents familiar with FAS 71 indicated a preference for measurement criteria consistent with FAS 71. This approach can broadly be seen as a **cost accumulation** model (therefore with no remeasurement in subsequent periods).

38. The staff is aware that the Board has suggested measurement models similar to that proposed in the ED in other recent EDs (replacement of IAS 37, IAS 12, etc.). This measurement model captures the uncertainty of the future economic benefits in the measurement of the asset or liability and not as part of the recognition criteria.

39. Some respondents pointed out that if the Board desires a measurement model that is applied each reporting period to calculate some form of current value, the Board should explain the basis for the measurement model selected.

40. Additionally, some respondents pointed out that the ED proposes a model broadly consistent with a level 3 **fair value** calculation; therefore, some respondents believe that if the Board believes a 'current value' measurement model is the appropriate basis for regulatory assets and regulatory liabilities, then fair value should be used. It can be argued that this would produce a similar end result. .

41. Several preparer respondents questioned the discount rate proposed by the ED of that specific to the entity. These respondents raised questions around the appropriateness of 'Day 1 gains/ losses' in instances where the rate of return allowed by the regulator is different from the entity-specific discount rate (which will frequently be the case). Additionally, several preparer respondents familiar with FAS 71 recommend a discount rate be used that is consistent with the rate of return allowed by the regulator. That eliminates the 'Day 1 gain/ loss' issue; however, it can be argued that it does not capture all aspects of the future economic benefits or obligations of the regulatory asset or regulatory liability, respectively.

42. The ED requires that a 'specified return' is earned in order for the activities to fall within the scope. However, numerous comment letters also raise the issue of a lack of guidance in the ED on 'specified return'. Specifically, at what level must that specified return be achieved. Additionally, many respondents questioned whether the terms 'specified return', adequate return' and 'sufficient return' have the same meaning.

43. Finally, respondents commented on the potential mismatch between the measurement of deferred taxes and the offsetting regulatory asset or regulatory

liability. The ED does not include a measurement exception for deferred taxes; however, paragraph 53 of IAS 12 *Income Taxes* specifies that 'Deferred tax assets and liabilities shall not be discounted.'

Presentation

Self-constructed assets and theoretical equity costs

44. Respondents classified as utility industry preparers had broad support for paragraph 16 of the ED that states:

> In some cases, a regulator requires an entity to capitalise, as part of the cost of self-constructed property, plant and equipment or internally generated intangible assets, amounts that would otherwise be recognised as regulatory assets in accordance with this [draft] IFRS. After the construction or generation is completed, the resulting capitalised cost is the basis for depreciation or amortisation and unrecovered investment for rate-making purposes. In such cases, the amounts included in the cost of the asset for rate-making purposes shall also be included in its cost for financial reporting purposes, even if IAS 16 *Property*, *Plant and Equipment*, IAS 23 *Borrowing Costs* or IAS 38 *Intangible Assets* would not permit the entity to do so. Those amounts shall be included in the cost of the asset only if their inclusion in the cost for rate-making purposes is highly probable. Otherwise, they shall be accounted for as regulatory assets in accordance with this [draft] IFRS.

45. This presentation requirement includes 2 main items:

    (a) the ability to capitalise theoretical 'equity costs' that are not included in the current period statement of comprehensive income as an expense or revenue (as otherwise required by paragraph 10 of the ED); and

    (b) the ability to capitalise as part of the cost of self-constructed assets, such as part of PPE or intangible assets, amounts that would otherwise not meet the recognition criteria as assets under the applicable IFRS, such as IAS 16 or IAS 38. These costs would otherwise only be recognised as regulatory assets as a consequence of this project.

46. The requirements proposed in paragraph 16 of the ED are consistent with current practice for the application of FAS 71 which states in its summary introduction that this treatment is 'not usually accepted as costs in the present accounting framework for non-regulated enterprises.'

47. As part of its deliberations to amend IAS 23 in 2007, the Board considered whether 'borrowing costs' should be determined without regard for the type of financing (i.e. both debt and equity financings would qualify for capitalisation). IAS 23 (revised 2007) does not include the implicit cost of an entity that finances a self-constructed asset with equity instruments. Some constituents point out that the ED is therefore in conflict with the current requirements of IAS 23.

48. Some constituents argue that because, in some jurisdictions, the regulator permits (or requires) the specific regulatory accounting treatment of these costs to be recognised as regulatory assets and regulatory liabilities and that regulatory accounting treatment therefore impacts the calculation of future rates, that financial reporting should match the regulatory impact.

49. Other constituents argue that the only reason those transactions/ activities are recognised in the statement of financial position (and not directly in the statement of comprehensive income), is because of the effects of the regulatory environment. Therefore, those constituents believe that proper recognition of these transactions within the statement of financial position should be within the regulatory assets line item consistent with the impact of regulations on all other transactions/ activities. This treatment will result in consistent application of IFRSs and what transactions/ activities are included within property, plant and equipment and intangibles regardless of whether two different utility entities, both subject to rate regulation, are within or not within the scope of this project.

Statement of comprehensive income

50. The staff is aware of confusion as to '**where does the credit go** in the statement of comprehensive income then recognising a regulatory asset?' The ED did not provide an explicit statement regarding the recognition of the regulatory asset or regulatory liability in the statement of comprehensive income. Through various outreach activities, many constituents have understood that when recognising a regulatory asset, the credit would be recognised in the same location as the underlying past transaction/ activity is recognised. This treatment is similar to the application of FAS 71; however, FAS 71 is principally a cost accumulation model for measurement purposes.

51. The Board's tentative rationale included in the Basis for Conclusions to the ED comments that the impact of rate regulation is to affect the timing of collection of the asset or (outflow of benefits to fulfil the liability) as well as the primary measurement driver focusing on the value of the future economic benefits. Additionally, the ED refers to 'a cost plus contract in IAS 11'. Based on this rationale, some believe the appropriate location of the credit when recognising a regulatory asset is to revenue. Recognising revenue when recognising a regulatory asset would highlight the effect in the current period statement of comprehensive income of the events giving rise to the regulatory asset (for example, higher than expected raw material costs or unexpected asset impairments from storm damage) and the resulting impact of regulations. Those supporting this approach believe it would also better capture the underlying rationale supporting recognition of the regulatory assets and their linkage to a past event for which the effect of regulation is effectively to alter the timing of invoicing to customers.

52. However, the revenue recognition approach to the presentation issue raises other questions such as

    (a) Should the regulatory assets and regulatory liabilities be remeasured each period; and

    (b) If yes, is the remeasurement presented within revenue or elsewhere within the statement of comprehensive income?

Disclosures

53. Many respondents believe that the proposed requirement in paragraph 27 of the ED to 'disclose…information for each category of regulatory asset or regulatory liability recognised that is subject to a different regulator' is onerous. Several respondent preparers noted that they consolidate different activities for which different aspects of their consolidated business are subject to different regulators. Even many of the smaller respondent preparer entities noted they are subject to 4 or 5 different regulators and that this disclosure burden would be onerous.

Transition

54. Many respondents also requested transition guidance to clarify how an entity that is subject to rate regulation and had previously recognised 'other' assets that would now qualify within this project should be treated. Many respondents questioned the impact of previously embedded costs within other assets and their treatment at the date of transition.

55. Some respondents requested a review of the transition provisions and wondered if the project could apply prospectively to newly recognised regulatory assets and regulatory liabilities.

First-time adoption

56. In September 2008, the Board published exposure draft *Additional Exemptions for First-time Adopters* (Proposed amendments to IFRS 1) with comments to be received by 23 January 2009. That exposure draft included five invitation to comment questions, one of which related to operations subject to rate regulation:

> **Question 3—Deemed cost for operations subject to rate regulation**
>
> The exposure draft proposes an exemption for an entity with operations subject to rate regulation. Such an entity could elect to use the carrying amount of items of property, plant and equipment held, or previously held, for use in such operations as their deemed cost at the date of transition to IFRSs if both retrospective restatement and using fair value as deemed cost are impracticable (as defined in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*).
>
> *Question 3*
>
> Do you agree with the proposed deemed cost option for entities with operations subject to rate regulation? Why or why not? If not, what alternative do you propose and why?

57. In May 2009, the Board deliberated the aspects of that exposure draft relevant to regulated operations. The related staff analysis is included in the May 2009 Board agenda paper 18[4]. The May 2009 IASB Update states, in part:

[4] Observer Note available at http://www.iasb.org/NR/rdonlyres/F25C31EF-271D-49FF-9369-985441090B58/0/IFRS10905b18obs.pdf

> The Board published the Exposure Draft *Additional Exemptions for First-time Adopters: Proposed amendments to IFRS 1* in September 2008. The Board considered the comments received on the ED proposals for oil and gas assets in April 2009. At this meeting, the Board discussed the comments received on the remaining proposals and decided tentatively:
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> - that the proposed exemption for operations subject to rate regulation should apply to operations within the scope of the Board's project on rate-regulated activities (see separate article below).
> - to defer finalising that exemption pending deliberations on the rate-regulated activities project. The Board will consider transition and first-time adoption for that project in June 2009, in the light of comments received on this ED and the following tentative decisions.
> - that the exemption for operations subject to rate-regulation should also apply to qualifying intangible assets.
> - that use of that exemption should not require an entity to demonstrate that other alternatives are impracticable.
> - that an entity may use either the proposed exemption for operations subject to rate regulation or the existing exemption for borrowing costs, but not both.

58. The rate regulation aspect of that exposure draft received broad support in the comment letters. Likewise, the related Board deliberations resulted in overall support by the Board for providing relief to first-time adopters as modified by the main points included in the IASB Update.

59. The *Rate-regulated Activities* project will not be finalised within the originally planned timeline (that had included an estimate to issue a final standard by June 2010). All due process steps were previously completed regarding the proposed amendment to IFRS 1. The comment letters received on the ED (of the *Rate-regulated Activities* project) note a continuing desire for relief to entities transitioning to IFRSs in the near future. Therefore, the staff recommends that the proposed amendment to IFRS 1 be removed from the broader *Rate-regulated Activities* project, updated by the staff based on the decisions made by the Board at its May 2009 meeting and brought back to the Board with the intent to finalise and incorporate into the omnibus *Improvements to IFRSs* expected to be issued in April 2010. A formal question for the Board to confirm its approval is included at the end of this paper in the Questions for the Board section.

Logistical considerations, project timetable and potential paths forward

60. The staff has considered a number of potential paths forward for this project in response to the volume and significance of the comments received. The staff believes that the Board will needed to consider, as a minimum, the comments received relating to the key issue of whether regulatory assets and regulatory liabilities exist before it makes a decision on the direction of the project.

61. Many of the paths forward listed in this paper will likely require **re-exposure** of this *Rate-regulated Activities* project assuming significant changes from ED in light of the nature of the comments received. Before re-exposure is possible, the staff would need to prepare technical analyses for the Board to deliberate all significant aspects of this project. The staff is also conscious of the demands on the Board's time from other projects.

62. Taking account of all of the above, the staff's initial estimate of the time required to publish a re-exposed document for public comment is 6-12 months. Additional discussion of the project timetable is included in the Project timetable and paths forward section of this paper.

Logistical considerations

Not an MoU project

63. Previously, the Group of Twenty (G20) countries called for 'significant progress towards a single set of high quality global accounting standards.' To achieve this objective, the IASB is working intensively with the FASB, the Accounting Standards Board of Japan (ASBJ), and other national standard-setters. At their meeting on 24 March, the IASB and the FASB reaffirmed their commitment to a joint approach to the financial crisis and to the overall goal of seeking convergence between IFRSs and US GAAP. The Boards described this goal in a Memorandum of Understanding (MoU) first published in 2006 and updated in 2008.

64. As shown in the IASB's work plan[5] there are 16 MoU projects (or phases of projects as the Replacement of IAS 39 is shown in several phases), of which the *Income Taxes* project has been deferred with a revised project timeline not yet determined. All MoU projects have timelines concluding with the issue of a final standard by June 2011.

65. The *Rate-regulated Activities* project is not one of the projects included in the MoU. Given the amount of work required to complete the MoU projects in the scheduled timeline, some constituents have questioned whether the Board should focus exclusively on completing the projects included in the MoU.

Board work plan capacity

66. The Board's current work plan has several active projects that it is currently scheduled to complete by June 2011. Most of those projects are MoU projects. The Board has previously committed to performing **post-implementation reviews** of all major standards issued two years after application of the standard. The first of these post-implementation reviews will start in 2011 with a review of IFRS 3 (revised 2008) that became mandatorily effective for adoption in 2009.

67. Additionally, the Board already has several projects on its list of '**Research and other projects**' on the IASB's work plan website including: (a) Common control, (b) Credit risk in liability measurement, (c) IAS 33 Earnings per Share, (d) Extractives project, (e) Government grants, and (f) Intangible assets. All of these projects have been deferred with varying rationale for the deferrals.

68. Numerous constituents continue to comment that the Board's ***Conceptual Framework* project** should be given higher priority and completed prior to finalisation of most other projects. These constituents believe it is inappropriate to deliberate most aspects of individual projects when the *Conceptual Framework* project may continue to change. This may create differences in accounting for similar transactions that fall within different standards.

[5] IASB Work Plan at http://www.iasb.org/Current+Projects/IASB+Projects/IASB+Work+Plan.htm

Historical statements

Principles based standards

69. The Board has previously made statements that IFRSs are principles based standards creating similar accounting treatment for similar events or transactions across different entities and regardless of industry. The Board has previously stated that it does not issue 'industry specific guidance'. Many constituents state that while the *Rate-regulated Activities* project is titled to apply to any entity with 'activities' that are subject to rate regulation, the scope of the standard is such that it will only apply to 'utility companies'. Therefore, many constituents believe that this project would result in industry specific guidance that may result in significantly different accounting treatment by two utility companies, one being within the scope of this project and another not within the scope.

SEC review of industry guidance

70. On November 14, 2008, the US Securities and Exchange Commission (SEC) published a proposed roadmap and rule proposal *Roadmap for the Potential Use of Financial Statements Prepared in Accordance with International Financial Reporting Standards by U.S. Issuers*[6] (Proposed Roadmap). The Proposed Roadmap includes a request for comment on the limited amount of guidance applicable to specific industries, specifically areas were US GAAP has developed extensive guidance. For reference, the Proposed Roadmap does include a specific section on 'Disclosure from Oil and Gas Companies under FAS 69', but does not make a specific request for comment specific to regulated enterprises under FAS 71.

Current external guidance

71. A significant amount of external guidance currently exists regarding regulatory assets and regulatory liabilities in accordance with IFRSs. This guidance is broadly consistent with the August 2005 IFRIC agenda decision. See Appendix F to this paper for technical accounting excerpts on this issue from the large international accounting firms.

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[6] SEC Release No. 33-8982 at http://www.sec.gov/rules/proposed/2008/33-8982.pdf

72. Most large international accounting firms' internal processes for creating internal firm guidance involves review and deliberation by a panel of IFRS technical experts representing a broad range of member firms within the global firm. Despite this current guidance in practice, the staff is aware of some views that may desire to change or override this guidance. Additional information is presented in the Project timetable and paths forward section of this paper.

Project timetable and paths forward

Project timetable

73. There are several potential paths forward for this project. The staff's current estimate of the project timetable, assuming the project proceeds and taking account of the logistical considerations described above:

March 2010	Finalisation of proposed amendment to IFRS 1 to permit at the date of transition deemed cost of property, plant and equipment and intangible assets based on national GAAP.
Q2 2010–Q3 2010	Redeliberation of individual technical issues based on comment letters received.
Q4 2010–Q1 2011	If necessary, re-exposure period of exposure draft.
Q2 2011–Q3 2011	Redeliberation of comment letters received on re-exposed exposure draft.
Q3/Q4 2011	Issue of final standard.

Paths forward

74. In the staff's opinion the paths forward listed below are reflect consideration of the breadth of additional information the staff has received through comment letter submissions as well as numerous formal and informal meetings with constituents. Those potential paths forward are detailed below.

75. Finalise a **standalone IFRS** with changes, as determined to be appropriate by the Board, from the ED. This option would allow the Board to finalise this project in the shortest timeframe.

(a) Completion of the project with minimal changes and no re-exposure of a revised proposed standard may result in external constituents questioning why comment letters were requested and ignored when virtual all comment letters supporting the project and several that do not support the project include recommended changes from the ED.

(b) If significant changes are made from the ED, this project would need to be re-exposed in accordance with paragraphs 47-48 of the *IASB Due Process Handbook*.

76. Proceed with the project and general concept of recognition of regulatory assets and regulatory liabilities, but review and incorporate the project as **amendments to current IFRSs**. This could potentially be accomplished through the addition of application guidance or implementation guidance being added to IAS 38 *Intangible Assets* and IAS 18 *Revenue*.

(a) This path would require the project to be re-exposed in accordance with paragraphs 47-48 of the *IASB Due Process Handbook*.

77. Alter the project to be a **disclosure only standard** (like IFRS 7 or IFRS 8). It is likely that many constituents currently in support of the recognition of regulatory assets and regulatory liabilities holding the belief that this information is important to properly analyse the financial performance of the entity would not be satisfied with this path.

78. Alternatively, one respondent that does not support the overall project concept of recognising regulatory assets and regulatory liabilities in the entity's statement of financial position acknowledges the importance of providing information on the economic impacts of rate regulations. That commenter stated, in part, 'We believe that providing enhanced disclosures alone would be a better way to address the effects of rate-regulated activities.'

79. This path would still require formal re-deliberation of the technical aspects of this project to ensure that a disclosure-only approach is appropriate and that the proper guidance is given to determine the amounts included in and supporting the required disclosures.

(a) This path should include formal acknowledgement and rationale for why the technical aspects for recognition of regulatory assets and

regulatory liabilities are not met to ensure all entities understand the Board's final decisions and have a basis for making changes to their current accounting practices, if necessary.

(b) This path would require the project to be re-exposed in accordance with paragraphs 47-48 of the *IASB Due Process Handbook*.

80. **Defer the project** due to work plan time constraints.

(a) This path should include detailed rationale addressing why the technical merits of this project are still valid, but acknowledging that the Board's work plan is constrained.

(b) Assuming this 'detailed rationale' is non-authoritative and included in IASB Update or similar external guidance, this will almost certainly lead to the introduction of newly permitted accounting policies within IFRSs (and divergence from prior IFRS practices).

(c) Additionally, given the split of views amongst different standard setters and split amongst different accounting firms, this path will almost certainly lead to conflicts of interpretation. In the absence of specific guidance, enforcement of a specific interpretation will be difficult.

(d) Those entities that are newly recognising regulatory assets and regulatory liabilities may attempt to seize the arguments included in the non-authoritative Basis for Conclusions to the ED. Those entities may desire to apply the provisions of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* in creating their accounting policy elections.

(e) If this path is taken, constituents will want an estimated timeline to re-start this project. That timeline would likely not accommodate first-time adopters with 2011 year ends.

(f) The Board may want to consider an 'interim' final standard that expressly permits application in an entity's IFRS financial statements of recognition of regulatory assets and regulatory liabilities in accordance the entity's prior national GAAP (i.e. 'status quo') similar to the

guidance provided in IFRS 4 *Insurance Contracts* or IFRS 6 *Exploration for and Evaluation of Mineral Resources*.

(g) If this path is taken, constituents transitioning to IFRSs may apply different variations of ‘regulatory accounting’. Additionally, current IFRS preparers may desire to start recognizing regulatory assets and regulatory liabilities when they have not presently been doing so in accordance with IFRSs. Therefore, the Board would need to consider the appropriate transition requirements for entities already applying IFRSs and whether a change in accounting policy from not recognising regulatory assets and regulatory liabilities to a policy that does permit recognition of regulatory assets and regulatory liabilities is a change that ‘results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity’s financial position, financial performance or cash flows’ as required by paragraph 14 of IAS 8.

(h) Finally, the Board would also need to consider how entities would properly transition from any ‘interim’ standard that may be issued to whatever the Board concludes during a comprehensive review of this project. This consideration should include the potential political ramifications that may result from changing current IFRSs to start permitting recognition of regulatory assets and regulatory liabilities, for at least some regulated entities, and then potentially making a second change to return to current application of IFRSs that do not permit recognition of regulatory assets and regulatory liabilities.

81. **Cancel the project** based on consideration of the comments received and the underlying technical merits of those comments.

(a) This path must include detailed rationale addressing why the technical merits of this project preclude the recognition of regulatory assets and regulatory liabilities.

(b) Assuming this ‘detailed rationale’ is non-authoritative and included in IASB Update or similar external guidance, this will almost certainly lead to the introduction of newly permitted accounting policies within

IFRSs (and divergence from prior IFRS practices) for reasons similar to those described above if the project is deferred.

(c) Therefore, if this path is selected by the Board, as a means to ensure divergence is not created within the 'IFRS world', the Board should strongly consider some form of authoritative guidance that clearly states the Board's revised thinking on the ability to recognise regulatory assets and regulatory liabilities in accordance with IFRSs.

Potential additional actions

82. In the staff's opinion, if the Board selects a path to significantly defer or cancel the project, the Board should consider addition actions as a means to ensure divergence is not created within the 'IFRS world' knowing there are constituents that continue support the notion that regulatory assets and regulatory liabilities should be recognised in accordance with IFRSs.

Questions for the Board

83. This summary comment letter analysis paper provides a significant amount of information for the Board's consideration. This paper provides the Board with minimal staff recommendations given the number of potential paths forward and the broad consequences for each potential path. As stated in the Technical issues section of this paper, the staff believes there is one key decision influencing which potential path forward is correct:

> Do regulatory assets and regulatory liabilities exist in accordance with the current *Framework for the Preparation and Presentation of Financial Statements* and consistent with current other IFRSs?

84. The purpose of this agenda paper is not to provide the Board with the technical analysis of this key question. Rather, the staff requests the Board approve the staff to bring back to a subsequent meeting an analysis of the technical merits to allow the Board to answer this key question.

85. The staff also recommends a revised timeline be created for the project given the variety and depth of comment letters received and technical issues raised.

Question 1 – How should staff proceed
Does the Board approve the staff to prepare an analysis of the technical merits of whether regulatory assets and regulatory liabilities exist in accordance with current IFRSs including the *Framework for the Preparation and Presentation of Financial Statements?* Does the Board approve the staff to prepare a revised project timeline?

86. Additionally, the staff recommends the Board remove the proposed exemption for first-time adopters from the ED. The staff recommends a brief deliberation at a future Board meeting to finalise this exemption as part of the next omnibus *Improvements to IFRSs* expected to be issued in April 2010. See the First-time adoption section within Technical issues for additional information.

Question 2 – First-time adoption exemption permitting deemed cost at the date of transition
Does the Board approve the removal from the ED and finalisation of an exemption for an entity with operations subject to rate regulation the election to be able to elect to use the carrying amount of items of property, plant and equipment held, or previously held, for use in such operations as their deemed cost at the date of transition to IFRSs?

Appendix A – List of Comment Letter Respondents

CL #	Respondent	Respondent Type	Industry	Geography
1	Mrs Deepika Periwal (Ernst & Young India)	Miscellaneous	Unspecified	India
2	Institute of Chartered Accountants in Australia (ICAA) & CPA Australia and National Institute of Accountants	Accountancy Body	Accounting	Australia
3	JT Browne Consulting	Miscellaneous	Unspecified	Canada
4	Accounting Standards Board (ASB)	Standard Setter	Accounting	UK
5	Australasian Council of Auditors-General	Public Sector	Non for profit	Australia
6	TransAlta Corporation	Preparer	Utilities	Canada
7	The special task force of the Financial Accounting Standards Committee (FASC) of Accounting Research and Development Foundation in Taiwan	Standard Setter	Accounting	Taiwan
8	neoCFO	Miscellaneous	Unspecified	India
9	CLP Power Hong Kong Limited	Preparer	Utilities	Hong Kong
10	The National Rural Electric Cooperative Association (NRECA)	Association	Utilities	USA
11	National Association of Water Companies	Association	Utilities	USA
12	Financial Reporting Standards Board (FRSB) of the NZICA	Standard Setter	Accounting	New Zealand
13	SEOPAN	Association	Construction	Spain
14	PPL Corporation	Preparer	Utilities	USA
15	Heads of Treasuries Accounting and Reporting Advisory Committee (HOTARAC)	Public Sector	Non for profit	Australia
16	Canadian Association of Members Public Utility Tribunals	Utilities Regulator	Utilities	Canada
17	Financial Reporting Advisors, LLC	Miscellaneous	Unspecified	USA
18	BC Hydro	Preparer	Utilities	Canada

CL #	Respondent	Respondent Type	Industry	Geography
19	BC Ferry Services Inc	Preparer	Transportation	Canada
20	Federation of Auditors, Accountants and Financiers of Agroindustrial Complex of Ukraine	Accountancy Body	Accounting	Ukraine
21	Fortis Inc	Preparer	Utilities	Canada
22	Hydro Québec	Preparer	Utilities	Canada
23	Oncro Electric Delivery	Preparer	Utilities	Canada
24	Grant Thornton	Accounting Firm	Accounting	International
25	NAV Canada	Preparer	Utilities	Canada
26	American Electric Power (EAP)	Preparer	Utilities	USA
27	New Zealand Accident Compensation Corporation (ACC)	Preparer	Insurance	New Zealand
28	Canadian Energy Pipeline Association (CEPA), Canadian Gas Association (CGA) and Canadian Electricity Association (CEA)	Association	Utilities	Canada
29	British Columbia Transmission Corporation (BCTC)	Preparer	Utilities	Canada
30	Australian Accounting Standards Board	Standard Setter	Accounting	Australia
31	Golden State Water Company	Preparer	Utilities	USA
32	Energie Steiermark AG	Preparer	Utilities	Austria
33	Institute of Chartered Accountants in England & Wales (ICAEW)	Accountancy Body	Accounting	UK
34	Energy East Corporation	Preparer	Utilities	USA
35	The United Illuminating Company	Preparer	Utilities	USA
36	International Energy Accounting Forum (IEAF)	Association	Utilities	International
37	Actividades de Construccion Y Servicios (ACS)	Preparer	Construction	Spain
38	Robert Kwan	Analyst	Unspecified	Canada
39	National Grid	Preparer	Utilities	UK

CL #	Respondent	Respondent Type	Industry	Geography
40	EDF	Preparer	Utilities	France
41	TD Securities	Analyst	Unspecified	Canada
42	Instituto de Contabilidad y Auditoría de Cuentas (ICAC)	Accountancy Body	Accounting	Spain
43	Fluxys	Preparer	Utilities	Belgium
44	PricewaterhouseCoopers	Accounting Firm	Accounting	International
45	American Gas Association	Association	Utilities	USA
46	Empire District Electric Company	Preparer	Utilities	USA
47	Spectra Energy Corporation	Preparer	Utilities	USA
48	SNC Lavalin Group Inc	Preparer	Utilities	Canada
49	FirstEnergy	Preparer	Utilities	USA
50	Northwest Territories Power Corporation (NTPC) and the Northwest Territories Hydro Corporation (NT Hydro)	Preparer	Utilities	Canada
51	Southern California Edison (SCE)	Preparer	Utilities	USA
52	EPCOR	Preparer	Utilities	Canada
53	AES Corporation	Preparer	Utilities	USA
54	Group of 100	Preparer	Unspecified	Australia
55	Enmax Corporation	Preparer	Utilities	Canada
56	New Zealand Treasury	Public Sector	Non for profit	New Zealand
57	Enbridge	Preparer	Utilities	Canada
58	The Rural Utilities Service (RUS)	Utilities Regulator	Utilities	USA
59	Entergy Services Inc	Preparer	Utilities	USA
60	Alliance Pipeline Ltd	Preparer	Utilities	Canada

CL #	Respondent	Respondent Type	Industry	Geography
61	Alabama Gas Corporation	Preparer	Utilities	USA
62	Brazilian Accounting Pronouncements Committee (CPC)	Standard Setter	Accounting	Brazil
63	Accounting Standards Council of Singapore	Standard Setter	Accounting	Singapore
64	Eskom South Africa	Preparer	Utilities	South Africa
65	Korea Accounting Standards Board (KASB)	Standard Setter	Accounting	Korea
66	Institute of Chartered Accountants of Pakistan (ICAP)	Accountancy Body	Accounting	Pakistan
67	South African Institute of Chartered Accountants (SAICA) Accounting Practice Board (APB) of South Africa and the Accounting Practices Committee (APC)	Standard Setter	Accounting	South Africa
68	IBERDROLA	Preparer	Utilities	Spain
69	Malaysian Accounting Standards Board (MASB)	Standard Setter	Accounting	Malaysia
70	German Association of Energy and Water Industries (Bundesverband der Energie-und Wasserwirtschaft -BDEW)	Association	Utilities	Germany
71	E-ON	Preparer	Utilities	Germany
72	Mazars	Accounting Firm	Accounting	International
73	Edison Electric Institute	Association	Utilities	USA
74	Dutch Accounting Standards Board (DASB)	Standard Setter	Accounting	Netherlands
75	California Water Association	Association	Utilities	USA
76	ABRADEE, Brazilian Association for Electricity Distribution Network Companies,	Association	Utilities	Brazil
77	Dayton Power and Light Company	Preparer	Utilities	USA
78	Deloitte Touche Tohmatsu	Accounting Firm	Accounting	International
79	Spanish Electricity Industry Association	Association	Utilities	Spain
80	Toronto Hydro Corporation (THC)	Preparer	Utilities	Canada

CL #	Respondent	Respondent Type	Industry	Geography
81	Electricity Distribution Association	Association	Utilities	Canada
82	Institute of Chartered Accountants of Scotland (ICAS)	Accountancy Body	Accounting	UK
83	AltaLink LP	Preparer	Utilities	Canada
84	Association of Chartered Certified Accountants (ACCA)	Accountancy Body	Accounting	UK
85	Office of the Auditor General of New Brunswick	Public Sector	Non for profit	Canada
86	Federal Energy Regulatory Commission (FERC)	Utilities Regulator	Utilities	USA
87	Oakville Hydro Electricity Distribution Inc	Preparer	Utilities	Canada
88	Norsk RegnskapsStiftelse - Norwegian Accounting Standards Board	Standard Setter	Accounting	Norway
89	Gaz Metro Limited Partnership	Preparer	Utilities	Canada
90	NSTAR (NYSE: NST)	Preparer	Utilities	USA
91	Interstate National Gas Association of America (INGAA)	Association	Utilities	USA
92	Dominion Resouces Inc	Preparer	Utilities	USA
93	The National Association of Regulatory Utility Commissioners (NARUC)	Utilities Regulator	Utilities	USA
94	National Association of State Utility Consumer Advocates (NASUCA)	Association	Utilities	USA
95	Duke Energy Corporation	Preparer	Utilities	USA
96	Hydro Ottawa Limited	Preparer	Utilities	Canada
97	Eurelectric	Trade Unions	Utilities	Europe
98	The Insurance Corporation of British Columbia	Preparer	Insurance	Canada
99	FPL Group Inc	Preparer	Utilities	USA
100	Xcel Energy Inc	Preparer	Utilities	USA
101	OGE Energy Corp	Preparer	Utilities	USA
102	BDO	Accounting Firm	Accounting	International

CL #	Respondent	Respondent Type	Industry	Geography
103	PowerStream Inc	Preparer	Utilities	Canada
104	Manitoba Hydro	Preparer	Utilities	Canada
105	AltaGas Utilities Inc	Preparer	Utilities	Canada
106	Canadian Accounting Standards Board	Standard Setter	Accounting	Canada
107	United Water Inc	Preparer	Utilities	USA
108	The Laclede Group Inc	Preparer	Utilities	USA
109	TransCanada Corporation	Preparer	Utilities	Canada
110	Consolidated Edison	Preparer	Utilities	USA
111	Sempra Energy	Preparer	Utilities	USA
112	Energias De Portugal	Preparer	Utilities	Portugal
113	MidAmerican Energy Holdings Company	Preparer	Utilities	USA
114	Ontario Power Generation	Preparer	Utilities	Canada
115	Financial Executives Institute Canada	Preparer	Unspecified	Canada
116	California Water Group Services	Preparer	Utilities	USA
117	Exelon Corporation	Preparer	Utilities	USA
118	Yukon Energy	Preparer	Utilities	Canada
119	Chuck Chandler	Miscellaneous	Unspecified	Canada
120	Province of British Columbia	Public Sector	Non for profit	Canada
121	Zambia Institute of Chartered Accountants	Accountancy Body	Accounting	Zambia
122	Agência Nacional de Energia Elétrica - ANEEL	Association	Utilities	Brazil
123	Ernst & Young	Accounting Firm	Accounting	International
124	Province of Manitoba	Public Sector	Non for profit	Canada

CL #	Respondent	Respondent Type	Industry	Geography
125	BUSINESSEUROPE	International Body	Unspecified	International
126	Province of Ontario	Public Sector	Non for profit	Canada
127	Enersource Hydro Mississauga Inc.	Preparer	Utilities	Canada
128	Southern Company	Preparer	Utilities	USA
129	TECO Energy	Preparer	Utilities	USA
130	NiSource	Preparer	Utilities	USA
131	PNM Resources	Preparer	Utilities	USA
132	Hong Kong Institute of Certified Public Accountants	Accountancy Body	Accounting	Hong Kong
133	RTE Reseau de Transport d'Electricité	Preparer	Utilities	France
134	Constellation Energy	Preparer	Utilities	USA
135	Organismo Italiano di Contabilita	Standard Setter	Accounting	Italy
136	KPMG	Accounting Firm	Accounting	International
137	Thomas Ryder of TRM&M Associates	Miscellaneous	Unspecified	USA
138	Association pour la participation des entreprises françaises à l'harmonisation comptable internationale (ACTEO)	Accountancy Body	Unspecified	France
139	Office of the Auditor General of Canada	Public Sector	Public Sector	Canada
140	Acto Group	Preparer	Utilities	Canada
141	GDF Suez Group	Preparer	Utilities	France
142	Israel Government Companies Authority	Public Sector	Non for profit	Israel
143	Belgian Accounting Standards Board	Standard Setter	Accounting	Belgium
144	Conseil National de la Comptabilité (CNC)	Standard Setter	Accounting	France
145	Northeast Utilities System	Preparer	Utilities	USA

CL #	Respondent	Respondent Type	Industry	Geography
146	Bangor Hydro Electric Company	Preparer	Utilities	USA
147	Emera Inc	Preparer	Utilities	Canada
148	Nova Scotia Power	Preparer	Utilities	Canada
149	New Brunswick Power Holding Corporation	Preparer	Utilities	Canada
150	Ministry of Finance (China)	Public Sector	Unspecified	Canada
151	E-Control/Bundesnetzagentur	Utilities Regulator	Utilities	Germany
152	EFRAG	Public Sector	Unspecified	Europe
153	Hydro One	Preparer	Utilities	Canada
154	Federal of European Accountants (FEE)	Accountancy Body	Unspecified	Europe
155	International Organization of Securities Commissions (IOSCO)	Public Sector	Unspecified	International

Appendix B – Respondent Summary by Type and Geography

Respondent type	Africa	Asia-Pacific	Europe	North America	South America	International	Total
Accountancy Body	1	3	7	-	-	-	11
Accounting Firm	-	-	-	-	-	7	7
Analyst	-	-	-	2	-	-	2
International Body	-	-	-	-	-	1	1
Preparer (Insurance)	-	1	-	1	-	-	2
Preparer (Transportation)	-	-	-	1	-	-	1
Preparer (Representative Body)	-	1	-	-	-	-	1
Public Sector	-	3	3	5	-	1	12
Standard Setter	1	6	6	1	1	-	15
Other	-	2	-	4	-	-	6
Sub-total Non-Utilities	**2**	**16**	**16**	**14**	**1**	**9**	**58**
Association	-	-	3	9	2	1	15
Preparer (Utilities)	1	1	10	64	-	-	76
Trade Unions	-	-	1	-	-	-	1
Utilities Regulator	-	-	-	5	-	-	5
Sub-total Utilities	**1**	**1**	**14**	**78**	**2**	**1**	**97**
Total	**3**	**17**	**30**	**92**	**3**	**10**	**155**

Appendix C – General Agreement or Disagreement with ED by Respondent Type

Respondent type	Agree	Disagree	Neither Agree nor Disagree	Total
Accountancy Body	3	8	-	**11**
Accounting Firm	3	2	2	**7**
Analyst	2	-	-	**2**
International Body	-	1	-	**1**
Preparer (Insurance)	1	1	-	**2**
Preparer (Transportation)	1	-	-	**1**
Preparer (Representative Body)	-	1	-	**1**
Public Sector	5	6	1	**12**
Standard Setter	7	7	1	**15**
Other	3	2	1	**6**
Sub-total Non-Utilities	**25**	**28**	**5**	**58**
Association	15	-	-	**15**
Preparer (Utilities)	70	6	-	**76**
Trade Unions	1	-	-	**1**
Utilities Regulator	5	-	-	**5**
Sub-total Utilities	**91**	**6**	**-**	**97**
Total	**116**	**34**	**5**	**155**

Appendix D – General Agreement or Disagreement with ED by Geography

Respondent type	Africa	Asia-Pacific	Europe	North America	South America	International	Total
Agree	2	5	15	87	3	4	**116**
Disagree	1	10	15	5	-	3	**34**
Neither agree nor disagree	-	2	-	-	-	3	**5**
Total	**3**	**17**	**30**	**92**	**3**	**10**	**155**

Appendix E – Matrix of Respondent Type by Geography by General Agreement or Disagreement

Respondent type	Africa	Asia-Pacific	Europe	North America	South America	International	Total	Agree	Disagree	Neither Agree nor Disagree
Accountancy Body	1	3	7	-	-	-	**11**	3	8	-
Accounting Firm	-	-	-	-	-	7	**7**	3	2	2
Analyst	-	-	-	2	-	-	**2**	2	-	-
International Body	-	-	-	-	-	1	**1**	-	1	-
Preparer (Insurance)	-	1	-	1	-	-	**2**	1	1	-
Preparer (Transportation)	-	-	-	1	-	-	**1**	1	-	-
Preparer (Representative Body)	-	1	-	-	-	-	**1**	-	1	-
Public Sector	-	3	3	5	-	1	**12**	5	6	1
Standard Setter	1	6	6	1	1	-	**15**	7	7	1
Other	-	2	-	4	-	-	**6**	3	2	1
Sub-total Non-Utilities	**2**	**16**	**16**	**14**	**1**	**9**	**58**	**25**	**28**	**5**
Association	-	-	3	9	2	1	**15**	15	-	-
Preparer (Utilities)	1	1	10	64	-	-	**76**	70	6	-
Trade Unions	-	-	1	-	-	-	**1**	1	-	-
Utilities Regulator	-	-	-	5	-	-	**5**	5	-	-
Sub-total Utilities	**1**	**1**	**14**	**78**	**2**	**1**	**97**	**91**	**6**	**-**
Total	**3**	**17**	**30**	**92**	**3**	**10**	**155**	**116**	**34**	**5**
Agree	2	5	15	87	3	4	**116**			
Disagree	1	10	15	5	-	3	**34**			
Neither agree nor disagree	-	2	-	-	-	3	**5**			

Appendix F – Large International Firm Guidance on Regulatory Assets and Regulatory Liabilities

F1. Selected portions of each the large international firm guidance excerpts have been underlined for emphasis.

F2. Deloitte *iGAAP* 2010 states, in part:

> ***3.2.4 Regulatory assets***
>
> In August 2005, the IFRIC considered a request for guidance on operations subject to price regulation, specifically where a regulatory agreement allows an entity to increase its prices in future years to cover outflows of economic resources incurred in current or previous years. An example of such an agreement is set out as example 3.2.4 below.
>
> The IFRIC observed that it had previously discussed whether a regulatory asset should be recognised in the context of service concession arrangements, either as deferred costs or as an intangible asset to reflect an expectation that the entity will recover these costs as part of the price charged in future periods. The IFRIC concluded that assets should only be recognised if they qualify for recognition in accordance with the IASB's *Framework for the Preparation and Presentation of Financial Statements* and relevant Standards such as IAS 11, IAS 18, IAS 16 and IAS 38. Therefore, the determination as to whether a regulatory asset should be recognised will be based on the facts of each individual arrangement.
>
> In December 2008, the IASB decided to add to its technical agenda a project on rate regulated activities (see 14.3).
>
> **Example 3.2.4 Regulatory assets**
>
> Company X, an electricity producer, operates in Country B. Electricity producers in Country B are subject to government regulation of electricity charges. Company X has incurred operating losses in the two years ending 20X0 as a consequence of the regulatory pricing mechanism.
>
> The government of Country B subsequently approves a regulatory agreement allowing the electricity producers to increase their prices in future years to offset losses incurred for the previous two years ending 20X0.
>
> Company X should not recognise an asset and associated revenues at the end of 20X0 for the recovery of past operating losses through invoicing future consumption at higher prices. In order to recover operating losses incurred, electricity companies are required to produce electricity for their clients in the future. Even though it is arguable that electricity companies will recover the operating losses, Company X has not, at the end of 20X0, provided the service for which the customers will be paying and, therefore, the regulatory asset cannot be recognised as it does not qualify for recognition as an asset in accordance with the *Framework for the Preparation and Presentation of Financial Statements*. Moreover, customers can choose not to purchase electricity from this producer even if electricity is produced. In other words, it is not just a matter of producing

electricity for clients in the future but clients purchasing electricity.

Consequently, the authorisation given by the government to increase prices in the future is merely a pricing mechanism that regulates prices for the following periods, and does not give rise to an asset and additional revenue in the current period (i.e. 20X0). The recovery of the operating loss is included in the calculation of the price the regulated entity may charge to its customers and should be recognised only when such revenues are received or receivable.

F3. Ernst & Young *International GAAP* 2010 states, in part:

Chapter 15 *Intangible assets*, 3.1 Regulatory assets

In many countries the provision of utilities (e.g. water, natural gas or electricity) to consumers is regulated by the national government. Regulations differ between countries but often regulators operate a cost-plus system under which a utility is allowed to make a fixed return on investment. Similarly, a regulator may allow a utility to recoup its investment by increasing the prices over a defined period.

Consequently, the future price that a utility is allowed to charge its customers may be influenced by past cost levels and investment levels. Under a number of national GAAPs accounting practices have developed whereby an entity accounts for the effects of regulation by recognising a 'regulatory' asset (or liability) that reflects the increase (or decrease) in future prices approved by the regulator. Such 'regulatory assets' may have been classified as intangible assets under those national GAAPs.

During 2008 the IFRIC considered for a time whether regulated entities could or should recognise an asset or a liability as a result of regulation by regulatory bodies or governments. The IFRIC again decided not to add the issue to its agenda, coming to the same conclusion as before that whilst rate regulation is widespread and significantly affects the economic environment of regulated entities, there did not seem to be significant divergence in practice for entities that were already applying IFRS. The current consensus among existing IFRS reporters was that no regulatory assets or liabilities are recognised, unless they meet the definition of a financial asset or a financial liability (these arise in few regulatory regimes).

However, the IASB decided to add a project on rate-regulated activities to its agenda. The Board acknowledged that this was a matter of significant interest in a number of countries that would be adopting IFRS in the near future and where recognition of regulatory assets and liabilities was either permitted or required. In July 2009, the IASB issued an exposure draft on rate-regulated activities, which is discussed at 5.1 below.

Chapter 15 *Intangible assets*, 5.1 Exposure draft on rate-regulated activities (consistent with Chapter 24, 8.4 not repeated in this Appendix)

5.1 Exposure draft on rate-regulated activities

As noted at 3.1 above, there are a number of countries adopting IFRS in the near future that currently allow or require the recognition of regulatory assets and liabilities, whereas existing IFRS reporters seem to do so rarely. In July 2009, the IASB issued an exposure draft on certain types of rate-regulated activities, to secure what the board describes as 'a definitive conclusion on the question'. The deadline for comments is 20 November 2009.

5.1.1 Scope of the proposals

The scope of the proposals is intended to be restrictive, applying only to entities whose operating activities meet the following criteria:

(a) an authorised body (the 'regulator') establishes the price the entity must charge its customers for the goods or services that the entity provides and the customers are bound by that price; and

(b) 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 (cost-of-service regulation). The specified return could be a minimum or range and need not be fixed or guaranteed.

Cost-of-service regulation is defined as 'a form of regulation for setting an entity's prices (rates) in which there is a cause-and-effect relationship between the entity's specific costs and its revenues. Forms of regulation that establish different rates for different categories, such as different classes of customers or volumes purchased, are within this scope provided that the regulator approves the definition and the rate for each of those categories and that all customers of the same category are bound by the same rate. For example, the rate-regulated activities of an entity would not be excluded from the proposals simply because the entity is also engaged in unregulated activities. However, regulatory mechanisms applying targeted or assumed costs, such as industry averages, rather than an entity's specific costs, are outside the scope of the proposals.

The scope of the proposals is limited to regulation based on an entity's actual costs because the Board has concluded that a regulatory asset can only be deemed to exist if the entity's rights under rate-regulation relates to identifiable future cash flows linked to costs it previously incurred, rather than relating to any expectation of future cash flows based on the existence of predictable demand. Such a 'cause-and-effect relationship' must be evident for an asset to exist.

It is clear that a scope restriction would be required, because entities operating outside a regulatory environment might look for similar cause-and-effect relationships. For example, if a customer contractually agrees to suffer a future price increase on the basis of data demonstrating that its supplier had incurred higher than reasonable production costs in the past, the supplier might try to argue that there is just as compelling a case for recognising an intangible asset for the right to future price increases.

In addition, given the wide range of regulatory frameworks worldwide, it will be important that such a scope restriction clearly identifies which regimes would fall under the scope of the proposals and which would not.

If drafted too loosely, the consequence may be that in meeting the conversion needs of, for example, North American power generators and distributors, the proposals bring into their scope entities previously unaffected by similar requirements under their local GAAP. Therefore, the IASB should confirm whether the proposals should be restricted to monopoly operators and to certain industries.

5.1.2 Recognition and measurement

The Exposure Draft proposes that when an entity falling within its scope has the right to increase or the obligation to decrease rates in future periods as a result of the actual or expected actions of the regulator, it shall recognise:

(a) a regulatory asset for its right to recover specific previously incurred costs and to earn a specified return; or

(b) a regulatory liability for its obligation to refund previously collected amounts and to pay a specified return.

Accordingly a regulatory asset (or liability) is recognised to reflect amounts that would otherwise be recorded in that period in the statement of comprehensive income as an expense (or revenue). That asset or liability should be carried initially and at the end of subsequent reporting periods at its expected present value. Such an expected present value would comprise the following elements for a regulatory asset or a regulatory liability:

(a) an estimate of the future cash flows that will arise in a range of possible outcomes;

(b) an estimate of the probability of each outcome occurring

(c) the time value of money, represented by the current market risk-free rate of interest; and

(d) the price for bearing the uncertainty inherent in the regulatory asset or regulatory liability.

Changes in the estimate of the expected present value of the regulatory asset or regulatory liability after initial recognition are recorded as adjustments to the carrying value of the asset. Where such assets are components of an item of property, plant and equipment or an internally generated intangible asset, it is proposed that entities could disregard the usual prohibition from capitalising costs after the asset is available for use, but only if their inclusion by the regulator in the cost for rate-setting purposes is highly probable. Otherwise a separate regulatory asset is recognised.

The proposals also require that regulatory assets are subject to a test of recoverability, whereby the entity considers the extent to which it will recover the previously incurred costs from its customers. This consideration should take into account the net effect that the imposed increase or decrease in prices is expected to have on the level of customer demand or competition during the period of cost recovery. If an entity concludes that it is not reasonable to assume that it will be able to collect

sufficient revenues from its customers to recover its costs, this is an indication that the cash-generating unit in which the regulatory assets and regulatory liabilities are included may be impaired and it will have to be tested for impairment in accordance with IAS 36.

5.1.3 Presentation and disclosure

Regulatory assets and liabilities would be presented separately from other assets and liabilities on the face of the balance sheet, and classified as current and non-current items. Offsetting would only be allowed for each category of asset or liability subject to the same regulator.

The Exposure Draft proposes that entities would disclose the fact that some or all of its operating activities are subject to rate regulation, including a description of their nature and extent. For each set of operating activities subject to a different regulator, an entity would disclose the following information:

(a) if the regulator is a related party;

(b) an explanation of the approval process for the rate subject to regulation (including the rate of return), including information about how that process affects both the underlying operating activities and the specified rate of return;

(c) the indicators that management considered in concluding that such operating activities have met the scope criteria (if that condition requires significant judgement);

(d) significant assumptions used to measure the expected present value of a recognised regulatory asset or regulatory liability including:

  (i) the supporting regulatory action, for example, the issue of a formal approval for costs to be recovered pending a final ruling at a later date and that date, when known, or

  (ii) the entity's assessment of the expected future regulatory actions; and

(e) the risks and uncertainties affecting the future recovery of the regulatory asset or final settlement of the regulatory liability, including the expected timing.

For each category of regulatory asset or regulatory liability recognised that is subject to a different regulator, it is proposed that the entity disclose:

(a) a reconciliation from the beginning to the end of the period, in tabular format unless another format is more appropriate, of the carrying amount in the balance sheet of the regulatory asset or regulatory liability, including at least the following elements:

  (i) the amount recognised in the income statement/statement of comprehensive income relating to balances from prior periods collected or refunded in the current period;

(ii) the amount of costs incurred in the current period that were recognised in the balance sheet as regulatory assets or regulatory liabilities to be recovered or refunded in future periods; and

(iii) other amounts that affected the regulatory asset or regulatory liability, such as items acquired or assumed in business combinations or the effects of changes in foreign exchange rates, discount rates or estimated cash flows. If a single cause has a significant effect on the regulatory asset or regulatory liability, the entity shall disclose it separately.

(b) the remaining period over which the entity expects to recover the carrying amount of the regulatory asset or to settle the regulatory liability; and

(c) the amount of financing cost included in the cost of self-constructed property, plant and equipment and internally developed intangible assets in the current period that would not have been capitalised under IAS 23.

At the time of writing it is difficult to determine how this exposure draft will be received. Some might point to the way that a customer base acquired in a business combination is recognised as an intangible asset and regard the exposure draft as a logical extension of this thinking to assets and liabilities that arise in situations where a regulator is effectively negotiating on behalf of a whole customer base. Others might point to the current lack of diversity in practice and question the need for the proposed new standard. The challenge for the IASB will be twofold: to define clearly in what situations and regulatory environments it is appropriate to recognise regulatory assets and liabilities and to make the case for its proposals to current users of IFRS.

Chapter 24 *Provisions, contingent liabilities and contingent assets*, 5.4.12 Regulatory liabilities

Under certain national GAAPs, an entity can defer benefits that would otherwise be included in profit for the period (for example, revenues) as regulatory liabilities on the basis that the regulator requires it to reduce its tariffs so as to return the amounts concerned to customers. Under IFRS, should an entity recognise a liability (or a provision) when a regulator requires the entity to reduce its future prices/revenues so as to return to customers what the regulator regards as the excess amounts collected in the current period?

No reference is made within IAS 37, or any of its examples, to this type of situation. However, we believe that under IFRS no such liabilities can be recognised since there is no present obligation relating to a past transaction or event. A liability is defined in IAS 37 as 'a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits'.

The return to customers of amounts mandated by a regulator depends on future events including:

- future rendering of services

- future volumes of output (generally consisting of utilities such as water or electricity) consumed by users; and
- the continuation of regulation.

Consequently, items described as 'regulatory liabilities' do not meet the definition of a liability cited above since there needs to be a present obligation at the end of the reporting period before a liability can be recognised. Entities, in general, would recognise a liability for those items only if an obligation to refund exists as a result of past events or transactions, and regardless of future events.

This conclusion is consistent with the position in the UK. In Appendix VII to FRS 12, which discusses the development of the standard, it is noted that by basing the recognition of a provision on the existence of a present obligation, the standard rules out the recognition of any provision made simply to allocate results over more than one period or otherwise to smooth the results reported. To illustrate this, it goes on to say 'For example, in a regulated industry the results achieved in the current period may cause the pricing structure in the next period to be adjusted, e.g. the higher the profits in this year the lower the prices permitted for next year. There is no justification under the FRS for a provision to be recognised in such circumstances. The purpose of such a provision would be to transfer some of the current year's profit to the following year, which would suffer from lower prices because of the current year's profits. However, there is no present obligation that requires the transfer of economic benefits to settle it and nothing to justify recognition of a provision.'

As discussed in more detail at 3.1 in Chapter 15, the IFRIC has been asked a number of times to consider whether such regulatory liabilities should be recognised and on each occasion, the most recent being in November 2008, decided not to add the issue to its agenda, noting in particular that whilst rate regulation is widespread and significantly affects the economic environment of regulated entities, divergence did not seem to be significant in practice for entities that were already applying IFRS. The current consensus among existing IFRS reporters is that no regulatory liabilities are recognised, unless in those rare cases where they meet the definition of a financial liability.

However, in response to a request made to the November 2008 meeting of the Standards Advisory Council and discussions at its December 2008 meeting, the IASB decided to add a project on rate-regulated activities to its agenda. The Board acknowledged that while divergence in practice did not currently exist, this was a matter of significant interest in a number of countries that would be adopting IFRS in the near future and where recognition of regulatory liabilities (and assets) was either permitted or required. The approaching conversion of these jurisdictions to IFRS would increase pressure for a definitive conclusion on the question. In July 2009, the IASB issued an exposure draft on rate-regulated activities (see 8.4 below).

Chapter 25 *Revenue recognition*, 6.12 Regulatory liabilities

In many countries the provision of utilities (e.g. water, natural gas or electricity) to consumers is regulated by a government agency. Regulations

differ between countries but often regulators operate a cost-plus system under which a utility is allowed to make a fixed return on investment. Consequently, the future price that a utility is allowed to charge its customers may be influenced by past cost levels and investment levels.

Under many national GAAPs (including US GAAP – see FAS 71 – *Accounting for the Effects of Certain Types of Regulation*) accounting practices have been developed that allow an entity to account for the effects of regulation by deferring revenue and recognising a 'regulatory liability' that reflects the decrease in future prices required by the regulator.

The issue of regulatory assets and liabilities has been discussed by the IFRIC on numerous occasions, most recently at its meetings in September and November of 2008 where it concluded that it would not take this matter onto its agenda on the grounds that it thought divergence in practice was not significant under IFRS, where such items are only rarely recognised.

However in December 2008 the IASB agreed to add this project to its agenda. In July 2009 it issued an exposure draft – *Rate-regulated Activities*. This exposure draft favours the US GAAP approach, requiring an entity to:

(a) recognise a regulatory asset or regulatory liability if the regulator permits the entity to recover specific previously incurred costs or requires it to refund previously collected amounts and to earn a specified return on its regulated activities by adjusting the prices it charges its customers; and

(b) measure a regulatory asset or regulatory liability at the expected present value of the cash flows to be recovered or refunded as a result of regulation, both on initial recognition and at the end of each subsequent reporting period. This net present value will be an estimated probability-weighted average of the present value of the expected cash flows.

The proposals within the exposure draft would apply to the activities of an entity that meet both of the following criteria:

(a) an authorised body (the regulator) establishes the price the entity must charge its customers for the goods or services the entity provides, and that price binds the customers; and

(b) 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 (cost-of-service regulation). The specified return could be a minimum or range and need not be a fixed or guaranteed return.

If finalised as drafted this exposure draft would have a significant impact on rate regulated entities within its scope. For further details, including our opinion of the proposals within the exposure draft, see Chapter 15 at 3.1 and Chapter 24 at 5.4.12.

F4. KPMG's *Insights into IFRSs* 2009/2010 states, in part:

3.3.180 Regulatory assets

3.3.180.10 In many countries utility companies (or other entities operating in regulated industries) have contractual arrangements with the local regulator to charge a price based on a cost-plus model. Some arrangements will allow the entity to recover excess costs incurred through future price increases. Typically under such arrangements the regulator should approve the costs to be recovered based on conditions set out in the contractual arrangement. In our view, any excess cost that is incurred that may be recovered through future price increases does not qualify for recognition as an asset as it does not meet the definition of an intangible asset and there is no contractual right to receive cash or other financial assets. The legal right to increase prices in the future is not sufficient to satisfy the definition of an intangible asset because the entity does not control the customers. The customers might decide not to buy or buy less and thereby leave the entity with uncovered cost. For a discussion of regulatory liabilities, see 3.12.720.

3.12.720 Regulatory liabilities

3.12.720.10 In many countries utility companies, and other entities operating in regulated industries, have contractual arrangements with the local regulator to charge a price based on a cost-plus model. When costs incurred are lower than budget, some arrangements may require the regulated entity to return any "excess margin" to customers through future price decreases.

3.12.720.20 Under such arrangements the regulator specifies the reduction in future prices, generally based on conditions set out in the agreement. For example, in 2009 an electricity generator U was subject to rate regulation that limits the return on capital to six percent. Actual sales and costs resulted in U earning eight percent and U knows that under the terms of its licence it must reduce 2010 prices to achieve a target return of four percent. This expected future rate reduction is equal to 750,000 of "excess" 2009 revenue.

3.12.720.30 The question is whether a liability for the expected future rate reduction of 750,000 should be recognised in the 2009 financial statements and if yes, then what type of obligation is being recognised and measured. In our view, when the claw-back of the excess margin is contingent on future activity and sales, U has no contractual obligation to deliver cash to a third party; therefore it does not have a financial liability within the scope of IAS 32 and IAS 39. However, if U was required to pay the 750,000 to the local regulator if it stops operating, or to another entity if that entity took over U's licence, then the 750,000 would be considered a financial liability. Further, since the mechanism for "returning" current year excess revenue is a reduction in prices on future sales, U does not have a present obligation within the scope of IAS 37 and a provision would be recognised only if U had an onerous contract, i.e., if it was obligated to provide future services at a loss.

3.12.720.40 In our view, in the circumstances described in 3.12.720.20 - .30 U also would have to consider, in preparing its 2009 financial statements, if it has satisfied the revenue recognition requirements of IAS 18 in respect of the 750,000 of excess revenue. Revenue recognition requires that the risks and rewards of ownership of goods have been

> transferred and that services have been rendered, and measured by the reference to the stage of completion. If an entity is required to deliver additional goods or services for monies already collected via an adjustment of the sales price, then in our view recognition of revenue related to these additional goods or services would not be appropriate. Instead the excess of 750,000 would be recognised as deferred revenue. Deferred revenue is recognised in profit or loss as the future discounted goods or services are provided. This approach is similar to the approach for multiple deliverables such as customer loyalty programmes (see 4.2.50 and .340).
>
> **3.12.720.50** For a discussion of regulatory assets, see 3.3.180.

F5. PricewaterhouseCoopers' *IFRS Manual of Accounting 2009* does not provide explicit guidance on regulatory assets or regulatory liabilities.