

International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH
United Kingdom

15 January 2015

Dear Board members,

Invitation to comment - Discussion Paper DP/2014/2 - *Reporting the Financial Effects of Rate Regulation*

Ernst & Young Global Limited, the central coordinating entity of the global EY organisation, welcomes the opportunity to offer its views on the Discussion Paper DP/2014/2 *Reporting the Financial Effects of Rate Regulation* (the DP) issued by the International Accounting Standards Board (the Board or IASB) in September 2014.

We support the Board's initiative to provide guidance on the accounting for rate regulated activities under IFRS as we believe information on the financial effects of an entity's regulatory environment will be useful and relevant to users of financial statements in making their investment and lending decisions. Also, this topic has been discussed by the IASB and IFRS Interpretations Committee (IFRIC) on several occasions. How the effects of an entity's regulatory environment are reflected in its financial statements is a significant issue for both existing IFRS preparers and many countries currently converting to IFRS.

Alternative financial reporting approaches

Section 5 of the DP outlines four alternatives to reporting the financial effects of rate regulation. We support the third financial reporting approach - recognising the impact of rate regulation through specific IFRS requirements. Within this approach, we generally believe that deferring/accelerating the recognition of a combination of costs and revenue, as outlined in paragraphs 5.77 to 5.81, may be the best approach to reflect useful and relevant information for the different types of rate-setting mechanisms across jurisdictions. However, during subsequent phases of this project, we suggest that the IASB continue to evaluate all three alternatives described in the DP under the third financial reporting approach. We also urge the Board to elaborate on the application of these alternatives to ensure constituents have a clear understanding of the impact to financial statements prepared by rate-regulated entities.

If the IASB decides not to proceed with developing a financial reporting approach, we believe that developing disclosure-only requirements for rate-regulated entities would be necessary in order to provide users of financial statements with useful and relevant financial information on their regulated operations.

Definition of rate regulation

In order to create a common starting point for the rate regulated activities discussion, the DP includes a defined rate regulation which could become the basis for developing the scope of the specific accounting guidance. We suggest that the scope proposed by the IASB could be enhanced by including the following aspects in the definition (some of which are consistent with the IASB's proposal):

- ▶ A main principle that defined rate regulation balances the needs of the customers to purchase goods or services at a reasonable price with the needs of the entity to attract capital and remain financially viable, through a rate-setting framework that allows and/or requires entities to adjust future rates charged to customers.
- ▶ The involvement of an independent regulator who establishes or approves the rate-setting framework to be applied by the entity during a period of time, including automatic renewal or extension periods.
- ▶ A linkage of the rate-setting framework to costs or expenditures incurred, or expected to be incurred, by the entity. This linkage does not preclude the regulator from using rate adjustments for certain other purposes, such as providing incentives to the supplier or encouraging changes in customer usage patterns.
- ▶ The entity has the intent and ability to collect the revenue from customers through future billings based on the approved rates/rate-setting framework.
- ▶ The existence of a regulatory licence or other agreement that mandates the overall rights and obligations of the entity and regulatory body. These overall rights and obligations may be more comprehensive than the specific rights and obligations that create accounting requirements.

In addition, we believe accounting guidance should be developed for the combination of enforceable rights and obligations created by the rate-setting framework/mechanism.

Presentation and disclosure requirements

We support the separate presentation of regulatory deferral account balances on the statement of financial position as we believe this will be useful and relevant information for users of financial statements. However, we believe the movements in these accounts should be presented within the line items to which the movements relate in the statement of profit or loss and other comprehensive income.

In addition, we believe that the disclosure requirements of IFRS 14 *Regulatory Deferral Accounts* are an appropriate starting point for the disclosure requirements in a comprehensive standard on rate regulated activities.

The asset and liability debate

As discussed in the DP, the IASB has not formed a preliminary view on whether regulatory deferral account balances meet the revised proposed *Conceptual Framework* definitions of an asset and a liability. However, if the Board decides to continue with the rate-regulated activities project, they will need to clarify their position on this matter. We suggest the IASB to consider either of two approaches:

- ▶ Revising the existing (or revised proposed) asset and liability definitions in the *Conceptual Framework* such that regulatory deferral account balances will meet those definitions; or
- ▶ Explicitly state that the recognition of regulatory deferral account balances is a departure from the existing (or revised proposed) *Conceptual Framework* definitions.

We have responded to certain of the questions, as set out in the DP, in the Appendix to this letter.

Should you wish to discuss the contents of this letter with us, please contact Leo van der Tas on +44 (0)20 7951 3152.

Yours faithfully

Ernst + Young Global Limited

Appendix A - Responses to questions

Question 1

(a) What information about the entity's rate-regulated activities and the rate-regulatory environment do you think preparers of financial statements need to include in their financial statements or accompanying documents such as management commentary?

Please specify what information should be provided in:

- (i) the statement of financial position;
- (ii) the statement(s) of profit or loss and other comprehensive income;
- (iii) the statement of cash flows;
- (iv) the note disclosures; or
- (v) the management commentary.

(b) How do you think that information would be used by investors and lenders in making investment and lending decisions?

(a) We believe that regulated entities operate in a different business environment and have unique characteristics that, in combination, give rise to economic effects that should be reflected in the IFRS financial statements. Therefore, we support the recognition of regulatory deferral account balances in IFRS financial statements under these circumstances.

On the basis that the Board decides to proceed with developing specific requirements to account for regulatory deferral account balances, we propose that the following financial information be included in the IFRS financial statements of rate-regulated entities:

- (i) The statement of financial position
 - ▶ The amount of any separately identified regulatory deferral account balances, including regulatory deferral account balances classified as current and non-current assets or liabilities.
- (ii) The statement(s) of profit or loss and other comprehensive income
 - ▶ We believe the movements in regulatory deferral accounts should be presented within the related line item on the statement(s) of profit or loss and other comprehensive income.
- (iii) The statement of cash flows
 - ▶ We believe no additional information should be presented on the statement of cash flows, aside from the existing presentation requirements of IAS 7 *Statement of Cash Flows*.
- (iv) and (v) the note disclosures or the management commentary
 - ▶ Broadly, we believe the disclosures currently required in IFRS 14 provides decision-useful information that will give users the information necessary to understand the nature of the entity's

Question 1

regulatory scheme and its impact on the financial statements, while giving preparers the flexibility to include only relevant and material disclosures. Consequently, we support using the disclosure requirements in paragraphs 27-36 of IFRS 14 in the accompanying notes to the financial statements or management commentary as a starting point for the disclosure requirements of a separate standard on rate-regulated activities.

In addition, the IASB may wish to consider the following items for additional disclosure:

- ▶ Status of any pending regulatory action, approvals and the estimated financial impact on the operating results and financial position of the entity.
- ▶ Additional narrative disclosures which describe the regulatory jurisdictions in which an entity operates.

The above items are in addition to any general disclosure requirements that currently exist in other IFRSs. Furthermore, it is important that the IASB considers the nature and extent of the disclosure of this information in annual and/or interim financial statements.

- (b) We do not intend for the above to be a complete list of all relevant information that should be presented or disclosed in a rate-regulated entity's financial statements. However, we believe the above information will be important to users of financial statements in order for them to understand the risks and uncertainties over an entity's rate-regulated activities as it provides decision-useful information for an investor to assess the long-term viability and financial stability of the entity's operations.

Question 2

Are you familiar with using financial statements that recognise regulatory deferral account balances as regulatory assets or regulatory liabilities, for example, in accordance with US generally accepted accounting principles (GAAP) or other local GAAP or in accordance with IFRS 14? If so, what problems, if any, does the recognition of such balances cause users of financial statements when evaluating investment or lending decisions in rate-regulated entities that recognise such balances compared to:

- a) non-rate-regulated entities; and
- b) rate-regulated entities that do not recognise such balances?

Based on our experiences with entities that prepare their financial statements in accordance with Accounting Standards Codification (ASC) 980 *Regulated Operations* under U.S. GAAP, we are not aware of any problems that users of these financial statements face when evaluating investment or lending decisions concerning these entities.

Question 3

Do you agree that, to progress this project, the IASB should focus on a defined type of rate regulation (see Section 4) in order to provide a common starting point for a more focused discussion about whether rate regulation creates a combination of rights and obligations for which specific accounting guidance or requirements might need to be developed (see paragraphs 3.6-3.7)? If not, how do you suggest that the IASB should address the diversity in the types of rate regulation summarised in Section 3?

We agree that the IASB should focus on a defined type of rate regulation in order to establish the scope of any IFRS requirements that it decides to develop for rate-regulated entities. However, as described in our response to question 5, we believe the proposed scope should be enhanced to reduce some of the difficulty that may arise when the guidelines are applied in practice. We also believe as described in response to question 7 that the IASB should focus on whether regulatory assets and liabilities meet the definition of an asset or a liability in the revised proposed *Conceptual Framework*.

In our experience, there are many different types of rate-setting mechanisms across jurisdictions, including cost-based, incentive-based and a combination of a cost- and incentive-based mechanisms. We support the Board's acknowledgement of the current diversity in regulatory regimes and understanding that these regimes will likely evolve in the future. As such, we encourage the Board to develop the scope of rate-regulated activities based on principles that will address the dynamic regulatory environment and be supported with guidelines that will allow consistent application across jurisdictions.

We are also aware that entities in some jurisdictions, for example, Brazil and Portugal, have service concession utility arrangements that allow them to charge the respective government for costs incurred, but not recovered, from the customers at the end of the concession period. We urge the IASB to consider such arrangements when developing the scope and accounting requirements of a standard on rate-regulated entities.

Question 4

Paragraph 2.11 notes that the IASB has not received requests for it to develop special accounting requirements for the form of limited or 'market' rate regulation that is used to supplement the inefficient competitive forces in the market (see paragraphs 3.30-3.33).

- a) Do you agree that this type of rate regulation does not create a significantly different economic environment and, therefore, does not require any specific accounting requirements to be developed? If not, why not?
- b) If you agree that this type of rate regulation does not require any specific accounting requirements, do you think that the IASB should, alternatively, consider developing specific disclosure requirements? If so, what would you propose and why?

Question 4

- (a) We agree with the Board's assessment that market rate regulation, as outlined in the DP, does not create a significantly different economic environment and, therefore, does not require any specific accounting requirements to be developed. Specifically, market regulation as defined in the DP is applied to suppliers in a competitive market and is rarely based on the specific costs that an individual supplier incurs in providing the rate-regulated goods or services. As such, market rate regulation would not satisfy the second tenet of the Board's defined rate regulation: "rate regulation balances the needs of the customers to purchase essential goods or services at a reasonable price with the **needs of the entity to attract capital and remain financially viable.**"
- (b) We believe disclosures on the regulatory environment and its impact on an entity's operating results promote clarity and consistency in the level of decision-useful information provided to users of the financial statements, regardless of whether the rates charged to customers are influenced by defined rate regulation or by market rate regulation. Therefore, we recommend that the IASB considers additional disclosure requirements even for entities subject to market rate regulation. These additional disclosures may either be included in the specific IFRS requirements that the IASB may decide to develop or be added to existing standards through the consequential amendments process.

Question 5

Paragraphs 4.4-4.6 summarise the key features of defined rate regulation. These features have been the focus of the IASB's exploration of whether defined rate regulation creates a combination of rights and obligations for which specific accounting guidance or requirements might be developed in order to provide relevant information to users of general purpose financial statements.

- (a) Do you think that the description of defined rate regulation captures an appropriate population of rate-regulatory schemes within its scope? If so, why? If not, why not?
- (b) Do you think that any of the features described should be modified in order to include or exclude particular types of rate-regulatory schemes or rate-regulated activities included within the scope of defined rate regulation? Please specify and give reasons to support any modifications to the features that you suggest, with particular reference to why the features may or may not give rise to circumstances that result in particular information needs for users of the financial statements.
- (c) Are there any additional features that you think should be included to establish the scope of defined rate regulation or would you omit any of the features described? Please specify and give reasons to support any features that you would add or omit.

Question 5

- (a) We generally support the main principle included in paragraph 4.4: Defined rate regulation balances the needs of the customers to purchase essential goods or services at a reasonable price with the needs of the entity to attract capital and remain financially viable. However, the restriction of this principle to the purchase of essential goods or services may be too restrictive and difficult to apply in practice.

Similarly, we believe some of the aspects of the regulatory pricing framework included in paragraphs 4.4(a) to 4.4(d) are too broad and would be difficult to apply in practice. Although all of the features described in these paragraphs will likely exist in the regulatory environment to which rate-regulated accounting should be applied, their application will require significant judgement and likely result in inconsistent treatment. For example, it may be difficult to evaluate whether rate-regulated railroad services are essential to customers or whether there is no effective competition to supply. Although transporting goods by rail may be restricted to a single rail operator, certain markets may have ample roadways and haulage-based operators to provide alternatives and competition.

In addition, in our view, the rate-setting framework mechanisms described in paragraphs 4.5 and 4.6 may be too restrictive when considering the regulatory schemes that currently exist and will likely continue to change. For example, the specific requirements for the framework to include a “revenue requirement” and an adjustment mechanism which seeks to ensure that the rate-regulated entity earns no more or no less than the amount of the revenue requirement and any related profit or return, may be too restrictive for the population of rate-regulatory schemes that currently exist and may evolve in the future.

- (b) In the response (a) above and the summary provided below, we have provided suggestions on the modifications to the key features of defined rate regulation outlined in paragraphs 4.4-4.6.
- (c) We believe the scope of an accounting standard on rate-regulated activities should also include the following: (i) the existence of a regulatory licence or other agreement which mandates the overall rights and obligations of the entity and regulatory body; (ii) the involvement of an independent regulator who establishes or approves the rate-setting framework; and (iii) a linkage of the rate-setting framework to costs or expenditures incurred, or expected to be incurred, by the entity.

Combining these features with the modifications described in (a) above results in a scope that we believe addresses the Board’s main principle, that defined rate regulation balances the needs of the customers to purchase goods or services at a reasonable price with the needs of the entity to attract capital and remain financially viable. In addition, we suggest the main principle is expanded to incorporate a rate-setting framework that allows and/or requires entities to adjust future rates charged to customers.

Question 5

In summary, we suggest that the scope proposed by the IASB could be enhanced by including the following aspects in the definition (some of which are consistent with the IASB's proposal):

- ▶ A main principle that a defined rate regulation balances the needs of the customers to purchase goods or services at a reasonable price with the needs of the entity to attract capital and remain financially viable, through a rate-setting framework that allows and/or requires entities to adjust future rates charged to customers.
- ▶ The involvement of an independent regulator who establishes or approves the rate-setting framework to be applied by the entity during a period of time, including automatic renewal or extension periods.
- ▶ A linkage of the rate-setting framework to costs or expenditures incurred, or expected to be incurred, by the entity. This linkage does not preclude the regulator from using rate adjustments for certain other purposes, such as providing incentives to the supplier or encouraging changes in customer usage patterns.
- ▶ The entity has the intent and ability to collect the revenue from customers through future billings based on the approved rates.
- ▶ The existence of a regulatory licence or other agreement that mandates the overall rights and obligations of the entity and regulatory body. These overall rights and obligations may be more comprehensive than the specific rights and obligations that create accounting requirements.

Question 6

Paragraphs 4.62-4.72 contain an analysis of the rights and obligations that arise from the features of defined rate regulation.

- a) Are there any additional rights or obligations that you think the IASB should consider? Please specify and give reasons.
- b) Do you think that the IASB should develop specific accounting guidance or requirements to account for the combination of rights and obligations described? Why or why not?

- (a) The defined rate regulation in paragraphs 4.4-4.6 and the distinguishable features giving rise to the rights and obligations that the DP suggests should be accounted for (paragraphs 4.64-4.72), are very similar, if not identical. As such, it is not clear whether the scope of the proposal is based on the defined rate regulation or the distinguishable combination of rights and obligations.

In our view, the exclusive right to supply essential goods or services and obligations to achieve the defined minimum service level do not create assets or liabilities for which specific accounting guidance should be developed. This seems to be consistent with the IASB's conclusions in paragraphs 4.64 and 4.71.

Question 6

However, we believe the rate setting framework creates rights and obligations for which accounting guidance should be developed. For example, an entity's right to recover storm costs in a subsequent period is created through the rate setting framework in connection with the approval of future rates.

We are also aware that entities in some jurisdictions, for example, Brazil and Portugal, have service concession utility arrangements that allow them to charge the respective government for costs incurred but not recovered from the customers at the end of the concession period. We urge the IASB to consider such arrangements when developing the scope, and accounting requirements, of a standard on rate-regulated entities.

(b) As mentioned above, we support the IASB's development of specific accounting requirements for the combination of enforceable rights and obligations created by the rate-setting framework/mechanism.

Question 7

Section 5 outlines a number of possible approaches that the IASB could consider developing further, depending on the feedback received from this Discussion Paper. It highlights some advantages and disadvantages of each approach.

- a) Which approach, if any, do you think would best portray the financial effects of defined rate regulation in IFRS financial statements and is most likely to provide the information that investors and lenders consider is most relevant to help them make their investing and lending decisions? Please give reasons for your answer?
- b) Is there any other approach that the IASB should consider? If so, please specify and explain how such an approach could provide investors and lenders with relevant information about the financial effects of rate regulation.
- c) Are there any additional advantages or disadvantages that the IASB should consider before it decides whether to develop any of these approaches further? If so, please describe them.

If commenting on the asset/liability approach, please specify, if it is relevant, whether your comments reflect the existing definitions of an asset and a liability in the *Conceptual Framework* or the proposed definitions suggested in the *Conceptual Framework Discussion Paper*, published in July 2013.

The DP explores four alternatives to reporting the financial effects of rate regulation:

1. Recognising the package of rights and obligations established by the regulatory agreement as an intangible asset (i.e., a licence)
2. Adopting the regulatory accounting requirements
3. Developing specific IFRS requirements to defer or accelerate the recognition of costs and/or revenue
4. Prohibiting the recognition of regulatory deferral account balances in IFRS financial statements. In this approach, the Board explores whether specific disclosure requirements should be further developed to explain the financial effects of rate regulation to users of IFRS financial statements.

Question 7

We believe **Approach 3**, recognising the impact of the rate regulation through specific IFRS requirements, is the most appropriate manner to portray the financial effects of rate regulation in IFRS financial statements.

Within this approach, we generally believe that deferring and/or accelerating the recognition of a combination of costs and revenue as outlined in paragraphs 5.77 to 5.81 may be the best approach to allow for flexibility in accounting for the different rate-setting mechanisms across jurisdictions. Therefore, any accounting approach that the Board consequently develops under the third financial reporting approach should reflect the nature of the regulatory deferral account debit and credit balances.

We suggest that the Board continues to evaluate all three alternatives (deferring/accelerating the recognition of costs, deferring/accelerating the recognition of revenue and deferring/accelerating the recognition of a combination of costs and revenue) described in the DP under the third financial reporting approach during the subsequent phases of the rate-regulated activities project.

Approach 1 recognises aspects of the rate-setting process in changes to the carrying amount of the regulatory licence or other agreement. We agree with the arguments presented in the DP which seem to indicate that this approach is not necessarily viable. We agree that this componentisation approach is not reflective of amounts expended in order to add to, replace or service the original licence since the nature of the adjustments to the carrying amount under this approach is a result of the application of the terms of the licence and the rate-setting mechanism. It does not enhance the functionality or operability of the original licence.

Furthermore, the carrying amounts of the intangible asset are exposed to positive and negative fluctuations that are not a result of changes in the expected economic benefits flowing to the entity (i.e., fair value or value-in-use of the asset). It poses practical challenges for entities in determining the changing value of any regulatory asset recognised and would be difficult to apply this guidance to regulatory deferral credit balances (i.e., regulatory liabilities).

In addition, it is also unclear from the DP how such regulatory licences will be amortised. Such regulatory assets are a result of past transactions whereas any recovery of costs or revenue will typically occur through rate adjustments that are prospectively collected from customers in the future.

Approach 2 may result in unintended consequences where revenues and costs are recognised and measured in a manner and timing that is inconsistent with the existing IFRS requirements, regardless of whether they are impacted by regulated activities. Although this approach lessens the burden on an entity to keep two sets of books (i.e., one for accounting and the other for regulatory requirements) and therefore helps entities in managing their cost of compliance, this approach significantly reduces consistency and comparability with other regulated entities which apply IFRS. Therefore, we are not in favour of this approach.

Question 7

If the IASB decides not to proceed with developing specific IFRS requirements (i.e., Approach 3), we think that **Approach 4** would be the next best alternative in order to provide users of financial statements with useful and relevant financial information related to an entity's regulated operations.

As discussed in the DP, the IASB has not formed a preliminary view on whether regulatory deferral account balances meet the revised proposed *Conceptual Framework* definitions of an asset and a liability. However, if the Board decides to continue with the rate-regulated activities project, they will need to clarify their position on this matter. We suggest the IASB to consider either of two approaches:

- ▶ Revising the existing (or revised proposed) asset and liability definitions in the *Conceptual Framework* such that regulatory deferral account balances will meet those definitions; or
- ▶ Explicitly state that the recognition of regulatory deferral account balances is a departure from the existing (or revised proposed) *Conceptual Framework* definitions.

Question 8

Does your organisation carry out activities that are subject to defined rate regulation? If so, what operational issues should the IASB consider if it decides to develop any specific accounting guidance or requirements?

We are a public accounting firm and do not carry out activities that are subject to defined rate regulation.

Question 9

If, after considering the feedback from this Discussion Paper and the *Conceptual Framework* project, the IASB decides to prohibit the recognition of regulatory deferral account balances in IFRS financial statements, do you think that the IASB should consider developing specific disclosure-only requirements? If not, why not? If so, please specify what type of information you think would be relevant to investors and lenders in making their investing or lending decisions and why.

As mentioned earlier, we believe the nature of, and risks associated with, an entity's rate-regulated activities significantly affect its operations, financial results and financial position. Hence, such information will be useful and relevant to users of IFRS financial statements. Therefore, even if the Board decides to prohibit the recognition of regulatory deferral account balances in IFRS financial statements, we believe the next best alternative is for the Board to develop specific disclosure-only requirements in order to provide decision-useful information to investors and users in assessing the entity's long-term viability.

Question 9

We believe several of the disclosure requirements included in IFRS 14 incorporate the type of information that would be relevant to the decision making of investors and lenders. Below are modified disclosure paragraphs from IFRS 14 which the IASB should consider:

- 27 **An entity that ~~elects to apply~~ applies this Standard shall disclose information that enables users to assess:**
- (a) **the nature of, and the risks associated with, the rate regulation that establishes the price(s) that the entity can charge customers for the goods or services it provides; and**
 - (b) **the effects of that rate regulation on its financial position, financial performance and cash flows.**
- 30 To help a user of the financial statements assess the nature of, and the risks associated with, the entity's rate-regulated activities, an entity shall, for each type of rate-regulated activity, disclose:
- (a) a brief description of the nature and extent of the rate-regulated activity and the nature of the regulatory rate-setting process;
 - (b) the identity of the rate regulator(s). If the rate regulator is a related party (as defined in IAS 24 *Related Party Disclosures*), the entity shall disclose that fact, together with an explanation of how it is related;
 - (c) how the entity's financial position, financial performance and cash flows are ~~future recovery of each class (ie each type of cost or income) of regulatory deferral account debit balance or reversal of each class of regulatory deferral account credit balance~~ is affected by risks and uncertainty, for example:
 - (i) demand risk (for example, changes in consumer attitudes, the availability of alternative sources of supply or the level of competition);
 - (ii) regulatory risk (for example, the submission or approval of a rate-setting application or the entity's assessment of the expected future regulatory actions); and
 - (iii) other risks (for example, currency or other market risks).

Question 10

Sections 2 and 6 discuss some of the information needs of users of general purpose financial statements. The IASB will seek to balance the needs of users of financial statements for information about the financial effects of rate regulation on an entity's operations with concerns about obscuring the understandability of financial statements and the high preparation costs that can result from lengthy disclosures (see paragraph 2.27).

Question 10

- a) If the IASB decides to develop specific accounting requirements for all entities that are subject to defined rate regulation, to what extent do you think the requirements of IFRS 14 meet the information needs of investors and lenders? Is there any additional information that you think should be required? If so, please specify and explain how investors or lenders are likely to use that information.
- b) Do you think that any of the disclosure requirements of IFRS 14 could be omitted or modified in order to reduce the cost of compliance with the requirements, without omitting information that helps users of financial statements to make informed investing or lending decisions? If so, please specify and explain the reasons for your answer.

- (a) To date, we have not had any exposure to entities that have prepared financial statements in accordance with IFRS 14. Accordingly, we do not have any perspectives on whether the requirements of IFRS 14 meet the information needs of investors or lenders.
- (b) We believe the IFRS 14 disclosures should become the starting point of the disclosure requirements of a standard to be applied by all entities subject to rate regulation. The IFRS 14 disclosure requirements related to the regulatory deferral accounts may need to be modified to incorporate the specific recognition, measurement, impairment and derecognition requirements of the new standard. We have proposed some minor enhancements to the disclosure requirements of IFRS 14 in our response to question 9.

Question 11

IFRS 14 requires any regulatory deferral account balances that have been recognised to be presented separately from the assets and liabilities recognised in the statement of financial position in accordance with other Standards. Similarly, the net movements in regulatory deferral account balances are required to be presented separately from the items of income and expense recognised in the statement(s) of profit or loss and other comprehensive income.

If the IASB develops specific accounting requirements that would apply to both existing IFRS preparers and first-time adopters of IFRS, and those requirements resulted in the recognition of regulatory balances in the statement of financial position, what advantages or disadvantages do you envisage if the separate presentation required by IFRS 14 was to be applied?

We support the separate presentation of regulatory deferral account balances in the statement of financial position similar to the requirements of IFRS 14. However, we believe the movements in these accounts should be presented within the line items to which the movements relate in the statement of profit or loss and other comprehensive income.

The advantages of presenting regulatory deferral account balances in separate line items in the statement of financial position (as required by IFRS 14) include:

Question 11

- ▶ Greater transparency on the impact of the respective regulatory regime on an entity's financial results. We believe this will assist investors and users of the financial statements in assessing the regulated entity's long-term viability of their operations for the purposes of making investing and lending decisions.
- ▶ Increased comparability of rate-regulated entities with entities that are not within the scope of the rate-regulated activities standard.

The disadvantages include:

- ▶ Increased cost of compliance and efforts required by entities to gather the data required for the separate presentation requirements. Specifically, additional costs and effort will be required to segregate aspects of accounts which have both rate-regulated and non-rate-regulated activity (e.g., property, plant and equipment and income taxes).

Presenting the movements as a separate line item in the statement of profit or loss may appear to indicate that these movements are segregated from an entity's normal operations. Given that they are an integral part of a rate-regulated entity's normal operations and business, we believe it would be more useful and relevant if these movements are included in the related revenue or costs line items. As such, we recommend that the IASB clarify that the movements of the regulatory deferral account balances be included in the related revenue and/or cost line items in the statement of profit or loss and consider requiring entities to disclose the amounts and the specific financial statement line items in which these movements are reported.

Question 12

Section 4 describes the distinguishing features of defined rate regulation. This description is intended to provide a common starting point for a more focused discussion about whether this type of rate regulation creates a combination of rights and obligations for which specific accounting guidance or requirements should be developed.

Paragraph 4.73 suggests that the existence of a rate regulator whose role and authority is established in legislation or other formal regulations is an important feature of defined rate regulation. Do you think that this is a necessary condition in order to create enforceable rights or obligations, or do you think that co-operatives or similar entities, which operate under self-imposed rate regulation with the same features as defined rate regulation (see paragraphs 7.6-7.9), should also be included within defined rate regulation? If not, why not? If so, do you think that such co-operatives should be included within the scope of defined rate regulation only if they are subject to formal oversight from a government department or other authorised body?

We agree that the existence of a rate regulator whose role and authority is established by legislation or other formal regulations is an important feature of defined rate regulation. We believe co-operatives or similar entities which operate under self-imposed rate regulation could be included within defined rate regulation if

Question 12

they are subject to formal oversight from a government department or other authorised body and all other scope requirements are met. Specifically, adequate evidence should exist to substantiate that “the rate regulation balances the needs of the customers to purchase essential goods or services at a reasonable price with the needs of the entity to attract capital and remain financially viable.” Additionally, the co-operative agreement and/or rate-setting framework would need to create enforceable rights and obligations on the entity (including enforcement by third parties).

Question 13

Paragraphs 7.11–7.22 highlight some of the issues that the IASB may consider if it continues to progress this project.

Do you have any comments or suggestions on these or any other issues that may or may not have been raised in this Discussion Paper that you think the IASB should consider if it decides to develop proposals for any specific accounting requirements for rate-regulated activities?

We broadly agree that the IASB should consider the issues that are as outlined in Section 7 of the DP. Our suggestions for other issues that the Board should consider in connection with proposals for specific accounting requirements for rate-regulated activities include:

- ▶ Clarification of the interaction of regulatory deferral accounts with the definitions of assets and liabilities under the *Conceptual Framework*. It will be important for the specific accounting requirements established for rate-regulated activities to include a statement on whether the regulatory deferral accounts meet the definition of assets and liabilities under the *Conceptual Framework* or if they will be deemed an exception to those definitions.
- ▶ If the IASB decides not to proceed with the comprehensive rate-regulated project, additional guidance may be needed for entities that have adopted IFRS 14. For example, if IFRS 14 is rescinded, transitional guidance may be needed to address derecognition of regulatory deferral accounts.
- ▶ If the IASB decides to develop accounting requirements specifically for rate regulated activities, the Board should consider further application guidance on the recognition and measurement of an impairment loss as it relates to regulatory deferral account balances. Specifically, some areas to consider include:
 - ▶ Whether the regulatory deferral accounts should be included in the carrying amount of the respective CGU.
 - ▶ The determination of the recoverable amount of a regulatory deferral account debit balance in connection with the requirements of paragraphs 105 and 106 of IAS 36 *Impairment of Assets*, which limit the recognition of an impairment loss to the individual assets’ recoverable amount.

Question 13

- ▶ The Board may need to provide specific guidance on the treatment of unique income tax aspects of regulatory regimes, which may differ from IAS 12 *Income Taxes*.
- ▶ The IASB may need to include accounting and disclosure requirements for regulatory deferral accounts in connection with an entity's interim financial statements prepared under IAS 34 *Interim Financial Reporting*. Specifically, the new standard may need to clarify how regulatory deferral account balances should be recognised and measured for interim periods and if any additional interim disclosures should be considered.
- ▶ The Board may need to address the treatment of a subsidiary's regulatory deferral account balances in the group's consolidated financial statements if certain activities from the consolidated group's perspective do not meet the scope of the defined rate regulation. Similarly, if a standard on rate-regulated activities is developed, the IASB should consider clarifying how to apply the scope requirements to an entity for which only a portion of its operations are rate-regulated.