



To:	AASB members	Date:	2 December 2014
From:	Clark Anstis & Angus Thomson	Agenda Item:	18.1
Subject:	Rate Regulation	File:	--

Action

Consider the key matters the AASB could include in its comments to the IASB on DP/2014/2 *Reporting the Financial Effects of Rate Regulation*.

The AASB staff comments in the Appendix to this memo and the New Zealand Accounting Standards Board Draft comment letter [agenda paper 18.3] are intended to assist the Board in determining the key matters it may wish to raise with the IASB.

Attachments

As of the date of this memo the AASB had not received any responses to Invitation to Comment ITC 32 *Reporting the Financial Effects of Rate Regulation*, which incorporates IASB DP/2014/2. Any responses received by the time of the Board meeting will be tabled and designated as part of agenda paper 18.2.

The New Zealand Accounting Standards Board Draft comment letter (for consideration at the NZASB's 10 December meeting) is agenda paper 18.3.¹

AASB 14 *Regulatory Deferral Accounts* is available on the AASB's website:

http://www.aasb.gov.au/admin/file/content105/c9/AASB14_06-14.pdf

ITC 32 is a 109-page document and is available on the AASB's website:

http://www.aasb.gov.au/admin/file/content105/c9/ITC32_09-14.pdf

Background

The AASB issued ITC 32 in September 2014, which is open for comment to the AASB until 15 December 2014. DP/2014/2 is open for comment to the IASB until 15 January 2015.

DP/2014/2 is part of a research project designed to determine what the IASB should do next on addressing rate regulation, having already issued IFRS 14 *Regulatory Deferral Accounts* as an interim measure. IFRS 14 grandfathers much of the 'previous GAAP' on rate regulation accounting undertaken in jurisdictions that have recently adopted IFRS. IFRS 14 was designed to facilitate

¹ The formatting of this letter has been changed to meet Website Content Accessibility Guidelines.

IFRS adoption – it does not necessarily reflect a view that regulatory balances should be recognised [DP/2014/2, paragraph 1.10]

DP/2014/2 provides a wide range of arguments both for and against the need for special rate regulation accounting.

The IASB has tried to focus the discussion in the DP by defining a particular form of rate regulation (termed ‘defined rate regulation’), which is most clearly articulated at paragraph 4.4 of the DP.

Not-for-profit entities

The IASB is considering rate regulation in the context of for-profit entities. The AASB may also need to consider the flow-on consequences of the IASB’s work to not-for-profit entities, some of which may source revenue from charges to customers that are determined by regulatory mechanisms (and which may or may not be ‘defined rate regulation’).

DP/2014/2 questions

The DP includes 13 questions. The Appendix to this memo outlines matters that the AASB might wish to consider including in its submission to the IASB.

Rate regulation accounting in other jurisdictions

A number of jurisdictions currently have some form of rate regulation accounting or favour having some form of rate regulation accounting restored after having adopted IFRS. They include Brazil, Canada, India, Korea and the United States.

The most widely known rate regulation accounting requirements are in US GAAP and include SFAS 71 *Accounting for the Effects of Certain Types of Regulation*, issued by the FASB in 1982. To provide some context for the types of accounting that some jurisdictions might be seeking, the following is a very high level summary of key aspects of SFAS 71.

In general, the type of regulation covered by this Statement permits rates (prices) to be set at levels intended to recover the estimated costs of providing regulated services or products, including the cost of capital (interest costs and a provision for earnings on shareholders’ investments).

For a number of reasons, revenues intended to cover some costs are provided either before or after the costs are incurred. If regulation provides assurance that incurred costs will be recovered in the future, this Statement requires companies to capitalize those costs. If current recovery is provided for costs that are expected to be incurred in the future, this Statement requires companies to recognize those current receipts as liabilities.²

2 <http://www.fasb.org/summary/stsum71.shtml>

Appendix

Matters that the AASB might wish to consider including in its submission to the IASB

DP/2014/2 Question 1 – general question about information on rate regulated activities

- (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?*

AASB staff comment

1.1 Paragraph 2.25 of the DP notes:

The IASB has heard that users of financial statements particularly value information that helps them to distinguish variability in performance that is adjusted through the rate-regulatory mechanism from variability for which the mechanism provides no adjustment. This information is needed to help them to understand the effect of the rate regulation on the revenue, profit and related cash flows of the entity, and to assess how reliable the rate regulation is in ensuring that the entity can earn its targeted returns through its billings to customers.

1.2 As acknowledged later in the DP, the impacts of various forms of rate regulation are much more subtle than paragraph 2.25 suggests. That is, the impact on items recognised in the financial statements could be difficult to try and isolate. For example, the regulation of electricity prices might be reflected in the market price of electrical generating equipment an entity acquires and that becomes the recognised cost in an entity's balance sheet. The same would apply in subsequent periods if the entity were to revalue that asset.

1.3 AASB staff consider there is a risk of double counting of assets and liabilities if the separate recognition of regulatory deferral balances is required or permitted.

1.4 In broad terms, a regulatory regime in which an entity might operate can be regarded as being an aspect of its business environment. This view would tend to imply that, if information about the entity's rate-regulated activities and the rate-regulatory environment is to be addressed in or with financial statements, it would be as note disclosure or as part of management commentary. However, in many cases, this information might be so widely known that users would not be relying on the financial statements as a source of that information. Also see comments on Question 9 in relation to the requirements of IFRS 8 *Operating Segments*.

- 1.5 The AASB has so far communicated to the IASB that it does not support special recognition and measurement requirements to address issues relating to rate regulation (for example, in responding to consultation documents that led to IFRS 14). The AASB has previously noted that any effort to address rate regulation accounting should be as part of the wider issue, such as a project to revise the requirements relating to intangible assets.

DP/2014/2 Question 2 – familiarity with regulatory deferral accounting

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?*

AASB staff comment

- 2.1 We are not yet familiar with financial statements that recognise regulatory deferral account balances because they have never been recognised under Australian Accounting Standards, before or after adopting IFRS.

DP/2014/2 Question 3 – focus on defined type of rate regulation

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?

AASB staff comment

- 3.1 Based on earlier feedback from a Request for Information (RFI) *Rate Regulation* (March 2013) the IASB found there is a wide variety of regulatory schemes that might need to be considered. Paragraph 1.14 of the DP notes:

... in order to provide a common focus for a technical discussion, the IASB has decided to focus, in this Discussion Paper, on a generic type of rate regulation that the responses to the RFI suggest is reasonably representative of the type of rate regulation that stakeholders consider relevant for this project. ... Defined rate regulation applies when customers have little or no choice but to purchase the rate-regulated goods or services from the entity. The rate regulation is designed to ensure that the rate-regulated entity recovers a determinable amount of consideration (the 'revenue requirement') in exchange for the rate-regulated activities that it performs. In addition, the rate regulation establishes, through the rate per unit chargeable to customers, the time at which the entity can bill customers for that consideration. ...

- 3.2 AASB staff understand how difficult it is for the IASB to try and discuss issues on a project that has a potentially indeterminate scope and consider that identifying a defined type of rate regulation might help. However, it signals that scoping is a major problem with the project.
- 3.3 Even with a defined type of rate regulation, interpreting the pre-conditions such as ‘customers having little or no choice’ could be problematic.
- 3.4 In parts of the DP (for example, paragraph 3.10); the notion of a good or service being ‘essential’ is considered as a pre-condition for ‘customers having little or no choice’. The DP acknowledges that ‘essential’ is hard to define and staff think the notion could be highly jurisdiction-specific. For example, in some societies, public liability insurance might be considered essential while in other societies it would not.
- 3.5 The notion of a ‘revenue requirement’ is repeatedly referred to in the DP in various contexts. There is an implication in some parts of the DP that the revenue requirement is a ‘right’ that is somehow an enforceable right to receive a certain amount of revenue. However, other parts of the DP clarify that this ‘right’ only represents an ‘intention’ that the entity will receive revenue of a particular amount or at a particular rate to recover its reasonable costs. Also see Question 6 below, which quotes paragraph 4.72 of the DP in relation to the revenue requirement.

DP/2014/2 Question 4 – limited or market rate regulation

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?*

AASB staff comment

- 4.1 Based on our misgivings about the whole project, AASB staff would prefer the project scope to be as narrow as possible. We consider that the market or incentive-based regulation noted by the IASB (for example, regulatory price caps) does not require specific accounting or disclosure requirements.

DP/2014/2 Question 5 – key features of defined rate regulation

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.*

AASB staff comment

5.1 Paragraph 4.4 of the DP notes:

Defined rate regulation involves a regulatory pricing (ie rate-setting) framework that includes all of the following:

- (a) it applies in situations in which customers have little or no choice but to purchase the goods or services from the rate-regulated entity because:
 - (i) there is no effective competition to supply; and
 - (ii) the rate-regulated goods or services are essential to customers (such as clean water or electricity).
- (b) it establishes parameters to maintain the availability and quality of the supply of the rate-regulated goods or services and other rate-regulated activities of the entity.
- (c) it establishes parameters for rates (sometimes referred to as prices or tariffs) that provide regulatory protections that:
 - (i) support greater stability of prices for customers; and
 - (ii) support the financial viability of the rate-regulated entity.
- (d) it creates rights and obligations that are enforceable on the rate-regulated entity and on the rate regulator.

5.2 AASB staff consider that, unless the rate regulation gives rise to enforceable rights and/or obligations between the regulated entity and its customers, the entity should not recognise regulatory deferral balances. [We note that factor (d) refers to rights and obligations that are enforceable on the rate-regulated entity and on the rate regulator.]

5.3 The AASB staff view is consistent with the sentiments expressed in paragraph 5.10 of the DP, which notes:

Many of those who do not support recognising ‘regulatory assets’ and ‘regulatory liabilities’ have argued that the right to increase or the obligation to decrease the rate chargeable for future sales does not create a present resource/right or a present obligation for the entity. Instead, they suggest that the right or obligation to recover or reverse regulatory deferral account balances by adjusting the future rate constitutes a possible

future asset or possible future liability that is conditional on future sales being made. As such, the regulatory deferral account balances would be classified as contingent assets or contingent liabilities because, although they may arise from past events and transactions, their existence as assets and liabilities will only be confirmed by the occurrence of a sufficient volume of future sales.

- 5.4 Another possible concern with the factors noted in paragraph 4.4 of the DP is that they could scope in activities that are already the subject of another IFRS. For example, staff think that the factors outlined in paragraph 4.4 of the DP would apply to various types of insurance services such as Workers' Compensation insurance and Compulsory Third Party (road vehicle) insurance in some Australian states. Although those contracts are currently accounted for as insurance contracts under AASB 4 *Insurance Contracts* and AASB 1023 *General Insurance Contracts*, if a rate regulation standard were promulgated based on the factors in paragraph 4.4 there could be an issue around which standard, in principle, should apply in the first instance.
- 5.5 AASB staff consider that, in the event there remains an IFRS on rate regulation among the suite of IFRS, it should be made clear that rate regulation accounting can only be applied if no other IFRS applies to the relevant transactions. That is, any rate regulation IFRS would only apply after an entity has exhausted all other avenues in IFRS in determining an accounting treatment for the relevant transactions.

DP/2014/2 Question 6 – rights and obligations relating to rate regulation

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?*

AASB staff comment

- 6.1 The DP discusses various regulatory arrangements such as when an entity:
- * must supply rate-regulated goods or services to customers on a non-discriminatory basis;
 - * must maintain minimum service levels and at the regulated price; and
 - * has an inability to cease, suspend, restructure or transfer operations without the approval of the rate regulator.
- 6.2 Paragraph 4.71 of the DP concludes "... that such obligations do not create a special environment for which specific accounting requirements need to be developed for rate-regulated entities. ... because these regulatory obligations can be found in many competitive environments ...".
- 6.3 Paragraph 4.72 of the DP notes:
- To compensate the entity for such rate-regulated obligations, and to prevent the obligations from becoming onerous, the rate regulation also grants rights to the entity.

Some suggest that the most distinguishable feature of defined rate regulation is the entity's right to recover the revenue requirement, using the rate-setting mechanism to adjust for under-billings or over-billings over time. This right ensures that the entity (and its capital providers) can rely on the rate regulation to recover its reasonable costs over the operational life of the assets that are used in providing the rate-regulated goods or services (see paragraph 4.57). However, defined rate regulation also ensures that the entity has a right to recover only the amount of its revenue requirement. Defined rate regulation seeks to do this by prohibiting the entity from retaining any excess amounts billed to customers.

- 6.4 Accordingly, a key focus of 'defined rate regulation' in the DP is a 'right to recover the revenue requirement, using the rate-setting mechanism to adjust for under-billings or over-billings over time'. However, AASB staff consider that, while such a right might add to the level of assurance about the recoverability of an entity's costs, it is not a right to a particular amount of revenue and is not a sufficiently distinct feature to justify regulatory deferral accounting or a specific IFRS on rate regulation accounting.
- 6.5 The customers may be locked into a rate at which they buy the relevant goods or services, but they are not locked in to particular quantities of those goods or services. Customers may not buy the quantity of goods or services assumed when the rate regulation arrangement was established. Although the arrangements under which electricity is supplied in Australia are not regarded as falling within the IASB's defined rate regulation, the recent trend in electricity demand in Australia provides a prime example of how long-term forecasts for an 'essential' product can be materially wrong.
- 6.6 Paragraph 4.79 of the DP notes:
- The finalised regulatory agreement (sometimes called a 'rate ruling') is binding on both the entity and the rate regulator. It confirms the entity's obligations for the next regulatory period, together with the amount of revenue that the entity is entitled to charge to customers in exchange for satisfying those obligations. In addition, the agreement distinguishes between the amount of revenue that can be billed to customers using the current regulatory rate per unit and any amount of the revenue requirement that will be carried forward as part of a future rate adjustment.
- 6.7 The fact that there is a specific agreement between the entity and the regulator overseeing the market (which is not a source of revenue for the entity) seems of little relevance to the accounting.
- 6.8 Paragraph 4.75 of the DP notes:
- If the rate-regulated entity fails to satisfy any of its obligations established in the regulatory agreement or terms of service, the rate regulator has various sanctions built into the rate regulation. These include:
- (a) imposing fines or penalties;
 - (b) reducing the future rate to be charged to customers; or
 - (c) withdrawing the entity's operating licence and forcing the transfer of the rate-regulated business, including the infrastructure and other supporting assets, to another entity or to a government body.
- 6.9 AASB staff consider that, if an entity has already undertaken an act that obligates it to pay a fine or has an onerous contract as a result of having committed to supply customers at a reduced rate; it would recognise a liability under existing IFRS, including applying IAS 37

Provisions, Contingent Liabilities and Contingent Assets. If an entity is to have its licence to operate in a particular business revoked and be forced to transfer the assets relating to that business to another entity, the entity would probably need to apply IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* and IAS 36 *Impairment of Assets*.

- 6.10 Overall, it's not clear that any new IFRS requirements would be needed to address the circumstances outlined in DP paragraph 4.75.

DP/2014/2 Question 7 – approaches the IASB could adopt

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.

AASB staff comment on asset recognition approach

- 7.1 Paragraph 5.17 of the DP notes:

Some suggest that an entity that is subject to defined rate regulation should recognise regulatory deferral account debit balances (that is, amounts of the revenue requirement not yet billed to customers) as assets in IFRS financial statements. This is, they suggest, because the entity controls the resource (that is, its right to recover the regulatory deferral account balance in accordance with the rate regulation), because it has an exclusive right to provide the rate-regulated goods or services, at the regulated rate, within the defined territory. Consequently, it is the entity, and no other party, that receives the economic benefits generated from the future delivery of the rate-regulated goods or services at the higher regulated price.

- 7.2 Staff consider that a right to charge a higher price on future sales should not be recognised as an asset because the entity has yet to satisfy the relevant performance obligations (supplying the relevant goods or services). We note that a multi-period contract (covering both 'low' and 'high' prices) under paragraph 17 of IFRS 15 *Revenue from Contracts with Customers*, might

give rise to assets and liabilities.³ However, the contracts contemplated in paragraph 17 of IFRS 15 (which may result in the recognition of assets and liabilities) are between the supplier and customer (not a regulator).

7.3 AASB staff concur with the sentiments expressed in paragraph 5.98 of the DP, which notes:

The focus in IFRS 15 is on the contract between the entity and the individual customers to whom it delivers the goods or services in exchange for consideration. For an entity subject to defined rate regulation, the entity's only source of consideration/revenue is the customers that purchase the rate-regulated goods or services. Consequently, the entity's only 'revenue-generating' activity appears to be the delivery of the rate-regulated goods or services to its customers. This means that revenue should be recognised using the regulated rate per unit when those goods or services are transferred to customers.

AASB staff comment on liability recognition approach

7.4 Paragraph 5.21 of the DP notes:

In defined rate regulation, many regulatory deferral account balances arise from differences between the revenue requirement and the revenue billed to customers using the regulated rate. For rate-regulatory purposes, a credit balance arising in a regulatory deferral account represents the excess revenue billed to customers over the amount of consideration to which the entity is entitled in exchange for its rate-regulated activities performed to date. The entity is obliged to reverse the excess that has been billed to customers by reducing the rate that is charged for the delivery of rate-regulated goods or services in future periods.

7.5 Consistent with sentiments expressed in paragraph 5.22 of the DP, staff consider that a requirement to sell a good or service at a relatively low price, which depends on making future sales, is different from an obligation to pay a customer back due to past 'over-charging'. Under IAS 37, a liability would generally only be recognised if the future supply constitutes an onerous contract. That is, a squeeze on margins on future sales should not trigger liability recognition.

7.6 If the onerous contract requirements of IAS 37 are not considered satisfactory, they should be considered for revision in respect of all types of contracts, not just in the context of rate regulation.

7.7 In the context of the current revision to the Conceptual Framework and identifying liabilities, agenda paper 10A for the IASB's November 2014 meeting summarises the IASB's tentative decisions to date, and notes the following:

The IASB noted that it will need to consider what 'no practical ability' means for transactions within the scope of particular Standards it develops or amends. However, the *Conceptual Framework* should clarify that the fact that an entity intends to make a

3 Paragraph 17 of IFRS 15 states: "An entity shall combine two or more contracts entered into at or near the same time with the same customer (or related parties of the customer) and account for the contracts as a single contract if one or more of the following criteria are met:

- (a) the contracts are negotiated as a package with a single commercial objective;
- (b) the amount of consideration to be paid in one contract depends on the price or performance of the other contract; or
- (c) the goods or services promised in the contracts (or some goods or services promised in each of the contracts) are a single performance obligation in accordance with paragraphs 22–30."

transfer or that the transfer is probable is not sufficient to conclude that the entity has no practical ability to avoid the transfer. The IASB tentatively decided that the *Conceptual Framework* should include the following general guidance:

- (a) Most obligations arise from contracts, legislation or some other operation of the law. In the absence of legal enforceability, an entity has no practical ability to avoid transferring an economic resource if its customary practices, published policies or specific statements create a valid expectation in another party that the entity will transfer the resource to (or on behalf of) that other party. In such situations, the entity has a constructive obligation to transfer the resource.
- (b) In some situations, an entity might be required to transfer an economic resource if it takes a particular course of action in the future, such as conducting particular activities or exercising particular options within a contract. In such situations, if the entity has no practical ability to avoid the particular course of action that would require the transfer, and the other criterion is also met (the amount of the transfer is determined by reference to benefits that the entity has received, or activities that it has conducted, in the past), the entity has a present obligation.
- (c) Situations in which an entity has no practical ability to avoid a particular course of action include those in which all courses of action that avoid the transfer would cause significant business disruption or have economic consequences significantly more adverse than the transfer itself.
- (d) An entity that prepares financial statements on a going concern basis has no practical ability to avoid a transfer that could be avoided only by liquidating the entity or ceasing trading.

7.8 In the context of a rate regulated entity that has charged a higher than ‘normal’ mark up on goods or services in the past and is now expected to accept a lower than ‘normal’ mark up, some of the above possible guidance might be viewed as encouraging liability recognition; especially (b) and (c). However, there would still need to be an impending transfer; and simply selling at a low (or zero) margin would not involve such a transfer.

AASB staff comment on recognising a ‘regulatory licence’

7.9 Paragraphs 5.35 to 5.46 of the DP discuss whether existing IFRS could be applied to enable recognition of a regulatory licence, either by applying IAS 38 *Intangible Assets* unamended or by amending IAS 38.

7.10 Some think that the periodic rate-review process would distinguish a regulatory licence from other licences accounted for under IAS 38, and that this points to a need to amend IAS 38. The possible amendments flagged in the DP are to either adopt a components approach (such as that in IAS 16 *Property, Plant and Equipment*) to the regulatory licence or widen the availability of fair value accounting to enable regulatory licences to be revalued. [Regulatory licences are unlikely to be able to meet the existing IAS 38 threshold of having a fair value available from an active market.]

7.11 Staff think that it would probably be beneficial for the IASB to consider a wide review of IAS 38, which could include consideration of the accounting for regulatory licences. The AASB has previously put to the IASB a view that the difference between the revaluation accounting policy choice in IAS 16 *Property, Plant and Equipment* (no need for an active market price to be available) and IAS 38 (an active market price is needed) is inappropriate, particularly since the release of IFRS 13 *Fair Value Measurement*.

AASB staff comment on ‘IFRS exemption’ approach

- 7.12 Paragraph 5.47 discusses as an option requiring or permitting the accounting prescribed by the rate regulator to be used as an exception from IFRS.
- 7.13 Staff regard this option as being totally unacceptable because it would give rise to inconsistencies across jurisdictions and between industries. It would also be completely inconsistent with the IASB’s philosophy to-date about industry accounting – both IFRS 4 and IFRS 6 *Exploration for and Evaluation of Mineral Resources* are regarded as interim standards.

AASB staff comment on ‘amending IFRS’ approach

- 7.14 The DP discusses three possible ways of taking this approach:
- * deferring/accelerating the recognition of costs;
 - * deferring/accelerating the recognition of revenue; and
 - * deferring/accelerating the recognition of a combination of costs and revenue.
- 7.15 In paragraph 5.55 of the DP the IASB acknowledges the complexity that any one of these forms of amendment might introduce to IFRS.
- 7.16 Cost deferral is an issue that arises in a number of contexts – for example, it’s currently part of the Insurance Contracts project in relation to acquisition costs. There may be justification for specifically addressing cost deferral in a revised IFRS 14 as a kind of acquisition cost for future business; however, the fundamental difference from the contractual arrangements under which acquisition costs might typically be deferred is that, for defined rate regulation, the ‘contract’ is between the entity and the regulator (not the customer).

AASB staff comment on prohibiting the recognition of regulatory deferral account balances

- 7.17 In one sense this option would bring about consistency because no entity would separately recognise the impacts of regulation in their statements of financial position.
- 7.18 This option is closest to the views that the AASB has so far communicated to the IASB.
- 7.19 The AASB has previously noted that the impact of rate regulation would be best addressed in the context of other projects dealing with intangible assets or liability recognition.

DP/2014/2 Question 8 – information on your organisation

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?

AASB staff comment

- 8.1 Not applicable.

DP/2014/2 Question 9 – disclosure-only approaches

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.

AASB staff comment

9.1 In brief, in relation to classification and disclosure, IFRS 14 requires:

- * regulatory deferral account debit balances and regulatory deferral account credit balances to each be separately classified as separate line items [paragraphs 20 and 21];
- * line items for the net movement in all regulatory deferral account balances relating to items recognised in other comprehensive income (OCI) to be recognised in OCI, separately for the amounts that will be recycled through profit or loss and those that won't be recycled [paragraph 22];
- * the remaining net movement in all regulatory deferral account balances to be separately classified in profit or loss [paragraph 23];
- * disclosures that enable users to assess: the nature of, and the risks associated with, the rate regulation affecting the entity; and the effects of that rate regulation on its financial position, financial performance and cash flows [paragraph 27]. This includes the accounting policy for regulatory deferral accounting.

9.2 Staff consider that investors and others would regard knowledge of the rate regulation of a material aspect of an entity's operations to be important in any analysis of an entity's financial position and performance. Broader disclosure requirements about the key elements of the business environment in which an entity operates might achieve that outcome without the need for specific disclosure requirements about rate-regulated activities.

9.3 In this respect, staff note that IFRS 8 *Operating Segments*⁴ includes disclosure requirements about the business and product environments in which an entity operates (even for entities with only one operating segment), including:

An entity shall disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates. [paragraph 20]

An entity shall report the revenues from external customers for each product and service, or each group of similar products and services, unless the necessary information is not available and the cost to develop it would be excessive, in which case that fact shall be disclosed. The amounts of revenues reported shall be based on the financial information used to produce the entity's financial statements. [paragraph 32]

4 AASB 8 applies to entities with equity and/or debt traded in public markets.

DP/2014/2 Question 10 – information needs of users on rate regulation

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).

- (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.*

AASB staff comment

10.1 Refer to comments on Question 9.

DP/2014/2 Question 11 – separate presentation of regulatory amounts

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?

AASB staff comment

11.1 If the form of accounting that the IASB were to require resulted in the recognition of regulatory deferral balances that are not assets and/or liabilities, AASB staff consider separate presentation would be essential to distinguish them from balances that do represent assets and/or liabilities.

DP/2014/2 Question 12 – self-imposed regulation

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?

AASB staff comment

- 12.1 AASB staff consider that regulatory deferral balances should only be recognised when they meet the definition and recognition criteria for assets and/or liabilities. There would need to be enforceable rights and/or obligations between the entity and the customer(s). This could apply when there are long-term supply contracts between the entity and its customers.
- 12.2 In the absence of enforceable arrangements between entities and customers, the existence of a third-party rate regulator, or of self-imposed regulation, should not lead to asset or liability recognition.
- 12.3 In the case of co-operatives, the members may play a dual role. If a co-operative's 'self-imposed regulation' gives rise to enforceable rights and/or obligations between the entity and the members as customers, at a conceptual level (under the most recent IASB thinking) they would result in asset and/or liability recognition.

DP/2014/2 Question 13 – other issues and comments

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?

AASB staff comment

13.1 Paragraphs 7.10 to 7.22 of the DP discuss interactions with other IFRS, including the following.

- * The regulation of prices charged by service concession arrangement operators under IFRIC 12 *Service Concession Arrangements*. [paragraphs 7.11 to 7.14]
- * A contract between an entity and a regulator representing customers is likened to a transaction that might fall within the scope of IFRS 15. [paragraphs 7.15 to 7.17]

... IFRS 15 restricts recognising variable consideration as revenue to the extent that it is highly probable that the consideration will not reverse (see paragraph 56 of IFRS 15). This view would support deferring the recognition of revenue, together with recognising a related liability to reflect the reversal of amounts over-billed (ie amounts above the revenue requirement that are expected to be adjusted through future rate reductions).” [paragraph 7.16].

However, paragraph 31 of IFRS 15 requires an entity to ‘recognise revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service (ie an asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset’. In defined rate regulation, many of the rate-regulated activities for which

the consideration is included in the revenue requirement do not involve the transfer of goods or services to the rate regulator or to the customers, either individually or collectively. ... [paragraph 7.17];

The fact remains that customers can make their own decisions about whether they consume the regulated good or service and how much they consume, whether or not there is a regulator whose role is to represent customers' interests.

- * When the rate(s) required to compensate the entity for carrying out its required rate-regulated activities is not considered to be affordable by the customers, the rate regulator might compensate the entity with tax concessions and grants, which may involve interaction with the existing requirements of IAS 12 *Income Taxes* and IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*. [paragraphs 7.18 and 19]
- * Rate-regulated entities might be acquired in a business combination and there may be interaction with the existing requirements of IFRS 3 *Business Combinations*. [paragraph 7.20]
- * In some cases, the rate regulator might pay cash to the entity as consideration for performing specified tasks or settling. The DP acknowledges that these amounts would be classified as financial instruments within the scope of IFRS 9 *Financial Instruments*. [paragraphs 7.21 and 7.22]

13.2 In respect of those interactions, as we noted in relation to Question 5, staff consider that any rate-regulation IFRS should only apply after an entity has exhausted all other avenues in IFRS in determining an accounting treatment for the relevant transactions.