825 Ann Street, Fortitude Valley QLD 4006
PO Box 264, Fortitude Valley QLD 4006

ergon.com.au

ITC32 sub 2

AASB 11 February 2015
Agenda paper A3 (M143)

15 December 2014

The Chair
Australian Accounting Standards Board
P.O Box 204
Collins Street West Victoria 8007
AUSTRALIA

Dear Sir

ITC32 Reporting the Financial Effects of Rate Regulation

Please find attached Ergon Energy Corporation Limited's (Ergon Energy) response to the invitation to comment referred to above.

Ergon Energy is subject to regulation of revenue generated from its electricity distribution network. This regulation is overseen by the Australian Energy Regulator (AER) and takes the form of a fixed revenue cap. The views expressed in this submission represent those of Ergon Energy.

Overall, Ergon Energy is supportive of the AASB to issue a new accounting standard with specific guidance on the accounting treatment for rights and obligations arising from rate regulation. Specifically, the accounting standard should allow for the alignment of the recognition of revenue with the regulated revenue cap, where revenue regulation requires any under or over recovery to be returned to customers in future periods. Attached are the views on specific matters for comment.

The opportunity for comment is appreciated and I trust you will find the attached comments useful.

Yours sincerely

Gary Gaffel
Acting Group Manager Finance Operations

Comments on the IASB Discussion Paper

1(a). Information about rate regulated activities and regulatory environment which preparers of financial statements need to include in their financial statements or accompanying documents.

(i) Statement of financial position

- Receivable - for under recovery of regulated revenue (asset) which the entity is entitled to recover from its customers in the form of increases to future year revenue caps: OR
- Provision for over recovery of regulated revenue (liability) which the entity is required to return to its customers in the form of decreases in future year revenue caps

(ii)The statements of profit or loss and other comprehensive income

- Revenue equivalent to the entity's regulated revenue cap for the financial year, excluding adjustments for prior year or current year under or over revenue recoveries.

(iii) Statement of cash flows

- Cash flows from regulated revenue during the financial year.

(iii)Note disclosures

- Nature of the rate regulation i.e. revenue/price cap, governing body etc.
- Critical accounting estimates and judgements and any assumptions used, for example forecasted demand.
- Assessment for the recoverability of regulated revenue under recoveries.
- Sensitivity analysis on changes in regulated revenue as a result of changes in forecasted demand.

(iii) Management commentary

Ergon Energy is of the view that no additional disclosures are required.

1(b). How the above information will be used by investors and lenders in making investment and lending decisions.

Investors

Potential investors would be interested in the impact of regulated revenue over recoveries on key financial ratios such as gearing.

Lenders

As lenders are interested in the net asset position of the entity, they will be interested in knowing the impact of regulated revenue under or over recoveries on revenue. The balance of any under or over recovery assets or liabilities will impact balance sheet ratios.

Lenders may also be interested in knowing management's assessment for recoverability of regulated revenue under recoveries.

Question 2 – no comment

Question 3 – no comment

Question 4 – no comment

5(a). Whether the description of defined rate regulation captures an appropriate population of rate-regulated schemes within its scope.

The description captures the rate regulated scheme that governs Ergon Energy's revenue.

6(a). Rights and obligations arising from the features of defined rate regulation

Under the rules set out by the Australian Energy Regulator, Ergon Energy is allowed to earn a fixed amount of electricity distribution revenue per annum. At the start of each financial year Ergon Energy determines a set of tariffs which, based on forecast demand, it believes will achieve its revenue cap. Any difference between the revenue cap and actual revenue collected is either returned to, or recovered from, its customers. This adjustment to revenue is effected by adjusting the tariffs in future financial years.

The adjustments to revenue are enforceable under Coordination Agreements between Ergon Energy and electricity retailers. These Coordination Agreements detail the respective rights and obligations of electricity distributors and retailers. The clauses concerning billing stipulate that the prices charged by distributors to retailers must be those set by the Australian Energy Regulator.

Rights

The accounting framework defines an asset as:

(a) a resource controlled by an entity as a result of past events; and

(b) from which future economic benefits are expected to flow to the entity.

The right to collect revenue from the rendering of a service creates a gross inflow and economic benefits can be quantified and measured in monetary terms. Accordingly, management believes that the right to collect revenue (in the event of collecting less revenue than allowed under the AER revenue cap) meets the definition of an asset and it is appropriate to recognise this on the balance sheet as a receivable at fair value.

There is a view that an asset does not exist because the past under billing is reversed by increasing the rate that is charged for future sales, hence recoverability is dependent on the entity's future actions. Ergon Energy believes that the AER regulatory framework ensures that the inflow of economic benefit will occur in the future. Thus, under the substance of AER regulation and the Coordination Agreements, the shortfall represents a receivable, as Ergon Energy is permitted to recover this shortfall from customers through its revised tariffs and the retailers are required to adhere to the revised tariffs approved by the AER.

Obligations

AASB137 *Provisions, Contingent liabilities and Contingent Assets*, defines a liability as follows:

> "*…..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*".

In instances where Ergon Energy has collected regulated revenue in excess of the cap set by the AER, it has a legally enforceable obligation to reduce tariffs in the future financial years. This liability results in reduced future economic benefits.

It can be argued that a liability does not exist because the reversal of the regulatory deferral account credit balance depends on the entity's future actions; that is it depends on the entity making sales to customers in the future. Management believe that although the AER regulatory regime means that the outflow of economic benefit occurs in the future; the substance of AER regulation and the Coordination Agreements represents a current obligation, as Ergon Energy would not be permitted to operate unless it returns the over recovery to customers.

AASB 137 paragraph 14 states that *a provision shall be recognised when:*

- (a) *an entity has a present obligation (legal or constructive) as a result of a past event;*
- (b) *it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and*
- (c) *a reliable estimate can be made of the amount of the obligation.*

Each element of the *provisions* definition is considered below:

Present obligation

A present obligation to reduce tariffs for the new financial year arises when Ergon Energy exceeds its revenue cap.

Past event

The past event is Ergon Energy earning more than the revenue cap set by the AER for the regulatory year.

Probable outflow of economic benefits

Given the application of the revenue cap for the regulatory year, Ergon Energy is able to calculate whether it has exceeded the cap set by the AER and, in turn, will be required to return excess revenue to its customers. Therefore, at the conclusion of a regulatory year, Ergon Energy is able to confirm whether there will be an outflow of economic benefits.

Furthermore, the AER regulatory regime is enforced by the National Electricity Law and the National Electricity Rules which provides the mechanism under which this liability is enforced.

Reliable estimate

As Ergon Energy accurately accounts for revenue earned, Ergon Energy can readily calculate by how much it has exceeded the cap set by the AER and determine the required adjustment to future tariffs.

Ergon Energy's position is that the collection of revenue in excess of the AER revenue cap meets the definition of a liability and should be accounted as a provision as opposed to a trade payable or accrual.

6(b). Whether the IASB should develop specific accounting guidance or requirements to account for the combination of rights and obligations described.

Ergon Energy supports the IASB's proposal to issue a new accounting standard with specific guidance on the accounting treatment for rights and obligations arising from rate regulation. This would eliminate ambiguity in accounting for the effect of rate regulation and enable comparability of the financial performance of rate regulated entities.

7(a). The approach which will best portray the financial effects of defined rate regulation in IFRS financial statements and is most likely to provide information that investors and lenders consider is most relevant to help them make their investing and lending decisions.

Ergon Energy supports the development of specific IFRS requirements to align the recognition of revenue with allowable regulated revenue cap due to the following reasons:

- To a great extent this approach will use the already existing accounting standards and require a few modifications to reflect the consequences of rate regulation.
- Deferral accounts will be disclosed separately, making it to easier to compare the financial performance for regulated entities with non-regulated entities.
- Approach gives more decision making information to potential investors and lenders.
- The approach better reflects the effects of the transactions and events which have occurred in the period, even if the recovery of under or over recoveries occurs in future periods.
- Although IFRS14 is a temporary standard, the current guidance in the accounting standard is in line with this proposed approach to regulatory accounting.

The above comments reflect the existing definitions of an asset and a liability in the Conceptual Framework. However, it would be helpful for the IASB to adopt the proposed definitions of an asset and a liability in order to eliminate any ambiguities.

7(b). Any other approach that the IASB should consider.

None noted.

7(c). Additional advantages or disadvantages for each of the approaches which the IASB should consider.

No additional advantages or disadvantages were noted.

8. Whether Ergon Energy carries out activities which are subject to defined rate regulation.

Ergon Energy is subject to regulation over the revenue generated from its electricity distribution network. This regulation is administered by the Australian Energy Regulator.

Under the rules set out by the Australian Energy Regulator, Ergon Energy is allowed to earn a fixed amount of electricity distribution revenue per annum. At the start of each financial year Ergon Energy determines a set of tariffs which, based on forecast demand, it believes will achieve its revenue cap. Any difference between the revenue cap and actual revenue collected is either returned to, or recovered from, its customers. This adjustment to revenue is effected by adjusting the tariffs in future financial years.

The adjustments to revenue are enforceable under Coordination Agreements between Ergon Energy and electricity retailers. These Coordination Agreements detail the respective rights and obligations of electricity distributors and retailers. The clauses concerning billing stipulate that the prices charged by distributors to retailers must be those set by the Australian Energy Regulator.

If the IASB releases a new accounting standard that does not allow recognition of regulatory deferral account balances, this may cause Ergon Energy to write off significant under recovery assets recorded on our balance sheet.

9. Whether there is need to develop specific disclosure only requirements if the IASB decides to prohibit the recognition of regulatory deferral account balances.

If the IASB determines that the rights and obligations do not meet the definition of an asset and liability to be recognised on the balance sheet, the balances are still significant to Ergon Energy operations, and hence it would be appropriate to make additional disclosures.

10(a). Extent to which the requirements of IFRIS 14 meet the information needs of investors and lenders for entities that are subject to defined rate regulation.

Ergon Energy considers the presentation and disclosure requirements contained in IFRS 14 to be sufficient and appropriate for rate regulated entities.

10(b). Whether any of the disclosure requirements of IFRS14 could be omitted or modified in order to reduce the cost of compliance, without omitting information that help users of financial statements make investment and lending decisions.

No disclosures in IFRS14 were noted which could be omitted or modified in order to reduce the cost of compliance, without omitting information that help users of financial statements make investment and lending decisions.

11. Advantages and disadvantages if the separate presentation required by IFRS 14 was to be applied.

Advantages of reporting rate regulated assets and liabilities on a gross basis

- Gives a true and fair view of the rights and obligations arising from the rate regulation.
- Makes it easier to assess the entity's future cash flows.
- Reporting gross figures in line with AASB101, para 32, which states that assets and liabilities, and income and expenses, shall not be offset unless required or permitted by an Australian Accounting Standard. The only exception is when offsetting reflects the substance of the transaction.

Disadvantages of reporting rate regulated assets and liabilities on a gross basis

- None noted.

12. Whether the existence of a rate regulator whose role and authority is established in legislation or other formal regulation is an important feature of a defined rate regulation.

Ergon Energy supports the notion that the existence of a rate regulator whose role and authority is established in legislation or other formal regulations is an important feature to consider when analysing what rights and obligations established by the rate regulation are enforceable. This is because, in order for there to be a substantive right or obligation, there has to be an enforcement mechanism outside the entity.

The presence of a rate regulator also indicates that customers have little or no choice but to purchase the essential rate regulated goods or services from the entity at the regulated prices. On the other hand the entity will have no practical ability to avoid reversing the regulatory deferral credit balance by providing the rate-regulated goods or services at the reduced rate per unit.

Co-operatives or similar entities, which operate under self-imposed rate regulation should not be included within the scope of defined rate regulation as there is greater flexibility in decision making, making it difficult to predict the outcome of the rate setting mechanism or enforce it. Self-imposed rate regulation will also mean that there will be no sanctions if the regulated entity fails to satisfy any of its obligations.

Entities subject to formal oversight from a government department or other authorised body should be included within the scope of defined rate regulation, provided there is a sufficiently predictable and enforceable rate-setting mechanism in place.

13. Whether there are any comments or suggestions on issues which may or may not have been raised in the Discussion Paper which the IASB should consider if it decides to develop proposals for any specific accounting requirements for rate-regulated activities.

No further issues for consideration have come to our attention at the time of submitting this request for comments.

INNOVATION
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Suite 1, Level 6, 2 Collins Street, Melbourne, Victoria 3000
Tel: (03) 9639 8868 Fax: (03) 9639 8860
Email: vicwater@vicwater.org.au Web: www.vicwater.org.au
ABN: 46 541 210 712 Inc Reg No. A0016320F

VICTORIAN WATER
INDUSTRY ASSOCIATION INC

17 December 2014

Mr Jim Paul
Senior Project Manager – Research
Australian Accounting Standards Board
Level 7
600 Bourke Street
MELBOURNE VIC 3000

Dear Mr Paul

Re: Reporting the Financial Effects of Rate Regulation

Thank you for the opportunity to respond to the discussion paper '*Reporting the Financial Effects of Rate Regulation*'. VicWater is the peak body of the Victorian Water Industry with its membership constituted of Victoria's 19 statutory water corporations. Those corporations are responsible for the provision of urban water and wastewater services, rural water supply including irrigation and related drainage services.

This VicWater submission has been prepared on behalf of three Victorian water corporations: Yarra Valley Water, Barwon Water and Melbourne Water. On their behalf, VicWater engaged a third party to conduct a series of three interviews with members of their finance and accounting teams, structured around the 13 questions included in the discussion paper. Please find a summary paper of the interviews and responses to the discussion paper questions attached.

Please contact James Cleaver (james.cleaver@vicwater.org.au or 9639 8868) with any questions or matters of clarification.

Yours sincerely

Tony Wright
Chief Executive Officer

Summary of responses from: Yarra Valley Water, Melbourne Water, Barwon Water

Companies' background

The companies interviewed were subject to a range of different price-setting mechanisms, and the range of preferred outcomes varied between respondents. The water corporations provide water supply, sanitation and drainage services as well as waterways' management, with each responsible for a designated geographical area in Victoria, Australia. All three respondents are subject to independent economic regulation, however, the mechanism whereby prices are set (including the extent to which past revenues are taken into account in setting future prices) differs between the entities.

Yarra Valley Water – regulatory framework

Yarra Valley Water is subject to independent economic regulation, determining the revenue required to cover the efficient costs of the business together with a return of and on the regulated asset base (RAB) based on the weighted average cost of capital (using the building block approach). Recently the regulator approved a revenue cap price setting mechanism for major products (water, sewerage and trade waste). Prices for major products (net of unit costs) are set annually within the five-year regulatory period based on forecast demand to recover no more or less than the determined net revenue[1] for those products. Where actual demand in a given year is higher than forecast, future prices are adjusted to return the additional net revenue through reduced future charges. Similarly, where actual demand is below forecast, prices are increased in future years to recover the shortfall (for completeness, it is noted that the allowable rate increase to recoup any shortfall has been capped at 2% p.a. in real terms). The charges are established for the Yarra Valley Water customer base as a whole.

Melbourne Water – regulatory framework

Melbourne Water is subject to independent economic regulation. However, it is largely subject to a different price-setting mechanism (price cap) to Yarra Valley Water. Maximum prices are set by the regulator to recover the efficient costs of the business together with a return on and of the regulated asset value (using the building block approach). However, for most products, no mechanism is available to increase future prices as a result of less than forecast demand. Adjusting future prices for a current increase in demand is at the discretion of the business. The financial impact of demand changes over the regulatory period is therefore retained by the business. Permanent changes in demand will flow through prices at the commencement of the next regulatory period.

Barwon Water – regulatory framework

Like Melbourne Water and Yarra Valley Water, Barwon Water is subject to independent economic regulation. It is currently not subject to a clawback mechanism for revenue that applies to Yarra Valley Water. However, this is currently being reviewed by the regulator.

The proposed responses to the impacts of regulation differed between entities. Specifically:

- Yarra Valley Water noted a significant impact from regulation on the relevance of its financial statements to users. It would support the development of specific financial reporting guidance relating to the recognition and measurement of transactions of regulated entities to better reflect the impact of regulatory rights and obligations.

[1] Net revenue is calculated as the difference between sales revenue from major products and the costs of major products. Yarra Valley water pays wholesale charges for the storage, treatment and delivery of bulk water to its network and wholesale costs for transfer, treatment and disposal of sewage from its customers.

- Barwon Water also noted a significant impact of regulation on the relevance of its general purpose financial statements, specifically with respect to comparability against unregulated entities. However, it would not support the development of specific recognition and measurement requirements. In its view this discrepancy would be best addressed by disclosure.

- Melbourne Water noted a less significant impact from regulation, although it noted that differences exist between the regulated asset base and the figures reported in its general purpose financial statements (e.g. finance leases are treated differently for regulatory and financial reporting purposes). It did not identify a need for specific recognition or measurement requirements arising from the specific regulation they are subject to.

- All three entities interviewed would support the development of disclosure requirements to clarify the impact of regulation on the financial statements of regulated entities (although Yarra Valley Water noted that disclosures would be insufficient to address the current informational gap that arises in respect of its specific type of regulation).

Financial reporting impacts of regulation

Yarra Valley Water in particular raised a concern that the regulatory framework creates a difference between the economic value of assets that can be recovered through future revenues, and the value of those assets for IFRS reporting purposes. This is due to some key differences between the treatment of certain transactions for the purpose of determining the RAB on the one hand, and for the purpose of financial reporting on the other.

Given the regulatory asset base rather than the financial statement values ultimately drive the company's returns, differences between the two result in the values reported in its general purpose financial statements being misaligned with true economic value. To illustrate some of the sources of difference for regulatory and general purpose financial reporting purposes, the following examples are included:

- Where assets are contributed to the network by new customers, in particular by developers, the contribution is required to be recognised as revenue under IFRIC 18 *Transfers of Assets from Customers*. From a regulatory perspective however, these assets are not included in the RAB, and therefore their value cannot be recovered through future revenues. Therefore, while customer contributed assets increase overall demand for services by enabling additional users to connect to the network, they do not ultimately result in additional economic value. In this regulatory environment therefore, the value of customer-contributed assets do not represent a right to an additional future economic benefit.

- Where assets are sold, the gain or loss on disposal of assets is treated differently for regulatory and for financial reporting purposes. From a regulatory perspective, the sale proceeds are deducted from the RAB, providing the benefit to the customer through future prices. Therefore the benefit of any profit or cost of a loss arising from the disposal of an asset is borne by the customer and not the shareholder as reflected in the statutory accounts.

- Depreciation is calculated on a different basis for regulatory and for financial reporting purposes.

Barwon Water also identified reduced relevance in its financial statements as a result of operating in a rate regulated environment. Specifically, they noted that where there is a significant difference between the regulatory asset base and the asset base for financial reporting purposes, profitability becomes less comparable between a regulated and unregulated entity. For example, return on assets is primarily driven by the value of the regulated asset base, and the existing asset base is not necessarily reflective of true value. A statutory return on assets figure is therefore less likely to be directly relevant to an end user. Similarly, a higher financial reporting asset amount may result in higher reported depreciation rates and accordingly lower statutory profit than the entity's true economic return based on its regulated asset base. To address this issue they would support the development of specific disclosure guidance. However, to ensure the disclosures do not result in added disclosure complexity and increased reporting burden, they would recommend this disclosure be provided as part of management commentary, rather than forming part of the audited general purpose financial statements.

Melbourne Water did not identify a significant impact from the specific regulation that they are subject to on the amounts recognised in their general purpose financial statements. They would not support the development of specific additional recognition and measurement requirements relating to their specific rate regulation.

User impact

Primary users of the general purpose financial statements of the respondents include owners, creditors, customers, and employees.

As noted above, Yarra Valley Water identified that there is a difference between the way value is articulated for regulatory and for financial reporting purposes. As a result, there is a perception from users of Yarra Valley Water's general purpose financial statements that the reports do not represent true economic value. For example, credit rating agencies place more emphasis on regulatory accounts than general purpose financial statements figures in establishing a credit rating for the company.

Melbourne Water and Barwon Water identified that user understanding and comparability could be improved through disclosure.

Recommended approach

Notwithstanding the above discussion, Yarra Valley Water do not consider it would be appropriate to simply report amounts prepared for regulatory purposes in place of the IFRS amounts. This approach would drastically reduce comparability between entities subject to different types of regulation, given how widely regulatory frameworks can vary. Regulatory accounts serve a different and narrower purpose than general purpose financial statements, and should therefore not be seen as a substitute for them.

For the same reasons, simply disclosing regulatory balances alongside IFRS financial statements would not be useful to users, and the presentation of two different sets of accounts would potentially confuse users.

Yarra Valley Water are of the view that the IASB should amend the principles in IFRS to better reflect the economic rights and obligations that are created by regulation. For example, where assets are contributed by customers, but their value does not contribute to the regulated asset base, recognition of revenue upfront from the transaction is not reflective of the substance of the transaction. Yarra Valley Water (and Melbourne Water) consider the transaction would be better reflected by deferral of revenue on initial receipt of the assets. This deferred revenue should subsequently be amortised as the asset is depreciated.

Barwon Water would not support the development of specific recognition and measurement principles to deal with the impacts of regulation. As discussed above, they consider information about the impacts of regulation on a regulated entity's profitability would be best provided as disclosures that form part of management commentary.

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?

See comments upfront.

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?

None of the entities interviewed considered themselves to be users of financial statements that recognise regulatory deferral account balances as regulatory assets or regulatory liabilities. However, Yarra Valley Water consider the regulatory deferral account approach would improve the relevance of general purpose financial statements.

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?

No specific comments were provided by the respondents, although it was observed that regulation appeared to have the most significant impact on Yarra Valley Water, whose major products are subject to “defined rate regulation” as described in the discussion paper.

> *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?*

The 3 water corporations interviewed did not consider that the impacts of price-cap (i.e. market-based) regulation should result in different recognition and measurement requirements for financial statement items.

However, there was a view that disclosures detailing the key characteristics of the regulation, and a high-level assessment of its impact on the financial performance of an entity would provide useful additional information to users.

> *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.*

Defining rate regulation is not necessary to define the scope of the standard. A clearer discussion of the rights and obligations, and how these would arise in the context of a regulated environment would be more useful. While the features identified in respect of ‘defined rate regulation’ are common to the regulatory environments that are most likely to create rights and obligations, these features are not necessary to create the rights and obligations in their own right. For example, a monopoly may not be essential in all circumstances to create rights and obligations.

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?

See detailed response upfront.

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.

See comments upfront. The key issue raised relates to the accounting for assets in the context of a regulatory asset framework.

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?

As noted above, the respondents carry out activities that are subject to regulation.

Based on the definition in the discussion paper, only Yarra Valley Water is subject to “defined” rate regulation.

In the absence of a clawback mechanism, it would appear that Barwon Water and Melbourne Water are subject to regulation that is more aligned with "market" 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.

All three entities would support disclosures about the key characteristics of regulatory framework they operate within and the impacts of that regulation on their financial performance. However, Barwon Water identified that these disclosures would be best provided as part of management commentary.

Yarra Valley Water noted that a disclosure-only standard would not address the information gap created by the nature of regulation that it is subject to.

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).

(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.

The three respondents supported the purpose of disclosures described in IFRS 14 (i.e. identifying the nature and risks of rate regulation as well as the effects of that rate regulation on the financial statements). However, Barwon Water identified that these disclosures would be best provided as part of management commentary.

Disclosure requirements should ultimately be informed by the accounting model developed. A reassessment of the disclosure requirements developed for IFRS 14 would be appropriate in the context of these requirements.

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?

Suggest that any proposals allow management flexibility to present the effects of rate regulation in a manner that provides the most relevant information in the context of any accounting guidance.

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

The respondents agreed that an external regulator is necessary to create enforceable rights or obligations. In the absence of an external regulatory authority, it is difficult to envisage how such rights could be enforced.

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?

See detailed comments upfront. The key issues raised by Yarra Valley Water focus on the impact of regulation on the relevance of an entity's reported asset values and other transactions, which, due to regulation, do not necessarily have the same economic impact as they might for an unregulated entity. This issue is broader than whether regulatory deferral balances should be recognised. A broader analysis of the broader economic impacts of regulation on an entity's financial reporting should be undertaken to improve the relevance of general purpose financial reports of regulated entities.