13 October 2009

Mr Kevin Stevenson
Chairman
Australian Accounting Standards Board
PO Box 204
COLLINS STREET WEST VIC 8007

Email: standard@aasb.gov.au

Dear Kevin

Comments on ED 185 Rate-regulated Activities

Thank you for the opportunity to comment on the AASB Exposure ED 185 *Rate-regulated Activities*. CPA Australia, The Institute of Chartered Accountants in Australia (The Institute) and the National Institute of Accountants (the Joint Accounting Bodies) have considered the above [proposed] Standard and our comments follow.

The Joint Accounting Bodies represent over 180,000 professional accountants in Australia. Our members work in diverse roles across public practice, commerce, industry, government, academia throughout Australia and internationally.

Our response to matters on which Australian comment is requested is included in the attached Appendix. Also attached for your consideration is our submission to the IASB that includes our responses to the specific IASB questions for comment.

If you have any questions regarding this submission, please do not hesitate to contact either Mark Shying (CPA Australia) at mark.shying@cpaaustralia.com.au, Kerry Hicks (The Institute) at kerry.hicks@charteredaccountants.com.au or Tom Ravlic (NIA) at tom.ravlic@nia.org.au.

Yours sincerely

Alex Malley
Chief Executive Officer
CPA Australia Ltd

Graham Meyer
Chief Executive Officer
Institute of Chartered Accountants in Australia

Andrew Conway
Chief Executive Officer
National Institute of Accountants

Question

(a) **Are there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to not-for-profit entities and public sector entities?**

The Joint Accounting Bodies understanding of the regulatory methodologies used in Australia is that the rate-regulated activities of private for-profit sector Australian entities will not meet the second criterion of the scope paragraph of the [proposed] Standard. Our initial conclusion was that the [proposed] Standard would have no application in Australia. However, some commentators have suggested that the [proposed] Standard could be applied to excluded rate-regulated assets or liabilities by way of analogy. The Joint Accounting Bodies share this concern. It is not clear to us whether this outcome would be problematic.

However, we understand that some entities in the public sector might be within scope. The [proposed] Standard recommends adoption, for rate regulated infrastructure assets such as power distribution systems or water treatment plants, of a valuation approach based on discounted future income streams which is based on situations where the asset will be held for no more than 20 years and will not be replaced. This model may not be appropriate in the public sector where these types of assets are held for significantly longer periods and where the government of the day will always require that they be replaced.

Further, the public sector utilise valuation methodologies for these type of assets which include the use of optimised depreciated replacement cost. It is not clear how the proposed standard would apply, if at all, in these circumstances.

(b) **Overall, would the proposals result in financial statements that would be useful to users?**

Refer to our response to Question (a).

(c) **Are the proposals in the best interests of the Australian economy?**

Refer to our response to Question (a).

13 October 2009

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
LONDON EC4M 6XH
United Kingdom

Email: CommentLetters@iasb.org

Dear Sir David

Comments on ED 2009/8 Rate-regulated Activities

Thank you for the opportunity to comment on the IASB Exposure Draft 2009/8 *Rate-regulated Activities*. CPA Australia, The Institute of Chartered Accountants in Australia (The Institute) and the National Institute of Accountants (the Joint Accounting Bodies) have considered the above [proposed] Standard and our comments follow.

The Joint Accounting Bodies represent over 180,000 professional accountants in Australia. Our members work in diverse roles across public practice, commerce, industry, government, academia throughout Australia and internationally.

The Joint Accounting Bodies do not support the [proposed] Standard. We see a strong nexus between the issues around the accounting for rate-regulated activities and the issues that surround the accounting for intangible assets and goodwill – be they internally generated or acquired. We are concerned that the [proposed] Standard does not have a sound foundation, as its development is not consistent with a principles-based approach to standard setting. Conceptually, the presence of a cause and effect relationship between incurred costs and rate-regulated revenue is not relevant to the identification of assets or liabilities. However, the second scope criterion excludes from the application of the [proposed] Standard any asset or liability that does not present with this attribute. Some commentators have suggested that the [proposed] Standard could be applied to excluded rate-regulated assets or liabilities by way of analogy. The Joint Accounting Bodies share this concern. Accordingly, we consider the second scope criterion is flawed. We strongly suggest that the conceptual framework project of the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) is the appropriate vehicle for resolving the issues around the accounting for rate-regulated activities and the wider issues of intangible assets and goodwill.

Should the IASB conclude that there is an urgent need to provide authoritative literature for rate-regulated activities; the Joint Accounting Bodies suggest that the principle behind the approach in IFRS 6 *Exploration for and Evaluation of Mineral Resources* might be replicated as a short term measure. Therefore, a rate-regulated entity may continue to use the accounting policies applied to its rate-regulated assets and liabilities immediately before adopting the IFRS. We strongly suggest that the application of the authoritative literature not be applied to new rate-regulated assets and/or liabilities that emerge on or after transition to IFRS.

Our response to matters on which specific comment is requested are included in the attached Appendix.

If you have any questions regarding this submission, please do not hesitate to contact either Mark Shying (CPA Australia) at mark.shying@cpaaustralia.com.au, Kerry Hicks (The Institute) at kerry.hicks@charteredaccountants.com.au or Tom Ravlic (NIA) at tom.ravlic@nia.org.au.

Yours sincerely

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Chief Executive Officer
Institute of Chartered Accountants in Australia

Andrew Conway
Chief Executive Officer
National Institute of Accountants

cc: Mr Kevin Stevenson : Chairman : Australian Accounting Standards Board

Scope

Question 1
The exposure draft proposes two criteria that must be met for rate-regulated activities to be within the scope of the proposed IFRS (see paragraphs 3–7 of the draft IFRS and paragraphs BC13–BC39 of the Basis for Conclusions). Is the scope definition appropriate? Why or why not?

Should the IASB resolve to proceed with the [proposed] Standard, the Joint Accounting Bodies agree with the inclusion within its scope the first criterion that an identifiable body is authorised in some way to set prices for regulated goods or services and the prices set by the body bind the entity's customers – although we do question why an entity that is only able to make immaterial change to the set price is excluded. However, we do not agree with the inclusion of a second criterion that the scope of the [proposed] Standard be limited to cost-of-services regulation. We are concerned that the [proposed] Standard's reliance on the presence of a cause and effect relationship between incurred costs and rate-regulated revenue is not relevant to the identification of assets or liabilities. Accordingly, we consider the second scope criterion is flawed. It may result in entities inappropriately recognising (or not recognising) rate regulated assets and/or liabilities.

Please also see our response to Question 8.

Recognition and measurement

Question 2
The exposure draft proposes no additional recognition criteria. Once an activity is within the scope of the proposed IFRS, regulatory assets and regulatory liabilities should be recognised in the entity's financial statements (see paragraphs BC40–BC42 of the Basis for Conclusions).
Is this approach appropriate? Why or why not?

The Joint Accounting Bodies agree that no additional recognition criteria are appropriate when the scope is consistent with the *Framework*. However as indicated in Question 1 above and Question 8, we do not believe the scope is consistent with the *Framework* in that items will be recognised as assets and liabilities that would not be recognised under the *Framework* definitions.

Question 3
The exposure draft proposes that an entity should measure regulatory assets and regulatory liabilities on initial recognition and subsequently at their expected present value, which is the estimated probability-weighted average of the present value of the expected cash flows (see paragraphs 12–16 of the draft IFRS and paragraphs BC44–BC46 of the Basis for Conclusions).
Is this measurement approach appropriate? Why or why not?

The Joint Accounting Bodies consider the proposed approach to measurement on both initial and subsequent recognition may be overly complex to apply, thereby reducing comparability. We note it is claimed that this approach is consistent with the current approach required by IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and the approach proposed in the recent exposure draft *Income Tax*. However, IAS 37 requires the best estimate with the probability-weighted approach being one method of arriving at this estimate. This proposal mandates the components that formulate the expected present value measurement. We would prefer a best estimate principle, with the components in paragraph 13 being one method of determining the best estimate.

Question 4
The exposure draft proposes that an entity should include in the cost of self-constructed property, plant and equipment or internally generated intangible assets used in regulated activities all the amounts included by the regulator even if those amounts would not be included in the assets' cost in accordance with other IFRSs (see paragraph 16 of the draft IFRS and paragraphs BC49–BC52 of the Basis for Conclusions). The Board concluded that this exception to the requirements of the proposed IFRS was justified on cost-benefit grounds. Is this exception justified? Why or why not?

The Joint Accounting Bodies do not agree with the proposal in the [proposed] Standard to include in the cost of self-constructed property, plant and equipment assets or internally generated intangible assets all the amounts included by the regulator even if those amounts would not be included in the assets' cost in accordance with other IFRS. We do not believe that a requirement to include the cost of the regulatory asset in the cost of the asset recognised in other IFRS is consistent with the way that the unit of account question should be resolved – as the regulatory assets do not have the same characteristics as assets recognised in accordance with other IFRS. We strongly suggest that all regulatory assets should be accounted for separately from other assets of the entity to which they are closely related.

Question 5
The exposure draft proposes that at each reporting date an entity should consider the effect on its rates of its net regulatory assets and regulatory liabilities arising from the actions of each different regulator. If the entity concludes that it is not reasonable to assume that it will be able to collect sufficient revenues from its customers to recover its costs, it tests the cash-generating unit in which the regulatory assets and regulatory liabilities are included for impairment in accordance with IAS 36 Impairment of Assets. Any impairment determined in accordance with IAS 36 is recognised and allocated to the assets of the cash-generating unit in accordance with that standard (see paragraphs 17–20 of the draft IFRS and paragraphs BC53 and BC54 of the Basis for Conclusions). Is this approach to recoverability appropriate? Why or why not?

The Joint Accounting Bodies do not support the proposal to include in the [proposed] Standard a recoverability requirement. Instead, we strongly suggest that the requirements of IAS 36 that entity assess at each reporting date whether there is any indication that the asset may be impaired apply to regulated assets recognised under the [proposed] Standard. We agree that the test for impairment and the recognition of any impairment loss be in accordance with IAS 36.

Disclosures

Question 6
The exposure draft proposes disclosure requirements to enable users of financial statements to understand the nature and the financial effects of rate regulation on the entity's activities and to identify and explain the amounts of regulatory assets and regulatory liabilities recognised in the financial statements (see paragraphs 24–30 of the draft IFRS and paragraphs BC59 and BC60 of the Basis for Conclusions). Do the proposed disclosure requirements provide decision-useful information? Why or why not? Please identify any disclosure requirements that you think should be removed from, or added to, the draft IFRS.

The Joint Accounting Bodies support the proposal that the minimum disclosure requirements require a table showing reconciliation from the beginning to the end of the period, of the carrying amount in the statement of financial position of the various categories of regulatory items.

Transition

Question 7
The exposure draft proposes that an entity should apply its requirements to regulatory assets and regulatory liabilities existing at the beginning of the earliest comparative period presented in the period in which it is adopted (see paragraph 32 of the draft IFRS and paragraphs BC62 and BC63 of the Basis for Conclusions). Any adjustments arising from the application of the draft IFRS are recognised in the opening balance of retained earnings. Is this approach appropriate? Why or why not?

The Joint Accounting Bodies support the proposal as the information required may not be available to apply retrospectively.

Other comments

Question 8
Do you have any other comments on the proposals in the exposure draft?
The Joint Accounting Bodies do not support the [proposed] Standard. We see a strong nexus between the issues around the accounting for rate-regulated activities and the issues that surround the accounting for intangible assets and goodwill – be they internally generated or acquired. We are concerned that the [proposed] Standard does not have a sound foundation and as it appears to be rules based its development is not consistent with a principles-based approach to standard setting. Conceptually, the presence of a cause and effect relationship between incurred costs and rate-regulated revenue is not relevant to the identification of assets or liabilities. However, the second scope criterion excludes from the application of the [proposed] Standard any asset or liability that does not present with this attribute. Some commentators have suggested that the [proposed] Standard could be applied to excluded rate-regulated assets or liabilities by way of analogy. The Joint Accounting Bodies share this concern. Accordingly, we consider the second scope criterion is flawed. We strongly suggest that the conceptual framework project of the IASB and the FASB is the appropriate vehicle for resolving the issues around the accounting for rate-regulated activities and the wider issues of intangible assets and goodwill.

Should the IASB conclude that there is an urgent need to provide authoritative literature for rate-regulated activities; the Joint Accounting Bodies suggest that the principle behind the approach in IFRS 6 *Exploration for and Evaluation of Mineral Resources* might be replicated. Therefore, a rate-regulated entity may continue to use the accounting policies applied to its rate-regulated assets and liabilities immediately before adopting the IFRS. We strongly suggest that the application of the authoritative literature not be applied to new rate-regulated assets and/or liabilities that emerge on or after transition to IFRS.

The Joint Accounting Bodies have identified some further issues with the [proposed] Standard. First, the proposal regarding the inclusion of costs in self-constructed property, plant and equipment assets addresses the topic of the unit of account a topic we consider part of the conceptual framework project.

Second, it is not clear to us how the application of the [proposed] Standard interacts with the revaluation model in IAS 16 *Property, Plant and Equipment* and IAS 36 (when the revaluation model is applied). Further guidance needs to be provided on these areas to ensure that cash flows are not double counted.

Third, there could be practical difficulties where entities currently recognise assets and liabilities in accordance with other IFRSs that would qualify as rate-regulated activities under this proposed standard. Paragraph 10 implies that the proposals would not be applicable, but this could result in further inconsistencies in practice.

Finally, the illustrative examples are simplistic and not helpful for complex situations. We recommend the illustrative are bolstered to ensure they provide guidance to those with more complex rate-regulated activities.