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AUSTRALASIAN
COUNCIL OF
AUDITORS-GENERAL

20 October 2009

Mr. Kevin Stevenson
Chairman
Australian Accounting Standards Board
P O Box 204
Collins Street West
MELBOURNE VIC 8007

Dear Mr Stevenson

ISAB EXPOSURE DRAFT ED/2009/8 RATE-REGULATED ACTIVITIES

Attached for your information is a copy of the Australasian Council of Auditors-General (ACAG) response to the Exposure Draft referred to above.

The views expressed in this submission represent those of all Australian members of ACAG.

Yours sincerely

Simon O'Neill
Chairman
ACAG Financial Reporting and Auditing Committee

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ACAG AUSTRALASIAN COUNCIL OF AUDITORS-GENERAL

20 October 2009

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

Dear Sir David

EXPOSURE DRAFT ED/2009/8 RATE-REGULATED ACTIVITIES

Attached is the Australasian Council of Auditors-General (ACAG) response to the Exposure Draft referred to above.

The views expressed in this submission represent those of all Australian members of ACAG.

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

Yours sincerely

Simon O'Neill

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Chairman
ACAG Financial Reporting and Auditing Committee

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

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EXPOSURE DRAFT ED/2009/8 RATE-REGULATED ACTIVITIES

ACAG has reviewed the exposure draft on rate-regulated activities and provides the following comments.

Overall Comment

ACAG supports the recognition of an asset where current regulated rates do not cover costs and a liability where costs have been over recovered. It is beneficial to have specific guidance to address these accounting issues. However, we do not agree that all proposals in the exposure draft are appropriate and have detailed our views below.

Specific Comments

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?

ACAG has concerns with the rules based scope definition, which provides many ways for entities to qualify as being out-of-scope. The first leg of the criteria includes 'the price the entity must charge', which enables an entity to make a small change to the price to qualify out of the scope. The second leg is open to varying interpretations and could lead to inconsistent decisions on which operating activities fall within the scope. For example, paragraph 6 states that where rates are based on targeted or assumed costs the activities are not within the scope. Some regulators base some cost components on the actual retailer and others on hypothetical estimates. Also the objective of the regulator could be to establish prices to recover costs and provide the entity with a profit margin. However, the specific details of the determination may lead to a convincing argument that the entity does not fall within the scope.

From an auditor's perspective, this could lead to many issues of contention with our clients. We acknowledge that Appendix B and the Basis for Conclusions provide guidance on determining whether an entity is within the scope. However, the terminology used cannot readily be applied across different jurisdictions to different rate-regulated activities.

ACAG would prefer the scope definition to be principle based.

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?

ACAG notes that this proposed standard may be inconsistent with the approach in other accounting standards, for example *IAS 38 Intangible Assets*, which include additional recognition criteria. However, as BC41 does explain why operating activities that are within the scope automatically meet the recognition criteria it may be appropriate in this case not to include additional recognition criteria.

If the argument in BC41 is accepted, it is questionable why these assets and liabilities are not currently recognised under the existing *Framework for the Preparation and Presentation of Financial Statements*. One explanation could be that the recognition principle for regulatory assets and liabilities under this standard is not consistent with other standards such as *IAS 37 Provisions, Contingent Liabilities and Contingent Assets.* The future cash inflows for the regulatory assets are contingent on one or more future events. Under *IAS 37* the inflows must be virtually certain for an asset to be recognised, but under this proposed standard being probable is sufficient. Also the difference between regulatory liabilities and future operating losses, which cannot be recognised under *IAS 37,* is not that clear cut.

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?

ACAG believes the elements that comprise the expected present value are overly complex and may result in reduced comparability.

ACAG notes that BC44 states that the measurement approach is consistent with the guidance in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. 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 selfconstructed 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?

ACAG supports this exception on cost-benefit grounds. However, it is not clear whether paragraph 16, 'a regulator requires an entity to capitalise', is referring to the regulatory accounts or the financial statements. In our jurisdiction, regulators may require certain accounting treatments for the regulatory accounts, but the infrastructure assets in the financial statements are recognised in accordance with *IAS 16 Property, Plant and Equipment*.

If the proposal is for the financial statements to include all amounts required by the regulator in the infrastructure balance then we have an issue with using a valuation approach based on discounted future income streams. This model is not appropriate where these types of assets are held for significantly long periods and often optimised depreciated replacement cost is the more relevant measure particularly when the entity will or must, replace the asset at the end of its useful life.

Also given the scope issues, this proposal could result in reduced comparability between entities with similar assets when one entity is regulated and another is not captured within the scope.

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?

ACAG supports this approach, as it is consistent with the treatment of other assets captured by IAS 36.

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.

ACAG believes the proposed disclosure requirements provide decision-useful information, but question whether the financial statements is the most suitable place for some of the detailed disclosures outlined in paragraph 26. In most cases, the users would be able to acquire this information from other sources and additional disclosure may not be beneficial. Alternatively, including this detailed information elsewhere in the annual report may be preferable for some entities.

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?

ACAG supports this approach, as the information may not be available to apply the requirements retrospectively.

Question 8

Do you have any other comments on the proposals in the exposure draft?

Firstly, 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.

Secondly, BC24 discusses that the regulator having the authority to reduce future cash flows means that the regulatory liability meets the present obligation criteria. However, the history of regulatory rate setting could lead to the conclusion that the outflow is not probable. This basis for conclusion appears to be ignoring substance over form when determining whether a present obligation exists.

Finally, the illustrative examples are simplistic and not helpful for complex situations. ACAG recommends the examples be reviewed to ensure they provide guidance for more complex rate-regulated activities. Possibly this would be best performed by the individual national standard setting bodies to ensure the examples are particularly useful in their jurisdictions.