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Ms Kris Peach
Chair
Australian Accounting Standards Board
Level 7, 600 Bourke Street
Melbourne, VIC 3000

Email: standard@aasb.gov.au

Dear Kris

ITC 32 Reporting the Financial Effects of Rate Regulation

CPA Australia welcomes the opportunity to comment on ITC 32 *Reporting the Financial Effects of Rate Regulation*. CPA Australia is one of the world's largest accounting bodies and represents the diverse interests of more than 150,000 members in public practice, industry, commerce, government, not-for-profits and academia in 121 countries throughout the world.

In our submission to the International Accounting Standards Board (IASB) we expressed our agreement that 'defined rate regulation' should provide the board with the best insight into the need or otherwise for the development of material on rate-regulated activities. We noted a fundamental tenet of IFRS is that entities should recognise assets and liabilities only to the extent that they meet the criteria to be recognised as assets and liabilities in accordance with the IFRS conceptual framework. The focus of the DP is on regulatory assets and liabilities that may be excluded from recognition by IFRS. The regulatory assets and liabilities discussed include those that exist in a regulatory environment in which adjustments to future rates charged to customers are used as the mechanism to recover or reverse differences between the rate-regulated activity entity's revenue requirement for carrying out the regulated activities and the billable revenue. We infer from the DP an expectation that currently such regulatory assets and liabilities would be excluded from recognition in the financial statements by existing IFRS. We also brought to the IASB's attention the practice of some Australian rate-regulated entities operating in an environment where any current period under or over-recovery of revenue is recovered from or returned to customers in future periods through an adjustment to prices. It is the accounting policy of some of those entities to recognise regulated revenue receivables using IFRS, notwithstanding the absence of specific guidance in IFRS on this matter. We believe information about this practice may be helpful to the development of the project. More information is available in our response to the questions for comment and the Appendix.

We are not aware of any regulatory or other issues arising in the Australian environment that should be considered.

The Attachment to this letter sets out our comments on the specific matters for comment. If you require further information on any of our views expressed in this submission, please contact Dr Mark Shying by email at mark.shying@cpaaustralia.com.au.

Yours sincerely

Dr Eva Tsahuridu
Manager – Accounting Policy

Attachment

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?

We believe that when an entity's annual report includes general purpose financial statements and management commentary, that annual report will provide information about:

- the entity's financial position and performance
- matters that are relevant to understanding the entity's business performance and the factors underlying its financial position and performance
- the entity's business strategies and prospects relevant to future financial position and performance.

For entities with rate-regulated activities (e.g., some entities operating electricity distribution networks), it is our expectation that the publication of information about those activities, including the regulatory environment, will provide users of the entity's financial statements with information that achieves the outputs described above. We see the publishing of information about the entity's rate-regulated activities as comparable to the reporting practice of banks, when they are the subject of regulatory capital requirements and include in the annual report information about their strategies and their significant plans for capital, including a focus on regulatory capital requirements. We have observed that it is the practice of some banks to produce a separate unaudited regulatory capital disclosures document that the bank views as an integral element of the annual report.

As a principle, we do not believe that disclosure in the notes to an entity's financial statements or elsewhere in the annual report (including in a separate regulatory disclosures document) is a substitute for the recognition and measurement of economic phenomena in the entity's financial statements that are constructed using the elements of the conceptual framework for financial reporting. Academic research, which indicates that market prices are more sensitive to recognised values than disclosed values, is consistent with our view. However, our support for this principle does not extend to amending the definitions of those elements if to do so would distort their essential characteristics as we believe this would make the elements less easily understandable. Accordingly, we accept that by constraining amendments to the definitions of the elements in this way there may be economic phenomena that are not captured by the elements as defined in the conceptual framework. Examples of phenomena not recognised in the financial statements may include some or all rate-regulated activities. In such situations, we believe disclosure is appropriate and we believe it is too early to determine the best place for those disclosures.

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?

We do not have any experience of Australian entities preparing financial statements using SFAS 71 *Accounting for the Effects of Certain Types of Regulation*. However, in the process of preparing the submission we became aware that regulated revenue receivables are recognised in the financial statements of some Australian rate-regulated activity entities. Energex Limited is one example. The financial statements state compliance with Australian Accounting Standards, which incorporate IFRS verbatim. AASB 14 *Regulatory Deferral Accounts* does not apply to Energex Limited. In effect, Energex Limited has developed an accounting policy to recognise regulated revenue receivables using IFRS, notwithstanding the absence of specific guidance in IFRS on this matter. We provide here and in the Appendix for your information some material about Energex Limited and its accounting policies relevant to its rate-regulated activities.

Energex Limited is a Queensland Government owned company that builds, owns, operates and maintains the electricity distribution network in South East Queensland, Australia.

According to the accounting policies articulated in the Energex Limited Annual Report 2013/14, the current electricity regulatory framework entitles Energex Limited to recover regulated revenue under-recoveries and the solar photovoltaic (PV) feed-in tariff rebate through future distribution use of system charges. Any current period under or over-recovery of revenue is recovered from or returned to customers in future periods through an adjustment to prices. Where over-recoveries result in an obligation, they are brought to account as a liability in the period in which they are over-recovered. Where there is sufficient certainty regarding the recoverability of under-recoveries, they are brought to account as an asset in the period in which they are under-recovered.

The Directors' Report states
The Group's regulated revenue receivables comprise:

	Recoverable within 12 months $M	Recoverable after 12 months $M	Total $M
Under-recoveries in 2011/12	-	82	82
Under-recoveries in 2012/13	46	153	199
Under-recoveries in 2013/14	-	142	142
Total regulated under-recoveries	**46**	**377**	**423**
2012/13 solar PV feed-in tariff pass through	186	-	186
2013/14 solar PV feed-in tariff pass through	-	222	222
Total solar PV feed-in tariff pass throughs	**186**	**222**	**408**
2011/12 service target performance incentive scheme	34	-	34
2012/13 service target performance incentive scheme	-	12	12
2013/14 service target performance incentive scheme	-	26	26
Total service target performance incentive schemes	**34**	**38**	**72**
Total regulated revenue receivables	**266**	**637**	**903**

Regulated revenue entitlements not recovered through pricing in the period during which the Group becomes entitled to that revenue and proposed pass through costs are carried as regulated revenue receivables and recovered in future periods within guidelines established by the Australian Electricity Regulator (AER). Conversely, over-recoveries of regulated revenue entitlements are carried as liabilities and returned to customers through future tariff adjustments within those guidelines. The current year saw under-recoveries of allowed revenue as prescribed by the current determination of $142 million arising as a result of lower energy consumption and demand than assumed in the calculation and setting of 2013/14 prices. The lower consumption is ascribed to a range of factors, predominantly lower new connections than anticipated, milder temperatures compared to long-term averages, slowing commercial and industrial energy growth, continued focus on reducing peak energy demand and energy efficiency improvements.

A further contributing factor to total revenue under-recoveries is the level of solar PV activity. The Group's inflation adjusted under-recovery of $222 million (2013: $162 million) for meeting its prescribed obligations is to be recovered in future periods. The amount to be recovered is calculated in accordance with the AER's methodology, which includes an adjustment based on the actual consumer price index (CPI). The levels of solar PV under-recoveries are expected to continue at current levels for this determination period as actual solar PV activity continues to exceed the levels anticipated in the regulatory determination.

The timing of the recovery of regulated revenue receivables is subject to AER approval as part of the annual pricing approval process. The 2014/15 pricing proposal was approved by the AER on 13 June 2014 and incorporates a recovery of $266 million regulated revenue receivables which arose in 2011/12 and 2012/13.

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?

Yes, we agree with the definition. We agree with the IASB that 'defined rate regulation' should provide the board with the best insight into the need or otherwise for the development of material on rate-regulated activities.

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?**

We have no response to this question.

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.**

We think it appropriate that the description and discussion of defined rate regulation does extend to a consideration of how the defined rate regulation adjusts for differences between the revenue requirement and the billed requirement, especially, in situations in which adjustments to future revenue rates are charged to customers are used as a mechanism to recover or reverse differences.

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?

Paragraph 4.53 states that the rights and obligations created by the rate regulation are rarely separable from the rate-regulated business. We see a strong nexus between the issues around the accounting for rate-regulated activities, intangible assets and goodwill, be they internally generated or acquired. We would like the IASB to include both in its consideration.

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.

Please see our response to Question 1 above.

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?

No, we do not.

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.

Please see our response to Question 1 above.

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.

We have no response to this question.

Question 11

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

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

We have no response to this question.

Question 12

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

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

We would like to see more work undertaken in the identification of the main features of defined rate regulation as it is through the establishment of principles that this conundrum can be resolved.

Question 13

Paragraphs 7.11–7.22 highlight some of the issues that the IASB may consider if it continues to progress this project. Do you have any comments or suggestions on these or any other issues that may or may not have been raised in this Discussion Paper that you think the IASB should consider if it decides to develop proposals for any specific accounting requirements for rate-regulated activities?

We have no further comments.

Energex Limited – selected accounting policies
https://www.energex.com.au/__data/assets/pdf_file/0019/218305/Annual-Report-2013-14-Form-8028.pdf

[1.3] Critical accounting estimates and judgements
The preparation of consolidated financial statements requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and other factors that are considered relevant. Actual results may differ from these estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in relevant future periods.

The estimates, assumptions and judgements that have a potential significant effect are discussed below.

- **Future recovery of regulated revenue under-recoveries**

Under the current framework imposed by the *National Electricity Rules*, the Group is entitled to recover regulated revenue under-recoveries and the solar photovoltaic (PV) feed-in tariff rebate through future distribution use of system (DUOS) charges. The Group estimates the timing of the expected recovery of these amounts with reference to the recovery mechanism allowed by the Australian Energy Regulator (AER) and classifies the amounts expected to be recovered within 12 months as current assets. Amounts expected to be recovered after 12 months are classified as non-current assets.

- **Regulated revenue**

Various assumptions are used in the recognition of the Group's regulated revenue and associated assets. These estimates and assumptions are described in Notes 1.5 and 1.12.

1.5 Revenue
Revenue is measured at the fair value of the consideration received or receivable net of goods and services tax (GST). Revenue is recognised when the amount can be reliably measured and it is probable that future economic benefits will flow to the Group or benefits have already flowed to the Group.

Revenue is recognised for the major business activities as follows:
Rendering of services

- **Network use of system**

Energex is subject to regulation under the *National Electricity (Queensland) Law*, the *National Electricity Rules*, and other rules established by the Australian Energy Market Commission as administered and enforced by the AER.
There are two broad categories of regulated distribution services applicable to Energex, being Standard Control Services (SCS) and Alternative Control Services (ACS). SCS comprise network services, connection services and metering services. ACS includes streetlighting services, quoted services and fee-based services. These two categories of regulated distribution services earn revenue under one of two regulated revenue models known as a revenue cap and a price cap. The revenue cap applies to SCS activities and entitles the Group to a pre-determined allowance for DUOS charges. The price cap applies to certain ancillary distribution services and is determined as a price per unit of service (refer to the service charges section below).

Assets utilised in the provision of SCS form part of the Regulated Asset Base (RAB) and earn a regulated return over their life under the revenue cap. ACS related assets are generally subject to the price cap with the revenue recognised on commissioning and, therefore, do not generally earn a regulated return over their life. SCS and ACS assets are measured at fair value.

DUOS is billed to customers based on a combination of energy consumption, demand, capacity and fixed charges at AER approved prices which are calculated to recover the revenue cap for the financial year.

Regulated network use of system (NUOS) revenue is determined based on the allowed revenue cap for DUOS services plus regulated transmission use of system charges (TUOS, also referred to as designated pricing proposal charges - DPPC) paid predominantly to the transmission network service provider (Queensland Electricity Transmission Corporation Limited trading as Powerlink Queensland). The revenue from the TUOS charges is passed through to the providers of transmission services.

Under the current regulatory determination, the Group is entitled to recovery of the solar PV feed-in tariff payments in future periods. This recovery is also included in NUOS revenue.

Any current period under or over-recovery is recovered from or returned to customers in future periods through an adjustment to prices. Where over-recoveries result in an obligation, they are brought to account as a liability in the period in which they are over-recovered. Where there is sufficient certainty regarding the recoverability of under-recoveries, they are brought to account as an asset in the period in which they are under-recovered.

When circumstances arise which, in the opinion of the Directors, significantly change the assumptions on which the revenue cap is based, the AER is advised and the adjustments are reflected against the revenue cap and the resulting prices.

The AER also administers a Service Target Performance Incentive Scheme (STPIS). The purpose of the scheme is to provide financial incentives for DNSPs to maintain and improve service performance levels. The scheme enables the Group to earn a reward or incur a penalty capped at ±2.0 per cent of allowed revenue as set by the AER. The STPIS reward or penalty is recovered from or returned to customers in future periods through the regulated revenue and pricing mechanism.

1.12 Trade and other receivables

Trade and other receivables are recognised when the Group has a legal right to receive cash, cash equivalents or economic benefits and are measured at amounts due at the time of sale or service delivery. Trade receivables are due for settlement within 10 to 30 days of the customer being billed. Other receivables are due in accordance with their contractual terms.

Collectibility of trade receivables is reviewed on an ongoing basis. A provision for impairment of receivables is raised when the collection of the full amount of the debt is no longer probable. Bad debts are written off when it has been identified that there is no reasonable prospect of recovery. Movements in the provision are recognised in the income statement (refer Note 6).

Regulated revenue under-recoveries

A current asset is recognised for the net balance of regulated revenue under-recoveries to be recovered over the next 12 months where the net balance is an asset. A non-current asset is recognised for any remaining under-recovery of regulated revenue if there is sufficient certainty over its recoverability in future years. It is expected that the non-current asset relating to this remaining portion will be recovered systematically over the next determination period, being the 60 months between the commencement of the 2015 and the end of the 2020 financial periods.

The non-current asset is escalated by the allowed rate of return or weighted average cost of capital (WACC) as determined by the AER and discounted at the same rate to reflect the discounted present value of the amount expected to be recovered at the end of the reporting period (refer Note 6).

6 Trade and other receivables

Current:	**2014 $m**	**2013 $m restated**
Trade receivables	**274**	**231**
Provision for impairment of receivables	**(2)**	**2**
Regulated revenue recoveries	**266**	**103**
Other receivables	**34**	**36**
Total current trade and other receivables	**572**	**367**
Non-current:		
Regulated revenue recoveries	**637**	**455**
Other receivables	**-**	**1**
Total non-current trade and other receivables	**637**	**456**
* Refer to Note 32		