GazMétro

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**International Accounting Standards Board**
30 Cannon Street
London EC4M 6XH
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Dear IASB

RE: Proposed Amendments to IFRS 1

Gaz Métro is pleased to submit its comments on the question 3 of the IASB's Exposure Draft Additional Exemptions for *First-time Adopters: Proposed Amendments to IFRS 1*, that you will find in appendix.

With almost $3.3 billion of assets and more than 1,300 employees in Quebec, **Gaz Métro Limited Partnership** is a leading Quebec (Canada) energy company and one of Canada's largest natural gas distributors. Gaz Métro serves about 175,800 customers in Quebec through an underground pipeline network of more than 10,000 km. The distribution's activity of Gaz Métro is regulated by the Régie de l'énergie, which fixes the annual transportation, load-balancing and distribution rates and the rate of return allowed on deemed common equity. Rates are established primarily on a cost of service-based method, which allows Gaz Métro to set its revenues each year so as to recover the expenditures it expects to incur to serve its clientele and earn a reasonable return on rate base allocated to this activity.

Gaz Métro supports the proposed deemed cost option for operations subject to rate regulation with some concerns related to the impracticability notion in the present exemption. The impracticability will avoid the possibility for these entities to use the exemption since it is possible, in most cases, to estimate the fair value with a method other than fair market value (ex: discounted cash flow). Since the fair value is equivalent to their carrying value, the calculation of the fair value at the first-time adoption of IFRS would represent a significant load of work without any supplementary value. Also, using the carrying amount of fixed assets as their deemed cost at the date of transition to IFRS will allow entities subject to rate regulation to avoid incurring costs that would likely exceed the benefits for users of retroactively restating the amounts of fixed assets. Also, considering the economic reality of rate-regulated entities, financial information disclosed using a value different from the carrying amount as deemed cost at the date of transition would not show a true and fair view of the entities' performance. You will find detailed responses in Appendix.

Yours truly,

**APPENDIX**

**DETAILED RESPONSE TO THE QUESTION 3 - DEEMED COST FOR OPERATIONS SUBJECT TO RATE REGULATION**

The exposure draft proposes an exemption for an entity with operations subject to rate regulation. Such an entity could elect to use the carrying amount of items of property, plant and equipment held, or previously held, for use in such operations as their deemed cost at the date of transition to IFRS if both retrospective restatement and using fair value as deemed cost are impracticable (as defined in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*).

*Question 3*

*Do you agree with the proposed deemed cost option for entities with operations subject to rate regulation? Why or why not? If not, what alternative do you propose and why?*

***Gaz Métro agrees with the proposed deemed cost option for entities with operations subject to rate regulation for the following reasons:***

- In a regulated environment, fixed assets included in the rate base generate a return by cash flows. As those cash flows are regulated, the fair value of the fixed assets is equivalent to their carrying amount. Those entities are therefore authorized by their regulatory body to recover all their capital expenditures through rates.

- In case that the fair value was not equivalent to their carrying value, the revaluation of the opening balances at the fair value of the fixed assets would result in a distortion between economic reality and the results presented in the financial statements. The present economic reality of entities subject to rate regulation is that the expenditures made to acquire and construct fixed assets are fully recoverable in rates over periods that vary according to the nature of the assets. In this way, the rates charged to customers include those expenditures. If fixed assets are re-valued at fair value, rates would be based on an amortization expense calculated on past expenditures rather than an amortization expense calculated using the fair value recorded at the first-time adoption of IFRS. As a result, the rate-regulated entities would have to keep two set of financial statements, one for the regulatory bodies based on regulation and another one under IFRS. In our view, the use of the carrying amount as the deemed cost at the date of transition will show a true and fair view of the financial position and the performance of entities (IASB Framework .46).

- After the first application of this exposure draft, considering using carrying amount as deemed cost, the rate-regulated entities would change their rate base to include the fixed assets under IFRS. As a result, the financial statements will be equivalent to the regulation results and will show the economic reality of the entity.

- Implementing the fair value option for fixed assets would require revaluing all of a company's fixed assets. For entities subject to rate regulation, the fact that a large portion of those fixed assets have been constructed by the entities themselves and the fact they operate in a virtual monopolistic market should be taken into account. As a result, there is no open market for those assets and determining their fair market value could be very difficult. The lack of qualified independent valuators may mean a large number of valuations would have to be done by an entity's employees who may not have the required competence and independence.

- The calculation of the opening balance under IFRS at the transition date would require a significant amount of work without sufficient additional value – cost/benefit balance (.44 IASB Framework) :
  - As mentioned before, fixed assets amortization is included in the rate charged to the client and the fair value of those assets is equivalent to their carrying value. The calculation of the fair value at the first-time adoption of IFRS would represent a significant load of work without any supplementary value for the users. Considering that fact, we suggest to consider the carrying value of fixed assets of the entities subject to rate regulation equivalent to their fair value without creating exemptions in case of impracticability of the calculation of fair value. In other word, we suggest that the IFRS 1 includes a supplementary options for the entities subject to rate regulation that would permit the utilization of the carrying value as deemed cost at the first-time adoption.

  - In case of exposure draft adoption, we think that the notion of impracticable would need to be excluded from the present exemption or to be defined for that case since the definition of IAS 8 seems to have a different meaning. Presently, most of entities subject to rate regulation would not meet the exemption of impracticability since the evaluation of the fixed assets fair value could be made with the discounted cash flow method. The information required to do this evaluation were available at this time.

  - Since most entities subject to rate regulation construct their own fixed assets, they capitalize the interest and equity components and the overhead costs in the cost of those assets. Also, some entities subject to rate regulation record realized gains and losses on the disposal of retired properties as adjustments of the accumulated amortization on the fixed assets. Those accounting standards are in line with the regulation and as mentioned before, permit to keep one set of financial statements, equivalent for regulatory bodies and IFRS. Based on the present restatement standards under IFRS 1, these entities would have to re-compute the historical cost, the accumulated amortization expense, the gains and losses on disposal and the net book value as at the transition date to exclude those expenses.
    - These items have been capitalized in the fixed assets and included in the rate base. The modification of the opening balance sheet at the first-time adoption would create distortion between the economic reality and the financial statements.
    - The information required to restate may not be available.
    - Restating the historic cost balances of fixed assets involves recreating the records retroactively to the beginning of a company's operations, which would be imprecise, complex and time-consuming.

- The application of the exemption would be items by items for the fixed asset of the entities. Considering that fact, some components of a class of fixed assets would be evaluating at cost, at fair value or at deemed costs. The comparability would be decreased and it would be difficult to be meaningfully applied.

## CONCLUSION

Using the carrying amount of fixed assets as their deemed cost at the date of transition to IFRS will allow entities subject to rate regulation to avoid incurring costs that would likely exceed the benefits for users of retroactively restating the amounts of fixed assets. Also, considering the economic reality of rate-regulated entities, financial information disclosed using a value different from the carrying amount as deemed cost at the date of transition would not show a true and fair view of the entities' performance.