Project **Rate-regulated activities**

Topic **Presentation and disclosure requirements**

## Introduction

### *Objectives of this paper*

1. The objectives of this paper are:

   (a) to establish the principles that define the presentation and disclosure requirements for rate regulated activities and assets and liabilities recognised as a result of rate regulation.

   (b) to specify the minimum disclosures necessary to satisfy the principles.

## Staff analysis

### *General principles*

2. In accordance with the Board's general approach to presentation and disclosure, the staff recommends that the standard include the following general principles:

   > 1. An entity shall disclose information that enables users of its financial statements to understand the nature and economic effects of rate regulation on its financial statements.
   >
   > 2. An entity shall disclose information that identifies and explains the amounts recognised in its financial statements arising from rate regulation.

### *Presentation of assets and liabilities arising from rate regulation*

*Presentation on the face of the statement of financial position*

3. The staff has identified two main issues relating to presentation on the face of the statement of financial position. The first issue deals with whether assets and liabilities arising from rate regulation ("regulatory assets and liabilities") should be offset. As noted in Agenda Paper 9A, regulatory assets and liabilities do not meet the definition of financial instruments. Consequently, they cannot meet the

criteria in IAS 32 *Financial Instruments: Presentation* to be presented net. IAS 12 *Income Taxes* permits (non-financial) current and deferred tax assets and liabilities to be offset if certain conditions are satisfied. One of those conditions for both current tax and deferred tax amounts is that the entity must have a legal right to set off the recognised amounts. Regulatory assets and regulatory liabilities arise from specific individual costs to be collected from or amounts to be refunded to customers. For these reasons, the staff does not believe offsetting should be permitted. However, it is true that all the individual assets and liabilities recognised that are related to a distinct regulatory activity will affect the determination of the same rate. Consequently, the staff can see an argument for offsetting regulatory assets and liabilities subject to the same regulator that will be affect the determination of a single rate.

| **Recommendation and question 1 – Offsetting** |
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| For the reasons set out in paragraph 3, the staff recommends that offsetting of assets and liabilities arising from rate regulation should not be permitted. Does the Board agree? If not, does the Board agree with the criteria for net presentation set out in paragraph 3? |

4. IAS 1*Presentation of financial statements* requires separate presentation of current and non-current assets and liabilities. The staff is proposing that the timing of recovery of regulatory assets/maturity of regulatory liabilities be disclosed in the notes to the financial statements (see paragraph 10(a)(iii) below). Such a disclosure implies the need for a current/non-current classification of regulatory assets and liabilities on the face of the statement of financial position.

| **Recommendation and question 2 – Current/Non-current separation** |
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| The staff recommends that current and non-current regulatory assets and liabilities should be presented separately in the statement of financial position. Does the Board agree? |

*Presentation in the statement of comprehensive income*

5. In the statement of comprehensive income, the question is whether to present a specific separate line item that includes the total effect of rate regulation on the

entity's reported performance or to include the effect in each appropriate line item.

6. The staff favours presenting the effect of rate regulation as a single line item as it is bound to be significant for most entities within the scope of the standard. A breakdown detailing which line items that total amount relates to should then be disclosed in the notes to the financial statements (see paragraph 10 below).

| **Recommendation and question 3 – Line item in comprehensive income** |
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| The staff recommends that the effect of rate regulation be presented as a single line in the statement of comprehensive income to show at a glance the impact of rate-regulation. Does the Board agree? |

## Disclosure requirements

7. Rate regulation can affect both the revenue-generating ability of an entity and the periods in which its revenues are recognised. It is, therefore, an important consideration in evaluating the financial performance of entities with rate-regulated operations.

### *Minimum disclosures for general principle 1 in paragraph 2*

8. Paragraph 2 proposes that entities subject to rate regulation should disclose general information facilitating an understanding of the nature and economic effects of rate regulation. The staff believes that the following disclosures should be specified as the minimum necessary to achieve that principle:

   (a) the fact that the entity is subject to rate regulation, and a description of the nature and extent of the rate-regulated operations; and

   (b) for each set of operations subject to a different rate-setting authority:

      (i) the identity of the rate-setting authority and, if it meets the definition of a related party (see IAS 24 *Related Party Disclosures*), a statement to this effect, together with an explanation of why this is the case; and

      (ii) the process by which the entity's rates are approved, as well as information providing a basic understanding of how it has been applied including the allowed rate of return.

9. The staff believes that the following information should be disclosed in accordance with requirements that already exist in IAS 1 (paragraphs 122 and

125). However, for greater certainty, we believe it would be useful to specify the required information in this standard:

(a) the indicators management considered in reaching its conclusion that its activities are within the scope of the standard, when that determination requires significant management judgement (see Agenda Paper 9C). (IAS 1.122)

(b) information about how the entity estimates regulatory assets and liabilities, either:

  (i) the supporting regulatory action, for example, issuance of a final rate order or approval to accumulate amounts pending final disposition at a later date (the date being disclosed, when known), or

  (ii) the expectations of the entity regarding future regulatory actions. (IAS 1.125)

(c) a description of the regulatory risks and uncertainties affecting the eventual recovery of the assets or settlement of the liabilities and their timing. (IAS 1.125)

***Minimum disclosures for general principle 2 in paragraph 2***

10. Paragraph 2 proposes that entities subject to rate regulation should disclose information that identifies and explains the amounts recognised in their financial statements arising from rate regulation. The staff believes that the following disclosures should be specified as the minimum necessary to achieve that principle:

(a) for each category of item and if appropriate by classes, how it has been reflected in the financial statements and:

  (i) the carrying amount of the asset or liability, as at the most recent balance sheet date;

  (ii) the income statement effect of such recognition for the current period;

  (iii) the remaining period over which the carrying amount of the asset is expected to be recovered or the liability is expected to be settled;

(b) costs being amortised in accordance with the actions of a regulator, but which are not being allowed to earn a return during the recovery period as well as the remaining amounts being amortised and the remaining recovery period;

(c) when accounting for the effects of rate regulation has been discontinued since the last financial statements issued, a statement to that effect together with the reasons for the discontinuance and identification of the rate-regulated operations affected.

| **Recommendation and question 4 – Minimum disclosures** |
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| The staff recommends that the disclosures set out in paragraphs 8-10 should be required as the minimum necessary to achieve the principles in paragraph 2. Does the Board agree? What, if any, additional disclosures does the Board believe should be required? |

11. Most entities presenting assets and liabilities arising from rate-regulated activities in accordance with US GAAP (SFAS 71) and the disclosure requirements of Canadian GAAP (Accounting Guideline 9) provide the information required by paragraph 10(a) in a table showing the opening balance, collection/settlement for the period, additions during the period and closing balance for each class of asset and liability. The staff understands that many users favour information being disclosed in tabular formats.

| **Question 5 – Format of disclosure** |
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| Does the Board wish to specify the format of these disclosures? |