STAFF PAPER

December 2012

IASB Meeting

Project	**Rate-regulated Activities**
Paper topic	Issues to be addressed in the DP

CONTACT(S)	Jane Pike	jpike@ifrs.org	+44 (0)20 7426 6925
	Michael Stewart	mstewart@ifrs.org	+44 (0)20 7426 6922

This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IASB and does not represent the views of the IASB or any individual member of the IASB. Comments on the application of IFRSs do not purport to set out acceptable or unacceptable application of IFRSs. Technical decisions are made in public and reported in IASB *Update*.

Introduction

1. In September 2012, the IASB decided to focus the new Rate-regulated Activities research project on developing a Discussion Paper (DP) to document different rate regulation regimes and identify whether any of those rate regulations create rights or obligations that meet the IFRS definitions of assets and liabilities. The objective would be set to use this research to develop reporting requirements for rate-regulated activities. If the research conclusion is that rate regulation typically does not create assets or liabilities, the IASB might consider developing disclosure requirements to reflect any unique features of these activities.

2. The project will interact with the work being done in the restarted IFRS Conceptual Framework project. The agreed target date for publication of the Rate-regulated Activities DP is the fourth quarter of 2013.

3. The purpose of this Agenda Paper 6A is:

   (a) to outline the issues identified that should be considered in the DP; and

   (b) to ask the IASB for any comments or additional issues.

Background

4. The previous Rate-regulated Activities project produced an Exposure Draft (the 2009 ED), issued in July 2009. This 2009 ED suggested that items described as

The IASB is the independent standard-setting body of the IFRS Foundation, a not-for-profit corporation promoting the adoption of IFRSs. For more information visit www.ifrs.org

"regulatory assets" and "regulatory liabilities" could be recognised (either as separate line items or, in specific situations, as part of the cost of property, plant and equipment) if an entity's activities are subject to cost-of-service[1] rate regulation.

5. The responses to the 2009 ED and the IASB's subsequent redeliberations failed to identify a clear path to answering the fundamental issue: do items described as "regulatory assets" and "regulatory liabilities" meet the definitions of assets and liabilities within the IFRS Conceptual Framework?

6. Some respondents to the 2009 ED argued that the nature of rate regulation in different jurisdictions justifies the recognition of regulatory assets and regulatory liabilities in some jurisdictions but not in others. So far, this analysis seems to be based on anecdotal evidence. Consequently, a critical part of the research for the DP will be to identify the common types of rate regulation in a variety of jurisdictions and industries to try to identify what types of rights and obligations are created by the rate regulation. Subsequently, those rights and obligations will be analysed against both the existing and developing definitions of assets and liabilities in the IFRS Conceptual Framework. This analysis will help to determine what features would need to be present in a particular regulatory regime in order to identify what assets and liabilities can be recognised.

7. During the IASB's redeliberations on the 2009 ED, some time was spent considering whether the impact of rate regulation would be better reflected as a change of value of a broader intangible asset, such as the licence to operate in the regulated industry. This raised (unanswered) questions about whether the underlying intangible (or a component thereof) could be remeasured to reflect the impact of the rate regulation.

---

[1] Cost-of-service regulation was defined in the 2009 ED as: "A form of regulation for setting an entity's prices (rates) in which there is a cause-and-effect relationship between the entity's specific costs and its revenues."

The scope of the 2009 ED was set out as follows:
An entity shall apply this [draft] IFRS to its operating activities that meet the following criteria:

(a) an authorised body (the regulator) establishes the price the entity must charge its customers for the goods or services the entity provides and that price binds the customers; and

(b) the price established by regulation (the rate) is designed to recover the specific costs the entity incurs in providing the regulated goods or services and to earn a specified return (cost-of-service regulation). The specified return could be a minimum or range and need not be a fixed or guaranteed return.

Issues to be addressed in the DP

8. We have reviewed the comment letters and other documentation from the previous Rate-regulated Activities project, responses to the Agenda Consultation and related round tables, and recently received comments in other outreach (see paragraphs 13-16 of the accompanying Agenda Paper 6B). We summarise here the issues that we think need to be addressed in the DP and expand on them in the Appendix to this paper:

   (a) What do we mean by “rate regulation” and should we define it?

      (i) What should be the scope of guidance on Rate-regulated Activities?

   (b) What characteristics of the rights and obligations created by rate regulations meet the definitions of assets and liabilities in the IFRS Conceptual Framework?

   (c) If the rights and obligations created by particular rate regulations do meet the definitions of assets and liabilities, what type of asset, liability or combination of assets and liabilities are created?

      (i) For any assets or liabilities identified, what are the relative advantages and disadvantages of alternative accounting models for recognition and measurement?

      (ii) Does IFRS already include appropriate accounting models for recognition and measurement that can be applied to any regulatory assets or regulatory liabilities identified?

      (iii) How should any regulatory assets and regulatory liabilities be presented in the financial statements?

   (d) What disclosures are needed to help users understand the impact of rate regulation on the financial position, performance and cash flows of the rate-regulated entity?

   (e) If the conclusion is that rate regulation does not create additional assets and liabilities to be recognised, what information about the rate regulation needs to be presented, and how should this be done?

Questions for the IASB

Question: Issues identified
Do you agree that the staff have identified the appropriate issues to be addressed in the Discussion Paper? If not: • Are there any issues that you think should not be addressed? or • Are there any other issues that you would like to see addressed?

Appendix: Summary of issues to be addressed in the DP

9. The following paragraphs expand on the issues summarised in paragraph 8.

10. What do we mean by "rate regulation" and should we define it?

    (a) What are the features of rate regulation that differentiate rate-regulated activities from non-rate-regulated activities, ie what specific rights and obligations does the rate regulation convey to or impose on the rate-regulated entity?

    (b) Do the different forms of rate regulation (such as cost-of-service, incentive-based, price-cap, hybrid, etc) create different rights and obligations?

    (c) Are the differentiating features of rate regulation specific to the industry in which it applies or to the form of regulation?

11. What should be the scope of guidance on Rate-regulated Activities?

    (a) Should it apply to all entities that have activities subject to rate regulation or should any specified industries be explicitly excluded or included?

    (b) Should its application be restricted to entities or business segments that are fully rate-regulated or should it apply to the specific activities within the entity or segment that are subject to rate regulation?

    (c) Should it be limited to cost-of-service rate regulation (as it was in the 2009 ED)?

12. What characteristics of the rights and obligations created by rate regulations meet the definitions of assets and liabilities in the IFRS Conceptual Framework?

    (a) What are the current definitions and recognition criteria in the Conceptual Framework?

    (b) What are the working definitions being developed in the Conceptual Framework DP and how does this affect the analysis?

    (c) What features (ie what rights and obligations) would need to be present in a particular regulatory regime in order to identify what assets and liabilities can be recognised?

13. If the rights and obligations created by particular rate regulations do meet the definitions of assets and liabilities, what type of asset, liability or combination of assets and liabilities are created?

    (a) If a separately identifiable asset or liability is created, is it:

        (i) a financial asset or financial liability?

        (ii) an intangible asset?

        (iii) any other type of asset or liability, eg a deferred cost asset, an unbilled receivable asset, or a deferred income liability?

    (b) If an asset or liability is created that is not separately identifiable as an individual item, is it an integral or separable component of a broader asset (eg part of the cost of an item of plant or equipment or part of the value of an operating licence)?

14. For any assets or liabilities identified, what are the relative advantages and disadvantages of alternative accounting models for recognition and measurement?

    (a) What recognition criteria are required, eg should probability of economic inflows/outflows be a recognition hurdle or part of the measurement basis? (This issue will be influenced by the Conceptual Framework project. The 2009 ED did not contain any recognition criteria, relying instead on the scope definition.)

    (b) Should the regulatory item be measured at historical cost or using a current value model?

        (i) Should the subsequent measurement be on the same basis as initial measurement?

        (ii) If the regulatory item is to be measured using a current value model, what discount rate should be used, eg the rate determined as allowable by the rate regulator?

15. Does IFRS already include appropriate accounting models for recognition and measurement that can be applied to any regulatory assets or regulatory liabilities identified?

    (a) If so, can the appropriate models be applied without changing existing requirements, eg by providing application guidance?

(b) If not, should the existing guidance be modified to deal with the particular features of rate regulation, eg to match the accounting model determined by the rate regulator?

16. How should any regulatory assets and regulatory liabilities recognised be presented in the financial statements?

    (a) In which line items in the statement of profit or loss and other comprehensive income for the period should the changes in the value of the assets and liabilities recognised be presented?

    (b) If a regulatory asset or regulatory liability is identified as a component of a broader asset (see paragraph 13(b)), should it be presented within the broader item or as a separate item?

17. What disclosures are needed to help users understand the impact of rate regulation on the financial position, performance and cash flows of the rate-regulated entity?

    (a) Should reconciliations be provided between the IFRS amounts and those used for rate regulation purposes?

    (b) Should the assumptions made by management about the outcomes of regulatory reviews, expected future rate level, expected rate or timing of recovery of any regulatory items recognised be disclosed?

    (c) What level of detail should be disclosed about the type of rate regulation that the entity is subject to and the extent of the rate-regulated activities?

    (d) If relevant regulatory information is publicly available elsewhere, eg directly from the rate regulator, does it (or a summary of it) need to be included in the financial statements or can it be cross-referred to instead?

18. If the conclusion is that rate regulation does not create additional assets and liabilities to be recognised, what information about the rate regulation needs to be presented, and how should this be done?