STAFF PAPER

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IASB Meeting

Project	**Rate-regulated Activities**		
Paper topic	Proposed project plan		
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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 (CF) project. The agreed target date for publication of the Rate-regulated Activities DP is the fourth quarter of 2013.

3. The decision by the IASB to start the new project with a research phase acknowledges that comments received on the previous Rate-regulated Activities Exposure Draft (the 2009 ED), issued in July 2009, raised complex and fundamental issues at a conceptual level that require more research and analysis. Consequently, the IASB has also received requests for an interim Standard to be published for use until a more comprehensive solution is developed.

4. The purpose of this Agenda Paper 6B is:

   (a) to outline a proposed project plan and timetable for developing the DP; and

   (b) to outline the issues to consider when deciding whether or not to publish an interim Standard.

Proposed project plan for the DP

5. The previous Rate-regulated Activities project produced the 2009 ED, which suggested that items described as "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.

6. The responses to this 2009 ED identified that, although there does not seem to be significant diversity in the accounting for rate-regulated activities under IFRS in practice, it is an issue for which the IASB needs to provide greater clarity. The IASB's redeliberations on the ED did not reach a consensus on the fundamental issue of whether items described as "regulatory assets" and "regulatory liabilities" meet the definitions of assets and liabilities within the IFRS *Conceptual Framework*.

7. A separate paper (Agenda Paper 6A) outlines the issues that we have identified to be addressed in the DP and asks the IASB for comments or further suggestions.

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[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.

External consultation

8. The IASB's due process requirements specify that for a major project (ie a project "involving pervasive or difficult conceptual or practical issues"), the IASB normally establishes a working group.

9. At this stage, we do not recommend the formation of a formal working group for this project. We consider that it will be more effective to obtain information about different types of rate regulation from various interested parties, such as regulators, preparers and industry bodies. We can also use the existing network of National Standard-Setters to identify any existing GAAP requirements that support the recognition of regulatory assets and regulatory liabilities (eg in the USA, Canada and India).

10. Once the initial research is completed, we will compare the common characteristics of various regulatory regimes to the existing and developing definitions of assets and liabilities within the IFRS Conceptual Framework. We are aware that the CF project team is currently putting in place consultative group(s) for that project. Because the two projects are closely interlinked, we expect to test the initial views identified in the rate regulation research against those developed in the CF project with the same consultative groups.

Question for the IASB

Question 1: External consultation
Do you agree with the staff recommendation to make use of the Conceptual Framework consultative groups instead of establishing a separate working group for this project?

Proposed timetable

11. We expect that it will take at least three months to gather information about various regulatory regimes to feed into the analysis of issues identified in Agenda Paper 6A. In addition, the CF project is aiming to publish a DP in mid-2013, which will include discussions about the definitions of assets and

liabilities, when they should be recognised and how they should be measured. All of these features will influence the development of the Rate-regulated Activities DP. Consequently, the timetable for the DP will naturally have to lag a little way behind that of the CF project.

12. We have set out, in paragraph 3939, a proposed timetable for the development of the DP, but will consider the question of whether to develop an interim Standard before asking the IASB to comment on this timetable.

Requests for an interim Standard

13. We sought initial views from the IASB at their September 2012 meeting about some requests for an interim Standard that could provide temporary guidance until the comprehensive project has been completed (see IASB Agenda Paper 15, September 2012). We did not ask for a decision at that time, pending further outreach with the IFRS Advisory Council and others.

Feedback from the IFRS Advisory Council and others

14. A paper was presented to the IFRS Advisory Council in October 2012 (Agenda Paper 3). This asked the Council members to consider the factors that the IASB should be aware of when deciding whether or not to develop an interim Standard and if such an interim Standard is developed, what form should it take. The options considered for the form of any interim Standard were:

    (a) set disclosure-only requirements;

    (b) establish specified accounting requirements; or

    (c) allow some sort of 'grandfathering' of existing accounting policies, with or without modifications.

15. We also consulted the Capital Markets Advisory Committee (CMAC) and others, albeit in a less detailed way. The following summary of the IFRS Advisory Council discussion is included in the Chairman's report to the Trustees and the IASB. Although this is specific to that discussion, it reflects the other outreach comments received.

Rate-regulated activities

7. The project to develop a Standard has been reactivated. A comprehensive Discussion Paper is planned for 2013. However, any new Standard would not be likely to become effective before 2016. Members were asked for their views on whether an 'interim solution' is needed. The reports by the discussion leaders and the subsequent discussion indicated that:

- Views of the break-out groups were mixed. One group advised against an interim solution; one group supported an IFRS 6 approach; while another supported a 'disclosure only' approach. Another group preferred there not to be an interim solution, but if this posed a problem, particularly in deterring first-time adopters of IFRSs, the group would support a 'disclosure only' interim solution.
- Members supported the importance of completing the main standard-setting project quickly and worried that an interim solution might delay starting the main project and lessen the incentive to complete it expeditiously (noting that IFRS 4 and IFRS 6 have been in place for many years).
- Members warned against a policy of adopting an interim solution whenever a major standard-setting project is activated. In particular, 'grandfathering' existing practices could be opening a 'Pandora's Box'.
- In the closing session, the Chairman summarised the discussion as indicating that a majority of members did not support an interim solution. The members concurred.

16. Although there is some support for an interim Standard, there were clearly concerns that this would divert resources away from the DP. An interim solution could also reduce the incentive to develop a better and more sustainable solution. The main message we took from the outreach is that the timetable for the comprehensive solution should not be jeopardised, and that if any interim solution is to be developed, this should be done quickly and not delay the outcome of the comprehensive project.

17. The following sections of this paper outline:

(a) our recommendation for the form of an interim Standard that could be developed with the minimum risk of disruption to the main project, if the IASB decide to develop an interim Standard; and

(b) the factors identified in outreach for the IASB to take into account when considering whether to go ahead with such an interim Standard.

18. We outline the form of an interim Standard that could be developed within the constraints identified through our outreach before we discuss the relevant benefits and disadvantages of issuing such an interim Standard. It is clear that the type of interim Standard is important, in terms of the likely general acceptance as an interim solution and the likely time required to develop and issue an interim Standard. Different factors would apply to each form of interim Standard, which are summarised in the Appendix to this paper and are described in more detail in the October 2012 Advisory Council Agenda Paper 3 (http://www.ifrs.org/Meetings/MeetingDocs/Advisory%20Council/2012/October/AC1012-3.pdf).

If an interim Standard is to be developed, what form should it take?

19. As noted in paragraph 14, the staff considered three types of approach to an interim Standard: disclosure-only; new financial reporting requirements; and grandfathering.

Disclosure only

20. Although a disclosure-only interim Standard could be developed quickly, it would not address the key issues of uncertainty about the appropriate accounting for rate-regulated activities. Consequently, we do not recommend that such a disclosure-only interim Standard should be developed.

New 'interim' requirements

21. Developing an interim Standard that sets out specific scope, recognition and measurement requirements would require a significant amount of research and work. Many of the comment letters received in response to the 2009 ED, including from those who, in principle, supported the recognition of regulatory items, raised issues in these areas about the proposals. The staff do not have enough information at this time to be able to develop such an interim solution. Any such solution would also likely have to focus on specific regulations, such as cost-of-service regulation. This approach was adopted in the 2009 ED but was not generally supported by respondents. Consequently, we do not support an interim standard with specified accounting requirements.

Grandfathering

22. The IASB has previously issued interim Standards, for insurance contracts and extractive activities. In those cases, the IASB did not have specific requirements for the related activities. The purpose of developing interim standards was to improve the comparability of the information being reported without causing significant disruption to current practices, pending the development of more comprehensive IFRS requirements. Those standards (IFRS 4 and IFRS 6), generally permit the reporting entities to retain their pre-IFRS accounting.

23. This 'grandfathering' approach to an interim Standard could be produced relatively quickly, without delaying the DP. Consequently, we consider that, if an interim Standard is to be developed quickly, it would need to permit grandfathering of existing recognition and measurement policies.

Should an interim Standard be developed?

24. The outreach reported on in outline in paragraphs 13-16 highlighted various factors both in support of, and against, the development of different types of interim Standard. As noted in the previous section, we consider that the only viable form of interim Standard, if one is produced, is one that permits grandfathering of existing recognition and measurement accounting policies. Consequently, the benefits and risks identified in this section refer only to that type of interim Standard.

25. In addition, we have set out a proposed timetable for the development of such an interim Standard alongside the proposed timetable for the development of the DP, to assist the IASB in reaching a decision about whether to develop an interim Standard. The timetable highlights that an interim Standard could be issued by the end of 2013. The earliest a separate IFRS addressing rate regulated activities is likely to be able to be completed is Q1 of 2016.

Benefits of issuing an interim Standard permitting grandfathering

26. Some outreach respondents noted that in countries where regulatory items are currently recognised, many large utility companies have longstanding accounting policies that are familiar to many users of financial statements in those countries.

We heard that in many jurisdictions, the accounting policies developed are based on US GAAP or on local GAAP that provides similar guidance and so is understood to allow a reasonable level of comparability. An interim Standard of the type recommended would reduce the disruption to trend information for these entities on transition to IFRS until clearer guidance is developed for issues that many agree are currently uncertain.

27. Some commentators also noted that although the case has not been made clearly for recognising regulatory assets and regulatory liabilities, neither has it been made clearly for eliminating such balances and changing existing accounting policies that are being widely applied and that are familiar to many users of financial statements in those jurisdictions that currently permit or require the recognition of rate-regulated items. An interim Standard would avoid the entities applying these policies having to make a major change to their accounting policies that might be followed by another major change once the comprehensive project is completed.

28. An interim Standard is likely to remove a major barrier to adoption of IFRS, particularly for those entities for which rate-regulated items represent a significant proportion of net assets. An interim Standard might reduce the risk of locally developed 'carve-outs' from the application of IFRS[2] or 'carve-ins' of specific guidance for rate-regulated activities guidance[3] that overlie IFRS requirements as issued by the IASB.

29. Having those entities apply IFRS would ensure that their other activities are reported in accordance with IFRS, thereby increasing comparability for those other assets and liabilities. Importantly, an interim Standard cannot reduce comparability from current levels. The current levels of comparability within a jurisdiction are retained. Whether comparability can be increased depends on

[2] For example, in Canada, entities that are SEC-registered are permitted to file US GAAP financial statements with the Canadian Securities Administrators (CSA). Other entities have been granted, on a case-by-case basis, permission from the CSA to defer transition to IFRSs until 2015 and instead file US GAAP financial statements.
In addition, , the Canadian Accounting Standards Board (AcSB) has extend the existing deferral of the mandatory IFRS changeover date for entities with qualifying rate-regulated activities by a further year to 1 January 2014.

[3] For example, in February 2012, the Indian Accounting Standards Board issued a Guidance Note to provide information on the accounting considered appropriate in India for rate-regulated activities in the context of applying Indian Accounting Standards converged with IFRS.

whether the interim Standard restricts in some way how the rate regulated activities are presented, or whether specific disclosures are required—these modifications are discussed in the next section.

Risks associated with issuing an interim Standard permitting grandfathering

30. The external pressure to identify a comprehensive solution quickly may be reduced if an interim Standard is issued.

31. Issuing an interim Standard that addresses the specific concern of a particular jurisdiction or small group of jurisdictions may be perceived as unfair treatment by other jurisdictions that have or had specific local concerns with transition to IFRS that were not similarly addressed.

32. The feedback from outreach described in paragraphs 13-16 confirmed that, in jurisdictions that are using IFRSs, regulatory assets and regulatory assets are not generally recognised and there is little diversity in practice. Consequently, permitting some entities to grandfather their existing local GAAP policies resulting in the recognition of regulatory assets and regulatory liabilities could create confusion and act as a barrier to comparison between entities in similar industries.

33. It seems that the publication of the 2009 ED, which proposed that regulatory assets and regulatory assets should be recognised when attached to activities subject to cost-of-service rate regulation, raised expectations that the IASB does in fact already accept that such items meet the definition of assets and liabilities within the Conceptual Framework. Issuing an interim Standard that permits the recognition of such items through grandfathering of existing policies may reinforce this perception and risks pre-empting the outcome of the more comprehensive project. However, this risk can be managed by making it clear that the interim Standard does not anticipate the outcome of the major project. Also, by not attempting to propose any specific scope, recognition or measurement requirements, the IASB would not be undertaking any assessment of different rate regulations.

34. Establishing the scope of any interim Standard could be difficult. The proposed scope of the 2009 ED was designed to capture activities subject to cost-of-service

rate regulation, which is intended to create a clear link between allowable costs and future chargeable rates. However, many of the comments received on the 2009 ED raised questions about the types of regulatory regimes that would be captured, and identified a number of potential differences in interpretation. Such differences could carry over into an interim Standard and so would risk allowing a greater range of activities to be grandfathered. This could introduce a greater diversity of application in practice within the IFRS environment.

Addressing some risks associated with issuing an interim Standard permitting grandfathering

35. To address some of the concerns about the risk of inconsistency and lack of comparability, an interim Standard could include presentation and disclosure requirements. Specifically, the impact of rate-regulation should be presented in separate line items within the financial statements, rather than within other items, such as related property, plant and equipment as is currently required by local GAAP in some jurisdictions. This ensures those other items are accounted for in accordance with IFRS as applied by non-rate-regulated entities. Our outreach has indicated that rate-regulated entities have the ability to separate the effect of rate regulation from property, plant and equipment.

36. In addition, entities applying an interim Standard and recognising regulatory items could be required to provide additional disclosure to help users to understand the implications of rate regulation on the entity. This would enable them to better compare the financial position, performance and cash flows of the entity with other similar entities that do not recognise regulatory items within their IFRS financial statements. The 2009 ED contained extensive disclosure requirements that could be adapted for this purpose.

37. We think an interim Standard that requires isolation of the results of grandfathering by requiring separate presentation and additional disclosure would improve comparability. Consequently, we recommend that, if the IASB wishes to develop an interim Standard, that it should develop such presentation and disclosure requirements. If the IASB decides to go ahead with the development of an interim Standard in this form, we could take a working draft to the IASB for discussion at the meeting in January 2013.

Proposed timetable

38. If the IASB decides to propose an interim Standard, the strong message from the outreach, including many of those who support the issue of some sort of interim Standard, is that the interim Standard should not delay the main project and the development of the DP.

39. The table below sets out a tentative timeline for the progress of the project, showing the development of both documents (ie the DP and an ED for an interim Standard). This incorporates the following assumptions:

    (a) the ED for the interim Standard permits grandfathering of existing recognition and measurement policies, but sets out presentation and disclosure requirements, as outlined in paragraphs 35-37;

    (b) the timetable for the DP is not shortened if an interim Standard is developed. The research required for the DP will take time to gather and analyse. This will feed into the CF project. Decisions made in that project will have an impact on the analysis required for the DP; and

    (c) decisions will be made on the contents of the DP before the comments on the interim Standard ED are received and analysed.

2013	**Interim Standard**	**Discussion Paper**
Jan	IASB decision-making session	
Feb	Begin balloting process	
Mar	Publish ED with 120-day comment period	
Apr		IASB education session
May		IASB decision-making session
June		IASB decision-making session
July	Comments back from ED	Begin balloting process
Aug		
Sept	Comments analysis to IASB and decision-making session	*Publish DP with 120-day comment period
Oct	Begin balloting process	
Nov		
Dec	**Publish interim Standard	

2014	Interim Standard	Discussion Paper
Jan		Comments back from DP
Feb		
Mar		Comments analysis to IASB
Q1 2015		#Publish ED
Q1 2016		##Issue IFRS (assumes)

* Assuming the comments from the interim Standard ED are not 'fatal' to the decisions made for the DP.

** Assuming supported by the ED comments and subsequent IASB decisions.

Assuming the IASB decides to develop a Standard.

Assuming the IASB wants, and is able to, proceed to finalise an IFRS.

Questions for the IASB

Question 2: An interim Standard
Should the IASB develop a proposal for an interim Standard?

Question 3: The form of an interim Standard (if any)
If a proposal for an interim Standard is to be developed, do you agree with the staff recommendation that it would be expected to permit grandfathering of existing recognition and measurement policies with specified presentation and disclosure requirements? If not, what form of interim Standard do you consider could be developed quickly?

Question 4: The proposed timetable
Do you have any comments on the proposed timetable(s) outlined in paragraph 39?

Appendix: Summary of advantages and disadvantages of various forms of interim Standard

The following table is copied from paragraph 31 of IFRS Advisory Council Agenda Paper 3, October 2012. Further details can be found in that paper at (http://www.ifrs.org/Meetings/MeetingDocs/Advisory%20Council/2012/October/AC1012-3.pdf):

Alternative in paragraph 27	**Advantages**	**Disadvantages**
a) Disclosure only	• Quick to develop • Improves consistency of disclosure	• Doesn't address the fundamental issue
b) IFRS 6 grandfathering of existing policies	• Quick to develop • May reduce barrier to adoption of IFRS	• Introduces diversity into IFRS practice • May unfairly disadvantage entities that eliminated regulatory assets/liabilities when making the transition to IFRSs
c) (i) grandfathering of national GAAP	• As b) above	• As b) above
c) (ii) grandfathering with isolation of impact	• Reduces the diversity introduced into IFRS by isolating the impact into a single line item	• Time and resources to develop may delay the main project • Introduces major change to accounting by first-time adopters • May unfairly disadvantage entities that eliminated regulatory assets/liabilities when making the transition to IFRSs
d) grandfathering of existing and previous policies	• Reduces unfair disadvantage for entities that eliminated regulatory assets/liabilities when making the transition to IFRSs	• Time and resources to develop could significantly delay the main project • Introduces diversity into IFRS practice • Creates confusion with reversal of previous policy change, which may be followed by another change when main project is completed
e) specified requirements	• Reduces the diversity introduced into IFRS practice	• Time and resources to develop could significantly delay the main project • May introduce major change to accounting for some first-time adopters and existing IFRS preparers, which may be followed by another change when main project is completed