

## STAFF PAPER

January 2013

## IASB Meeting

Project	Rate-regulated Activities		
Paper topic	Interim Standard: Disclosure		
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. This paper considers the disclosure requirements of the [draft] interim Standard. Overall, the staff recommend that the disclosures proposed in the Exposure Draft *Rate-regulated Activities*, issued in July 2009 (the 2009 ED), are largely retained but with the following substantive modifications:
  - (a) all entities that have activities subject to rate regulation should disclose that fact and provide a qualitative description of the nature and extent of the effect of rate regulation on those activities, either in the financial statements or in the accompanying management commentary (with a cross-reference from the financial statements);
  - (b) rate-regulated entities that do not recognise regulatory account balances need only disclose the qualitative information in paragraphs 1(a) above and 1(d) below, but more detailed qualitative and quantitative information should be disclosed when regulatory deferral account balances are recognised in the financial statements in accordance with the [draft] interim Standard;
  - (c) these more detailed disclosures may be aggregated for similar activities that are subject to similar regulation imposed by different regulators instead of being presented for each individual regulator;

- (d) for each set of rate-regulated activities that are material to the financial performance or position of the entity, the identity of the rate regulator should be disclosed;
- (e) a statement that the regulator does not permit a return on investment for a regulatory deferral account balance should be disclosed, together with the amount of the restricted balance recognised and the remaining recovery period applicable to that amount;
- (f) the rate of return or discount rate that an entity is required or permitted to adjust a regulatory deferral account for the time value of money should be disclosed, together with the amount of the related account balance and the remaining recovery period applicable to that amount;
- (g) the amount of, and reason for, any reduction in a deferral account balance resulting from an assessment that the amount is no longer recoverable should be disclosed; and
- (h) the impact of rate regulation on the amounts of current and deferred tax recognised and the related net regulatory deferral account debit and credit balances should be disclosed.

### **Background**

2. Understanding the effect of rate regulation on both the revenue-generating ability of an entity and the periods in which its rate-regulated revenues (and expenses) are recognised is an important consideration in evaluating the financial performance of entities with rate-regulated activities. Currently, there are no specific requirements within IFRS that deal with accounting for the impact of rate regulation. Similarly, there are no specific disclosure requirements.
3. As noted in previous IASB discussions about rate-regulated activities, regulatory deferral accounts are generally not recognised within those entities that present their financial statements in accordance with IFRS. However, evidence suggests that many such entities do disclose some information about the rate-regulated environment in which they operate. This disclosure is sometimes presented within the financial statements but is more commonly presented in the accompanying management commentary. Some of these entities confirm, in the

note that describes the entity's significant account policies or elsewhere, that regulatory deferral account balances are not recognised in the financial statements.

4. Paragraphs 24-30 of the 2009 ED set out proposed disclosure requirements which, as explained in paragraphs BC59-60 of the Basis for Conclusions, largely mirrored the disclosures that entities already provide in accordance with US GAAP or similar requirements in other jurisdictions in which regulatory deferral account balances are recognised in the financial statements. However, the 2009 ED proposed that these disclosures should be brought together in tabular format (unless another format is considered more appropriate). This disclosure in a single location was considered more useful for helping users to understand how the entity's reported financial results and position have been affected by rate regulation.
5. Most respondents agreed with the general content of the proposals. However, many noted that the proposal to give the disclosures for each set of operating activities that was subject to a different regulator was impractical or onerous. Several respondent preparers noted that they aggregate similar activities that are subject similar regulation imposed by different regulators. Even many of the smaller respondent preparer entities noted they are subject to four or five different regulators and that this disclosure burden would be onerous.
6. In addition, many respondents noted that the proposal in paragraph 26(d)(ii) of the 2009 ED to disclose the entity's assessment of the expected future regulatory action could be prejudicial if presented for individual regulators.

### ***Staff recommendation***

7. We think that the disclosures proposed in the 2009 ED provide a useful basis for the disclosures that should be proposed in the [draft] interim Standard. However, we agree with the concerns noted in paragraphs 5-6 above. Consequently, we recommend that the disclosures proposed in the 2009 ED are largely retained, but that aggregating the disclosures should be allowed for similar activities that are subject to similar regulation imposed by different regulators instead of being presented for each individual regulator.

8. We also recommend some modifications and additions to the 2009 ED proposals to reflect the different accounting treatment proposals in the [draft] interim Standard compared to those in the 2009 ED.

*Disclosure objective*

9. The 2009 ED proposed the following disclosure objective:

**24 An entity shall disclose information that:**

- (a) enables users of the financial statements to understand the nature and the financial effects of rate regulation on its activities; and**
- (b) identifies and explains the amounts of regulatory assets and regulatory liabilities<sup>1</sup>, and related income and expenses, recognised in its financial statements.**

10. We think that this objective is still valid and so recommend that it is retained in the [draft] interim Standard.

*Disclosure of nature and extent of rate regulation*

11. We understand that the IASB tentatively decided to develop the [draft] interim Standard for rate-regulated activities to reduce a barrier to adoption of IFRS in jurisdictions that currently recognise regulatory deferral account balances in accordance with local GAAP. An interim Standard that permits grandfathering of existing recognition and measurement accounting policies would avoid these entities having to make a major change to their accounting policies that might be followed by another major change once the comprehensive *Rate-regulated Activities* project is completed.
12. Similarly, we want to avoid introducing changes for those entities that currently do not recognise regulatory deferral accounts in accordance with IFRS. However, we think that it will be helpful for users to be aware of the nature and the financial effects of rate regulation on the activities of these entities. We therefore recommend that all entities that have activities subject to rate regulation should

---

<sup>1</sup> Regulatory deferral account balances are often referred to as “regulatory assets and regulatory liabilities”.

disclose that fact and provide a qualitative description of the nature and extent of the effect of rate regulation on those activities.

13. We observe that such disclosure is often provided in the management commentary reports accompanying the financial statements of some entities. We therefore recommend that these disclosures should be permitted to be disclosed in the financial statements, either directly or by cross-reference to the management commentary disclosures.

*Disclosure of amounts recognised in the financial statements*

14. As noted in paragraph 7 above, we recommend that the disclosures proposed in the 2009 ED are largely retained, with some modifications. We recommend that the proposal to provide the detailed disclosures should be limited to those entities that recognise regulatory deferral accounts in the financial statements to avoid imposing an additional burden on existing IFRS preparers, as noted in paragraph 12. Consequently, those entities that currently do not recognise such amounts, and that would continue with this policy in accordance with the [draft] interim Standard, will only need to provide the qualitative disclosures described in paragraph 12 above.
15. The disclosures proposed in the 2009 ED are reproduced in the Appendix to this paper, together with a summary of recommended modifications. Most of these proposed amendments are minor or result from the changes to the proposals for the [draft] interim Standard compared to the proposals of the 2009 ED and so are not discussed further here. Proposals for a substantive change and for some additional disclosures are discussed in the paragraphs below.

*Aggregation*

16. Paragraphs 26-27 of the 2009 ED proposed detailed disclosures for each set or category of operating activities that is subject to a different regulator. As noted in paragraph 5, many respondents to that ED noted that this was impractical or onerous. Several respondent preparers noted that they aggregate, in accordance with their current local GAAP, similar activities that are subject similar regulation imposed by different regulators. We agree with these respondents and recommend that the disclosures proposed should be allowed to be aggregated instead of being presented for each individual regulator.

17. The ability to aggregate disclosures will also address the concern noted in paragraph 6 that disclosure of the entity's expectations of future regulatory actions may, in some cases, be prejudicial if clearly identifiable as relating to an individual regulator.

*Additional disclosure: identity of rate regulator*

18. The 2009 ED did not propose that the reporting entity should disclose the identity of the rate regulator that governs the regulation to which the activities are subject. This information is commonly provided (either voluntarily or because of local GAAP requirements). We consider that this is useful for users of financial statements of all rate-regulated entities, because it will often enable users to obtain more detailed information about the rate regulation to which the entity's activities are subject. We therefore recommend that, for each set of rate-regulated activities that are material to the financial performance or position of the entity, the identity of the rate regulator should be disclosed.

*Additional disclosure: no return on investment*

19. Rate regulation within the proposed scope of the [draft] interim Standard can take many forms but one of its main objectives is to regulate the price (the rate) that an entity is permitted to charge customers for its goods and services. This is usually done through a mechanism that establishes a rate or revenue level that is designed to recover the entity's "allowable costs"<sup>2</sup> and also to restrict the return that the entity can earn. Sometimes, the rate regulation prohibits the rate-regulated entity from earning, through the regulated rate, any return on investment for specified allowable costs. This fact is usually required to be disclosed in jurisdictions that require or permit entities to recognise regulatory deferral account balances in accordance with their local GAAP.
20. We recommend that an entity subject to such a restriction should make a statement to that effect and disclose the amount of the regulatory deferral account balance recognised in the statement of financial position and the remaining recovery period applicable to that amount.

---

<sup>2</sup> Allowable costs are those costs for which the regulated rate is intended to provide recovery. Such costs are normally defined within the rate regulation or by the rate regulator.

21. In addition, we recommend that the rate of return or discount rate that an entity is required or permitted to adjust a regulatory deferral account for the time value of money should be disclosed, together with the amount of the related account balance and the remaining recovery period applicable to that amount.
22. We think that this is useful information to supplement the proposed disclosure of the approval process for the regulated rate and how that affects the underlying operating activities (paragraph 26(b) of the 2009 ED—see the Appendix to this agenda paper).

*Additional disclosure: impairment/recoverability*

23. Paragraph 28 of the 2009 ED cross-referred to the disclosures required by IAS 36 *Impairment of Assets*. The 2009 ED proposed impairment requirements that incorporated the regulatory deferral account balances into the related cash-generating unit (CGU) and that would then be linked into the impairment measurement and loss allocation requirements of IAS 36. Agenda Paper 5B contains a staff recommendation that the 2009 ED impairment proposals should not be retained in the [draft] interim Standard and, therefore, the associated disclosure cross-reference ceases to be relevant.
24. Instead, the staff recommend alternative proposals, namely that the entity should assess any regulatory deferral account balances for recoverability and reduce any such balance for amounts not considered recoverable (see Agenda Paper 5B paragraphs 29-36). We therefore recommend that the [draft] interim Standard should propose that the amount of, and reason for, any reduction in a deferral account balance resulting from an assessment that the amount is no longer recoverable should be disclosed.

*Additional disclosure: income taxes*

25. Regulatory accounting requirements may affect the amount and timing of a regulated entity's income tax payments. In some rate regulatory regimes, an entity may be able to recover some income tax costs through the rate-setting mechanism in the same way as other allowable costs. Consequently, a regulatory deferral account balance may arise when a deferred tax asset or liability is recognised. This regulatory balance may then create a further temporary difference for which deferred tax is recognised. Many respondents to the

2009 ED noted that, for some rate-regulated entities, the income tax effects are significant.

26. Consequently, we recommend that an entity should disclose the impact of rate regulation on the amounts of current and deferred tax recognised and should separately identify the net regulatory deferral account debit and credit balances.

## Questions for the IASB

### Questions: disclosure

1. Do you agree with the staff recommendation that the disclosures proposed in the 2009 ED are a useful starting point and should largely be retained (see Appendix A)? If not, what alternatives do you suggest?
2. Do you agree with the staff recommendation that all entities that have activities subject to rate regulation should disclose that fact and provide a qualitative description of the nature and extent of the effect of rate regulation on those activities, either in the financial statements or in the accompanying management commentary (with a cross-reference from the financial statements)? If not, what alternatives do you suggest?
3. Do you agree with the staff recommendation that rate-regulated entities that do not recognise regulatory account balances need only disclose the qualitative information in question 2 above, but more detailed qualitative and quantitative information should be disclosed when regulatory deferral account balances are recognised in the financial statements in accordance with the [draft] interim Standard? If not, what alternatives do you suggest?
4. Do you agree with the staff recommendation that these more detailed disclosures should be allowed to be aggregated for similar activities that are subject similar regulation imposed by different regulators instead of being presented for each individual regulator? If not, what alternatives do you suggest?
5. Do you agree with the staff recommendation that the following additional disclosures should be given? If not, what alternatives do you suggest?
  - (a) for each set of rate-regulated activities that are material to the financial performance or position of the entity, the identity of the rate regulator should be disclosed;



- (b) a statement that the regulator does not permit a return on investment for a regulatory deferral account balance should be disclosed, together with the amount of the restricted balance recognised and the remaining recovery period applicable to that amount;
- (c) the rate or return or discount rate (or range of rates) applied to any regulatory deferral account debit and credit balance;
- (d) the amount of, and reason for, any reduction in a deferral account balance resulting from an assessment that the amount is no longer recoverable should be disclosed; and
- (e) the net regulatory deferral account debit and credit balances, and the impact of rate regulation on the amounts of current and deferred tax recognised?

**Appendix: Disclosure proposals contained in the Exposure Draft  
Rate-regulated Activities, issued in July 2009 (the 2009 ED)**

27. The following table reproduces the disclosure proposals in the 2009 ED, together with suggested modifications recommended for the [draft] interim Standard.

Disclosures (as proposed in the 2009 ED)	Suggested action
<p><b>24 An entity shall disclose information that:</b></p> <p><b>(a) enables users of the financial statements to understand the nature and the financial effects of rate regulation on its activities; and</b></p> <p><b>(b) identifies and explains the amounts of regulatory assets and regulatory liabilities, and related income and expenses, recognised in its financial statements.</b></p>	<p>Retain in the [draft] interim Standard (see paragraphs 9-10 of the agenda paper).</p>
<p>25 An entity shall disclose the fact that some or all of its operating activities are subject to rate regulation, including a description of their nature and extent.</p>	<p>Retain in the [draft] interim Standard. Allow the narrative disclosure to be presented in the management commentary (with a cross-reference from the financial statements). Require an explicit statement in the financial statements that regulatory deferral account balances (RDABs) are not recognised when applicable (this should be located in the accounting policies note) (see paragraphs 11-13 of the agenda paper).</p>

<b>Disclosures</b> (as proposed in the 2009 ED)	<b>Suggested action</b>
<p>26 For each set of operating activities subject to a different regulator, an entity shall disclose the following information:</p>	<p>The detailed disclosures in paragraphs 26(b)-(e) should only be required by those rate-regulated entities that recognise RDABs in financial statements (see paragraph 14 of the agenda paper).</p> <p>In addition, allow aggregation (see paragraphs 16-17 of the agenda paper)</p>
<p>(a) if the regulator is a related party (as defined in IAS 24 <i>Related Party Disclosures</i>), a statement to that effect, together with an explanation of why the regulator is related to the entity.</p>	<p>Propose that this is extended to require disclosure of the identity of the regulator in all cases (see paragraph 18 of the agenda paper).</p>
<p>(b) an explanation of the approval process for the rate subject to regulation (including the rate of return), including information about how that process affects both the underlying operating activities and the specified rate of return.</p>	<p>The wording is focused on cost-of-service type regulation.</p> <p>Suggest changing the wording to encompass other types of rate regulation within the revised scope of the [draft] interim Standard.</p>

<b>Disclosures</b> (as proposed in the 2009 ED)	<b>Suggested action</b>
(c) the indicators that management considered in concluding that such operating activities are within the scope of this [draft] IFRS, if that conclusion requires significant judgement.	Delete this paragraph. This was more relevant for the 2009 ED, for which the identification of activities within the scope for complex and subject to a high degree of judgement. The [draft] interim Standard scope should require less judgement. If there are cases that require significant judgement, this disclosure note is already covered by IAS 1 <i>Presentation of Financial Statements</i> .
(d) significant assumptions used to measure the expected present value of a recognised regulatory asset or regulatory liability including:	Delete – not applicable because it related to the 2009 ED proposal to measure RDABs at expected present value. However, relocate the subsidiary points (i) and (ii) under item 26(e) instead.
(i) the supporting regulatory action, for example, the issue of a formal approval for costs to be recovered pending a final ruling at a later date and that date, when known, or	Retain because it provides useful information about certainty and timing of recovery.
(ii) the entity’s assessment of the expected future regulatory actions.	Retain – see paragraphs 6 and 16-17 of the agenda paper.
(e) the risks and uncertainties affecting the future recovery of the regulatory asset or final settlement of the regulatory liability, including the expected timing.	Retain because it is useful information for both certainty and timing of recovery.

<b>Disclosures</b> (as proposed in the 2009 ED)	<b>Suggested action</b>
27 An entity shall disclose the following information for each category of regulatory asset or regulatory liability recognised that is subject to a different regulator:	Allow aggregation by type of regulation (see paragraphs 16-17 of the agenda paper).  (Note: by category, we mean each type of deferred cost, such as storm damage costs, IFRS transition costs, indirect overheads, etc.)

<b>Disclosures</b> (as proposed in the 2009 ED)	<b>Suggested action</b>
<p>(a) a reconciliation from the beginning to the end of the period, in tabular format unless another format is more appropriate, of the carrying amount in the statement of financial position of the regulatory asset or regulatory liability, including at least the following elements:</p> <p>(i) the amount recognised in the statement of comprehensive income relating to balances from prior periods collected or refunded in the current period.</p> <p>(ii) the amount of costs incurred in the current period that were recognised in the statement of financial position as regulatory assets or regulatory liabilities to be recovered or refunded in future periods.</p> <p>(iii) other amounts that affected the regulatory asset or regulatory liability, such as items acquired or assumed in business combinations or the effects of changes in foreign exchange rates, discount rates or estimated cash flows. If a single cause has a significant effect on the regulatory asset or regulatory liability, the entity shall disclose it separately.</p>	<p>Retain because this provides useful information about timing and (together with other disclosures) certainty of recovery.</p>
<p>(b) the remaining period over which the entity expects to recover the carrying amount of the regulatory asset or to settle the regulatory liability.</p>	<p>Retain because it provides useful information about timing, and indirectly, recovery of the RDABs.</p>

<b>Disclosures</b> (as proposed in the 2009 ED)	<b>Suggested action</b>
<p>(c) the amount of financing cost included in the cost of self-constructed property, plant and equipment and internally developed intangible assets in the current period in accordance with paragraph 16 that would not have been capitalised in accordance with IAS 23.</p>	<p>This reflected the proposal in the 2009 ED to allow relevant RDABs to be presented within the carrying value of items of property, plant and equipment and intangible assets. Consequently, this can be deleted if the IASB accept the proposal to isolate RDABs as separate line items, as recommended in Agenda Paper 5C.</p>
<p>28 When an entity recognises an impairment loss in accordance with paragraph 20, it shall provide the disclosures required by IAS 36.</p>	<p>This can be deleted if the IASB accept the proposal to in Agenda Paper 5B to amend the impairment/recoverability proposals in the [draft] interim Standard. This would then be replaced by the disclosure discussed in paragraph 24 of this agenda paper.</p>
<p>29 When an entity derecognises regulatory assets and regulatory liabilities in accordance with paragraph 21 because the related operating activities fail to meet the criteria in paragraph 3, it shall disclose a statement to that effect, the reasons for the conclusion that the criteria in paragraph 3 are not met, a description of the operating activities affected and the amount of regulatory assets and regulatory liabilities derecognised.</p>	<p>Retain because derecognition is a major event that should not occur frequently so this disclosure is important.</p>

<b>Disclosures</b> (as proposed in the 2009 ED)	<b>Suggested action</b>
30 If the disclosures required by paragraphs 25-29 of this [draft] IFRS do not meet the objectives set out in paragraph 24, the entity shall disclose whatever additional information is necessary to meet those objectives.	Retain because it is a useful catch-all reminder to preparers to use judgement to provide users with sufficient information to understand the impact of rate regulation on the financial statements.