

STAFF PAPER

26 July 2013

Rate-regulated Activities Consultative Group

Project	Rate Regulation		
Paper topic	Summary of the meeting		
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Purpose of this paper

- The purpose of this paper is to provide a high level summary of the issues discussed at the first meeting of the IASB's Rate-regulated Activities Consultative Group. The meeting was held in public at the IASB's offices on Friday 26 July 2013. A recording of the meeting is available on the IFRS website at <http://www.ifrs.org/Meetings/Pages/RRA-Consultative-Group-July-13.aspx>.
- The following people participated in the meeting:

Participant	Organisation	Country
Patricia McConnell (Chair)	IASB member	
Amaro Gomes	IASB member	
Prabhakar Kalavacherla	IASB member	
Mary Tokar	IASB member	
Alan Teixeira	IASB Senior Director, Technical Activities	
Michael Stewart	IASB Director of Implementation Activities	
Jane Pike	IASB Rate-regulated Activities project manager	
Natasha Dara	IASB staff (observer)	
Lily Ayalon	Government Companies Authority	Israel
Jacob Buys	Eskom Holdings SOC Ltd	South Africa

Bryan Craig	US Federal Energy Regulatory Commission	USA
Duane DesParte	Exelon Corporation	USA
Leonardo George de Magalhães	Companhia Energética de Minas Gerais	Brazil
Dennis Deutmeyer	Ernst & Young	UK/Global
Casey Herman (for Michael Timar)	PricewaterhouseCoopers	USA/Global
Jesús Herranz Lumbreras	Ferrovial SA	Spain
Bill Hicks	European Financial Reporting Advisory Group	UK/Europe
Keyman Kim	Korea Gas Corporation	Korea
John Leotta (by video/phone)	Deloitte Touche Tohmatsu	Australia/Global
Richard McCabe	AltaLink Management Ltd	Canada
Pascale Mourvillier	GDF SUEZ	France
Tim Murray	RBC Capital Markets, Royal Bank of Canada	Canada
Sherman Myers (by phone)	Standard & Poor's	USA
Michel Picard	KPMG	Canada/Global
Poon Man Wah	CLP Power Hong Kong Limited	Hong Kong
Karen Taylor (by video)	Ontario Securities Commission	Canada

Introductory session

3. In the opening session, Patricia McConnell welcomed everyone to the meeting. Ms McConnell noted that Agenda Papers 1-2 had been provided for background information. These papers were not discussed.

Interactions with other projects and IFRSs

4. Mary Tokar introduced Agenda Paper 3 *Interactions with other projects and IFRSs* (and some slides that supplement that paper). She noted that the main interaction to highlight was with the IASB's Conceptual Framework project. The Discussion Paper *A Review of the Conceptual Framework for Financial Reporting* (the *Conceptual Framework DP*)¹ was published on 18 July 2013. The deadline for comments is 14 January 2014.
5. The discussion in the previous Rate-regulated Activities project was focused on the definitions of assets and liabilities in the existing *Conceptual Framework*. The main focus of the IASB's discussions about these definitions in the Conceptual Framework project has been on the definition of liabilities. The intention is to try to make the definition of assets as symmetrical as possible with this. The main change discussed is to remove the probability of outflows or inflows of future economic benefits from the recognition threshold. Instead, this probability assessment would become a measurement issue.
6. The *Conceptual Framework DP* explains that any new Standards issued after the completion of the Conceptual Framework project would be consistent with the new *Conceptual Framework*. However, if the IASB decides, when developing a new Standard, that an exception from the *Conceptual Framework* is justified, then it would explain its reasons for such an exception in the Basis for Conclusions for that new Standard.

Summary of RFI responses

7. In March 2013, the IASB published the Request for Information (RFI) *Rate Regulation* (the RFI). The objective of the RFI was to gather high level overviews of the types of rate regulation that are currently in force in order to provide factual evidence and examples that will be used to help to determine the scope of a Discussion Paper.

¹ The *Conceptual Framework DP* is available to download from the IFRS website at <http://www.ifrs.org/Current-Projects/IASB-Projects/Conceptual-Framework/Discussion-Paper-July-2013/Pages/Discussion-Paper-and-Comment-letters.aspx>.

8. Jane Pike introduced *Agenda Paper 4 Summary of RFI responses* and highlighted the main findings. The Consultative Group then discussed these to clarify various issues. This provided more background for the later discussions on the scope of the project (see paragraphs 12-13 of this paper).
9. Members of the Consultative Group observed that rate-regulatory objectives go beyond price restrictions, generally because of the public service nature of the rate-regulated activities. These objectives impose different obligations on rate-regulated entities and entitle them to different rights to those that exist in competitive markets.
10. The two main types of rate regulation are described as cost-of-service and incentive-based. All of the schemes described in the RFI responses included some elements of both types. Consequently, members of the Consultative Group suggested that defining the scope of the project needed to focus more on specific features of the rate regulation, such as:
 - (a) the public service or essential goods nature of the industries described in the RFI responses;
 - (b) the lack of choice of supplier available to customers for the service or goods and the monopoly right to provide the service or goods, granted or supported by the rate regulation;
 - (c) the type or level of infrastructure needed and whether it could be redeployed or substituted;
 - (d) the inability of customers to negotiate the price;
 - (e) the inability of the supplier to modify the price without approval by the rate regulator;
 - (f) the distinction between ‘market regulation’ (such as a price-cap that applies to all suppliers in a competitive market) and ‘rate regulation’ (that is, restrictions on prices to be charged by a specific (and usually monopolistic) supplier of goods or services);
 - (g) the authority of the rate regulator, and how it is supported by statute;
 - (h) rate-setting mechanisms and processes for recovering costs;

- (i) how rate regulation changes the pattern of the suppliers' cash flows;
- (j) impacts of demand/volume risk and which party (eg the government, the customers or the regulated entity) bears demand risk;
- (k) level of assurance of recovery provided by the rate regulation (that is, the certainty of future cash flows); and
- (l) the ability to borrow against 'regulatory' accounts.

What do users need?

11. The Consultative Group members discussed what information is considered necessary for users to understand the rate regulation and how it affects the reporting entity. The main messages heard were:
- (a) users are looking primarily for transparency of information about the amounts, timing and certainty of future cash flows;
 - (b) rate regulation is usually designed to smooth out the impact of volatility for the customers, which influences the timing and pattern of cash flows for the supplier;
 - (c) a major objective of rate regulation is to ensure that the supplier is allowed to recover its costs and, in most cases, to earn a fair or reasonable return on its investment. The allowed rate of return is usually fairly stable and not subject to much volatility. It is important for users to be able to understand the rate-regulatory environment and to be able to reconcile the earnings reported in financial statements to the 'stabilised' earnings achieved through the rate regulation;
 - (d) as well as quantitative information based on amounts recognised in financial statements, users (particularly credit analysts) rely heavily on qualitative information about the strength of the rate regulation, the relationship between the rate regulator and the entity, and the track record of the entity in recovering costs and earning the return allowed by the rate regulation;

- (e) both credit-analysts and equity analysts will use rate filings (if available) to obtain regulatory information that they consider is necessary to supplement the financial statements information; and
- (f) some entities provide additional information within their management commentary or the segmental information note in the financial statements. For IFRS preparers, this sometimes involves the extensive use of non-GAAP measures and disclosures in the financial statements, including ‘proforma’ statements of income and financial position that include regulatory balances.

Scope issues

12. Agenda Papers 6-6E outline some scope issues identified from the responses to the RFI and from the comment letters previously received on the 2009 ED. The Consultative Group members discussed these and other issues identified in the earlier session that considered the RFI responses (see paragraph 7-10). In particular, the Group discussed:
- (a) the importance of the ‘essential’ nature of the service and of a ‘captive’ customer base;
 - (b) the monopoly status of the supplier and restrictions on customer choice;
 - (c) the mechanisms to recover costs, the reliability of those mechanisms and the interaction between the entity and the rate regulator;
 - (d) the role of variance/deferral/tracker accounts within the rate-regulatory mechanisms and a ‘true-up’ process;
 - (e) the link between cost and the rate set, and the interaction of other elements of the rate, such as incentive bonuses that are provided in return for meeting specific targets (whether environmental, operational or financial) that are independent of the cost to achieve those targets;
 - (f) the certainty of future cash flows and the impact of demand risk;
 - (g) the source of the rate regulators’ authority and importance of statutory support;

- (h) the role of the rate regulator in approving prices that bind supplier and customers;
 - (i) the ability of the entity to discount prices below the approved rate; and
 - (j) the impact of the rate regulation on the timing of cash flows.
13. The Group also considered the potential interaction between the rate regulation and the arrangements within the scope of IFRIC 12 *Service Concession Arrangements*. The focus of the discussion was on concession arrangements that use the intangible asset model in IFRIC 12, the impact of demand risk and whether the scope of rate regulation being considered in this project would also capture arrangements within the scope of IFRIC 12.

Next steps

14. The IASB staff will consider the information discussed to develop proposals for the Discussion Paper. The IASB will begin to consider those proposals during the next IASB meeting, which will be held in September 2013.
15. The staff will seek further input from the Consultative Group as the project progresses.