

International Financial Reporting Standards

Rate-regulated Activities Consultative Group meeting, 26 July 2013
Agenda paper 2B

Rate-regulated Activities

28 June 2013

The views expressed in this presentation are those of the presenter, not necessarily those of the IASB or IFRS Foundation.

- Background
- The previous IASB Rate-regulated Activities project
- The new IASB Rate-regulated Activities project
 - Overview
 - Interim proposals - ED *Regulatory Deferral Accounts*
 - Main project – Discussion Paper
 - Request for Information: *Rate Regulation*
- Next steps
- Q&A

Rate-regulated Activities - Background (1)

- Rate regulation is a restriction in the setting of prices that can be charged to customers for (usually essential) goods or services
- Objectives of the rate regulator usually involve
 - setting ‘just and reasonable rates’ for consumers;
 - ensuring the financial viability of suppliers; and
 - protecting the availability and stability of supply
- Rate regulation usually requires suppliers to increase the selling price (rate) to recover ‘allowable’ costs, or lower the rate to eliminate ‘excess’ profits
- Rate changes usually apply prospectively and are often designed to ‘smooth’ the impact of rate changes over time

Rate-regulated Activities - Background (2)

Some national GAAPs permit or require regulatory balances to be recognised in financial statements – either as separate ‘**regulatory assets**’ or ‘**regulatory liabilities**’, or as part of another asset or liability balance (eg part of the cost of property, plant and equipment)

Regulatory debit balances represent deferred ‘allowable’ costs (the rate regulation gives the entity the right to increase future rates)

Regulatory credit balances generally represent deferred ‘excess’ profits (the rate regulation requires the entity to reduce future rates)

No specific guidance in IFRS

Requests for guidance

Historically, calls came from Europe for guidance

Desire to use US GAAP to recognise regulatory balances

IFRS Interpretations Committee decided US guidance was not fully consistent with IFRS *Conceptual Framework* and other Standards

Predominant practice = regulatory balances not recognised in IFRS financial statements

Later, more calls came for clear guidance and greater convergence with US GAAP

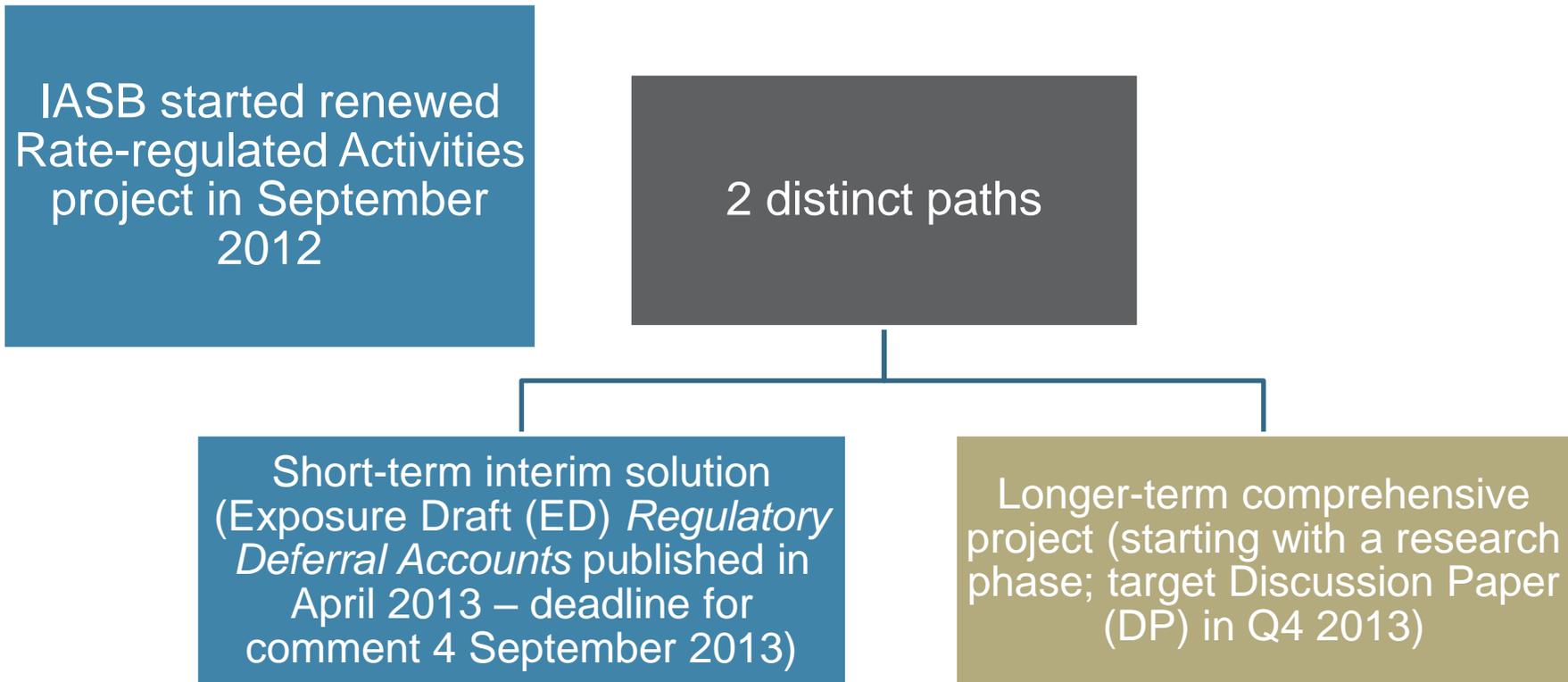
Project added to IASB Agenda in Dec 2008

Exposure Draft *Rate-regulated Activities* published in July 2009 (the 2009 ED)

Earlier Rate-regulated Activities project

- 2009 ED proposed that regulatory balances should be recognised as assets and liabilities for certain (cost-of-service) types of rate regulation
 - Responses split evenly between:
 - Support in principle for recognition (mainly those that already recognise, eg USA, Canada, Brazil and India) but disagreement with proposed present value measurement
 - Opposition in principle from others (on grounds that regulatory balances do not meet the IFRS definitions of assets/liabilities)
- IASB could not reach consensus on fundamental issues so suspended the project in September 2010
- Responses to 2011 Agenda Consultation recommended restarting the project to try to find a solution

The new Rate-regulated Activities project



Interim solution: ED Regulatory Deferral Accounts

Interim solution
proposes:

- to permit first-time adopters of IFRS to continue to recognise regulatory balances in accordance with their existing local GAAP (recognition and measurement)
- to require the impact of recognising regulatory balances to be isolated in order to allow direct comparison with rate-regulated entities that do not recognise regulatory balances (presentation and disclosure)

How will the proposals affect IFRS financial statements (1)

No impact on existing IFRS financial statements



No impact on cash flows



Isolated impact of recognising regulatory balances in the financial statements:

2 line items in the balance sheet:

- Regulatory debit balances – after total assets
- Regulatory credit balances – after total liabilities

1 line item in profit or loss – after profit before tax

How will the proposals affect IFRS financial statements (2)

If finalised, the Standard will lower a significant barrier to the adoption of IFRS for many entities

- will allow users to compare a greater number of rate-regulated entities across a wider range of countries
- limited scope (only first-time adopters that already recognise regulatory balances) will introduce some inconsistency in IFRS financial statements

Isolation of regulatory balances should improve comparability:

- should improve transparency of reported regulatory impact
 - regulatory amounts will no longer be incorporated within other line items in balance sheet or income statement
 - all other line items presented in accordance with IFRS

More research is needed on the nature of different types of rate regulation

- Request for Information-*Rate Regulation* (issued in March 2013 – deadline for responses 30 May 2013)

Responses will feed into the DP:

- what information about the effects of rate regulation are most useful to users
- does rate regulation create assets/liabilities (link to restarted Conceptual Framework project)

- Fact-finding document
 - What are the main objectives of rate regulation?
 - How does the rate-setting mechanism reflect these objectives?
 - What rights and obligations are created?
 - How are rights enforced and obligations settled?
- >70 responses, providing information from >25 countries and 8 broad industry types*

*responses received by 11 June 2013

Objectives of rate regulation

Substitute for competition

Main objectives	Other objectives
<ul style="list-style-type: none">• ‘just and reasonable rates’<ul style="list-style-type: none">• low prices for consumers• reasonable rate of return for suppliers/investors	<ul style="list-style-type: none">• availability/reliability of supply• service quality• environmental protection• encourage competition
<ul style="list-style-type: none">• reducing price volatility for consumers	

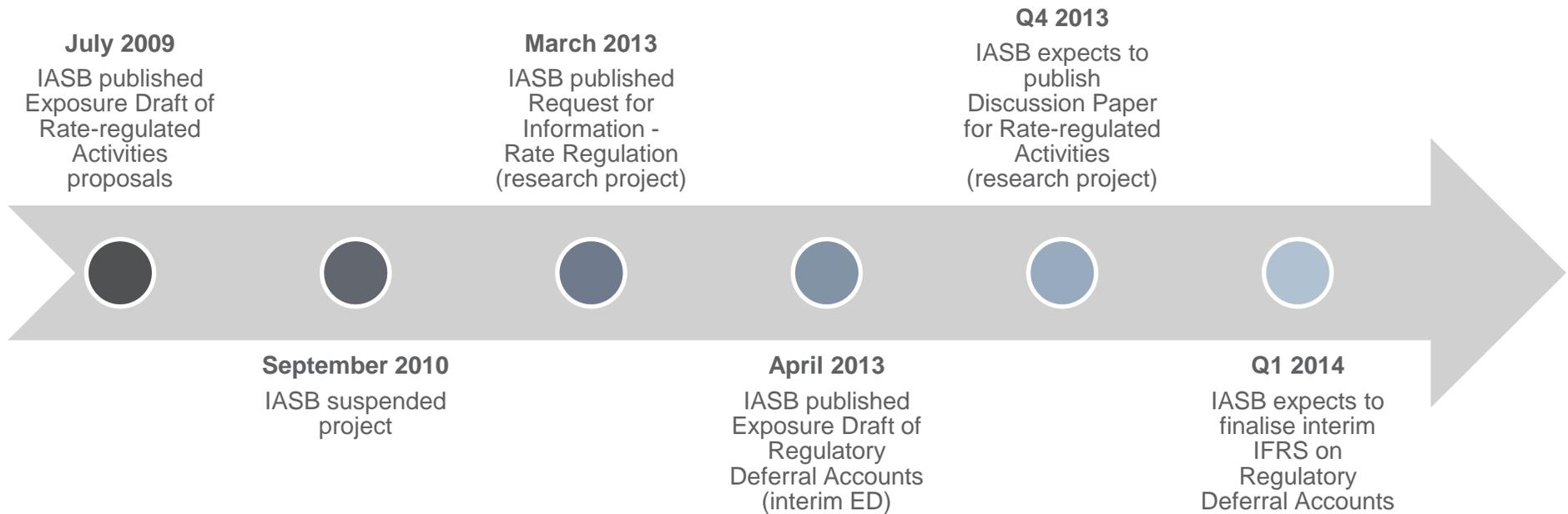
Price-setting mechanisms



We will need input from interested parties at various stages, including:

- reaction to the interim solution ED
 - will it achieve greater comparability and transparency?
 - will the information to be presented and disclosed be understandable and useful?
- input to the research for the DP
 - what are the common features of rate regulation?
- reaction to the DP
 - what information about the effects of rate regulation is most useful?

Rate-regulated activities project timeline



Where to go for more information

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- Rate-regulated Activities project page on the IFRS website
 - <http://www.ifrs.org/Current-Projects/IASB-Projects/Rate-regulated-activities/Pages/Rate-regulated-activities-oct.aspx>

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Thank you

