

STAFF PAPER

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Rate-regulated Activities Consultative Group

Project	Rate Regulation
Paper topic	What do users need?
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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*.

Purpose of the paper

1. The purpose of this paper is to seek input on user needs and on the strengths and weaknesses of existing accounting methods and disclosure requirements for rate-regulated activities.
2. We are not asking Consultative Group members to make decisions on what information should or should not be included in general purpose financial statements. We are trying to identify what information might be most useful to the maximum number of users. Later in the project, we will then explore how that information could best be presented, either in general purpose financial statements or in other ways, for example through the management commentary or other communication routes.

Background

3. The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit.¹

¹ *Conceptual Framework* paragraph OB2

4. Many existing and potential investors, lenders and other creditors cannot require reporting entities to provide information directly to them and must rely on general purpose financial reports for much of the financial information they need. Consequently, they are the primary users to whom general purpose financial reports are directed.²
5. So far, the IASB has received limited information from primary users about what information would best serve their needs when making decisions about providing resources to rate-regulated entities. Anecdotal evidence suggests that support for the recognition of regulatory variance or deferral account balances in financial statements is stronger among those primary users that are familiar with their recognition (for example, those users who are familiar with financial statements prepared in accordance with US GAAP). Conversely, support for the recognition of such balances is weaker among those primary users that are not familiar with their recognition. This outcome is unsurprising.
6. The IASB acknowledge that other parties, such as regulators and members of the public other than investors, lenders and other creditors, may also find general purpose financial reports useful. Some of the rate regulators who responded to the Exposure Draft *Rate-regulated Activities*, published in July 2009 (the 2009 ED) and/or the Request for Information *Rate Regulation*, published in March 2013 (the RFI) noted that they use the published general purpose financial statements of entities that they regulate. Those rate regulators commented that such financial statements provide a valuable source of information for regulatory purposes. However, those reports are not primarily directed to these other groups.³
7. At this time, we are interested in investigating what information is useful to both primary users and other users. It is, however, important for us to be able to distinguish the needs of the distinct user groups.

² *Conceptual Framework* paragraph OB5

³ *Conceptual Framework* paragraph OB10

What information is useful to primary users

8. We will ask analyst members of the Consultative Group to provide some background on what information they use, how they use it, and where they obtain that information.
9. We will also ask regulator members to provide some background on what information in the general purpose financial statement they find most useful for regulatory purposes. We would also like to know what other information regulators require and how they obtain that additional information.
10. We will then open up the discussion to all members of the group.

Presentation and disclosure proposals in the 2013 ED

11. The Exposure Draft *Regulatory Deferral Accounts*, published in April 2013 (the 2013 ED), proposes that rate-regulated entities within its scope can recognise regulatory variance and deferral account balances in the statement of financial position. In order to highlight the impact of these proposals, the ED proposes to require separate presentation of the amounts recognised in both the statement of financial position and in the statement(s) of profit or loss and other comprehensive income.
12. In addition, the 2013 ED proposes the disclosure of both qualitative and quantitative information about the rate regulation to which the entity is subject. The Appendix to this paper reproduces the presentation and disclosure proposals contained in the 2013 ED.
13. The 2013 ED is open for comment until 4 September 2013. Consequently, we are not seeking formal comments at this time as to whether Consultative Group members agree or disagree with the proposals. Nor are we seeking to debate the merits of the proposals. The extract from the 2013 ED is provided only for information and to encourage discussion about information needs more generally.

Questions for the Consultative group

User needs

Consultative Group members are asked to consider the following questions:

- (a) What are the main needs of users of a rate-regulated entity's general purpose financial statements?
- (b) Do different types of user (for example, investors, consumers, rating agencies, supervisors/regulators) have the same needs?
- (c) What are the main strengths and weaknesses of existing accounting methods and disclosure requirements for rate-regulated activities in terms of their ability to meet the needs of the primary users of financial statements?

Appendix: Extract from Exposure Draft *Regulatory Deferral Accounts*

- A1. The following extract reproduces the presentation and disclosure proposals contained in paragraphs 18-33 of Exposure Draft *Regulatory Deferral Accounts*, published in April 2013 (the 2013 ED).⁴

Presentation

Changes in presentation

- 18 This [draft] interim Standard introduces presentation requirements, outlined in paragraphs 19–21, for regulatory deferral account balances that are recognised in accordance with paragraphs 14–15. As stated in paragraph 6, regulatory deferral account balances are the incremental amounts that are recognised in addition to the assets and liabilities that are recognised in accordance with other Standards. These presentation requirements separate the impact of recognising regulatory deferral account balances from the financial reporting requirements of other Standards.
- 19 In addition to the items that are required to be presented in the statement of financial position and in the statement of profit or loss and other comprehensive income in accordance with IAS 1 *Presentation of Financial Statements*, an entity applying this [draft] interim Standard shall present all regulatory deferral account balances and the movements in those balances in accordance with paragraphs 20–21.

Classification of regulatory deferral account balances

- 20 **An entity shall present separate line items in the statement of financial position for:**
- (a) **the total of all regulatory deferral account debit balances; and**
 - (b) **the total of all regulatory deferral account credit balances.**

These separate line items shall be distinguished from the assets and liabilities that are presented in accordance with other Standards by use of sub-totals, which are drawn before the regulatory deferral account balances are presented.

Classification of movements in regulatory deferral account balances

- 21 **An entity shall present, in the profit or loss section of the statement of profit or loss and other comprehensive income, or in the separate statement of profit or loss, the net movement in all regulatory deferral account balances for the reporting period, except for amounts acquired or disposed of. This separate line item shall be distinguished from the income and expenses that are presented in accordance with other Standards by the use of a sub-total for the amount of profit or loss before the net movement in regulatory deferral account balances.**

⁴ Exposure Draft *Regulatory Deferral Accounts*, published in April 2013 (the 2013 ED) can be downloaded and comments on the proposals submitted via the IFRS website at <http://www.ifrs.org/Current-Projects/IASB-Projects/Rate-regulated-activities/Exposure-Draft-April-2013/Pages/Exposure-Draft-and-Comment-Letters.aspx>

Disclosure

Objective

- 22 **An entity shall disclose information that enables users to evaluate:**
- (a) **the nature of, and the risks associated with, the rate regulation that restricts the price that the entity can charge customers for the goods and services it provides; and**
 - (b) **the effects of that rate regulation on its financial position, financial performance and cash flows.**
- 23 If any of the disclosures set out in paragraphs 25–33 are not considered relevant to meet the requirements in paragraph 22, they may be omitted from the financial statements. If the disclosures provided in accordance with paragraphs 25–33 are insufficient to meet the requirements in paragraph 22, an entity shall disclose additional information that is necessary to meet those requirements.
- 24 To meet the disclosure requirements in paragraph 22, an entity shall consider all of the following:
- (a) whether the rate-regulated activities are material to the financial performance or position of the entity;
 - (b) the level of detail that is necessary to satisfy the disclosure requirements;
 - (c) how much emphasis to place on each of the various requirements;
 - (d) how much aggregation or disaggregation to undertake; and
 - (e) whether users of financial statements need additional information to evaluate the quantitative information disclosed.

Explanation of activities subject to rate regulation

- 25 To help a user of the financial statements assess the nature of, and the risks associated with, the rate regulation that restricts the price that the entity can charge customers for the goods and services it provides, an entity shall, for each portion of rate-regulated activities that is material to the financial performance or position of the entity, disclose:
- (a) a brief description of the nature and extent of the rate-regulated activities and the nature of the regulatory rate-setting process;
 - (b) the identity of the rate regulator. If the rate regulator is a related party (as defined in IAS 24 *Related Party Disclosures*), the entity shall disclose a statement to that effect, together with an explanation of how it is related; and
 - (c) how the future recovery of each regulatory deferral account debit balance or reversal of each regulatory deferral account credit balance is affected by risks and uncertainty, for example:
 - (i) demand risk (for example, changes in either consumer attitudes, the availability of alternative sources of supply, or the levels of competition);
 - (ii) regulatory risk (for example, the submission or approval of a rate-setting application; or the entity's assessment of the expected future regulatory actions); and
 - (iii) other risks (for example, currency or other market risks).
- 26 The disclosures required by paragraph 25 shall be given either in the financial statements or incorporated by cross-reference from the financial statements to some other statement, such as a management commentary or risk report, that is available to users of the

financial statements on the same terms as the financial statements and at the same time. If the information is not included in the financial statements or incorporated by cross-reference, the financial statements are incomplete.

Explanation of recognised amounts

- 27 An entity shall disclose the basis on which regulatory deferral account balances are recognised and measured initially and subsequently, including how regulatory deferral account balances are assessed for recoverability and the allocation of any impairment loss.
- 28 For each portion of rate-regulated activities that is material to the financial performance or position of the entity and for others in aggregate, an entity shall disclose the following information for each category of regulatory deferral account (ie for each type of cost or income) that is individually material and for others in aggregate:
- (a) a reconciliation of the carrying amount at the beginning and the end of the period, in a tabular format unless another format is more appropriate. The entity shall apply judgement in deciding the level of detail necessary (see paragraph 24), but the following components would usually be relevant:
 - (i) the amounts that have been recognised in the current period in the statement of financial position as regulatory deferral account balances to be recovered or reversed in the current or future periods;
 - (ii) the amount that is recognised in the statement of profit or loss and other comprehensive income relating to balances that have been recovered, amortised or reversed in the current period; and
 - (iii) other amounts that affected the regulatory deferral account balances, such as items acquired or assumed in a business combination or items disposed of, or the effects of changes in foreign exchange rates, discount rates or estimated cash flows. If a single cause has a significant effect on a regulatory deferral account balance, the entity shall disclose it separately;
 - (b) the rate of return or discount rate (including a zero rate or a range of rates, when applicable) allowed, or required, by the rate regulator to reflect the time value of money that is applicable to each regulatory deferral account balance; and
 - (c) the remaining periods over which the entity expects to recover or amortise the carrying amount of each regulatory deferral account debit balance or to reverse each regulatory deferral account credit balance.
- 29 When regulatory accounting requirements affect the amount and timing of a rate-regulated entity's income tax payments, the entity shall identify, as a separate category of deferral account in the reconciliation required by paragraph 28, the deferred tax that arises in respect of the regulatory deferral account debit and credit balances (see paragraphs B4–B6).
- 30 When an entity presents earnings per share in accordance with IAS 33 *Earnings per Share*, the entity shall present additional basic and diluted earnings per share, which are calculated using the earnings amounts required by IAS 33 but excluding regulatory amounts (see paragraphs B7–B8).
- 31 When an entity presents a discontinued operation or a disposal group in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, the entity shall include any related regulatory deferral account balances and the net movement in those balances, as applicable, as part of the regulatory deferral account balances and movements instead of within the disposal groups or discontinued operations (see paragraphs B11–B13).

- 32 When an entity provides disclosures in accordance with IFRS 12 *Disclosure of Interests in Other Entities* for an interest in a subsidiary, associate or joint venture that has rate-regulated activities and for which regulatory deferral account balances are recognised in accordance with this [draft] interim Standard, the entity shall disclose the amounts that are included for the regulatory deferral account debit and credit balances and the net movement in the balances for those interests (see paragraphs B14–B17).
- 33 When an entity concludes that a regulatory deferral account balance is no longer fully recoverable, it shall disclose that fact, the reason why it is not recoverable and the amount by which the regulatory deferral account balance has been reduced.