

## STAFF PAPER

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**Rate-regulated Activities Consultative Group**

Project	Rate Regulation
Paper topic	Scope issues
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**Scope issues to address**

1. The purpose of this paper is highlight the possible issues that the staff has identified as needing to be addressed to define the scope of the planned Discussion Paper ('the planned Rate Regulation DP' or 'the planned DP') that is being developed as part of the IASB's Rate-regulated Activities project. This planned DP will try to identify whether an accounting model can be developed for rate-regulated activities and, if so, what that model might look like.
2. Consultative Group members are asked to consider these issues and also to consider whether additional issues need to be addressed. The staff will use the outcome of the Consultative Group's discussions to develop proposals for the scope of the planned DP. Those proposals will be discussed by the IASB at their September 2013 meeting.

**Background**

3. The vast majority of responses to the Exposure Draft *Rate-regulated Activities*, published in July 2009 (the 2009 ED) commented on the scope of that project.
4. The scope of the 2009 ED proposals was set out in paragraph 3 of that ED:

3 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.

5. The following definitions are relevant to the scope proposals:

**Regulator:** An authorised body empowered by statute or contract to set rates that bind an entity's customers. The regulator may be a third-party body or may be the entity's own governing board if the board is required by statute or contract to set rates both in the interest of the customers and to ensure the overall financial viability of the entity.

**Cost-of-service regulation:** 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.

6. Some respondents supported a narrower scope, suggesting that it be aligned more closely with the US GAAP requirements in SFAS 71 *Accounting for the Effects of Certain Types of Regulation* and subsequent related guidance and amendments (now Topic 980 *Regulated Operations* in the *FASB Accounting Standards Codification*<sup>®</sup>). The current scope of Topic 980 is reproduced in Appendix A for reference.
7. Many other respondents supported a broader scope, suggesting that the scope distinction separating entities as being subject to either “cost-of-service” or “incentive-based” rate regulation was an arbitrary rule.
8. Many of the respondents, however, when proposing changes to the scope, focused on their desired outcome of what types of regulation should be in or out of the scope of the ED rather than identifying a core principle. Many of those comments

referred to their existing practices and regulatory regimes when supporting their views (and whether regulatory assets and regulatory liabilities were recognised in their local GAAP)<sup>1</sup>.

9. The IASB Request for Information *Rate Regulation*, published in March 2013 (the RFI), was an important step in the revised IASB research project. Its intention was to assist in investigating a wide variety of rate regulatory schemes to try to find common features that could guide the scope of any potential guidance or accounting requirements.
10. All of the respondents to the RFI that commented on the scope of the project welcomed the IASB's decision to investigate a wide variety of rate regulatory schemes. They caution the IASB against developing rule-based requirements applicable to only certain types of schemes. Instead they would prefer principles-based guidance or requirements that could be applied to a wide variety of circumstances, particularly in environments where the mechanisms used for rate regulation are changing.

### Scope issues to address

11. From the responses to the RFI and the 2009 ED, we have identified the following as issues that need to be addressed in order to establish the scope of the planned Rate Regulation DP:
  - (a) Types of rate regulation (agenda paper 6A);
  - (b) Use of variance or deferral accounts (agenda paper 6B);
  - (c) Identifying the rate regulator (agenda paper 6C);
  - (d) Prices that bind customers (agenda paper 6D); and
  - (e) Interaction with IFRIC 12 *Service Concession Arrangements* (agenda paper 6E).
12. Agenda paper 6A briefly summarises the problems associated with defining the scope based on the type of rate regulation in force. Consultative Group members

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<sup>1</sup> Further details are contained in paragraphs 26-30 of IASB Agenda paper 7: Summary comment letter analysis, February 2010

are asked to comment on the staff conclusion that the type of rate regulation does not provide a suitable basis for defining the scope of the planned DP.

13. Agenda paper 6B highlights the feature that is common to the vast majority of rate-regulatory schemes identified through the RFI; that is, the use of variance or deferral accounts. Consultative group members are asked to consider whether this should be the primary focus for developing the planned DP.
14. Agenda paper 6C asks the Consultative Group to consider how to define a rate regulator, as part of the definition of rate regulation.
15. Agenda paper 6D asks the Consultative Group to consider how rate regulation binds customers and how this might be reflected in the scope of the planned DP.
16. Agenda paper 6E considers the scope of IFRIC 12 *Service Concession Arrangements* and the interaction of that Interpretation with rate regulation. The Consultative Group is asked to consider whether the scope of the planned DP should incorporate a review of IFRIC 12 in the wider context of rate regulation generally. The Consultative Group are also asked to highlight any issues that they experience in practice between rate regulation and service concession arrangements in financial reporting (whether IFRS or other GAAPs).

## Questions for the Consultative Group

### General questions about the scope of the DP

1. Do you agree that the above are important scope topic areas that the planned Rate Regulation DP should address?
2. Does the above list omit other important scope questions that the planned DP should address?
3. If there is specific accounting guidance in your reporting jurisdictions that permit or require the reporting of regulatory balances within your general purpose financial statements, how is the scope of that guidance defined?

**Appendix: Extract from Topic 980 *Regulated Operations* in the FASB Accounting Standards Codification®: Scope**

**980-10-15-2** The guidance in the Regulated Operations Topic applies to general-purpose external financial statements of an entity that has regulated operations that meet all of the following criteria:

- a. The entity's rates for regulated services or products provided to its customers are established by or are subject to approval by an independent, third-party regulator or by its own governing board empowered by statute or contract to establish rates that bind customers.
- b. The regulated rates are designed to recover the specific entity's costs of providing the regulated services or products. This criterion is intended to be applied to the substance of the regulation, rather than its form. If an entity's regulated rates are based on the costs of a group of entities and the entity is so large in relation to the group of entities that its costs are, in essence, the group's costs, the regulation would meet this criterion for that entity.
- c. In view of the demand for the regulated services or products and the level of competition, direct and indirect, it is reasonable to assume that rates set at levels that will recover the entity's costs can be charged to and collected from customers. This criterion requires consideration of anticipated changes in levels of demand or competition during the recovery period for any capitalized costs. This last criterion is not intended as a requirement that the entity earn a fair return on shareholders' investment under all conditions; an entity can earn less than a fair return for many reasons unrelated to the ability to bill and collect rates that will recover allowable costs. For example, mild weather might reduce demand for energy utility services. In that case, rates that were expected to recover an entity's allowable costs might not do so. The resulting decreased earnings do not demonstrate an inability to charge and collect rates that would recover the entity's costs; rather they demonstrate the uncertainty inherent in

estimating weather conditions. This requirement must also be evaluated in light of the circumstances. For example, if the entity has an exclusive franchise to provide regulated services or products in an area and competition from other services or products is minimal, there is usually a reasonable expectation that it will continue to meet the other criteria. Exclusive franchises can be revoked, but they seldom are. If the entity has no exclusive franchise but has made the very large capital investment required to provide either the regulated services or products or an acceptable substitute, future competition also may be unlikely.