STAFF PAPER

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Rate-regulated Activities Consultative Group meeting

Project	**Rate-regulated Activities: Research project**		
Paper topic	Disclosure requirements		
CONTACT(S)	Natasha Dara	ndara@ifrs.org	+44 (0)20 7246 6919
	Jane Pike	jpike@ifrs.org	+44 (0)20 7246 6925

Purpose of the paper

1. Many respondents to the Discussion Paper *Reporting the Financial Effects of Rate Regulation* agreed that IFRS 14 *Regulatory Deferral Accounts* (IFRS 14) would provide a good foundation for disclosures about rate-regulated activities.

2. This paper provides further detail about respondents' requests for modifications and additions to the requirements in IFRS 14.

General responses

3. Most respondents generally commented that the disclosures should provide insight into how the amount, timing, and uncertainty of future cash flows are affected by rate regulation. They do not, however, think a disclosures-only approach is appropriate, but instead comment that appropriate disclosures should be provided as being supplementary to information provided in the statements of financial position and profit or loss and other comprehensive income.

4. Although some suggested that the disclosure requirements in IFRS 14 would be adequate, subject to any modifications necessary to reflect the accounting model that is developed, others requested more detailed information. Some suggested that

disclosures should be required for all rate-regulated activities, even if the related balances are not recognised.

5. Some analysts said that they would particularly value segment information to help more clearly identify the financial effects of rate regulation. Other respondents warned against ‘disclosure overload’ and suggested that management should be given more discretion about the level of detail provided. Some suggested that, in cases in which information about the rate regulation is already publicly available, that information should not be duplicated in the financial statements.

6. A few respondents commented that a Standard for rate-regulated activities should not have its own disclosure requirements, but should instead rely on IAS 1 *Presentation of Financial Statements* for the provision of supplementary information. In addition, some respondents commented that IFRS 8 *Operating Segments* could be considered as a source of guidance for much of the information requested. There are mixed approaches to disclosing information about the financial effects of rate regulation in accordance with IFRS 8. We would particularly value input from Consultative Group members about their experience in using IFRS 8 to disclose information about regulatory deferral account balances, movements in such balances and other narrative or quantitative information. (Appendix A reproduces extracts from IFRS 8 for reference.)

7. Many respondents commented about the need to establish an appropriate division between information provided in the note disclosures and the management commentary. Some noted that the management commentary is more appropriate for forward-looking information.

8. The following sections further explore respondents’ requests for information that is in addition to the requirements of IFRS 14. The staff think that some of the information requested is already required by IFRS 14, particularly by paragraphs 30 and 33 of IFRS 14. However, the responses suggest that more explicit guidance or requirements may be needed.

Questions for the Consultative Group

1. What items in the following lists of information do you think are most relevant for users of the financial statements in assessing the financial effects of rate regulation? Please explain the reasons for your answer.
2. Are there any items that you think are unsuitable or impracticable to disclose? Please explain the reasons for your answer.
3. Which items do you consider would be better placed in the management commentary or other investor communication, instead of in the disclosure notes to the financial statements? Please explain the reasons for your answer.

Explanation of activities subject to rate regulation

9. Paragraph 30 of IFRS 14 requires an entity to disclose:

    (a) a brief description of the nature and extent of the rate-regulated activity and the nature of the regulatory rate-setting process.

    (b) …

    (c) how the future recovery of each class (ie each type of cost or income) of regulatory deferral account debit balance or reversal of each class of regulatory deferral account credit balance is affected by risks and uncertainty, for example:

        (i) demand risk (for example, changes in consumer attitudes, the availability of alternative sources of supply or the level 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).

10. Most respondents agreed that these requirements provide important information to users of financial statements.

11. Other respondents, however, think that the information required in paragraph 30 of IFRS 14 is unnecessary in the financial statements. Of those respondents, a few think the information should be omitted altogether, because investors generally know about what they are investing in and much of the information is available from other sources such as investor presentations, public information provided by the rate regulator itself or through the management commentary. Others think that this information is better placed in the management commentary. The staff note that paragraph 31 of IFRS 14 allows this information to be given in the management commentary and incorporated into the financial statements by cross-reference.

12. Respondents asked for information to be provided about:

(a) identification of business segments or products and services subject to defined rate regulation and a description of the population base, including the nature of the relationship between the rate regulator, the entity and the customer;

(b) the regulatory environment, including, for example, jurisdictional differences in key aspects of the rate regulation, current economic conditions of the industry, market impacts, and the risks of economic regulation generally;

(c) political influence on the entity's activities and on the enforcement powers of the rate regulator, and the constraints and conditions imposed on the reporting entity by either contractual or statutory requirements;

(d) the stability of the regulatory mechanism, for example, changes in legislation and the resulting effects, the status of pending regulatory actions and approvals, or deferring increases in rate under unfavourable economic conditions and future plans for regulatory changes (eg an increase in competition, deregulation or changes in mechanism);

(e) an explanation of the process by which rates are applied and the formula for calculating changes in the rate, including how the revenue requirement is determined, duration of the regulatory period, the main variables and assumptions, changes during the year and foreseeable changes, the basis of allowable costs, and the nature of the circumstances in which the regulator may require deferral of current costs or direct refunds of past revenues;

(f) current obligations imposed by the regulator, how the rate regulator enforces settlement and the status of the rate regulation scheme at the end of the period;

(g) regulatory issues and strategies, tariff approvals/adjustments and the resulting impact on the entity's performance, information to distinguish between variability in performance that is adjusted through the rate-setting mechanism and variability for which the mechanism provides no adjustment, estimating the impact of future cash flows, and a review of material non-quantifiable events that occurred during the reporting period and probable future events;

(h) the entity's assessment of its efficiency in using its resources and of its financial and future stability, as well as its ability to collect (and cover costs), generate cash flows and dividends, manage regulatory risk, renew the agreement and continue to provide the goods or services at the minimum level of service; and

(i) if the entity engages in non-rate-regulated activities, information about whether assets acquired for rate-regulated activities can be deployed to those other activities.

Explanation of recognised amounts

13. Paragraph 33 of IFRS 14 requires that:

> For each type of rate-regulated activity, an entity shall disclose the following information for each class of regulatory deferral account balance:
>
> (a) a reconciliation of the carrying amount at the beginning and the end of the period, in a table unless another format is more appropriate. The entity shall apply judgement in deciding the level of detail necessary (see

paragraphs 28–29), 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;

(ii) the amounts that have been recognised in the statement(s) of profit or loss and other comprehensive income relating to balances that have been recovered (sometimes described as amortised) or reversed in the current period; and

(iii) other amounts, separately identified, that affected the regulatory deferral account balances, such as impairments, items acquired or assumed in a business combination, items disposed of, or the effects of changes in foreign exchange rates or discount rates.

(b) …

(c) the remaining periods over which the entity expects to recover (or amortise) the carrying amount of each class of regulatory deferral account debit balance or to reverse each class of regulatory deferral account credit balance.

14. Respondents requested the following information:

(a) an explanation of the nature and financial effects of recognised regulatory deferral account balances, including information about estimates;

(b) information about which of the entity's activities the regulatory deferral account balances and movements in those balances relate to;

(c) a time schedule, probability assessment and detailed description of the manner in which the regulatory deferral account balances are expected to be recovered/reversed in the current and future periods; and

(d) adjustments made to regulatory balances after recognition as a result of the rate regulator subsequently prohibiting all or part of a balance after a prudency review or to correct over/under recognition by entity.

Additional requests

15. Respondents think information about the value of the regulatory asset base (RAB) provides important information to users of financial statements. Some users commented that they acknowledge that, in some cases, it would be difficult to present in the balance sheet an IFRS amount that is reconcilable with the RAB. Consequently, these users of financial statements support disclosure of the RAB, not a reconciliation. Suggestions for disclosure of information about the RAB include:

    (a) description and value of the RAB as a store of future value and source of revenue allowances and the allowable returns;

    (b) end-of-period regulatory true-ups to the RAB;

    (c) a net debt to RAB gearing ratio; and

    (d) the regulator's gearing targets.

16. Other requests for disclosures that are not currently required by IFRS 14 include:

    (a) a distinction between the assets, liabilities, revenue and expenses of the rate-regulated activities from those of the non-rate-regulated activities, if applicable;

    (b) reconciliations and qualitative explanations of the principal differences between:

        (i) IFRS financial statement amounts and the regulatory account amounts; and

        (ii) estimated and actual regulatory returns;

    (c) disclosure of any regulatory deferral account balances that are not recognised, either because the IASB decides to prohibit recognition of regulatory deferral account balances or because the balance does not satisfy any recognition criteria that might be established.

Appendix A—Extracts from IFRS 8 *Operating Segments*

Disclosure

20 **An entity shall disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates.**

…

Information about profit or loss, assets and liabilities

23 An entity shall report a measure of profit or loss for each reportable segment. An entity shall report a measure of total assets and liabilities for each reportable segment if such amounts are regularly provided to the chief operating decision maker. An entity shall also disclose the following about each reportable segment if the specified amounts are included in the measure of segment profit or loss reviewed by the chief operating decision maker, or are otherwise regularly provided to the chief operating decision maker, even if not included in that measure of segment profit or loss:

(a) revenues from external customers;

…

(e) depreciation and amortisation;

…

(i) material non-cash items other than depreciation and amortisation.

…

Measurement

25 The amount of each segment item reported shall be the measure reported to the chief operating decision maker for the purposes of making decisions about allocating resources to the segment and assessing its performance. Adjustments and eliminations made in preparing an entity's financial statements and allocations of revenues, expenses, and gains or losses shall be included in determining reported segment profit or loss only if they are included in the measure of the segment's profit or loss that is used by the chief operating decision maker. …

…

27 An entity shall provide an explanation of the measurements of segment profit or loss, segment assets and segment liabilities for each reportable segment. At a minimum, an entity shall disclose the following:

…

(b) the nature of any differences between the measurements of the reportable segments' profits or losses and the entity's profit or loss before income tax expense or income and discontinued operations (if not apparent from the reconciliations described in paragraph 28)....

(c) the nature of any differences between the measurements of the reportable segments' assets and the entity's assets (if not apparent from the reconciliations described in paragraph 28). …

(d) the nature of any differences between the measurements of the reportable segments' liabilities and the entity's liabilities (if not apparent from the reconciliations described in paragraph 28). …

…

Reconciliations

28 An entity shall provide reconciliations of all of the following:

(a) the total of the reportable segments' revenues to the entity's revenue.

(b) the total of the reportable segments' measures of profit or loss to the entity's profit or loss before tax expense (tax income) and discontinued operations. …

(c) the total of the reportable segments' assets to the entity's assets...

(d) the total of the reportable segments' liabilities to the entity's liabilities...

(e) the total of the reportable segments' amounts for every other material item of information disclosed to the corresponding amount for the entity.

All material reconciling items shall be separately identified and described. For example, the amount of each material adjustment needed to reconcile reportable segment profit or loss to the entity's profit or loss arising from different accounting policies shall be separately identified and described.