Accounting Standards Board AcSB CNC Conseil des normes comptables

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Decision-usefulness of Financial Information that Reflects the Economics of Rate-regulated Activities

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Status of Research

- Staff research paper
- Canadian AcSB had first discussion at its September meeting
- Directed staff to seek input from national standard setters
- Given timing
  - Research is preliminary
  - Focus is on Canadian data; some global data included
- AcSB will continue to deliberate on overall project
- Next Steps

Setting the Context

- Focus on forms of rate regulation that can create enforceable rights and obligations
  - "Balances arising from rate regulation"
- Need to look at an entity's facts and circumstances
- Rate regulators need to determine which amounts are:
  - part of normal cost recovery process and should be assigned to customers; or
  - part of normal business risks that should be borne by an entity's investors or owners

Key Observation

Section I – Importance to the Capital Markets of Entities Subject to Rate Regulation (“Rate-regulated Entities”)

Based on the data gathered

- Due to size of their market presence, rate-regulated entities are important to investors and lenders

Data Gathered

- In Canada, $137.3 billion (6%) of the total $2.3 trillion market capitalization comes from rate-regulated entities*
  - Majority in Utilities and Pipelines sector (5th largest sector as of December 31, 2015)
- Government-owned entities – > $100 billion in outstanding debt*
  Investor-owned entities – > $90 billion in corporate bonds*
- Global – largest utilities (by market cap) are in U.S. and Europe**
- International Energy Agency
  - Estimates future global investment requirements for power sector overall to exceed $16 trillion from 2014-2035***

*Source: Information compiled by AcSB staff (see pages 9, 11 and 12 of staff research paper)
**Source: MSCI ACWI Utilities Index as of June 30, 2016 (see pages 12 and 13 of staff research paper)
*** Source: Special Report World Energy Investment Outlook 2014 (see page 14 of staff research paper)

Key Observation

Section IV – Decision-Making Effects of Financial Information on Rate-regulated Activities

Based on the data gathered

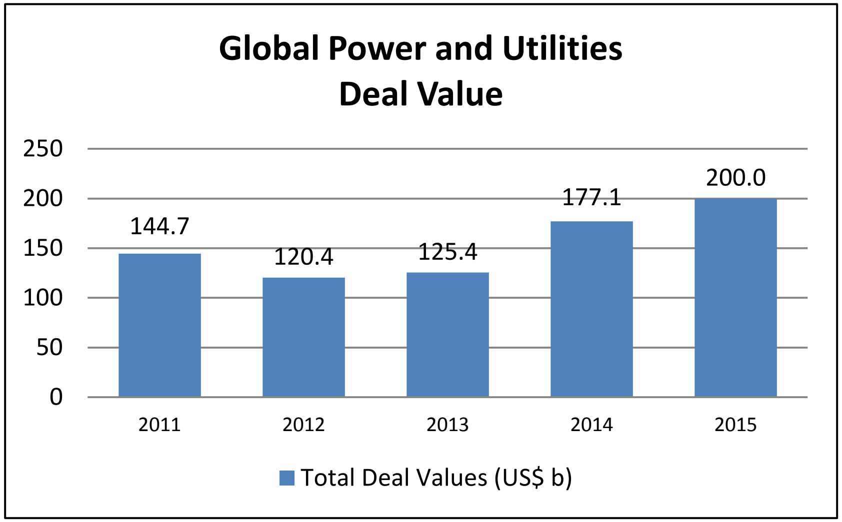
- Regulatory framework is a key factor considered by debt and equity analysts, and credit rating agencies because it can affect the entity's financial performance and future cash flows

- Acquisitions examined support that balances arising from rate regulation have commercial substance

Data Gathered

- Regulatory framework is a key assessment factor for debt and equity analysts, and credit rating agencies
  - e.g., credit rating methodologies
- Risks of the regulatory framework
  - Increased risks could result in credit rating downgrades, which in turn increase borrowing costs for entities
- Balances arising from rate regulation
  - In the purchase price allocations examined, the carrying value of these balances generally approximates their fair value

Data Gathered (cont'd)



- Acquisitions – Global Power and Utilities Deal Value
- Cross-border and domestic capital flow

Source: EY Power transactions & trends (see page 46 of staff research paper)

- Data indicates trend in Americas
  - Increased activity in regulated transmission and distribution segment
  - Seek stable earnings by adding regulated assets to portfolios

Key Observation

Section II – Importance of Understanding the Regulatory Framework

Based on the data gathered

- The regulatory framework affects the determination of an entity’s rights and obligations arising from the performance of rate-regulated activities

Data Gathered

- Regulatory Framework defines the environment in which the rate-regulated entity operates. Main components include:
  - **Governing legislation**
    - e.g., see case law demonstrating objective of rate regulation (pg. 18)
  - Rules and procedures established by the rate regulator through the design of the rate-setting mechanism (i.e., **form of rate regulation**)
    - e.g., see variety within Canada (pg. 21)
  - Regulatory decisions, and subsequent court rulings on those decisions, that **interpret the legislation and rules**
    - e.g., rate regulator decisions demonstrating confirmatory and predictive value – Alberta Utilities Commission and National Energy Board (pg. 24 to 28)

Key Observation

Section III – Strength of the Regulatory Framework and the Effects

Based on the data gathered

- Users perceive the strength of the regulatory framework as affecting the enforceability, and value, of an entity's rights and obligations arising from the performance of rate-regulated activities

Data Gathered

- Data gathered on a sample of 12 Canadian electric utilities over a 5-year period
  - Supports what users have said that write-offs or impairments of debit balances arising from rate regulation have been minimal in Canada
  - For the minimal amounts, note disclosures indicate write-offs and impairments due mainly to subsequent regulatory reviews rather than an inability to collect
  - Highlights that the nature and risk profile of balances arising from rate regulation can vary, resulting in differing degrees of uncertainty in their recovery or settlement patterns

Source: Information compiled by AcSB staff (see pages 31 to 36 of staff research paper)

Enforceability

Data gathered signals

- Strength or weakness of an entity's regulatory framework affects the enforceability of economic resources of, and claims against, the entity
- When assessing strength, users consider:
  - Trend of write-offs or impairments of debit balances arising from rate regulation
  - Expected recovery and settlement patterns
  - Subsequent regulatory decisions that confirm or differ from the entity's interpretation of the legislation and rules

Seeking Your Input

- Do you have any comments on:
  - Observations drawn from the data gathered
  - Overall findings
    - Financial information that reflects the economics of rate-regulated activities is useful
    - Such financial information has confirmatory and predictive value that is capable of making a difference in the decisions made by users
- What additional data do you have to further our research efforts?