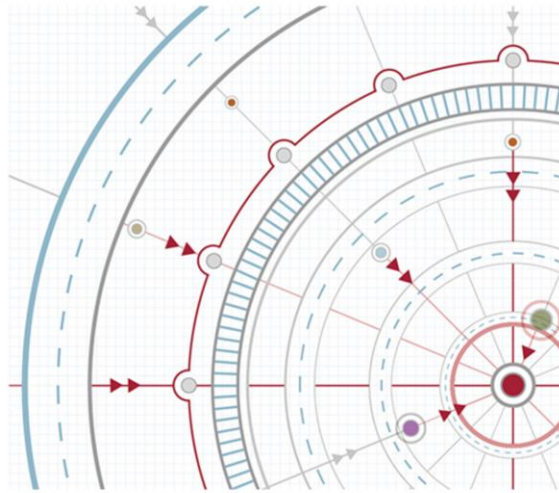


Accounting Standards Advisory Forum meeting
April 2018

Rate-regulated Activities Scope

Important Note:

The notes to these slides form an integral part of the presentation.



The views expressed in this presentation are those of the presenter, not necessarily those of the International Accounting Standards Board or IFRS Foundation.

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- This paper shows how the scope definition has evolved from:
 - Exposure Draft *Rate-regulated Activities*, July 2009;
 - Discussion Paper *Reporting the Financial Effects of Rate Regulation*, September 2014; to
 - the staff’s recommended definition to be discussed by the Board in March 2018

Scope ED *Rate-regulated Activities* (2009)

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- 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.



In July 2009, the Board issued Exposure Draft (ED) *Rate-regulated Activities*. This slide reproduces the scope criteria proposed in the ED.

Main comments received on the scope proposed in ED 2009

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- Many respondents proposed changes to the scope—many highlighted the need for 'linkage' between past events or transactions and future rate changes, suggesting this is the underlying rationale supporting recognition of regulatory assets and regulatory liabilities
- Comments supporting narrow scope
 - Restrict to cost-of-service type rate regulation to provide 'linkage' between past events or transactions and future rate changes
 - Requests to 'mirror' US GAAP FAS 71 *Accounting for the Effects of Certain Types of Regulation* (subsequently codified as Topic 980 *Regulated Operations*)—this would enable use of practice and non-authoritative guidance formed over the past three decades to aid application
- Comments supporting broad scope
 - Many incentive schemes provide 'linkage' between past events or transactions and future rate changes—distinction between cost-of-service and incentive-based regulation is an arbitrary 'rule'
 - Regulation has evolved so few cost-of-service schemes remain

4.4 [...] Defined rate regulation involves a regulatory pricing (ie rate-setting) framework that includes all of the following:

- (a) it applies in situations in which customers have little or no choice but to purchase the goods or services from the rate-regulated entity because:
 - (i) there is no effective competition to supply; and
 - (ii) the rate-regulated goods or services are essential to customers (such as clean water or electricity).
- (b) it establishes parameters to maintain the availability and quality of the supply of the rate-regulated goods or services and other rate-regulated activities of the entity.
- (c) it establishes parameters for rates (sometimes referred to as prices or tariffs) that provide regulatory protections that:
 - (i) support greater stability of prices for customers; and
 - (ii) support the financial viability of the rate-regulated entity.

Many respondents:

- highlighted that there may be significant operational difficulties in applying the features outlined in paragraph 4.4(a)-(c) if they were to be set as mandatory scoping criteria. For example:
 - determining which goods or services are **essential** was considered to be very subjective and conclusions could vary in different jurisdictions;
 - the terms '**customers have little or no choice**' and '**no effective competition to supply**' could be very difficult to apply in practice, particularly if there is some limited competition from another supplier or substitute product.
- emphasised that the **existence of a rate-setting framework** that created **enforceable rights and obligations** and included a **rate-adjustment mechanism** had a pivotal role to play in the scoping of the project.

There was strong support for using the description of defined rate regulation in the DP as the basis for ongoing discussion about how best to report financial effects of rate regulation. This was because many respondents:

- agreed that the description of defined rate regulation captured the common characteristics of a wide variety of schemes found in practice; and
- suggested that the combination of rights and obligations created by defined rate regulation, as described in the DP, creates distinguishable economic conditions that may not be faithfully represented by current IFRS practice.

However, many respondents highlighted that some of the features were subjective and would be difficult to apply as scope criteria, which could lead to diversity in practice. The views of these respondents were further emphasised by feedback received from the IASB's Consultative Group for Rate Regulation in its meeting in October 2017.

Scope to be discussed at the March 2018 Board meeting

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Defined rate regulation is established through a formal **regulatory framework** that:

- (a) is **binding** on both the entity and the regulator; and
- (b) establishes a **basis for setting the rate** that includes a **rate-adjustment mechanism**.
That mechanism creates, and subsequently reverses, **rights** and **obligations** arising from **timing differences** when the regulated rate in one period includes amounts related to specified activities the entity carries out in a different period.

- Staff propose that:

- these features are both necessary and sufficient for the creation of regulatory assets and regulatory liabilities and hence should be included in the criteria that establish the scope of the model for recognition and measurement; and
- the other features described in the DP should not be set as scope criteria because they are not necessary for the creation of regulatory assets and regulatory liabilities.



This slide includes the definition of defined rate regulation that the Board will discuss at its March 2018 Board meeting (Agenda Paper 9B can be accessed at: <http://www.ifrs.org/-/media/feature/meetings/2018/march/iasb/ap9b-rate-regulated-activities.pdf>). The Board is asked to tentatively decide which features of defined rate regulation are both necessary and sufficient for the creation of regulatory assets and regulatory liabilities.

Agenda Paper 9B stresses that the existence of terms that **bind** both the regulator and the rate-regulated entity (entity) is a necessary feature for the origination of regulatory assets and regulatory liabilities. The paper suggests the following aspects of the regulatory framework contribute to creating binding terms on both the entity and the regulator.

- (a) legislation;
- (b) regulations or regulatory agreement; and
- (c) regulatory decisions, and subsequent court rulings on those decisions that interpret the legislation and the regulations.

The need for binding terms on both the entity and the regulator means that activities subject only to 'self-regulation' would not be included in the scope of the model (ie an entity cannot create enforceable rights and obligations with itself). Some entities may need to exercise judgement to assess whether the process for setting and enforcing the rates is subject to:

- (a) the entity's internal governance mechanism that binds neither the entity nor the regulator; or
- (b) sufficient external oversight and/or approval through statute or regulation that creates terms binding both the entity and the regulator.

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