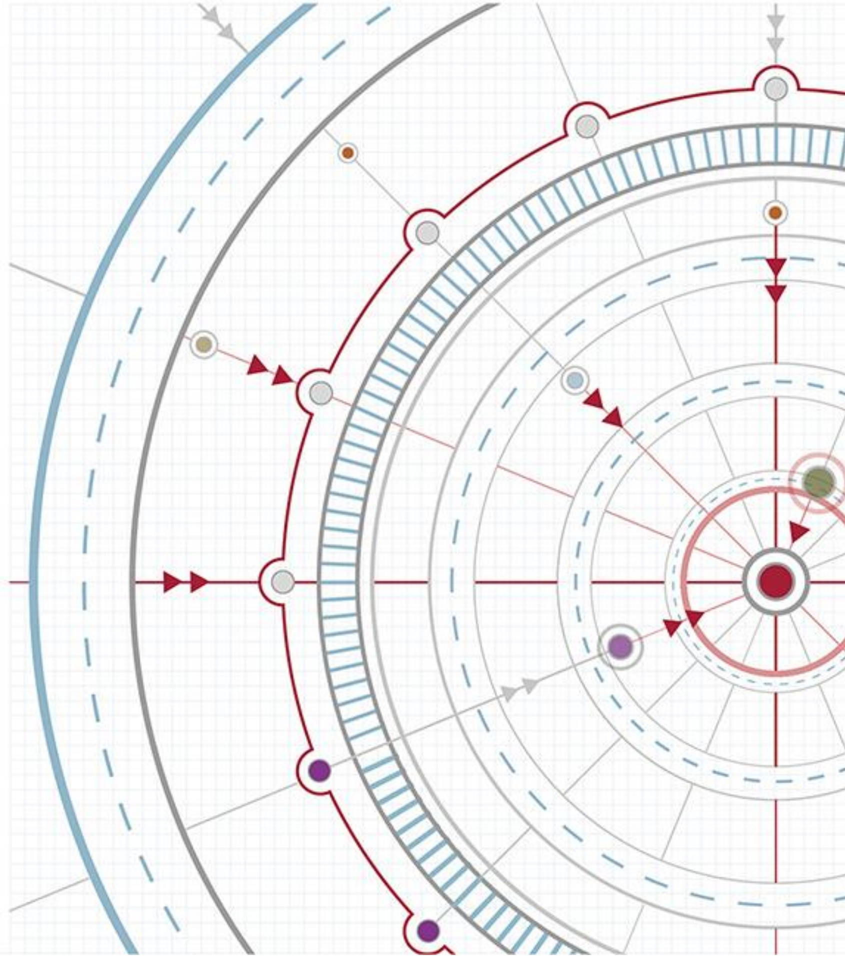
IFRS® Foundation



AP1B

Rate-regulated Activities

Scope, unit of account, regulatory asset and regulatory liability

EEG meeting

March 2019

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

IFRS®

Scope

Board's tentative decision—scope of the model

Scope of the model according to the Board's tentative decision in March 2018.

Formal regulatory framework, binding on both entity and rate regulator

establishes a basis for setting the rate

for specified goods or services

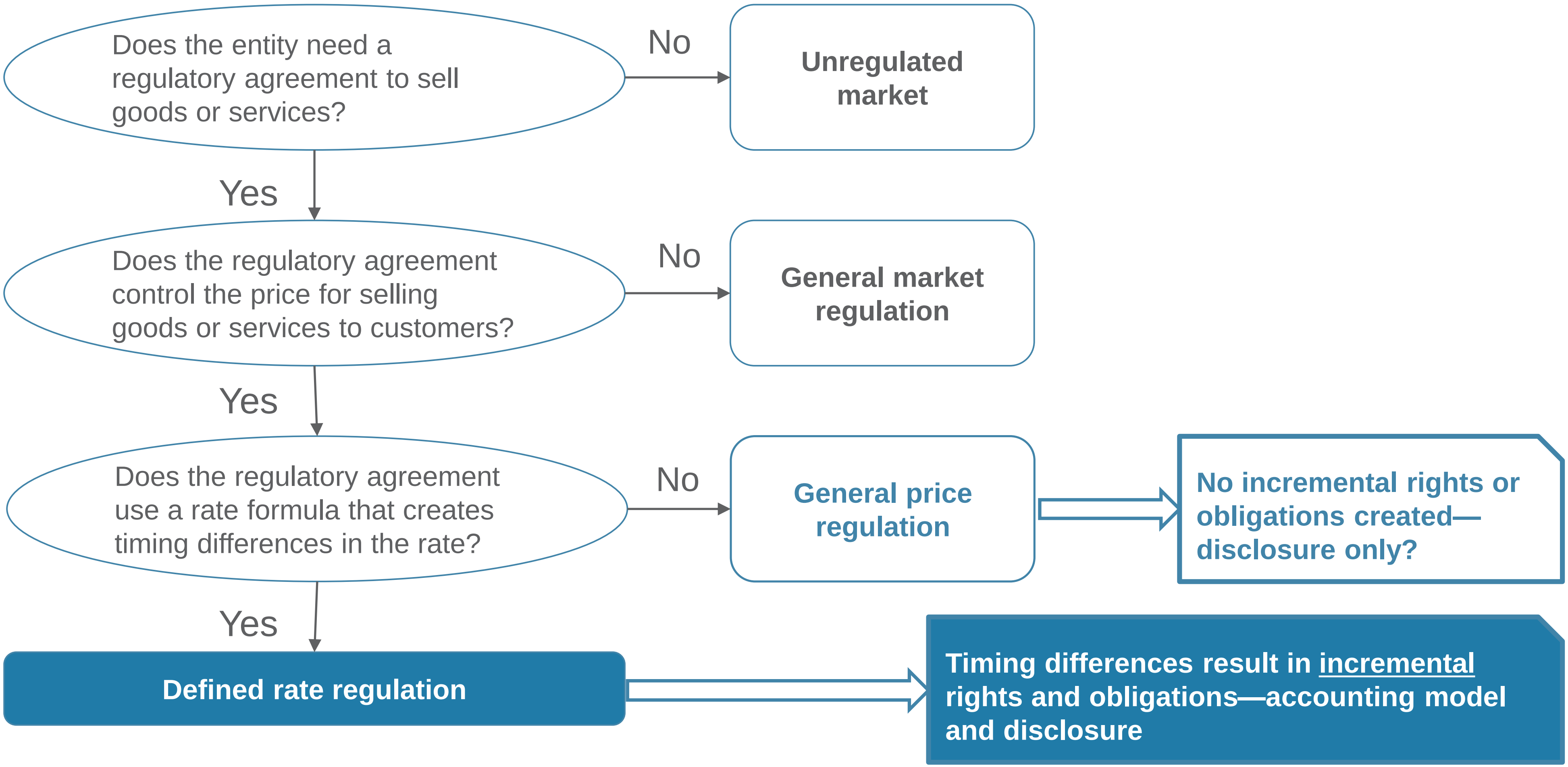
General price regulation

includes a **rate-adjustment mechanism (RAM)** that **creates**, and subsequently **reverses**, **rights and obligations** caused by the regulated rate in one period including amounts related to specified activities the entity carries out in a different period.

RAM

Defined rate regulation

Board’s considerations—defined rate regulation vs other regulation



Board's considerations—examples

General price regulation

Regulation that caps prices that:

(a) banks can charge for processing credit card transactions; and
(b) telecommunications providers can charge for mobile telephone 'roaming' services

Defined rate regulation

Regulation that empowers a regulator to:

(a) identify the estimated costs (the allowable costs);

(b) subject variances (difference between the allowable costs and actual costs) to a verification process; and

(c) if appropriate, approve an adjustment to the future rate(s) charged to customers to pass-through the variances over a specified period of time.

Board discussions on the scope of the model

Initially the Board considered the following definition of defined rate regulation.

Slide 7 — Formal regulatory framework, binding on both entity and rate regulator

Slide 8 — there are limitations on entry into an industry (and on exit from it)

Slide 9 — establishes basis for setting regulated rate (price)

Slide 10 — The rate-setting basis includes a rate-adjustment mechanism **that creates timing differences** — RAM

establishes service requirements

General price regulation

Defined rate regulation

IFRS

Board's considerations—binding on both regulator and entity ✓

Regulatory framework

- Legislation
- Regulations or regulatory agreement
- Regulatory decisions and court rulings

The features of the regulatory framework impacts on whether it is binding

Binding terms are a necessary feature because:

Binding terms provide support

- Control of the right (assets)
- No practical ability to avoid the obligation (liabilities)

Board’s considerations—Limitations on entry or on exit ✗

Limitations on entry/exit typically supports the effectiveness of defined rate regulation but:

(a) it does not determine whether a regulatory right or regulatory obligation exists. Limitations may affect measurement rather than existence.

(b) as a mandatory scoping criterion, the feature would be subjective, unclear and difficult to operationalise.

Example

Entity A is the largest entity in the power generating market of region X. Entity A is subject to rate regulation that employs a rate-adjustment mechanism. There is no regulator-imposed limitation on entry into the market. However, economies of scale of the rate-regulated entity, and its role in ensuring the stability of power supply in the market, supports application of defined rate regulation on that entity.

There are several smaller power generating entities that supply power to cover demand peaks. The rates charged by those entities are subject to supply contracts, not defined rate regulation. The lack of limitation does not impact the economics of the regulatory agreement.

Board's considerations—basis for setting the regulated rate ✓

Basis for setting the rate—necessary feature but not sufficient to distinguish general price regulation and defined rate regulation

Example

In general price regulation, the establishment of a cap price does not give entities any rights or obligations that would result in the recognition of assets or liabilities.

In general price regulation, **there is no direct cause-and-effect relationship between the entity's past transactions or other past events and the entity's present right to charge a higher rate**, **or present obligation to charge a lower rate**, for goods or services to be delivered to customers in the future.

Board’s considerations—the RAM and regulatory timing differences: present rights and present obligations ✓

- Through the basis for setting the rate, the regulator operationalises the regulatory objectives creating, in some cases, timing differences between the time when:
  (a) a transaction or event takes place; and
  (b) the effects (or some of the effects) of that transaction or event are reflected in the rate.
- Consequently, the rate formula creates a **direct and specific cause-and-effect relationship** between a rate-regulated activity and amounts included in the rate(s).
- Regulatory timing differences create a:
  (a) present right to charge a rate increased by an incremental amount when an entity (partially) fulfils service requirements in the current period but the current rate does not yet reflect the amount of compensation that the entity is entitled to include in the rate(s).
  (b) present obligation to reduce the future rate(s) by an amount as a result of the current rate charged to customers including compensation for service requirements that the entity has not yet fulfilled.

The existence of a rate-adjustment mechanism within the basis for setting the rate is a necessary feature.

Board's tentative decision—scope of the model

Scope of the model according to the Board's tentative decision in March 2018.

Formal regulatory framework, binding on both entity and rate regulator

establishes a basis for setting the rate

for specified goods or services

General price regulation

includes a **rate-adjustment mechanism (RAM)** that **creates**, and subsequently **reverses**, **rights and obligations** caused by the regulated rate in one period including amounts related to specified activities the entity carries out in a different period.

RAM

Defined rate regulation

Unit of account

Board's considerations and Board's tentative decision—unit of account (individual timing differences)

Option 1:
The entire regulatory agreement

Single asset (or liability)—reflects cost or value of the regulatory agreement

OR

Option 2:
Net of all timing differences affecting **future** rate(s)

Single net right or net obligation arising from the RAM

OR

Option 3:
Individual timing differences affecting **future** rate(s)

Individual rights and obligations arising from the RAM

Model currently focuses on individual timing differences affecting future rate(s)

Intangible asset model previously rejected for the regulatory agreement as a whole

The Board tentatively decided that the model will use as its unit of account the individual timing differences that create the rights and obligations arising from the regulatory agreement.

Regulatory asset

Regulatory liability

Board's considerations and Board's tentative decision—regulatory asset

Conceptual Framework

- An **asset** is a **present** ***economic resource controlled*** by the entity as a result of ***past events***.
- An **economic resource** is a ***right*** that has the potential to produce ***economic benefits***.

Right specified in the regulatory agreement

Entity controls the right—it is the only party that can use the right and obtain the benefits from it

Regulatory asset

The present regulatory right to charge a rate increased by an amount as a result of past events.

Entity has fulfilled service requirements

Economic benefits

Board's considerations and Board's tentative decision—regulatory liability

Conceptual Framework

- A **liability** is a **present obligation** of the entity to transfer an **economic resource** as a result of **past events**.
- An obligation is a duty or responsibility that an entity has **no practical ability** to avoid.
- Present obligation exists as a result of past events **only if**:
  - the entity has already **obtained economic benefits,** or **taken an action**; **and**
  - **as a consequence**, the entity will or may have to transfer an economic resource that it **would not otherwise have had to transfer**.

Obligations specified in the regulatory agreement

Entity has no practical ability to avoid

The economic resource

Regulatory liability

The **present regulatory obligation** to provide **goods or services at a rate reduced by an amount** as a result of **past events**.

Entity has received economic benefits for service requirements not yet fulfilled

Get involved

Find out more: www.ifrs.org

Follow us:

@IFRSFoundation

IFRS Foundation
International Accounting Standards Board

IFRS Foundation

IFRS Foundation

Join our team: go.ifrs.org/careers