REPORTING THE FINANCIAL EFFECTS OF RATE REGULATION
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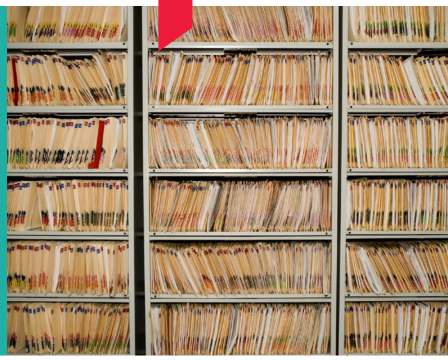

Summary

The International Accounting Standards Board (IASB) published DP/2014/2 *Reporting the Financial Effects of Rate Regulation* (the DP) on 17 September 2014.

The purpose of the DP is to identify what kind of information is most relevant to users of financial statements in making investment and lending decisions for entities that operate in rate regulated industries. In doing so, the IASB is asking:

- What distinguishes the economic environment in which rate-regulated entities operate; and
- Whether these differences would best be reflected in general purpose financial statements by modifying the requirements of IFRS.

No IFRS accounting guidance for rate-regulated entities existed before the issuance of IFRS 14 *Regulatory Deferral Accounts*. In practice, entities have not recognised assets or liabilities for the balances that arise when a rate-regulated entity recognises amounts of costs or income in a different period for regulatory purposes (regulatory deferral accounts).

The question is as to whether this practice faithfully depicts the financial effects of rate regulation on the entity. The key question is whether those regulatory deferral accounts give rise to an asset or a liability that meets the criteria stated in the *Conceptual Framework* of IFRS.

The IASB has published the DP to seek information to establish a common starting point for further discussion on the accounting for rate-regulated activities.

The deadline for comments on DP/2014/2 *Reporting the Financial Effects of Rate Regulation* is 15 January 2015.

STATUS
Discussion Paper

EFFECTIVE DATE
To be confirmed

ACCOUNTING IMPACT
None at present. The Discussion Paper has been issued to assist the IASB in establishing a starting point for further discussions about accounting for rate-regulated activities.

Background

Except for the guidance in IFRS 14 *Regulatory Deferral Accounts*, there are no requirements on the accounting for rate regulated entities within IFRS. However, local laws in some countries require entities to recognise an asset or a liability for regulatory deferral account balances, either as part of the asset (property, plant or equipment or intangible asset) or as a separate regulatory asset/liability. The recognition of those assets and liabilities affect the timing and amount of revenue recognition. When applying IFRS, entities usually eliminate regulatory account balances to comply with IFRS requirements.

To assess the question of whether regulatory deferral accounts meet the definitions of an asset or a liability in the Framework, the IASB started a comprehensive research project in September 2012 to investigate the issues raised by stakeholders with regard to rate-regulated activities. As a temporary solution, the IASB published IFRS 14 in January 2014 which is only applicable to first-time adopters of IFRS.

IFRS 14 allows the application of previous GAAP accounting for regulatory deferral account balances with presentation and disclosure requirements that may be different from previous GAAP. However, the IASB has not addressed the question whether regulatory deferral accounts give rise to an asset or liability and therefore issued the DP to further progress on this question.

Objective of the rate-regulated activities research project

The DP is seeking further evidence about the accounting for rate-regulated entities. In doing so, the DP aims to obtain further information about the:

- Most relevant information about the economic effects of rate regulation for users of financial statements;
- Features of rate regulation that have the greatest effect on the amount, timing and certainty of revenue, profit and cash flows;
- Possible amendments to IFRS that would be needed to provide more relevant information about rate regulation.

Many different forms of rate-regulation exist worldwide. Because of this, it is difficult to develop a consensus on accounting principles as the rights and obligations created by the different types of rate regulation vary widely. Therefore in the DP, the IASB focuses on a generic type of rate regulation which is referred to as 'defined rate regulation' and is described below.

Main sections of the Discussion Paper

The DP is divided into different sections that cover various aspects of the discussion on rate-regulated activities. The main sections are summarised below.

Providing useful information about rate regulation

The IASB summarises its view on what kind of financial information is most useful to users of financial statements in making investment decisions and outline the main message the IASB has reached from prior research on rate regulated activities.

It is noted that rate regulation generally has an impact on the amount, timing and certainty of future cash flows and affects the recognition of profits. The most relevant information about rate regulation for users of financial statements is identified to be:

- Information that provides confidence that the rate regulation will enable the entity to recover certain of its costs and generate sufficient returns to cover its cost of capital (repayment of borrowings, interest and dividend payments);
- Information that enables users to distinguish variability in performance that is adjusted through the rate-regulatory mechanism from variability for which the mechanism provides no adjustment.

What is rate regulation?

This section describes the reasons for the existence of rate regulation and its objectives as being:

- Protection of customers by price regulation or establishing a reasonable level of quality;
- Increased customer satisfaction;
- Increased supply capacity and reliability;
- Achievement of environmental goals;
- Development of innovative technologies/use of alternative resources;
- Encouragement of competition;
- Decreases or increases in customer demand.

Defined rate regulation

The definition of defined rate regulation is established in the DP to allow for a common approach for the discussion of rate regulated activities. Accordingly, the definition includes a number of features that are common for rate regulated entities.

- It applies when customers have little or no choice but to purchase the rate-regulated goods or services from the entity (e.g. energy, water, telecommunication services and postal services);
- The rate-regulation ensures that the rate-regulated entity recovers a determinable amount of consideration (revenue requirement) in exchange for the rate-regulated activities that it performs;
- The rate regulation establishes the time at which the entity can bill customers for that consideration through the rate per unit chargeable to customers.

Alternative financial reporting approaches

In considering how the financial effects of rate regulated entities might be presented in financial statements, the IASB sets out a number of approaches that it considers may provide useful information to users of those financial statements. These are:

- Recognition of the package of rights and obligations as an intangible asset (i.e. licence);
- Adopting the regulatory accounting requirements by providing an exemption to the general requirements of IFRS;
- Developing specific IFRS requirements to defer or accelerate the recognition of costs, revenue or a combination of both;
- Prohibiting the recognition of regulatory deferral account balances in IFRS financial statements.

Presentation and disclosure requirements in IFRS 14

The DP also discusses the existing presentation and disclosure requirements within IFRS 14 Reg*ulatory Deferral Accounts* and asks respondents for their views about their usefulness. The IFRS 14 requirements are set out in the following categories:

- Presentation of amounts recognised in the statement of financial position, profit or loss and other comprehensive income; and
- Disclosures about the activities that are subject to rate regulation.

Effective Date and Transition

An effective date for an IFRS that might be developed will be determined later in the project.

The deadline for comments on DP/2014/2 *Reporting the Financial Effects of Rate Regulation* is 15 January 2015.

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