

16 January 2015

International Accounting Standards Board  
30 Cannon Street  
London EC4M 6XH  
United Kingdom

Dear Sir/Madam,

**Re: DP/2014/2 Reporting the Financial Effects of Rate Regulation**

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the Discussion Paper, *Reporting the Financial Effects of Rate Regulation*, issued by the IASB on 15 September 2014 (the 'DP').

This letter is intended to contribute to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of definitive IFRS in the European Union and European Economic Area.

*General comments*

EFRAG welcomes the IASB's comprehensive project on rate-regulated activities and the publication of the above mentioned DP. IFRS do not generally require financial statements to contain the information that users regard as useful to understand the financial effects of rate regulation on an entity's rate-regulated activities. In the absence of specific guidance in the IFRS literature, the established practice is for rate-regulated entities not to recognise the effects of rate-regulation in the IFRS financial statements. As a result, users obtain the information they need from different sources – including local GAAP financial statements, investor presentations and public information provided by the rate regulator.

We have learned from many users that cover rate-regulated entities that they prefer these effects of rate regulation to be recognised in the financial statements, rather than being communicated through disclosure-only requirements. This would enhance their understanding of how rate regulation affects an entity's rate-regulated activities, and consequently the usefulness of the information provided in the financial statements. EFRAG therefore believes it is necessary for the IASB to consider how to account for the effects of rate regulation in the IFRS financial statements.

*Detailed comments on the DP*

Our detailed comments and responses to the questions in the DP are set out in the Appendix. A summary is provided in the paragraphs below.

We support the IASB's decision to initially focus the debate on accounting for rate-regulated activities on a particular type of rate regulation referred to as defined rate regulation in order to understand the economic impact of rate regulation on a limited range of activities before moving to the next stage of the project. We also broadly agree that defined rate regulation forms a good basis for identifying which features of rate-regulatory schemes distinguish rate-regulated activities from other commercial activities.

However, we believe that the DP represents only a starting point in this project. As the IASB progresses the project, we believe it will need to consider in which circumstances an entity's right to recover an agreed amount of revenue and obligations to perform certain rate-regulated activities create enforceable rights and obligations that should be

recognised in the IFRS financial statements. The IASB might also need to consider whether it should eventually widen the scope of any potential future accounting guidance, in order to require disclosures of a wider range of schemes, to enable a necessary understanding of the impact of rate regulation in the IFRS financial statements.

Whilst we broadly support the description of defined rate regulation, we believe that the existence of a rate-setting framework that creates enforceable rights and obligations and includes an adjusting mechanism based on the revenue requirement (as defined in the DP) has a pivotal role to play in the scoping of the IASB's Rate-regulated Activities project. In our view, it is the enforceable rights and obligations that stem from this rate-setting framework that should be considered for recognition in the IFRS financial statements and therefore we see the main purpose of the features listed in paragraph 4.4(a)–(c) of the DP as ensuring enforceability of those rights and obligations. We have also provided a number of suggestions about how these features might be improved so as to achieve this purpose, which may also assist in developing any potential future accounting guidance.

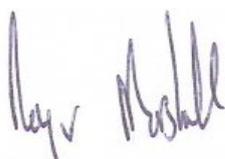
With regard to the accounting approaches proposed in the DP, we believe that the revenue approach has an important role to play in any future accounting guidance. We remain open to discussing a cost deferral approach described in the DP, and recommend the IASB to explore in more detail cases where such an approach might produce relevant information. Furthermore, we support an approach that is principle-based and which can be applied to different rate regulatory regimes that evolve over time.

We believe that the disclosures in IFRS 14 *Regulatory Deferral Accounts* are a good starting point. We also support separate presentation of regulatory balances in the IFRS financial statements, on the basis that it will enhance the relevance and usefulness of the information about the financial effects of rate regulation. We further note that it is important for the IASB to consider a balanced approach with respect to the disclosure requirements and to focus on the types of disclosures that are useful for users of financial statements without imposing excessive costs on preparers.

Finally, we believe that the IASB should test, using real life examples, the description of defined rate regulation and any accounting guidance it develops to ensure that no rate-regulatory scheme inappropriately falls outside the scope of the project.

If you would like to discuss our comments further, please do not hesitate to contact Isabel Batista, Giorgio Acunzo, Sapna Heeralall or me.

Yours faithfully,



Roger Marshall  
**Acting President of the EFRAG Board**

## APPENDIX

### Question 1

- (a) What information about the entity's rate-regulated activities and the rate-regulatory environment do you think preparers of financial statements need to include in their financial statements or accompanying documents such as management commentary?

Please specify what information should be provided in:

- (i) the statement of financial position;
  - (ii) the statement(s) of profit or loss and other comprehensive income;
  - (iii) the statement of cash flows;
  - (iv) the note disclosures; or
  - (v) the management commentary.
- (b) How do you think that information would be used by investors and lenders in making investment and lending decisions?

### EFRAG's response

**We have learned from many users that cover rate-regulated entities that IFRS financial statements do not provide relevant and useful information that meets users' needs about rate-regulated activities and that they prefer these effects to be recognised in the financial statements, rather than being communicated through disclosure-only requirements.**

**This would enhance their understanding of how rate regulation affects an entity's rate-regulated activities, and consequently the usefulness of the information provided in the financial statements. EFRAG therefore believes it is necessary for the IASB to consider how to account for the financial effects of rate regulation in the IFRS financial statements.**

### General comments

- 1 EFRAG has undertaken some outreach with analysts that cover rate-regulated industries and consulted with EFRAG's User Panel to understand what information users need when analysing rate-regulated activities that are subject to defined rate regulation.
- 2 During the outreach, we have learned that IFRS financial statements currently do not generally provide the information users regard as useful and relevant to understand the impact of rate-regulated activities on an entity's revenue and related costs, future cash flows and financial position associated with an entity's rate-regulated activities. Users presently obtain the information from different sources – for example directly from the entities, local GAAP financial statements, investor presentations and public information provided by the rate regulator.
- 3 We also understand that management of rate-regulated entities uses information that is significantly different to that reported in the IFRS financial statements to explain to investors and other users the financial effects of rate regulation.
- 4 We also note that preparers and auditors have stated that the effects of rate regulation should be recognised in the financial statements. Furthermore, they noted that the overall disclosure requirements should be in line with existing disclosure requirements such as the ones in IFRS 15 *Revenue from Contracts with*

*Customers.* These parties were concerned that any specific disclosure requirements were carefully targeted to meet the needs of users without imposing excessive costs on preparers.

Complexity and on-going changes in the regulation

- 5 A minority of users prefer rate-regulated entities to only disclose information about the impacts of rate regulation on their rate-regulated activities. These users believe that the recognition of the impacts of rate regulation has significant drawbacks primarily because of the complexity of rate-regulated regimes and on-going changes to regulations. In their view, recognition of the impacts of rate regulation at the potential expense of reliability and relevance would increase complexity and therefore reduce the understandability of financial statements.
- 6 Furthermore, we learned that users would be concerned if entities recognised the impacts of rate regulation without providing a sufficient understanding of whether the items that would result from such recognition would be recovered or settled in future periods. In their view, without a sufficient level of disaggregation that allows them to understand (a) the mechanics of the regulation(s); (b) the nature and enforceability of the rights and obligations; and (c) the expected timing and risks associated with their recovery and settlement, the information in the financial statements resulting from the recognition of the impacts of rate-regulation would not be understandable.
- 7 However, other users noted that the inherent complexity of rate regulation should not hinder the debate about the accounting for the effects of rate regulation as the performance of these entities is fully based on, and influenced by, the regulation. As explained in the above paragraphs, rate-regulated entities operate in a unique environment and entities are subject to unique rights and obligations created by the regulation that need to be reflected in the financial statements. Failure to do so will result in failing to appropriately reflect the economic reality in which rate-regulated entities operate. This view is consistent with the messages we have heard from preparers that have activities that are subject to defined rate regulation.

Comparability, transparency and level playing field

- 8 Some users stated that if the IASB were to develop specific accounting guidance, it would enhance comparability and consistency across entities and across jurisdictions. These users noted that while in some jurisdictions sufficient information is already available – even if currently outside the IFRS financial statements – circumstances exist where they are unable to perform an independent analysis without obtaining information from the entities operating rate-regulated activities.
- 9 Furthermore, we have heard that there are differences in users' ability to access some information. Large investors normally are privileged to have direct contact with rate-regulated entities to obtain the relevant information needed. However, this is not generally the case for smaller investors. Therefore, having a consistent set of information on rate regulation in the financial statements would create a level playing field for all users.

Stewardship

- 10 Finally, we believe that one of the factors to consider is the stewardship function of financial statements. From a stewardship perspective, it is considered relevant to recognise the impacts of regulation to provide information on an entity's performance during the year and the discharge of management's responsibility in this respect to its shareholders and other stakeholders.

Question 1(a)

Information users need

- 11 EFRAG has learnt from many users that cover entities that operate in rate-regulated industries that they would like to see the financial effects of rate-regulated activities reflected in the financial statements. This would enhance their understanding of how rate regulation affects an entity's financial position and return on assets generated by rate-regulated activities, performance, cash flows and consequently the usefulness of the information provided. We have not heard that users are seeking specific rate-regulated information in the statement of cash flows.
- 12 On the other hand, more generalist users express the concern that regulatory regimes could be extremely complex and subject to significant uncertainty about how external factors could affect regulations and how regulatory requirements apply to entities. This creates complexity with regards to any recognition of the impacts of rate regulation and raises questions about whether information would be comparable between entities and across jurisdictions. As a result, they tend to favour having the information through disclosure – either in the notes to the financial statements or in the management commentary. However, specialist users did not share this concern because entities already deal with the inherent complexities that arise from rate regulation.
- 13 All users agreed that they need an understandable qualitative description of the rate-regulated regime in which the entity operates because, without such a description, the financial statements cannot be analysed effectively. However, there were mixed views about where the information should be presented, with some users stating that some of the information could be included in the management commentary and others saying that information in the financial statements about the mechanics of rate regulation should be brief and understandable. In contrast, preparers and auditors stated that the level of granularity of these disclosures should depend on facts and circumstances, be clear, concise and to the point. They should help users in obtaining a clear understanding of the numbers reported and of the related risks but they should not replicate detailed information available from other sources.
- 14 Users indicated that the following information would be useful:
  - (a) How defined rate regulation works for each rate-regulated activity and in each jurisdiction in which the entity operates, including an explanation of the statutory framework that drives the regulatory agreement;
  - (b) Expected changes to that legislation and what effects (financial and non-financial) such changes could cause;
  - (c) The risks that entities face as a result of rate regulation, whether regulators (and potentially governments) are committed to supporting the revenue requirement as referred to in the DP, how rate calculations are made, and how stable/strong the regulatory framework is in terms of, for example, legal enforceability of the item recognised into the accounts to reflect impacts of regulation; and
  - (d) The relationship between the rate regulator and the entity, and the track record of the entity in recovering costs and earning the return allowed by the rate regulation.

Financial position

- 15 The impacts of rate regulation, that are relevant from an accounting prospective, result from differences between the time when particular revenue or costs are

allowed for regulatory purposes (the adjusting mechanism based on the revenue requirement and the agreed regulatory period) and when they are recognised in the statement of profit or loss in the IFRS financial statements. Many users argue that such impacts of rate regulation should be recognised in the statement of financial position. This is because users need to know whether an entity will be able to recover its costs and generate sufficient returns to cover its cost of capital.

- 16 Some regulatory schemes monitor the rate-setting mechanism and determine the revenue requirement either through a Regulatory Asset Base, or on a form of a revenue cap, without a formal reference to a Regulatory Asset Base. When a Regulatory Asset Base is used, users have informed us that the Regulatory Asset Base for each asset class in each geographical region is useful because:
- (a) Entities generally run their rate-regulated operations by managing their Regulatory Asset Base being the main factor that affects the revenue requirement, and therefore the cash flows, in future periods.
  - (b) The Regulatory Asset Base is used as a tool to assess enterprise value by applying multiples. It is fundamental in setting up a forecast of future earnings and cash flows in order to assess the return that a rate-regulated entity is entitled to earn. There are also wider implications of the Regulatory Asset Base, which users need to understand such as dividend and expenditure/cost policies.
  - (c) Rate regulations not only regulate the rate per unit to be charged to customers for the rate-regulated goods or services provided to them, but also regulate the activities that an entity must perform to be entitled to that rate per unit. As a result, this influences the future investment plans of the entity. Such information on future plans would be useful for users as it helps predict future investment cash outflows.
- 17 However, users generally acknowledge that it might be challenging or impracticable to present in the statement of financial position an amount that reconciles IFRS numbers with the Regulatory Asset Base, as it exists in the regulatory accounting, because it is often based on other frameworks of accounting (such as local GAAP or specific regulatory reporting). Furthermore, this could obscure financial information that results from applying IFRS (e.g. IAS 16 *Property, Plant and Equipment*). We have heard from preparers and auditors that this would be impracticable when the Regulatory Asset Base and IFRS systems are fundamentally different. These parties would support the disclosure of the Regulatory Asset Base, if available, but not a reconciliation. Some preparers would prefer to disclose it elsewhere in the annual report (such as the management commentary) particularly when the Regulatory Asset Base is not verifiable, creating issues with reliability.
- 18 Some of the potential difficulties noted above might explain why some users would prefer to obtain this type of information through a form of a qualitative single-note disclosure instead of aligning the amounts presented on the IFRS balance sheet to the ones determined under the regulatory regime (the regulatory balance sheet).

#### Performance

- 19 Rate regulation is generally designed to ensure that the rate-regulated entity recovers a determinable amount of consideration (revenue requirement) in exchange for the settlement of regulatory obligations and delivery of the rate-regulated goods or services. In addition, the rate regulation establishes, through the tariff per unit chargeable to customers, the time at which the entity can bill customers for that consideration (the regulatory period). We have heard that the key element

for users is that the performance reported in profit or loss faithfully reflects the revenue requirement that an entity is entitled to receive because it has fulfilled the obligations set in the rate regulation that include the provision of rate-regulated goods and services.

- 20 Revenue is impacted because rate regulation affects the amount of revenue an entity is entitled to charge its customers, under the regulatory agreement, over a period of time (i.e. the regulatory period) for a rate-regulated good or service. Some users argue that it is relevant to have information in profit or loss on revenue numbers that are linked to the cash flows that an entity is entitled to receive under the regulatory agreement and determined through the revenue requirement.
- 21 Furthermore, to understand the impact of rate regulation, EFRAG believes that users need to understand what causes the differences between the billable revenue and the revenue requirement and how to settle them using the adjusting mechanism based on the revenue requirement. For instance, the following qualitative *disclosure* would be useful depending on relevant facts and circumstances:
- (a) The causes of variability in revenue and related costs (performance) reported by an entity that depend on factors outside the control of both the rate-regulated entity and the rate regulator (such as a drop in demand for the rate-regulated good or service).
  - (b) The main differences between revenue reported in the IFRS financial statements for rate-regulated activities and the corresponding revenue to which an entity is entitled through the revenue requirement applicable to those activities, in the current and future periods.
  - (c) Which costs are recoverable and which costs are not, in relation to regulated activities, and the tariff per unit the entity will be entitled to charge through the revenue requirement in future periods and the expected return from the delivery of rate-regulated goods or services. Some preparers have stated that this general disclosure should be included in the description of the regulatory environment, which should not be described in detail in the financial statements given that it can be obtained from other sources such as the regulatory accounts or the entity's website.
  - (d) Users are interested in understanding how a tariff constraint would affect future cash flows such as:
    - (i) the uncertainty in future rate-setting that impacts the revenue requirement;
    - (ii) the rate-regulated activities an entity must perform to earn the revenue requirement and the period in which it is required to perform those activities; and
    - (iii) a breakdown of the revenue requirement depending on the nature of the components: for example, return on the Regulatory Asset Base when applicable, bonuses on qualitative performance and claw-back of non-controllable costs.
  - (e) Separate presentation of results from rate-regulated activities from non-regulated ones.
  - (f) Segment information per rate-setting framework on the revenue requirement with an explanation of the factors incorporated in each revenue requirement

and the related risks to recover it. Some preparers have stated that this disclosure should be included only in respect of circumstances that are materially different.

Disclosure of the effects of rate regulation

- 22 We note that some of the information about the financial position and performance of an entity that operates in an environment where some (or all) of its activities are subject to rate regulation could be reported in the notes to the financial statements or the management commentary.
- 23 However, as previously noted, we have heard that many users would prefer to have the information, particularly when it has a direct impact on an entity's revenue, costs and financial position, reflected in the financial statements. This should be supplemented by disclosures in one place within the notes and materiality should be taken into consideration.

Placement of rate regulation disclosures in the annual report

- 24 In the sub-sections above, we have described a set of disclosures that we understand are useful to users of entities operating rate-regulated activities regardless of where their placement should be in the annual report, e.g. whether they should belong in the notes to financial statements or be part of the management commentary.
- 25 If the IASB were to develop specific accounting guidance on the effects of rate regulation on an entity's performance, future cash flows and financial position, we recommend that the IASB consider EFRAG's past recommendations included in the Discussion Paper *Towards a Disclosure Framework for the Notes*<sup>1</sup> to identify:
- (a) what should be required as part of financial statements; and
  - (b) what should be recommended as part of the management commentary.

*Question 1(b)*

- 26 We have been advised that the information is used by investors and analysts mainly to assess the following:
- (a) estimating future cash flows (and valuation inputs);
  - (b) estimating the enterprise value of rate-regulated entities;
  - (c) isolating and understanding what causes volatility in earnings;
  - (d) assessing the regulatory risk that is mainly seen as twofold :
    - (i) regulatory stability: this depends on how political influences could affect the enforceability of the regulation and the actions of the entity operating rate-regulated activities (e.g. investments in green energy instead of in coal-fired plant; deferral in the rise of tariffs due to unfavourable economic cycle); and

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<sup>1</sup> This discussion paper was published in 2012. In the discussion paper EFRAG and its partners ANC and the FRC proposed the following definition that should guide the standard setter in setting disclosure requirements that would make financial statements a well-defined component of financial reporting: *'The purpose of the notes is to provide a relevant description of the items presented in the primary financial statements and of unrecognised arrangements, claims against and rights of the entity that exist at the reporting date'*.

- (ii) regulatory independence or leverage: this depends on the negotiation power that the entity operating rate-regulated activities has over the regulator.
- (e) efficiency of tariff setting procedures; and
- (f) assessing a company's credit worthiness; and financial stability.

### **Question 2**

Are you familiar with using financial statements that recognise regulatory deferral account balances as regulatory assets or regulatory liabilities, for example in accordance with US generally accepted accounting principles (GAAP) or other local GAAP or in accordance with IFRS 14? If so, what problems, if any, does the recognition of such balances cause users of financial statements when evaluating investment or lending decisions in rate-regulated entities that recognise such balances compared to:

- (a) non-rate-regulated entities; and
- (b) rate-regulated entities that do not recognise such balances?

### **EFRAG's response**

**EFRAG has heard from users that since some rate-regulated entities recognise the effects of rate regulation as regulatory deferral account balances and some do not, there is a lack of comparability and consistency across rate-regulated entities.**

- 27 We have heard from users that some European rate-regulated entities recognise the effects of rate regulation as regulatory deferral account balances in their IFRS financial statements and some do not.
- 28 These users noted that having some entities recognise deferral regulatory account balances and others not, reduces comparability for users that have different levels of access to information (for example, large investor institutions are granted a more privileged position compared to smaller investors in accessing information from an entity's management).

### **Question 3**

Do you agree that, to progress this project, the IASB should focus on a defined type of rate regulation (see Section 4) in order to provide a common starting point for a more focused discussion about whether rate regulation creates a combination of rights and obligations for which specific accounting guidance or requirements might need to be developed (see paragraphs 3.6–3.7 of the DP)? If not, how do you suggest that the IASB should address the diversity in the types of rate regulation summarised in Section 3 of the DP?

### **EFRAG's response**

**EFRAG agrees that defined rate regulation forms a good basis to identify which features of rate-regulatory schemes distinguish rate-regulated activities from other commercial activities and create a combination of rights and obligations that should be reflected in the IFRS financial statements.**

**However, we believe that the existence of a rate-setting framework that creates enforceable rights and obligations and includes an adjusting mechanism based on the revenue requirement has a pivotal role to play in scoping the Rate-regulated Activities project.**

- 29 We support the IASB's decision to focus the debate initially on accounting for a specific type of rate regulation referred to as defined rate regulation. This makes it easier to understand the economic impact of rate regulation on a limited range of entities before moving to the next stage of the project. We also support the focus on rate-regulated activities rather than rate-regulated entities as some entities undertake both regulated and unregulated activities and because IFRS should require a similar accounting treatment for transactions with similar economic characteristics rather than attempt to create industry specific standards applicable only to a subset of entities.
- 30 However, we believe that the DP represents only a starting point in this project. As the IASB progresses, we recommend that the IASB consider in which circumstances an entity's right to recover an agreed amount of revenue in exchange for performing certain rate-regulated activities creates rights and obligations that should be reflected in IFRS financial statements.
- 31 Furthermore, we believe that the existence of a rate-setting framework that creates enforceable rights and obligations and includes an adjusting mechanism based on the revenue requirement has a pivotal role to play in the scoping of the Rate-regulated Activities project. We explain our view further in our response to question 5.
- 32 Finally, we believe that the IASB should test, using real life examples, the description of defined rate regulation and any accounting guidance it develops to ensure that no rate-regulatory scheme inappropriately falls outside the scope of the project.

#### **Question 4**

Paragraph 2.11 notes that the IASB has not received requests for it to develop special accounting requirements for the form of limited or 'market' rate regulation that is used to supplement the inefficient competitive forces in the market (see paragraphs 3.30–3.33).

- (a) Do you agree that this type of rate regulation does not create a significantly different economic environment and, therefore, does not require any specific accounting requirements to be developed? If not, why not?
- (b) If you agree that this type of rate regulation does not require any specific accounting requirements, do you think that the IASB should, alternatively, consider developing specific disclosure requirements? If so, what would you propose and why?

#### **EFRAG's response**

**EFRAG broadly agrees that market rate regulation has characteristics that differ significantly from defined rate regulation. We also agree that it does not create an economic environment that differs significantly from other commercial activities because it does not give rise to rights and obligations which are found in defined rate regulation. On this basis, we believe that existing IFRS are sufficient to faithfully depict the financial position and performance of those activities.**

#### *Question 4 (a)*

- 33 EFRAG agrees that market rate regulation has characteristics that differ significantly from defined rate regulation. In addition, market rate regulation does not create a significantly different economic environment from other commercial activities for reasons stated in paragraphs 3.30–3.33 of the DP. Therefore, we believe that

existing IFRSs are able to faithfully depict the financial position and performance of those activities.

*Question 4 (b)*

- 34 EFRAG encourages the IASB, in the course of its comprehensive project on rate-regulated activities, to investigate whether there are features of so-called market rate regulation that have similarities to defined rate regulation. In such cases, the IASB might need to consider whether it should eventually widen the scope of any future accounting guidance to include disclosures about other forms of rate regulation (that do not fit within defined rate regulation) that will be useful for users of financial statements.
- 35 For example, during our outreach with industry specific users, we heard that it might be useful to explain the regulatory framework under which market rate-regulated entities operate. This would be consistent with the requirements in paragraph 112(c) of IAS 1 *Presentation of Financial Statements*, which require an entity to provide information in the notes where such information is not presented elsewhere in the financial statements, but is relevant to an understanding of any of them.

**Question 5**

Paragraphs 4.4–4.6 of the DP summarise the key features of defined rate regulation. These features have been the focus of the IASB’s exploration of whether defined rate regulation creates a combination of rights and obligations for which specific accounting guidance or requirements might be developed in order to provide relevant information to users of general purpose financial statements.

- (a) Do you think that the description of defined rate regulation captures an appropriate population of rate-regulatory schemes within its scope? If so, why? If not, why not?
- (b) Do you think that any of the features described should be modified in order to include or exclude particular types of rate-regulatory schemes or rate-regulated activities included within the scope of defined rate regulation? Please specify and give reasons to support any modifications to the features that you suggest, with particular reference to why the features may or may not give rise to circumstances that result in particular information needs for users of the financial statements.
- (c) Are there any additional features that you think should be included to establish the scope of defined rate regulation or would you omit any of the features described? Please specify and give reasons to support any features that you would add or omit.

**EFRAG's response**

**We broadly agree with the description of defined rate regulation as it captures the distinguishing features of rate-regulated activities and we provide some suggestions on how to improve their description.**

**However, we do not believe that these features should be given equal weight in any future specific accounting guidance.**

**Firstly, we believe that the existence of a rate-setting framework including an adjusting mechanism based on the revenue requirement should play a pivotal role in the scoping of the Rate-regulated Activities project.**

**Secondly, we believe that enforceable rights and obligations that stem from this rate-setting framework are the rights and obligations that should be considered for recognition in the financial statements.**

**Finally, we believe that the other features should serve as indicators for assessing whether the rights and obligations that stem from the rate-setting framework ought to be recognised in the IFRS financial statements.**

*Question 5(a) – does defined rate regulation captures an appropriate population?*

- 36 As noted in our answer to Question 3, EFRAG supports the IASB's decision to focus on defined rate regulation in the DP. We acknowledge this provides a common starting point for a focussed discussion to help understand the economic impact of rate regulation on a limited range of activities and specifically whether rate regulation creates a combination of rights and obligations.
- 37 However, we believe that the DP represents only a starting point in the discussion. As the IASB progresses on the project, we believe it will need to consider in which circumstances an entity's right to recover an agreed amount of revenue and obligations to perform certain activities creates enforceable rights and obligations that should be recognised in the IFRS financial statements.

The description of defined rate regulation

- 38 EFRAG broadly supports the description of defined rate regulation in the DP and notes that the features included in paragraph 4.4 of the DP are important characteristics of rate-regulated activities. However we do not believe that all these features should be given equal weight in setting future accounting guidance on rate-regulated activities.
- 39 During our discussions, we heard from preparers in the utility sector that an entity's distinguishable right to a revenue requirement – or 'distinguishable obligation' to have an entity's total return set by the regulator – is what differentiates rate-regulated activities from other activities (including regulated activities that do not contain this right). We agree with this view and therefore believe that the rate-setting framework, including the adjustment mechanism based on the revenue requirement, and the rights and obligations that stem from the rate-setting framework, should play a pivotal role in scoping the Rate-regulated Activities project.
- 40 Paragraph 3.6 of the DP explains that defined rate regulation is designed to ensure that the rate-regulated entity recovers the revenue requirement in exchange for the rate-regulated activities that it performs. We note that the connection between:
- (a) the legislation that sets and enforces the revenue requirement;
  - (b) the agreement that binds the customer; and

- (c) the rate-regulated activities an entity needs to deliver to be entitled to the revenue requirement

are important factors that need to be reflected in the definition of defined rate regulation. We explain our reasoning in the paragraphs below.

The legislation that sets and enforces the revenue requirement

41 Paragraph 4.5 of the DP describes a rate-setting framework as a means to establish a revenue requirement in the form of a consideration that grants a rate-regulated entity a right to receive from or a present obligation to pay its customers for delivering the rate-regulated goods or services. We broadly agree with this description. However, in order to further justify that rights and obligations can be made enforceable by the rate-setting framework, we believe that the definition of rate regulation needs to:

- (a) focus more predominantly on the legislation that enforces the rate-setting framework. In other words, the legislation that an entity can turn to in case it needs to enforce the consideration it is allowed to charge must be the starting point in the definition of defined rate regulation. As a result, we believe that the rate-setting framework needs to be clearly embedded within the description of defined rate regulation; and
- (b) require an external rate regulator (or similar body) that sets and enforces the rights and obligations.

The agreement that binds the customer

42 We think it is important to link the rights and obligations required by defined rate regulation with the customer or the customer base of the entity. The rights and obligations discussed in paragraphs 4.62 – 4.79 of the DP stem from the agreement between the rate regulator and the rate-regulated entity.

43 The customer is not a party to the agreement between the rate regulator and the entity in the majority of European regulatory regimes. It is therefore necessary to explain how defined rate regulation binds the customer. This is discussed further in the paragraphs below.

44 We also note that a supplier can be an intermediary between the rate-regulated entity and the customer, for instance a regulated gas distribution entity would invoice the usage of the gas distribution network to the gas supplier, who in turn invoices the customer. Therefore, we believe that the proposed definition should consider regulatory regimes which involve direct or indirect supply of the rate-regulated goods or services to customers.

The unit of account

45 EFRAG also believes that the unit of account has an important role to play in either the description of defined rate regulation or within one of the indicators of defined rate regulation. If it were to be considered within the indicators, we think it should be included in the indicator discussed in paragraph 4.4(a) of the DP.

46 Some argue that, under current IFRS, the unit of account for a utility entity is the provision of services to the individual customer. In their view, this is consistent with any other commercial activity. However, given the essential nature of the good or service, the low demand risk and the existence of the rate regulation, the question is whether the unit of account is the customer base, rather than the individual customer. The unit of account could therefore not focus on the relationship with individual customers, but instead on the customer base as a whole. For example,

to apply IFRS 15, the entity would need to identify the performance obligation(s) it has with the customer base as it would replace individual customer contracts with a customer base virtual contract. In this case, the delivery of rate-regulated goods or services to customers would be seen as the distinct performance obligation in this overall virtual contract and the revenue requirement would be seen as the consideration an entity is entitled to earn to fulfil its performance obligations set in the regulation and the delivery of the goods or services. We recommend the IASB explore whether such a change in the unit of account would help reflect faithfully the rights and obligations that arise from the revenue requirement.

- 47 We understand that there could be two agreements that a rate-regulated entity needs to consider with respect to the revenue recognition under the rate-setting framework:
- (a) the agreement it has directly with the customer to supply rate-regulated goods or services; and
  - (b) the agreement it has with the rate regulator.
- 48 In the exposure draft ED/2009/8 *Rate-regulated Activities*, the IASB noted in paragraph BC19 of the Basis for Conclusions that '*regulation governs the entity's relationship with its customer base as a whole*'; and '*although the individual members of that group may change over time, the relationship the regulator oversees is between the entity and the group*'. Therefore, the IASB concluded that the requirements in the ED should be applied at '*the aggregate customer level*'.
- 49 Given the above reasoning, we believe the IASB needs to explore further how to link the agreement an entity has with the rate regulator with the agreement it has with its individual customer and/or with its customer base as a whole.

Rate-regulated activities an entity needs to undertake to be entitled to the revenue requirement

- 50 As explained in paragraph 4.14 of the DP, an entity must satisfy certain activities to be entitled to the revenue requirement. These activities can be both direct and indirect obligations (for example satisfying government/rate regulator objectives such as changes to the infrastructure network) related to rate-regulated activities. These activities give rise to rights and obligations within the rate-setting framework and affect the amount of the revenue requirement through the adjusting mechanism.
- 51 In our view, direct and indirect activities, as described in the DP, can create different types of obligations, some of which involve performance to a customer (for example, delivered electricity); and others involve satisfying an obligation required by a rate regulator or a government (for example, availability of certain infrastructures). Some argue that performing towards the customers is not what creates the current right to the revenue requirement; an entity is already entitled to earn because they have met the obligations set in the rate-setting framework (regulatory agreement). EFRAG does not support this view because we believe that revenue should not be recognised until the performance obligations associated with the delivery of goods and services have been fulfilled.
- 52 We note that in paragraph 4.66 of the DP, the nature of rights that arise from undertaking these activities that settle indirect obligations with the regulator is analogised to those assets that '*creates an opportunity to generate an inflow of cash or another financial asset, but it does not give rise to a present right to receive cash or another financial asset*' (e.g. paragraph AG10 of IAS 32 *Financial Instruments: Presentation*). In our view, this further distinction between rights and obligations would permit the IASB to develop its project further.

- 53 We therefore believe it is important to understand the link between the performance of rate-regulated activities and the customer in the description of defined rate regulation. This is particularly important when assessing if revenue should be recognised only for services or goods delivered to the customer or whether there are other situations where revenue should also be recognised. Indirect activities as described in the DP are not directly linked to the satisfaction of the performance obligations with the customers, and may therefore not result in the recognition of revenue even if they directly affect an entity's current right to the earn the revenue requirement (e.g. maintaining the availability of infrastructures).
- 54 Overall, we believe that a clearer view of the rate-regulated entity's performance obligations to receive the revenue requirement is needed as the IASB progresses with this project. For example, the IASB should separately assess which type of rights and obligations arise from the fulfilment of other obligations (i.e. indirect obligations mentioned in the DP).

*Question 5(b) – should any of the features be modified?*

- 55 In responding to question 5(a) we have noted a number of features that in our view are crucial in describing a regulation which creates enforceable rights and obligations to the entities operating rate-regulated activities.
- 56 In the paragraphs below we have provided a number of suggestions about how the features of defined rate regulation as described in the DP might act as indicators of enforceable rights and obligations, which may also assist in supporting a particular future accounting approach.

Customers have little or no choice but to purchase the goods or services (paragraph 4.4(a) of the DP)

- 57 We support this feature being included as an indicator contributing to the enforceability of rights and obligations that stem from the rate-setting framework.
- 58 EFRAG understands that determining 'how much competition' would be viable to achieve a competitive environment that is similar to that of non-rate-regulated entities is difficult. However, we also believe that there is room for this feature to be less prescriptive with regards to (1) there being no effective competition and (2) the rate-regulated good or service being essential to customers.
- 59 We believe that a strong driver of this feature is that the customer has little or no choice but to buy the goods or services from the rate-regulated entity. We therefore think that to make this feature a workable indicator, it is necessary to have 'very low demand risk' (i.e. relatively inelastic demand), rather than 'no effective competition'. Indeed, it is the 'very low demand risk' that ensures that the entity can benefit from the rights and obligations that stem from the regulatory agreement. We recommend that the IASB considers incorporating 'very low demand risk' in the description of this indicator, rather than focus on the absence of competition.
- 60 We also question whether the reference to an 'exclusive right' in paragraph 4.35 of the DP is compatible with no 'effective competition'. In our view, an exclusive right is a right reserved exclusively to a particular person or group. Therefore, no other entity could have that right. However, the DP notes in paragraph 4.41 that defined rate regulation could be also applied when there is more than one supplier if the demand for the rate-regulated goods or services exceeds the supply capacity of a single entity (this is typical in regimes that have introduced capacity payments as forms of remuneration).

- 61 Finally, we believe that the IASB should analyse this feature in the context of our comments in the subsection ‘the agreement that binds the customer’ above, given the interaction between the demand for rate-regulated goods and services, and the agreed consideration for providing those goods or services, which is set by the regulator.

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 (paragraph 4.4(b) of the DP)

- 62 We support this feature being included as it depicts possible obligations that the regulatory framework can impose on a rate-regulated activity. However we consider that this feature is not essential in order to make a rate-setting framework effective.

- 63 EFRAG agrees that one of the objectives of rate regulation is to balance the needs of the customers with the needs of the supplier and with other government objectives (such as environmental objectives). For example, shortages in the supply, or reductions in quality, could have an adverse effect on customers. In order to avoid this, there are contractual obligations imposed by rate regulators on entities.

- 64 One common objective of defined rate regulation is to ensure that the consideration set under the revenue requirement ensures the availability and quality of supply of essential goods or services to customers, at tariffs that are reasonable and stable for customers and financially viable for the rate-regulated entity (in order to attract capital and investment).

- 65 However, we would be concerned if, for example, a rate-regulated activity was excluded from any future accounting guidance because maintaining the quality of the supply was not part of the legislation. Therefore, we recommend not making this feature mandatory.

It establishes parameters for rates that provide regulatory protections (paragraph 4.4(c) of the DP)

- 66 This feature, in EFRAG’s view, should play a role similar to the feature relating to 4.4(b) above and our comments above therefore apply. We agree that parameters to ensure physical capabilities (availability and quality of supply to customers at prices that are stable to customers and financially viable to the entity) and regulatory protections (reinforcing the rate-setting framework) could assist with determining enforceability of the rights and obligations that arise from the rate-setting framework; however we do not believe they are a necessary feature. Unlike non-regulated activities, the customer is not involved in agreeing a tariff it will pay for the rate-regulated goods or services it receives.

Creates rights and obligations that are enforceable on the rate-regulated entity and on the rate regulator (paragraph 4.4(d) of the DP)

- 67 As previously mentioned, EFRAG believes that the existence of rights and obligations that arise from rate regulation is central to any potential future accounting guidance, and should therefore not be considered a ‘feature’ *per se* but rather as an essential component of the definition.

- 68 We also note that the terminology in the description of ‘enforceable rights and obligations’ is consistent with the one used in IFRS 11 *Joint Arrangements* that refers to rights that are contractually or legally enforceable. We encourage the IASB to consider the interactions with the terminology that is already used in other IFRSs, for example:

*IASB DP: Reporting the Financial Effects of Rate Regulation*

- (a) IFRS 15 *Revenue from Contracts with Customers* that refers to the probability threshold to recognise a variable consideration that is set at a high level of probability; and
- (b) IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* regarding the recognition of liabilities for constructive obligations.

69 Finally we suggest amending the wording for the feature in paragraph 4.4(d) of the DP, as follows: 'creates rights and obligations that are enforceable on the rate-regulated entity, on the rate regulator and on the customers' because the tariff is binding on the customers as well. We believe that these improvements are consistent with the feature suggested in paragraphs 42 - 44 above.

*Question 5(c) – are there other features that should be included?*

70 The revenue requirement is described in paragraph 4.5 of the DP as the total amount of consideration to which an entity is entitled in exchange for providing rate-regulated activities over an agreed period of time. Furthermore, paragraph 4.6 of the DP describes the tariff adjusting mechanism as the mechanism to reverse specified differences between the amount of the revenue requirement accrued to date and the amounts billed to customers. We consider that the existence of a tariff adjusting mechanism based on the revenue requirement is the major source of rights and of obligations for the rate-regulated entity.

71 We recommend that the IASB include the existence of a tariff adjusting mechanism based on the revenue requirement in the description of defined rate regulation. However, we recommend that the IASB considers circumstances where the regulatory frameworks allows for adjustments to the revenue requirement indirectly, such as by extending the regulatory period.

72 EFRAG notes that there is no definition of a rate regulator in the DP and we consider that this term should be defined. One suggestion would be a definition similar to that in IFRS 14 *Regulatory Deferral Accounts*.

73 EFRAG also believes that the terms of service should be incorporated in the definition of defined rate regulation as it establishes the entity's rights and obligations (including the amount of revenue that the entity is entitled to charge to customers in exchange for satisfying those obligations) and contributes to making rights and obligations enforceable. Furthermore, we believe that the existence of clear terms of service would help an understanding of the relationship between the revenue requirement and the rights and obligations that stem from the regulatory agreement discussed in the paragraphs above.

**Question 6**

Paragraphs 4.62–4.72 contain an analysis of the rights and obligations that arise from the features of defined rate regulation.

- (a) Are there any additional rights or obligations that you think the IASB should consider? Please specify and give reasons.
- (b) Do you think that the IASB should develop specific accounting guidance or requirements to account for the combination of rights and obligations described? Why or why not?

## EFRAG's response

**We are not aware of any additional rights and obligations that the IASB needs to consider. Therefore, EFRAG agrees that the IASB has identified the key rights and obligations that create a specific economic environment for entities operating rate-regulated activities and for which specific IFRS guidance might be required.**

*Question 6(a) – are there additional rights or obligations that need to be considered?*

- 74 We are not aware that there are any additional rights and obligations that the IASB needs to consider. Therefore, EFRAG agrees that the IASB has identified the key rights and obligations that create a specific economic environment for entities operating rate-regulated activities.

*Question 6(b) - should the IASB develop specific accounting guidance or requirements to account for the combination of rights and obligations?*

- 75 EFRAG supports the IASB's project on rate regulation and recommends the development of specific guidance or requirements to account for enforceable rights and obligations that arise in defined rate regulation where an adjusting mechanism based on the revenue requirement exists in order to meet the objective of financial reporting as defined in the Conceptual Framework.
- 76 As stated in our response to question 1, currently IFRS financial statements do not generally provide the information users regard as relevant for an understanding of the impact of rate-regulated activities on a rate-regulated entity's performance, cash flows and financial position.
- 77 However, EFRAG recommends that the IASB explores whether existing IFRSs could form the starting point to account for the financial effects of defined regulation in the financial statements. This is explained in more detail in our answer to question 7.

### **Question 7**

Section 5 outlines a number of possible approaches that the IASB could consider developing further, depending on the feedback received from this Discussion Paper. It highlights some advantages and disadvantages of each approach.

- (a) Which approach, if any, do you think would best portray the financial effects of defined rate regulation in IFRS financial statements and is most likely to provide the information that investors and lenders consider is most relevant to help them make their investing and lending decisions? Please give reasons for your answer?
- (b) Is there any other approach that the IASB should consider? If so, please specify and explain how such an approach could provide investors and lenders with relevant information about the financial effects of rate regulation.
- (c) Are there any additional advantages or disadvantages that the IASB should consider before it decides whether to develop any of these approaches further? If so, please describe them.

If commenting on the asset/liability approach, please specify, if it is relevant, whether your comments reflect the existing definitions of an asset and a liability in the Conceptual Framework or the proposed definitions suggested in the Conceptual Framework Discussion Paper, published in July 2013.

## EFRAG's response

**EFRAG supports an approach that is principle-based and is able to be applied to different regulatory regimes that evolve over time.**

**We believe that the revenue approach discussed in the DP has an important role to play particularly when the description of defined rate regulation is based on the right of an entity to earn the revenue requirement once it has fulfilled the performance obligations associated with delivering goods and services.**

**At this stage, we remain open to considering the cost deferral approach described in the DP, and recommend that the IASB explores in more detail cases where such an approach might produce relevant information.**

**We do not support reporting using regulatory accounting as described in the DP and consider that it is unlikely that the package of rights and obligations established by the regulatory agreement is an intangible asset.**

### Question 7(a)

- 78 EFRAG acknowledges that there is a wide range of rate-regulatory frameworks in Europe, which typically include 'hybrid' regimes - i.e. elements of cost-based and incentive-based regimes are used in setting the revenue requirement. Such schemes may also change over time as described in paragraph 3.37 of the DP. Accordingly, we support an approach that is principle-based and which can be applied to different regulatory regimes that evolve over time, is faithful to the Conceptual Framework and consistent with existing IFRS. This would imply that the IASB should consider the interaction with the [revised] Conceptual Framework and existing standards (notably IFRS 15 *Revenue from Contracts with Customers*, IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and IFRIC 12 *Service Concession Arrangements*).
- 79 In EFRAG's view, the revenue approach discussed in the DP has an important role to play when an entity has fulfilled the performance obligations associated with delivering goods and services under the regulatory agreement. The revenue approach is hinged on the description of defined rate regulation and is based on the existence of a revenue requirement.
- 80 At this stage, we remain open to an approach that results in deferring/accelerating the recognition of costs for the reasons explained in paragraphs 5.77-5.90 of the DP, although, we have not explored and therefore not identified in which cases the cost deferral approach would produce useful information, other than mentioned in paragraph 82 below. We say this because we understand that the rights and obligations that stem from the regulatory agreement are linked to the amount of revenue an entity is entitled to earn. We therefore recommend the IASB to research when such an approach will produce relevant information.
- 81 As noted in paragraph 54 above, some rate-setting frameworks create indirect obligations that do not directly relate to the delivery of goods and services even if they may affect the revenue requirement. In these circumstances, we believe that the IASB should explore whether the fulfilment of these obligations (e.g. maintenance that does not qualify for recognition under IAS 16) may trigger the use of a cost deferral approach as it gives rise to a right that could be capitalised as it 'creates an opportunity to generate an inflow of cash or another financial asset, but it does not give rise to a present right to receive cash or another financial asset'.

### Other approaches in the DP

- 82 We do not support reporting using regulatory accounting that is described in paragraph 5.34 of the DP as we consider that it is inappropriate for IFRS financial

statements to rely on regulatory recognition and measurement criteria rather than criteria generally adopted in IFRS. Using regulatory accounting is likely to remove comparability between rate-regulated entities and non-rate-regulated entities.

- 83 We finally consider that it is unlikely that the package of enforceable rights and obligations established by the regulatory agreement is an intangible asset. It is not clear exactly what such an intangible asset could represent and, consequently, how it should be measured at initial recognition and subsequently.

*Question 7(b)*

- 84 We are not aware of any additional approach that the IASB should consider.

*Question 7(c)*

- 85 We are not aware of any additional advantages or disadvantages.

**Question 8**

Does your organisation carry out activities that are subject to defined rate regulation? If so, what operational issues should the IASB consider if it decides to develop any specific accounting guidance or requirements?

**EFRAG's response**

**Although EFRAG does not carry out activities that are subject to rate regulation, it is able to draw on the experience of European constituents in its work. Accordingly, EFRAG believes that if the IASB was to develop accounting guidance it should avoid increasing unduly the complexity and the cost of producing financial information.**

- 86 Regarding possible operational issues, we have been advised that, in developing any specific accounting requirements, the IASB should consider:
- (a) avoiding industry-specific disclosures for entities operating rate-regulated activities because, similar to other commercial entities, users need to understand how the regulation affects performance, financial position and future cash flows;
  - (b) having regard to the needs of users to understand the amounts that are recognised in the IFRS financial statements, albeit avoiding an undue level of granularity that may hinder the usefulness of financial information. The cost of producing financial information should be outweighed by benefits for users. For instance, IFRS 8 *Segment Reporting* requirements could help cater for users' needs regarding the breakdown of disclosures between rate-regulated and other activities whereas long narrative disclosures may reduce understandability and the usefulness of financial information; and
  - (c) the reliability of information required, such as information that is prospective or based on a different framework (i.e. Regulatory Asset Base).

### Question 9

If, after considering the feedback from this Discussion Paper and the *Conceptual Framework* project, the IASB decides to prohibit the recognition of regulatory deferral account balances in IFRS financial statements, do you think that the IASB should consider developing specific disclosure-only requirements? If not, why not? If so, please specify what type of information you think would be relevant to investors and lenders in making their investing or lending decisions and why.

### EFRAG's response

**EFRAG believes that IFRS financial statements should include relevant disclosure where an entity is impacted by rate regulation. However, EFRAG believes that disclosure-only requirements are not a substitute for the recognition of assets and liabilities and would not cater for users' needs.**

- 87 As explained in the response to Question 1, the outcome of our discussions with users has shown that irrespective of the decision to develop specific accounting guidance, users do not find the current disclosures about the effects of rate-regulation sufficient for their analyses. Furthermore, management of rate-regulated entities with defined rate regulation have informed us that they use information that is significantly different to that reported in the IFRS financial statements to explain to investors and other users the effects of rate regulation.
- 88 Therefore, we believe that disclosure-only requirements would not meet users' needs, where assets and liabilities are available to be recognised, and would not support it. We refer to question 1 regarding the information users have informed they would need to understand the financial effects of rate-regulation.

### Question 10

Sections 2 and 6 discuss some of the information needs of users of general purpose financial statements. The IASB will seek to balance the needs of users of financial statements for information about the financial effects of rate regulation on an entity's operations with concerns about obscuring the understandability of financial statements and the high preparation costs that can result from lengthy disclosures (see paragraph 2.27).

- (a) If the IASB decides to develop specific accounting requirements for all entities that are subject to defined rate regulation, to what extent do you think the requirements of IFRS 14 meet the information needs of investors and lenders? Is there any additional information that you think should be required? If so, please specify and explain how investors or lenders are likely to use that information.
- (b) Do you think that any of the disclosure requirements of IFRS 14 could be omitted or modified in order to reduce the cost of compliance with the requirements, without omitting information that helps users of financial statements to make informed investing or lending decisions? If so, please specify and explain the reasons for your answer.

### EFRAG's response

**EFRAG believes that the disclosures required in IFRS 14 provide a good starting point for comprehensive disclosures. In our response to Question 1, we have included the information that users believe to be useful for their analyses.**

Question 10 (a)

- 89 In our comment letter on the IASB's exposure draft ED/2013/5 *Regulatory Deferral Accounts*, while not supporting the exposure draft, we agreed with the general disclosure objectives and the disclosure requirements proposed in it.
- 90 We therefore agree that the disclosures required in IFRS 14 provide a good starting point for comprehensive disclosures.
- 91 In our response to Question 1, we have included the information that users believe to be useful for their analyses.

Question 10 (b)

- 92 EFRAG does not believe that any of the disclosure requirements of IFRS 14 should be omitted. Some modifications will presumably be needed to align the existing disclosure requirements in IFRS 14 to the specific IFRS requirements should the IASB decide to follow such an approach. If any specific guidance would be included in existing IFRS standards, for example IFRS 15, little or no supplementary disclosures may be needed.

**Question 11**

IFRS 14 requires any regulatory deferral account balances that have been recognised to be presented separately from the assets and liabilities recognised in the statement of financial position, in accordance with other Standards. Similarly, the net movements in regulatory deferral account balances are required to be presented separately from the items of income and expense recognised in the statement(s) of profit or loss and other comprehensive income.

If the IASB develops specific accounting requirements that would apply to both existing IFRS preparers and first-time adopters of IFRS, and those requirements resulted in the recognition of regulatory balances in the statement of financial position, what advantages or disadvantages do you envisage if the separate presentation required by IFRS 14 was to be applied?

**EFRAG's response**

**In EFRAG's view, separate presentation of regulatory balances will permit users to understand better how the financial effects of rate regulation modify both the revenue and expenses that an entity has reported and associated impacts on cash flows and financial position, and therefore enhance the relevance of the information provided.**

- 93 EFRAG believes that the accounting effects (i.e. regulatory deferral account balances) and changes in those balances that rate regulation creates should be presented separately in the financial statements as it enhances the understandability of financial information. This is supported by the requirement in paragraph 57(a) of IAS 1 that supports separate presentation for items that are sufficiently different in nature or function. This view is similar to EFRAG's view in its response to the IASB's ED *Regulatory Deferral Accounts* (now IFRS 14). We note that many users who we have spoken to prefer that the regulatory deferral account balances are presented separately in the financial statements.
- 94 EFRAG has learned that some constituents do not support separate presentation, as they believe that presentation should follow their inherent nature that stems from the revenue requirement. In their view, regulatory revenue and expenses should be

presented together with other revenue and expenses that arise from the ordinary/trading activities of the rate-regulated entity.

- 95 In our view, users should be able to understand how the effects of rate regulation modify a rate-regulated entity's revenue and expenses, cash flows and its financial position. Accordingly, we believe that these line items should be presented separately from other revenue or expenses and corresponding items (rate-regulated versus non-regulated) in the cash flow statement and statement of financial position. This would assist users when comparing information (revenue, costs and balance sheet items) of entities that undertake both rate-regulated and non-rate-regulated activities as well as comparing information for those entities that operate mostly in rate-regulated activities.
- 96 We would encourage the IASB to draw on the experience of the implementation of IFRS 14 before finalising any requirements in this regard.

### **Question 12**

Section 4 describes the distinguishing features of defined rate regulation. This description is intended to provide a common starting point for a more focused discussion about whether this type of rate regulation creates a combination of rights and obligations for which specific accounting guidance or requirements should be developed.

Paragraph 4.73 suggests that the existence of a rate regulator whose role and authority is established in legislation or other formal regulations is an important feature of defined rate regulation. Do you think that this is a necessary condition in order to create enforceable rights or obligations or do you think that co-operatives or similar entities, which operate under self-imposed rate regulation with the same features as defined rate regulation (see paragraphs 7.6–7.9), should also be included within defined rate regulation? If not, why not? If so, do you think that such co-operatives should be included within the scope of defined rate regulation only if they are subject to formal oversight from a government department or other authorised body?

### **EFRAG's response**

**EFRAG believes that the existence of a rate regulator who is an external party and whose role and authority is established by law or other enforceable acts is a necessary feature of defined rate regulation.**

- 97 EFRAG believes that the existence of a rate regulator who is an external party and whose role and authority is established by law or other enforceable acts (i.e. grant, concession agreements) is a necessary feature of defined rate regulation.
- 98 As explained in the DP, co-operatives are commonly self-regulated in terms of setting prices for goods or services that they supply, which are usually supplied to the members of the co-operative. We therefore conclude that co-operatives will not be classified within the scope of defined rate regulation since there is no external rate regulator.
- 99 Although we agree that it is important for the IASB to assess that it has appropriately captured the 'right' rate-regulated activities when developing further the scope of the project, we do not consider that all entities that are subject to some form of regulation should be within the scope of this project. All entities are subject to some regulation and attempting to address all regulation could lead to the need for guidance that is industry or entity-specific.

**Question 13**

Paragraphs 7.11–7.22 highlight some of the issues that the IASB may consider if it continues to progress this project.

Do you have any comments or suggestions on these or any other issues that may or may not have been raised in this Discussion Paper that you think the IASB should consider if it decides to develop proposals for any specific accounting requirements for rate-regulated activities?

**EFRAG's response**

**EFRAG agrees that the IASB should consider interactions with current IFRS in advancing this project.**

*Interaction with IFRIC 12 Service Concession Arrangements*

- 100 EFRAG acknowledges that there may be an overlap between the IASB's rate-regulated activities project and IFRIC 12 given the similarities between services provided under service concession arrangements and rate-regulated activities. For instance, that in the case of a service concession arrangement under IFRIC 12, the regulator and the grantor of the service concession are normally the same entity and rate regulation is set in the concession arrangement.
- 101 Furthermore, a rate-regulated entity may have some flexibility for charging different tariffs if the rate regulator approves the pricing structure to ensure that it is consistent with the rate-setting mechanism. However, in service concession arrangements, it is the regulator sets the tariff and not the entity. The entity is only able to review that the tariff is in accordance with the concession agreement.
- 102 Finally, we note that in reaching the consensus in IFRIC 12, the IASB supported (a) the recognition of the intangible asset that relates to concession arrangements; and (b) the recoverability of the tangible fixed assets that are employed in providing services and goods. In EFRAG's view, revenue from service concession agreements are usually agreed with the grantor, which has also the power to affect the timing of investments in the assets of the entity.
- 103 We believe that, in progressing with this project, the IASB will need to consider the interaction with IFRIC 12. For instance, we note IFRIC 12 does not have wording relating to rights and obligations but it mentions key features.
- 104 In addition, as stated in paragraph 71 above, the IASB should also consider the interaction with IFRIC 12 where:
- (a) the regulatory frameworks allow the revenue requirement to be adjusted indirectly, for instance by extending the regulatory period; and
  - (b) some concession agreements are based on the existence of a Regulatory Asset Base to set tariffs and include tariff adjustment mechanism which aim to ensure the economic and financial equilibrium within the concession period (i.e. some toll road concessions in Europe).

*Interaction with IFRS 15 Revenue from Contracts with Customers*

- 105 As noted in paragraph 5.21 of the DP, under defined rate regulation many regulatory deferral account balances arise from differences between the revenue requirement and the revenue billed to customers using the regulated rate.

- 106 During EFRAG's discussions on how to reflect rate-regulated activities in the IFRS financial statements, EFRAG has learned that some constituents operating in rate-regulated industries believe that a solution to rate regulation could be achieved using the requirements and guidance in IFRS 15.
- 107 Some of these constituents argue that the interaction with the revenue requirement is one of the most important issues the IASB will need to address in this project. For a utility provider, the service rendered to a customer is the provision of electricity transmission, gas transmission or distribution. Such an entity earns revenue from these rate-regulated services. However, there are a number of issues that require clarification of the principles in IFRS 15:
- (a) the agreement an entity has with the rate regulator needs to be linked with the agreement it has with its individual customers and/or with its customer base as a whole;
  - (b) it is unclear whether regulated tariffs are, in substance, a contract within the scope of IFRS 15, with the regulator representing the customer base;
  - (c) if the customer base is considered to be the unit of account, whether the financial effects of indirect obligations that an entity needs to fulfil to be entitled to earn the revenue requirement could be analogised to the recognition principles for contract assets and liabilities; and
  - (d) rate-regulated entities may be required to fulfil obligations where no direct performance towards the customer occurs. It is unclear whether the fulfilment of these obligations provides the right to the revenue requirement and thus revenue under IFRS 15. We refer to paragraph 53 above.

*Interaction with IAS 12 and IAS 20*

- 108 We agree that it will be necessary to consider the interaction with the existing requirements of IAS 12 and IAS 20 for the reasons mentioned in paragraphs 7.18 - 7.19 of the DP.

IAS 12 Income Taxes

- 109 The interaction with IAS 12 will largely depend on how tax expense/income is determined in the applicable jurisdiction. For example, EFRAG understands that in the UK, tax expense is determined based on the accounting treatment of rate-regulated activities. Therefore, regulatory differences would not affect the tax balances.
- 110 As a general comment, we think that applying the mechanics in IAS 12 to the accounting issue related to rate-regulated activities (i.e. the mismatch between the revenue requirement and billed revenue) could result in increased complexity. Therefore, the interaction with IAS 12 needs to be carefully considered.

IAS 20 Accounting for Government Grants and Disclosure of Government Assistance

- 111 Under IAS 20, government grants related to assets are presented as deferred income or as a deduction from the carrying amount of the related asset.
- 112 Some argue that bonuses (or some bonuses) granted in pure incentive-based schemes could be seen as 'grants' as they are transfers of resources to an entity by a government entity in return for compliance with certain efficiency conditions. Similarly, some argue that some of the elements in the tariffs that aim to compensate

the finance costs of an entity could also be seen as grants. Again, we believe that this is something that the IASB will need to consider.

*Interaction with IFRS 3 Business Combinations*

113 EFRAG considers that there are likely to be a number of interactions between IFRS 3 and the rate-regulated activities project. For example, recognition and measurement of acquired regulatory balances - application of the purchase price allocation under IFRS 3 and determining goodwill on the acquisition – would need consideration.

*Interaction with IFRS 9 Financial Instruments*

114 We agree that understanding the potential interaction with IFRS 9 is important. Paragraph 7.21 of the DP explains that in some cases, the rate regulator or other designated body pays cash to the entity as consideration for the performance of specified tasks or settles revenue mismatches (and therefore amounts receivable or payable could be classified as financial assets and financial liabilities). In other more common cases, a rate-regulated entity does not have a right to receive cash from, or an obligation to pay cash to, the rate regulator in order to settle revenue mismatches.

**Other matters**

*Terminology*

115 In order to enhance the understandability of rate-regulated activities, EFRAG recommends that the IASB ensures that the terminology used in the future development of the project should be consistent. For example, the DP refers to the terms 'rates' and 'prices' and 'tariffs' interchangeably.