

This paper has been prepared by the EFRAG Secretariat for discussion at a public meeting of EFRAG TEG. The paper forms part of an early stage of the development of a potential EFRAG position. Consequently, the paper does not represent the official views of EFRAG or any individual member of the EFRAG Board or EFRAG TEG. The paper is made available to enable the public to follow the discussions in the meeting. Tentative decisions are made in public and reported in the EFRAG Update. EFRAG positions, as approved by the EFRAG Board, are published as comment letters, discussion or position papers, or in any other form considered appropriate in the circumstances.

Rate-regulated Activities

Summary of recent discussions

Objective

- 1 This paper provides a summary of the discussions held in December 2016 by the Accounting Standards Advisory Forum (ASAF) and the IASB on IASB Staff proposals for a new accounting model for rate-regulated activities.
- 2 The IASB Staff proposals were discussed with EFRAG CFSS and EFRAG TEG at the EFRAG CFSS meeting in November 2016.

Background

- 3 The IASB published a Discussion Paper DP/2014/2 *Reporting the Financial Effects of Rate Regulation* ('the DP') in September 2014 as part of its Rate-regulated Activities project. The primary focus of the DP was on the type of regulation the IASB should address, referred to as 'defined rate regulation'. The IASB expects to publish a second discussion paper late in 2017 that considers a new accounting model for rate-regulated activities.
- 4 In order to address concerns on the description of 'defined rate regulation', the IASB Staff are considering focusing the scope of the project on rate regulation that creates enforceable rights and obligations meaning that the distinguishing features in the DP would become indicators of the type of regulation the IASB is addressing rather than required characteristics.

ASAF December 2016 discussion

- 5 At the December 2016 meeting, ASAF members considered the following in relation to IASB Staff proposals on a new accounting model for rate-regulated activities:
 - (a) Scope;
 - (b) Interactions with other IFRS Standards and the Conceptual Framework; and
 - (c) Segregating identifiable rate adjustments from the overall changes in value of the regulatory licence/agreement.
- 6 ASAF members were generally supportive of the proposed accounting model which focused on an 'overlay' approach that required regulatory adjustments which resulted in income or expense, to be recognised separately from revenue recognised under IFRS 15 *Revenue from Contracts with Customers*.

Scope of the proposed accounting model

- 7 Some ASAF members were concerned that the IASB Staff proposals could result in a 'cliff effect' and potentially lead to uncertainty in determining which activities would be in and out of scope.

- 8 Some ASAF members thought that the scope should be based on defined rate regulation as described in the DP to avoid potential conceptual issues and re-starting a debate on which activities should be included in the scope of the project.

Interactions with other IFRS Standards and the Conceptual Framework

- 9 One ASAF member suggested investigating whether regulatory adjustments would be 'double-counted' when an entity accounts for the infrastructure assets used to provide the rate-regulated good or service as a service concession agreement under IFRIC 12 *Service Concession Arrangements*. The issue was whether the rights created by the rate regulation were already reflected in the IFRIC 12 accounting.
- 10 Some ASAF members expressed a preference for a single revenue recognition model on the basis that it represented the revenue the entity was entitled to earn in a specific period for goods or services it had delivered in that period. These members added that a single revenue number was conceptually more convincing.
- 11 However, other ASAF members agreed with separate recognition of the effects created by the regulatory environment, as these effects did not arise from the individual customer contracts. Furthermore, these ASAF members thought that having separate numbers would be more informative than presenting them as a 'net' amount.
- 12 One ASAF member noted that the discussions so far had identified difficulties in determining whether regulatory assets and liabilities met the definitions of assets and liabilities under the IASB Conceptual Framework. This member suggested looking at other concepts in the Conceptual Framework, including the objectives of financial reporting.

Intangible assets

- 13 In discussing the nature of regulatory assets and liabilities, ASAF members generally agreed that they should be recognised separately from any licence to undertake rate regulated activities. This would avoid potential issues about subsequent measurement associated with accounting for intangible assets (including the use of a revaluation model).

Other matters

- 14 Some ASAF members indicated that the implications of IFRIC 12 on rate-regulated activities would need to be considered as the IASB progressed its project.

IASB December 2016 discussion

- 15 At its meeting in December 2016, the IASB received an educational session on the IASB Staff proposed accounting model for rate-regulated activities and asked for feedback on how to develop the proposals further. No decisions were taken at this meeting. The IASB December 2016 agenda papers were based on the ASAF December 2016 papers on rate-regulated activities, although they included examples that illustrated how regulatory adjustments would be accounted for under the proposals.
- 16 IASB members generally supported the proposed model and thought it was helpful to separate the revenue effects arising from the individual customer relationships from the effects of the regulatory environment. The detailed comments are summarised in the paragraphs below.

Scope

- 17 The IASB Staff explained that some constituents had said that the features describing 'defined rate regulation' in the DP supported the enforceability of the rate regulation, but were not essential criteria in determining the scope of the model. As

a result, the IASB Staff were proposing to focus the scope on enforceability of rights and obligations created by the rate regulation they were trying to address.

- 18 Some IASB members were concerned that not considering the features as essential criteria would widen the scope and include activities where customers had choices regarding the goods or services such as transportation and medical services which in some jurisdictions were also subject to a form of rate-regulation. These IASB members thought that the scope should continue to focus on defined rate regulation which covered mainly public sector utilities.

Customer base

- 19 Some IASB members were concerned with linking the enforceable rights and obligations created by the regulatory framework to the customer base. In their view, suggesting that the customer base had either 'underpaid' or 'overpaid' for the goods or services it had consumed in a period seemed contradictory to the proposed model that tried to segregate these two effects. Additionally, one IASB member noted that the notion of customer base might be present in other situations unrelated to rate regulation. It would therefore be important to explain the relationship between rate regulation and the customer base.
- 20 One IASB member thought that a 'customer base' did not imply a group of customers in its true sense. Instead, it was a hypothetical term used for the purpose of accounting for rate-regulated activities and worked well with the proposed supplementary approach proposed by the IASB Staff as it segregated the effects of rate-regulation and thereby enhanced transparency of information about rate-regulated activities.

Recognition, derecognition and measurement

- 21 One IASB member noted that, as the IASB project progressed, it would be important to determine the nature of the regulatory assets and liabilities and whether regulatory adjustments created 'income' rather than revenue under IFRS 15.
- 22 Some IASB members thought that, for some types of regulation, regulatory adjustments could not be individually identified and it would therefore be difficult to track them for recognition, measurement (including impairment) and derecognition purposes. The IASB Staff responded that entities subject to this type of rate-regulation would generally need to track the regulatory adjustments.

Presentation and disclosure

- 23 On presentation, the IASB Staff were proposing a gross presentation in which an entity would recognise an asset for its rights and a liability for its obligations under the regulatory agreement/framework. IASB members asked the IASB Staff to bring a worked example on presentation for discussion at a future IASB meeting.
- 24 Disclosure requirements were not discussed in detail.

Next steps

- 25 At a future meeting, the IASB plans to discuss more detailed analyses of scope, recognition, measurement, presentation and disclosure in the proposed model.

Question for EFRAG TEG

- 26 Does EFRAG TEG have any comments on the discussions held at the December 2016 ASAF and IASB meetings on the proposed model to account for rate-regulated activities?