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Scope of Rate-regulated Activities Issues paper

Purpose of this paper

- 1 The purpose of this session is to :
 - (a) consider the International Accounting Standard Board (IASB) tentative decisions on the scope of the project on accounting for rate-regulated activities (the IASB project) and seek the tentative views of EFRAG TEG; and
 - (b) to seek the views of EFRAG TEG on which activities other than utilities they consider to be, or likely to be, within the scope.

Project status

- 2 The IASB published a Discussion Paper *Reporting the Financial Effects of Rate Regulation* (the DP) in September 2014 that discussed a form of rate regulation termed 'defined rate regulation'. The IASB expects to publish a second discussion paper or an exposure draft in the first half of 2018 that considers the accounting for defined rate regulation.
- 3 During 2016 and 2017, the IASB has extensively discussed its project. In February 2017, the IASB tentatively decided that scope should focus on enforceable rights and obligations created through a formal regulatory pricing framework (a rate-setting mechanism). Other features discussed in the DP that are common to rate regulation, such as no effective competition and the provision of essential goods or services, should be used as indicators for the existence and enforceability of regulatory rights and obligations.
- 4 The IASB has also confirmed that the project should address only those rights and obligations that are not already covered by other IFRS Standards. An entity will therefore apply the requirements of other IFRS Standards, such as IFRS 15 *Revenue from Contracts with Customers*, IFRIC 12 *Service Concession Arrangements* and IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*, when applicable, before applying the accounting model being developed.
- 5 Paragraph 4.4(a) – (d) of the DP explained that defined rate regulation balances the needs of the customers to purchase essential goods or services at a reasonable price with the needs of the entity to attract capital and remain financially viable. Defined rate regulation involves a regulatory pricing (i.e. rate-setting) framework that includes all of the following:
 - (a) it applies in situations in which customers have little or no choice but to purchase the goods or services from the rate-regulated entity because:
 - (i) there is no effective competition to supply; and

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- (ii) the rate-regulated goods or services are essential to customers (such as clean water or electricity).
 - (b) it establishes parameters to maintain the availability and quality of the supply of the rate-regulated goods or services and other rate-regulated activities of the entity.
 - (c) it establishes parameters for rates (sometimes referred to as prices or tariffs) that provide regulatory protections that:
 - (i) support greater stability of prices for customers; and
 - (ii) support the financial viability of the rate-regulated entity.
 - (d) it creates rights and obligations that are enforceable on the rate-regulated entity and on the rate regulator.
- 6 The Appendix contains a summary of the characteristics used to define defined rate regulation and respondents' views on this definition.

Research on scope by the Canadian standard setter (AcSB)

- 7 In February 2017, the EFRAG Secretariat responded to an AcSB Staff research request that sought data about jurisdictions' regulatory frameworks and the impacts of defined rate regulation on rate regulated activities. The request focused on utilities, as rate regulation is commonly found in the utility sector, but asked to inform about activities in other sectors. The EFRAG Secretariat response included a European toll-road operator with some airport activities, which could potentially be within defined rate regulation.
- 8 The EFRAG Secretariat recently contacted the AcSB Staff who informed that based on their research findings, defined rate regulation is commonly found in the utility sector, although it might also affect the transport sector and potentially other sectors. The conclusion would depend on the applicable regulatory framework and whether it resulted in identifiable adjustments other than simply setting the price. At this stage it is not certain when, and whether the AcSB will publish the research findings. The AcSB Staff informed that their Board would continue to monitor progress of the IASB project before a decision was taken.

IASB tentative decision on the scope

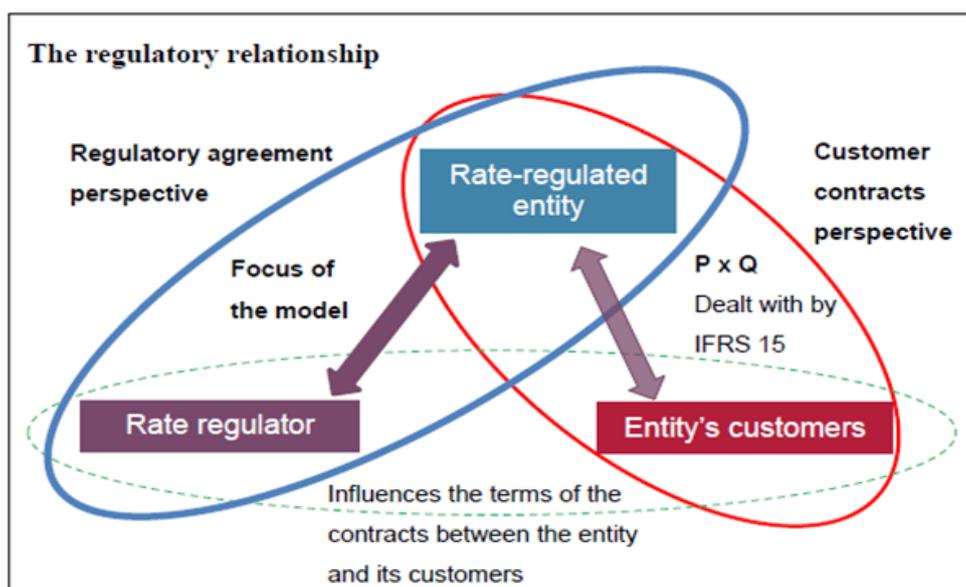
- 9 In its February 2017 meeting, the IASB tentatively decided that the scope criteria for the accounting model on rate-regulated activities should focus on **enforceable rights and obligations** arising from the **rate-adjustment mechanism** specified in the regulatory agreement. Other features described in the DP should be used as indicators for the existence and enforceability of the regulatory rights and obligations.
- 10 Paragraph 5 of this paper lists these other features which can be summarised as follows:
- (a) customers have little or no choice but to purchase the goods or services from the rate-regulated entity;
 - (b) parameters for rates provide regulatory protections; and
 - (c) the rate-setting mechanism establishes a 'revenue requirement' and a regulated rate, or rates, per unit.
- 11 In recent discussions the IASB has also considered the following 'additional' characteristics and whether they should be a necessary and separable characteristic of defined rate regulation:
- (a) Minimum service levels or other service requirements; and

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- (b) Limitations on entry into an industry (and exit from it).
- 12 In relation to (a), the indication is that this characteristic is not a separate characteristic, because it is an aspect of the basis for setting the regulated rate. In relation to (b) the discussions so far indicate that limitations on entry into, and on exit from, an industry, may not be necessary for the existence of regulatory assets or regulatory liabilities. It is necessary only that entities entering the industry are subject to the basis for setting the regulated rate.
- 13 As the IASB moves forward with its discussions and tentative decisions on scope, refinements are being made to the existing definition. In September 2017, in Agenda Paper 6A for the ASAF meeting, the scope of the project was summarised as:
- The model is being developed to be applied only to activities subject to 'defined rate regulation' established through a formal regulatory framework that imposes limitations on entry into an industry (and on exit from it) and that:*
- (a) **is binding on both the entity and the rate regulator;**
 - (b) **establishes a basis for setting the regulated rate chargeable by the entity to its customers (P) for the transfer of specified goods and/or services that comply with minimum quality levels or other service requirements (Q); and**
 - (c) **uses a rate-adjustment mechanism to create and reverse temporary differences that arise when the regulated rate in one period includes amounts related to specified activities the entity carries out in a different period.**

Binding on both the entity and the rate regulator

- 14 Enforceable rights and obligations are established through legislation or in a contractual regulatory agreement signed by both the rate regulator and the rate-regulated entity (regulatory agreement). The regulatory agreement may also take the form of a contractual licencing agreement signed by both parties and in some jurisdictions a concession agreement may exist. In some cases the licence (licence to operate) is granted by the Government (the State).
- 15 The regulatory relationship between the regulated entity and the regulator or other regulatory body is illustrated below:



Establishes a basis for setting the rate chargeable and includes a rate-adjustment mechanism

- 16 The rate-setting mechanism is typically set out in the regulatory framework. It is the rate-adjustment mechanism that creates rights and obligations for the entity **in addition to** the rights and obligations arising from the individual contracts between the entity and its customers (accounted for under IFRS 15). The rate-adjustment mechanism can exist only as part of the basis for setting the regulated rate.
- 17 The rate-setting mechanism is a driving force behind defined rate-regulation which affects the **amount and timing** of the rate adjustments. It includes a mechanism that originates, and subsequently reverses, 'temporary differences' that arise when the regulated rate in one period includes amounts intended to compensate the entity for specified activities the entity carries out in a different period. For example a cost to repair the infrastructure, due to an unexpected storm, incurred in year 1 which the entity is entitled to recover from its customers in year 2.
- 18 In summary, the rate-setting mechanism is the mechanism for an entity to recover the consideration (or the revenue requirement/revenue allowance) **it is entitled to receive from its customers** in exchange for goods or services delivered to its customers. The rate adjustments¹ represent the difference between the entity's revenue requirement it is entitled to charge its customers, and the amounts invoiced to customers (accounted for under IFRS 15).
- 19 As discussed in the DP, the revenue requirement² ensures that the entity earns a 'fair return/margin' and is established taking into account capital expenditure (capex), operating costs and an allowed return (profit) in order to recover the cost of capital.
- 20 The regulatory agreement establishes the period of recovery or settlement of the rate adjustments and identifies when to publish the 'adjusted' prices that will be in effect for the following year(s) by a predetermined date (for example in some countries the 'adjusted' rates are published in October of each year).

EFRAG Secretariat observations and analysis

Necessary characteristics of defined rate regulation

- 21 Overall, the EFRAG Secretariat consider that it is important not to have a rule-based scope, in order not to exclude activities with similar characteristics as defined rate regulation.
- 22 The EFRAG Secretariat considers that in general the description of the scope in paragraph 13 is in line with EFRAG's response to the definition of defined rate regulation. In its comment letter, EFRAG noted 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 project. It is the enforceable rights and obligations that stem from the rate-setting framework which should be considered for recognition in the IFRS financial statements. EFRAG considered the main purpose of the features described in the DP as ensuring enforceability of those rights and obligations.
- 23 In line with EFRAG's view, the EFRAG Secretariat considers the rate-adjustment mechanism to be a necessary characteristic of defined rate regulation, which is set out in the regulatory framework binding the entity and the applicable regulator.

¹ The rate adjustments are sometimes referred to as 'true-up' adjustments.

² Some jurisdictions refer to 'allowed revenue' or 'assumed revenue' instead of revenue requirement.

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- 24 Our understanding is that the purpose of the scope is to address the rate adjustments that result from the differences between the allowed revenue, determined by the regulator to charge the customers, and the amounts actually billed to customers. These differences are not covered by IFRS 15. If our understanding is correct, we consider that it would be helpful to clarify/confirm the following aspects of the scope:
- (a) Focuses on rate-adjustments that are not covered by other IFRS Standards.
 - (b) Clarifies that the rate-setting mechanism is the mechanism for an entity to recover the revenue requirement (consideration/revenue allowance) it is entitled to receive from its customers, as set by the regulator under the formal regulatory framework, in exchange for goods or services delivered to **its customers**.
 - (c) The rate-adjustments (that arise from the rate-setting mechanism) represent the difference between the entity's revenue requirement it is entitled to receive from its customers and the amounts invoiced to customers that are accounted for under IFRS 15.
- 25 The EFRAG Secretariat notes that incentive bonuses (to meet targets) and penalties (when targets are not met) common in incentive-based regulation, might in some cases not be included in the rate set by the regulator, while in other cases it is included. In our view, the fact that incentives and penalties exist in the rate regulation (and are dealt with in different ways by the regulator) should not affect the scope when the scope definition is met.
- 26 As an overall comment, the EFRAG Secretariat recommends that consistent and well-defined terminology is used when describing the characteristics of defined rate regulation, in order to clearly define the scope of the project and develop it in its totality. Although we understand that the aim of the IASB Staff is to refine and improve the scope description as the project progresses, we also consider that it would be useful to have a stable scope description that is consistently used in future IASB agenda papers.

Other characteristics that serve as indicators of defined rate regulation

- 27 We generally agree with the IASB's tentative decision that other features included in the DP and described in paragraph 10 of this paper, are not necessary for the existence of defined rate regulation but are rather indicators for defined rate regulation.
- 28 As reported by some constituents, including EFRAG, when responding to the IASB DP and specifically in relation to the other features, the term 'essential' goods and services had not been defined and could be interpreted differently by different people. In its comment letter, EFRAG also noted that determining 'how much competition' would be viable to achieve a competitive environment that is similar to that of non-rate-regulated entities would be difficult.
- 29 The EFRAG Secretariat considers that the features such as 'minimum service levels or other services requirements' and 'limitations on entry into an industry (and exist from it) would be part the regulatory framework that governs defined rate regulation. If that is the case, it would be unnecessary to consider them as required characteristics and doing so could risk making the scope definition overly perspective and rule-based.

Questions to EFRAG TEG

- 30 At this stage, does EFRAG TEG agree with the IASB's tentatively decision on the scope of the project as outlined in paragraph 13 this paper?

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| 31 | Do you agree with the EFRAG Secretariat observations and suggestions in paragraphs 21-26? |
| 32 | Do you agree with the EFRAG Secretariat observations and suggestions in paragraphs 27–29? |
| 33 | Do you have any other comments on the scope of the IASB project at this stage? |

Initial research on sectors subject to defined rate regulation

- 34 The EFRAG Secretariat observes that activities subject to defined rate regulation are commonly found in the utility sector (such as water, gas and electricity), regardless of jurisdiction. However, as explained in the DP, other rate-regulated activities in other sectors may also fall within the scope.
- 35 In preparation for the second consultation paper on rate-regulated activities, the EFRAG Secretariat has undertaken limited research to determine the practical implications of the scope of defined rate regulation on activities that are not utilities.
- 36 EFRAG Secretariat reviewed a limited number of recent IFRS financial statements of European entities within different sectors, other than utilities, and the applicable governing regulation. We also referred to selected responses, from non-utility companies, to the IASB's Request for Information on rate regulation issued in 2013 and the IASB's DP issued in 2014.
- 37 The characteristics of defined rate regulation in paragraph 13 of this paper were applied to those entities to assess whether they are likely to fall within the scope of defined rate regulation. The results are presented in the table below.

Entity	Necessary characteristics		Other characteristics	
	Enforceability of rights and obligations	Rate-setting mechanism	Competition	Quality of service
BPOST Universal Postal Services	The regulator may refuse to approve tariffs or tariff increases if they are not in compliance with the quality of service or price cap formula. Directive 2008/6/EC establishes a regulatory framework for European postal services. The Directive does not include a price-setting mechanism but sets the basic tariff principles.	The Directive does not include a price-setting mechanism but sets the basic tariff principles. Postal services are required to demonstrate that the pricing for their services complies with the principles of affordability, cost orientation, transparency, non-discrimination and uniformity of tariffs. Tariff increases are subject to a price cap formula and prior control by the competent regulator in the sector.	Competition exists	To guarantee a universal postal service encompassing a minimum range of services of specified quality to benefit all users, irrespective of their geographical location.

The EFRAG Secretariat initial assessment is that BPost is unlikely to be in the scope of defined rate regulation. This is mainly because we have found no evidence of a rate-setting mechanism in the regulatory framework that creates enforceable rights and obligations. The purpose seems to be to set the basic price. A further feature is that competition exists which suggests that BPost is subject to a more general type of regulation that is not defined rate regulation.

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Entity	Necessary characteristics		Other characteristics	
<p>HEATHROW Aeronautical services³</p>	<p>The Civil Aviation Authority ('CAA') is responsible for the economic regulation of Heathrow airport.</p> <p>The regulation takes the form of a price cap which is agreed in five yearly periods. The price cap is calculated to take account of the level of historical investment in the airport (known as the regulatory asset base or RAB), the capital investment plan for five year period, the cost of capital, operating costs, other revenues and passenger numbers.</p>	<p>Subject to incentive-based regulation that allows for a return on investment whilst incentivising lower costs of operation subject to defined service levels.</p> <p>The incentive mechanism is achieved by setting a price cap per passenger for a period of five years, allowing for returns to shareholders that may be higher or lower than those assumed when the price cap is by out-performing or under-performing the assumptions made to support the price cap.</p> <p>The rate (price cap) is calculated based on a revenue requirement (Capex + Depreciation + cost of capital + opex – other revenues) and divided by the number of passengers. Recoveries over and below the maximum aeronautical tariff per passenger are amended in the pricing in subsequent years and are intended to be resolved within 2 years.</p>	<p>Near-monopoly because of its unique size, location and level of historical investment.</p> <p>However, it is the CAA's remit to require it to promote competition where appropriate.</p>	<p>To further the interests of users in terms of the range, availability, continuity, cost and quality of airport operational services, and to, where appropriate, promote competition in the provision of those services.</p>
<p><i>The EFRAG Secretariat initial assessment is that Heathrow could potentially be in the scope of defined rate regulation. This is mainly because there is a basis for setting the rate chargeable to customers that includes a rate-setting mechanism that seems binding on the entity and the regulator (CAA). The rate-setting mechanism aims to recover the revenue requirement set by the regulator. We note that is incentive-based regulation which may attract penalties in case of under-performance and attract incentives in case of over-performance.</i></p>				
<p>AEROPORTS DE PARIS Aeronautical services</p>	<p>The purpose of the Economic Regulation Agreement (ERA) between the entity and the Government is to establish a ceiling for changes to the main fees and to set objectives for service quality.</p> <p>The price of all services included in</p>	<p>An annual capping system is applied to the average rate of change in fee prices. Changes in fee rates from one pricing period to another are capped by a "base ceiling rate" which is fixed in the ERA. These changes are adjusted by factors linked to passage traffic, quality of</p>	<p>No competition generally speaking.</p>	<p>Aéroports de Paris is committed to maintain and improve quality standard indicators and excellence indicators of its operations.</p>

³ Information taken from the Heathrow response to the IASB's request for information in 2013. Aeronautical services include aircraft landing and take-off, aircraft parking, air navigation, aircraft boarding baggage services, check-in desks and security services. It excludes retail services such as retail premises and car parking and other services related to maintaining the airport operations.

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Entity	Necessary characteristics		Other characteristics	
	<p>the regulated scope is based on price scales that are set with a view to each pricing period according to a Benchmark Pricing Scale and an Adjusted Pricing Scale for fees. Under ERA, the fees should be set within the limits of Adjusted Pricing Scale.</p>	<p>service, investments and cost control.</p> <p>As an incentive to improve performance of Aeroports de Paris, the ceiling adjustment may apply in the form of a bonus or penalty.</p>		<p>The ERA sets the quality of service and productivity targets for a fixed period of time.</p>
<p><i>The EFRAG Secretariat initial assessment is that we reach a similar conclusion for Aeroports de Paris as for Heathrow as the rate mechanism seems similar and both are subject to incentive-based regulation. In our view, the presence of incentive-based regulation when a rate-setting mechanism is present should not affect the scope.</i></p>				
<p>NATS⁴ En Route plc (NERL) (Air traffic controllers)</p>	<p>Operates under an air traffic services licence from the UK's Secretary of State for Transport.</p> <p>Activities are economically regulated by the Charging Regulations established by the European Commission's Single European Sky (SES) legislative package.</p> <p>The Civil Aviation Authority (CAA) is the UK's national supervisory authority (NSA).</p> <p>Regulation promotes cost efficiency and price stability but balances this against the need to ensure that the rate-regulated activities are financial viable and generate a return.</p> <p>EC Charging Regulations and NERL's licence set out the mechanism for the recovery of the revenue allowances through setting annual rates/charges.</p>	<p>The price control period is for 5 years – the most recent price control period is for 1 January 2015 – 31 December 2019.</p> <p>NERL's revenue allowances remunerate its efficient investment (capex), operating costs (opex), pension contributions and an allowed return on the capital invested in the regulatory asset base (RAB) to recover the cost of capital.</p> <p>The RAB is adjusted to reflect asset additions, disposal proceeds, regulatory depreciation and rate of inflation. Certain other income generated outside of the economically regulated activities is deducted under a 'single till' leaving a net revenue allowance.</p> <p>If the assumptions made by the regulator are borne out in practice, then over the regulatory period the revenue allowance will provide a return on the RAB equivalent to the cost of capital.</p> <p>The rate = (revenue allowance + (n+2) adjustments) / forecast traffic volumes. The</p>	<p>Monopoly provider of en route air navigation services in UK airspace and the Eastern North Atlantic.</p>	<p>En route air traffic control is an essential service to commercial airlines, which enables the safe movement of aircraft in controlled airspace.</p> <p>These services are provided by public or private sector monopolies in each Member State in the EU.</p>

⁴ This information has been taken from NATS's comment letter to the IASB in response to the DP.

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Entity	Necessary characteristics		Other characteristics	
		<p>n+2 adjustments are in respect of service performance incentives (bonuses or penalties) and traffic volume risk sharing and changes in inflation compared to the forecast.</p> <p>The revenue requirement is based on the traffic forecast (traffic volume) adopted by the economic regulator.</p>		
<p><i>The EFRAG Secretariat observes that in its comment letter, NATS notes that they believed that NERL activities would fall under the scope of defined rate regulation (as described in the DP) which captured the main features of NERL's incentive-based regulatory model.</i></p>				

Limited research conclusions

- 38 To summarise, based on limited research, other activities within Europe, identified by the EFRAG Secretariat that could fall within the scope of defined rate regulation as currently defined include the following:
- (a) Aeronautical services (operated by airports – see above); and
 - (b) Air-traffic control services in Europe (see NATS above and the relevant EU legislation).
- 39 Outside of Europe we also found that manufactures (some) of fertiliser in India could potentially be within the scope (based on responses to the IASB request for information in 2013). Based on discussions with the Staff of the AcSB, some ferry services in Canada could potentially be within the scope of defined rate regulation.

Questions to EFRAG TEG

- 40 Are you aware of activities, other than utilities and potentially the ones mentioned in the analysis above, that you consider to be, or likely to be, within the scope of defined rate regulation?

Next steps

- 41 The scope of the IASB project will be discussed at the IASB Consultative Group for Rate Regulation meeting on 26 October 2017 and with EFRAG's Rate-regulated Activities Working Group at the forthcoming meeting to be held towards the end of 2017.

Appendix 1: Defined rate regulation

Introduction

- 1 The IASB Discussion Paper (DP/2014/2) *Reporting the Financial Effects of Rate Regulation* set out the features of defined rate regulation in the paragraphs 4.4 – 4.7.

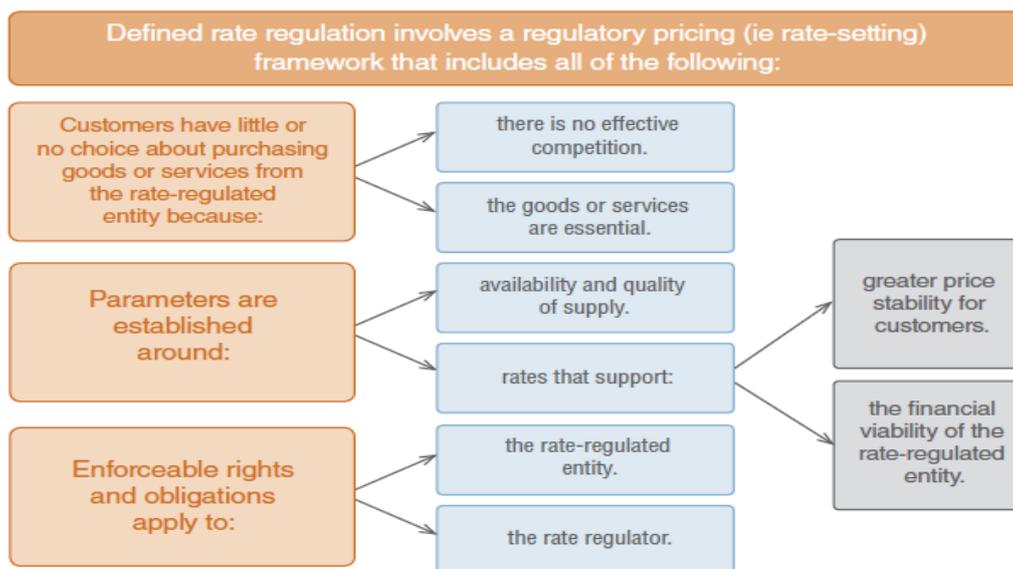
Regulatory frameworks

- 2 The DP explored the distinction between different types of rate regulation but focused on regulation that led to the existence of rights and obligations that might be recognised in an entity's financial statements referred to defined rate regulation.
- 3 The DP acknowledged that the concept of regulation can be interpreted very broadly, and can take many forms. Regulation might govern all of an entity's activities or only some of its activities.
- 4 In many cases the rate-regulated entity has an exclusive right and obligation to operate in specified areas and operates under a licence that is granted by the regulator or other government body. However, there might be cases where the right to operate is not established by a separate licence but forms of the regulatory agreement.
- 5 Regulatory frameworks might use different bases to determine the prices charged to customers, but have a similar rate-recovery mechanism that allows an entity to recover or settle under-or-over recoveries. The mechanism in many cases is the adjustment of future prices determined by the regulator or relevant government agency.
- 6 There are two broad frameworks commonly employed for price regulation: cost-based regulation and incentive-based regulation. In many jurisdictions, including the EU, both types of regulation exist, although incentive-based regulation has become more common as it encourages regulated entities to operate more efficiently. In incentive-based rate regulation, a rate-setting mechanism can exist but a regulated entity could be subject to penalties and incentive bonuses in case of under and over performance.

Defined rate regulation—an overview as defined in the DP

- 7 The DP explained that defined rate regulation normally occurs when there is a monopoly or near-monopoly and often exists in the delivery of public goods for which, generally considered 'essential' by the regulator or the relevant government agency and it would be inefficient to have competition (for example, because of the nature of the investment which is normally significant in amount). The overall objective of 'defined rate regulation' to ensure the quality of the public service and that the entity earns a fair return on the provision of the goods or services.
- 8 The distinguishing features of defined regulation in paragraph 4.4 of the DP can be illustrated as follows:

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- 9 Paragraph 4.5 of the DP explained that the rate-setting framework for defined rate regulation establishes:
- (a) a 'revenue requirement' (sometimes called 'allowable revenue' or 'authorised revenue'): this is the total consideration to which the entity is entitled in exchange for carrying out specified rate-regulated activities over a period of time; and
 - (b) a regulated rate, or rates, per unit that the entity charges to customers for delivering the rate-regulated goods or services during the regulatory period.
- 10 Paragraph 4.6 noted that for defined rate regulation, the mechanism used to calculate the regulated rate(s) includes a regulatory adjustment mechanism to reverse specified differences between the amount of the revenue requirement accrued to date and the amounts billed to customers. This regulatory adjustment mechanism seeks to ensure that the rate-regulated entity earns no more and no less than the amount of the revenue requirement and any related profit or return to which it is entitled. The regulatory adjustment to the rate also seeks to reflect the time value of money when increases or decreases in the rate are deferred.
- 11 Paragraph 4.7 explained that consequently, some suggest that defined rate regulation creates a combination of rights and obligations that supports the recognition of the entity's right to recover, or obligation to reverse, the specified differences as assets or liabilities in the statement of financial position.

Comments from respondents including EFRAG

- 12 Respondents to the DP agreed that defined rate regulation, as defined in the DP, was an appropriate starting point for developing an accounting model for activities subject to rate regulation.
- 13 However, while many respondents agreed that the features outlined in paragraphs 4.4(a) – (c) of the DP typically support the existence of the rate-regulatory framework, they highlighted that there may be operational difficulties in applying the features if they were set as mandatory scoping criteria. For example, the determination of which goods or services are deemed essential is very subjective and can vary in different regulatory regimes. Similarly, the terms "customers have little or no choice" and "no effective completion to supply" could be difficult to apply in practice, particularly in cases in which there is some limited competition from another source of supply or substitute product(s) exist.
- 14 Some respondents considered that the description of defined rate regulation in the DP was not sufficiently precise to determine the scope of an accounting model.

- 15 In its comment letter, the EFRAG position was summarised as:

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.*

- 16 EFRAG's view was consistent with many similar comments and recommendations for the IASB to focus on the existence of a regulatory pricing (i.e. rate-setting) framework that creates enforceable rights and obligations and includes an adjusting mechanism to reverse specified differences between the amount of the revenue requirement and the amounts billed to customers. The other features identified in the DP provide useful indicators of the existence of defined rate regulation.

Market regulation as described in the DP

- 17 Some activities are subject to a form of regulation that governs the maximum rate/amount an entity can charge the customer for the goods or services it provides termed in the DP as 'market regulation'.
- 18 In market regulation, the primary purpose of the regulator's intervention is to act as a proxy for efficient competition to protect customers from excessive profit-taking by the suppliers. Market regulation often takes the form of a 'price cap' that applies to all suppliers in a competitive market (and are not specific to a rate regulated entity). The price cap is based on benchmark costs, instead of specific costs that any individual supplier incurs.

Comments from respondents including EFRAG

- 19 Respondents to the DP generally agreed that market regulation should not be included in the scope of the IASB project.
- 20 In its comment letter on the DP, EFRAG stated:
- 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.*
- 21 Therefore, EFRAG did not support the extension of defined rate regulation to include market regulation.

Recent discussions by EFRAG TEG, EFRAG CFSS and ASAF

EFRAG CFSS/TEG discussion in November 2016

- 22 At the EFRAG CFSS/TEG meeting in November 2016, EFRAG CFSS/TEG members discussed a paper on the scope of the IASB project as well as the IASB Staff proposed changes.
- 23 One EFRAG CFSS member suggested that if the IASB project would allow defined rate-regulated entities to recognise regulatory assets and liabilities but not those entities that had activities subject to other forms of regulation, it might result in similar

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activities being accounted for differently. One EFRAG TEG member thought it was necessary to have an independent rate regulator otherwise service-type contracts might be included in the scope.

- 24 There was general agreement with the IASB Staff proposal that the scope should not be determined by a particular regulatory regime. In contrast, the IASB should consider where there were regulatory adjustments created by the rate-setting mechanism.

EFRAG TEG discussion in January 2017

- 25 At the EFRAG TEG meeting in January 2017, EFRAG TEG discussed another paper summarising the recent developments in the scope of the IASB's rate-regulated activities project.
- 26 Overall, EFRAG TEG considered that the IASB should approach the project by first identifying the accounting issue that needs to be addressed, instead of describing a particular type of rate regulation. This would reduce the risk of introducing different accounting treatments for activities that, from an economic perspective, are insufficiently dissimilar to justify such a difference but that fall in or out of the scope of a specific type of regulatory regime.
- 27 However, some EFRAG TEG members acknowledged that the accounting problem they were trying to solve was that IFRS 15 did not provide an adequate response for rate regulated activities, and this was what the scope of the project and the accompanying accounting model was trying to address.
- 28 One EFRAG TEG member noted that an entity would apply IFRS 15 to activities governed by market regulation and therefore it would be out of scope, not by the nature of the regulation but because it has no impact. Another EFRAG TEG member added that the issue the IASB was trying to address related to over and under payments relative to performance. The scope was about revenue without contracts with a customer base, and the IASB could potentially solve the issue with a definition of a customer base.
- 29 The IASB member presented at this meeting commented that he thought of the issue as rights and obligations that arose from the actions of the regulator. In relation to scope, it was not about utilities, and this has been acknowledged in the IASB DP and other previous agenda papers.