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Mr Hans HOOGERVORST
IFRS Foundation
30 Cannon Street
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N° : 1

Re: Discussion Paper DP/2014/2: Reporting the financial effects of rate regulation

Dear Mr. Hoogervorst ,

I am writing on behalf of the Autorité des Normes Comptables (ANC) to express the comments of the Collège on the discussion paper DP/2014/2 on *Reporting the financial effects of rate regulation*. These comments result from the ANC's due process, involving all interested stakeholders and the ANC's IFRS Commission.

The ANC welcomes the objective of the IASB to focus the scope of this Discussion Paper on a specific type of rate regulation referred to as “defined rate regulation” (DRR). The ANC agrees that it is critical to identify key features that distinguish rate-regulated schemes from other activities in a first step. Accordingly, the ANC considers that the main key features to analyse if a company operates in a rate regulated environment are as follows :

- Regulation creates **enforceable rights and obligations** on the rate-regulated entity and on the rate regulator, as well as on the customers;
- Rate regulation establishes such a level of authorized revenue that it supports **the financial viability of the rate-regulated entity** (for example through a pre-determined rate of return on investments in fixed assets);
- **Authorized revenue:** Under such a mechanism, the entity has the right to recover the pre-determined level of revenue, independently of actually delivered goods or services (higher or lower volumes of energy transport for example).

Other features like “no effective competition” or “essential goods and services” are useful to understand the usual context in which rate-regulated entities operate, but the ANC considers that they should not be retained as mandatory criteria. The ANC thinks that guidance should not be set for a scope of a specific sector or specific industries, as this could result in unstable accounting solutions.

The ANC believes that improvements in the definition of the scope are necessary before defining which accounting approach and disclosure requirements would best portray the financial effects of rate regulation.

Accordingly, the future guidance on Rate Regulated Activities should :

- **Be principle based**, and consistent with other IFRS standards ;
- Enable to reflect underlying economics and **the performance** of the rate regulated entity.

The ANC thinks that **no new specific standard should be designed to address rate regulated activities**. We recommend addressing this issue through IFRS 15 revenue recognition model, and considering how IFRS 15 should adapted. Such clarifications are necessary for the progress of the project, as companies submitted to rate regulation are facing IFRS 15 implementation.

If you have any question concerning our comments, we would be pleased to discuss them.

Yours sincerely,



Gérard Gil

ANC Board Member
IFRS Commission Chair

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?

a) Users of financial statements often consider that relevant information about the effects of rate regulation is missing in the financial statements.

Users need mainly a qualitative description of the rate-regulated regimes in which the entity operates, as:

- The role of the regulatory entity;
- The legal context of regulation;
- The nature of the relationship between the regulator, the entity and the customers;
- The activities performed by the entity subject to regulation;
- The description of the rate regulation mechanism;
- The decisions made by the regulator (tariff's adjustment, or instance) and their impacts on the entity's performance.

Note: For the energy sector in France, such information is publicly available on the website of the regulator (Commission de Régulation de l'Énergie - CRE).

b) The following information would be helpful to assess the performance of the regulated activities of the entity over time:

- How the context of the rate regulation and the decisions made by the regulator influence the performance of the entity;
- Opinion about the stability of the regulatory mechanism;
- And specific risks due to the regulatory environment.

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?

The French accounting standards do not deal with the recognition of the deferral account balances nor on the disclosure of the effects of the regulation in the notes to the financial statements.

However, for energy infrastructure businesses (transport and distribution) the amount of deferral account balances is available on the website of the French regulator. The detail of the annual amount of such a balance (i.e. the difference between the authorized revenue and the revenue invoiced to customers over the year based on the tariff imposed for the year) is available, and the accumulated balance too (if the deferral account from previous year has not yet been recovered). Thus the users of financial statements are liable to use these elements to estimate the impact of the rate regulation on the performance of such businesses.

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)? If not, how do you suggest that the IASB should address the diversity in the types of rate regulation summarised in Section 3?

We agree that focusing on a defined type of rate regulation (the “DRR”) is critical to capture a broad range of rate regulation systems, and to assess whether their features distinguish the rate-regulated activities from the non-regulated activities.

Nevertheless, we believe that improvements in the definition of the DRR are necessary before launching the discussion about whether this type of rate regulation creates a combination of rights and obligations, for which specific accounting guidance should be developed.

We have two concerns:

- The definition of the distinguishing features of the DRR (see our answer to question 5);
- The DP should better address the issue of the border between incentive regulation schemes or hybrid regulation schemes, included in the scope and “limited” incentive regulation schemes outside of the scope (see our answer to question 4).

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?

a) We agree that limited or "market rate" regulation does not create a specific environment for entities performing in such activities and, thus, does not require any specific accounting treatment.

We believe that the form of « market » rate regulation, that is used to supplement inefficient competition in the market, does not have the same features as DRR and, as a consequence, it should not be included in the scope.

b) Even if this type of regulation was considered not creating specific enforceable rights and obligations on the rate-regulated entity and the regulator, we believe that a "price cap" regulation binds the entity and that specific disclosure requirements (such as the description of the regulatory framework) could be useful for the users of financial statements to assess the performance of the regulated activities that are impacted by such a price cap. We would expect that such information should be covered by the new disclosures required under IFRS 15 (if material).

Nevertheless, we note that, as expressed in paragraphs 3.27 to 3.37, market-regulation is seen as a specific shape of incentive-based regulation, classified as "scheme at the end of the incentive-based range of rate regulation".

Furthermore, the IASB acknowledges that almost all of the schemes are hybrid rate regulation, combining to a certain extent cost-of-service regulation and incentive regulation.

It is not clear whether the distinguishing features of the DRR will include hybrid rate regulations systems and only exclude market regulation systems.

For example:

- Will a pure market regulation system applied to a market where there is absolutely no competition be included or excluded from the scope or not, according to the identified features of the DRR?
- Will a rate regulation mechanism combining a market regulation system and other incentive-based mechanisms (such as environmental objectives) be inside or outside the scope?

We believe that the issue of the border between rate regulation mechanisms inside and outside of the scope should be addressed in detail by the IASB before progressing with the project.

Question 5

Paragraphs 4.4–4.6 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.

a-b)

We believe that the key features of defined rate regulation are the following ones:

- *DRR creates rights and obligations that are enforceable on the rate-regulated entity and on the rate regulator, and also on the customers*

Companies in the rate regulated sector consider that the existence of enforceable rights and obligations provides assurance to the company to be entitled to obtain a revenue requirement as determined in the regulation.

This mechanism includes a regulatory adjustment mechanism to reverse specified differences between the amount of the revenue requirement (“authorized revenue”) and the amounts billed to the customers (paragraph 4.6 of the DP).

This is a key feature too, because it achieves the objective of balancing the needs of the customers with the needs of the rate-regulated entity.

- DRR establishes a level of authorized revenue, such that it supports the financial viability of the rate-regulated entity (for example through pre-determined rate of return on investments on fixed assets).

“Authorized Revenue” is a key feature too. This Authorized Revenue is a pre-determined revenue. Under such a mechanism, the entity has the right to recover the pre-determined level of revenue, independently of actually delivered goods or services (for example: higher or lower actual volumes of energy transport than the estimates used for setting the tariff per unit).

This is the main difference compared to “market rate regulation” because, under this type of regulation, there is no right to recover a certain level of revenues/margin. For an energy distribution company, under DRR, the key service promised is the availability of the network. Thus the revenue requirement is based on the estimated volumes, but if the billed amounts (based on actual volumes) do not equal the revenue requirement, the entity is entitled to an adjustment. However, the importance of this feature is linked to the characteristics of the

recovery period. The shorter the recovery period is, the higher the impact of this feature on the performance of the rate-regulated activity is.

We consider that the following features are important to understand the context, but we wonder whether they are able to capture precisely the appropriate population of rate-regulated schemes. In our view, these features are more background / context considerations but should not be criteria of the scope.

- There is no effective competition to supply (paragraph 4.4(a)(i) of the DP)

We consider that the lack of competition is an underlying condition, but that it will be difficult to determine if a low level of competition is acceptable to feature a rate-regulated environment. The assessment of this criterion ("what is competition") needs a strong exercise of judgment.

- The rate regulated goods or services are essential to customers (such as clean water and electricity) (paragraph 4.4(a)(ii) of the DP)

We think that the notion of « essential goods and services » may be difficult to define. This notion depends on many various factors, like the economic development level of the country, the consumer's habits, government's orientation and it can evolve over time. The identification of this criterion needs a high level of judgment as well.

Furthermore, the categories of the "essential goods and services" given by the paragraph 4.31 of the DP draw the shape of sectorial activities. Although the purpose of the DP does not seem to define a sectorial standard (which in our opinion is not the basis of principle-based and stable accounting requirements), this feature, if mandatory, could lead to such effects.

We understand that the lack of competition (or ineffective competition) on essential goods and services restricts the ability for a consumer to choose the supplier. This characteristic is able to give the supplier the reasonable assurance that the customer will have no other choice but continuing to buy the proposed goods and services at their regulated fare.

We believe that the key element to be captured is the inelastic demand for goods and services, and that lack of competition on so-called essential goods and services is a relevant parameter to identify inelastic demand, but not the only one. So we would recommend the IASB not retaining the 4.4(a)(i) and 4.4(a)(ii) features as criteria of the scope.

b) We note that the customer is not defined.

In France, the main industry captured by the DRR definition are the gas and electricity infrastructure operators (transport and distribution of gas and electricity). As a result of unbundling (Energy Directive), transport, distribution and supply (sale of energy itself) have to be separated. Therefore, the customers of infrastructure operators are suppliers of energy (and not final energy consumers). Energy supply is not regulated and is open to the competition.

The price of energy (ie. the amount billed by the supplier to consumers) includes a transport and distribution tariff. Such a tariff is set by the regulator. Transport and distribution tariffs are in general included (in the form of a pass through price) in the price billed by the supplier.

Thus, the customer for infrastructure operators is the "customer base", because the deferral amount is recovered from the customer base as a whole (and not from individually identified consumers).

We strongly believe that the IASB should address this issue to identify if the “customer base” as a whole could be considered as a “unit of account” for rate regulated activities.

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?

(a) (b) We are not aware of specific additional rights or obligations that the IASB should consider.

In our opinion, although rate regulation creates a specific economic environment, and that rights and obligations due to rate regulations can be identified, this does not necessarily imply that these rights and obligations are specific to rate regulated activities.

For example:

- The exclusive rights to supply essential goods and services are not necessarily specific to rate regulated activities, but can also result from certain concession arrangements.
- The obligation to achieve a minimum service level is not only specific to rate regulated activities, because a lot of other arrangements also provide such obligations.

So we think that a specific standard is not necessary to account for these rights and obligations described.

We suggest the following approach:

- Are these rights and obligations specific to rate regulated activities?
- How are these rights and obligations accounted for by entities involved in non-regulated activities?
- Are IFRS principles used to account for non-regulated activities also appropriate to accounts for the rights and obligations of rate regulated entities? Specifically, why would IFRS 15 not be an appropriate standard? Is a further interpretation of IFRS 15 needed?
- If not, should specific IFRS requirements dealing with regulated activities’ accounting be developed?

We believe that a decision about the opportunity of developing specific IFRS requirements cannot be made before addressing these issues.

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.

As mentioned before, we think that, first, the definition and the scope need to be further specified, and that the decision on the approach for providing information that best portrays the financial effects of defined rate regulation should be taken in view of the final definition and scope.

In conclusion, we do not support the following approaches:

- The ones which result in exceptions to the existing standards, only for the purpose of accounting for specific issues ;
- The one which consists in using regulatory accounting requirements, because :
 - Such requirements are not based on accounting concepts, but they are defined to meet the needs of the regulation;
 - There are many different regulatory requirements and this would result in a lack of comparability.

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?

The ANC does not carry out activities that are subject to defined rate regulation.

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.

In our opinion, such a “principle” of only disclosing information that is critical to understand the performance of an activity is not a common approach. Therefore, we think that prior to such a decision, compliance of this principle with the IFRS should be further investigated.

When applying IFRS, the first issue is to assess whether an asset / liability shall be recognised in the financial statements and, if not, what is the “nature” of such “items” like contingent asset / liability etc. The second issue is to assess whether disclosures are necessary. In any case, even for “disclosure-only” requirements, clear scope and definitions would be required.

If the IASB were to decide to prohibit the recognition of regulatory specific accounts in IFRS financial statements despite the fact that specific rights and obligations had been previously identified, the necessity for specific disclosure-only requirements could be assessed if the existing standards (IFRS 15, IAS 37) were not sufficient.

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.

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?

Answer to questions 10 and 11

In our comment letter on the IASB's Exposure Draft ED/2013/5 Regulatory Deferral Account, while not supporting it, we agreed that the presentation requirements isolated the effects of the application of the ED for those companies which do not currently apply IFRS, and that the proposed disclosure requirements would provide useful information.

In our view, separate presentation of Regulatory Deferral Accounts required by IFRS 14 was absolutely necessary because IFRS14 implementation resulted in a lack of comparability between first time adopters and others. We considered that this presentation was necessary but not sufficient to overcome this lack of comparability.

Our opinion in the context of the issuing of specific guidance to report the effects of rate regulation could be different. The shape of the disclosures shouldn't be necessarily the same as those required by IFRS14.

Nevertheless, it seems too early to define precisely the type of disclosures needed, and the advantages and drawbacks of IFRS14 disclosure requirements in the context of a different project, which final outcome is not yet defined.

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?

We consider that self-regulated entities do not meet the same features as entities regulated by an external body and we do not think that such entities should be included in the scope of rate regulated activities.

We are not aware of co-operatives which activities are regulated by an external regulator, but such a type of co-operative may exist in some jurisdictions. If so, they should be included in the scope if they meet the features characterising rate-regulated entities.

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?

The ANC believes that the future “guidance” on Rate Regulated Activities should:

- be principle based, and consistent with other IFRSs;
- enable to reflect underlying economics and the performance of the rate regulated entity ;

We consider that no new specific standard should be designed to address rate regulated activities. We recommend using the IFRS 15 revenue recognition model, which provides further guidance on the definition of enforceable rights and obligations. We understand that clarifications would be necessary to address whether and how some principles of IFRS 15 could be adapted to form the basis of a revenue recognition model for rate-regulated activities.

We believe that the following issues should be considered by the IASB:

- Whether the “unit of account” has a role to play. As explained in our answer to question 5, the issue is whether, for regulated activities, the unit of account becomes the consumer base, rather than the individual consumer;
- Whether the regulated entity has a “performance obligation” towards its consumer base;
- Whether differences arising between the “revenue requirement” and amounts billed to customers that are expected to be incorporated into the future tariff, could be considered as prepayments and deferred payments, or as a variable component of the consideration billed to customers.