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IFRS-Fachausschuss

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34. Sitzung IFRS-FA am 08.01.2015
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Dear Hans,

IASB Discussion Paper DP/2014/2 *Reporting the Financial Effects of Rate Regulation*

On behalf of the Accounting Standards Committee of Germany (ASCG) I am writing to comment on the IASB Discussion Paper DP/2014/2 *Reporting the Financial Effects of Rate Regulation* (herein referred to as 'DP'). We appreciate the opportunity to comment on the DP.

We closely follow the actual discussion about an accounting standard for rate regulated activities (herein referred to as 'RRA'), in particular within the proposed narrow scope of 'defined rate regulation' limited to the financial effects of the so-called revenue requirements. We identified the effects from these true-up mechanisms as a main trigger for the debate within our constituency about misleading accounting of RRA and the presentation mismatch in financial performance over multiple periods.

However, a narrow scope by itself is not sufficient to argue for a new standard if it tends to ground on rules more than on principles. Therefore we would like the IASB to carefully reconsider whether the high hurdles to introduce specific accounting principles for a specific type of business activities are met in the case of RRA.

Within our constituency, in most cases RRA do not cover all but only a particular type of transactions of the reporting entity or group (herein referred to as 'integrated businesses'). This is a very important factor when considering the cost/benefit-constraint of a proposed standard for RRA. In particular in vertically integrated businesses the preparation of additional information on RRA in the primary financial statements might be burdensome and might not necessarily provide users with useful information as it only affects a (minor) part of the overall business activities of the group.

Having said that, we would like to summarise our remaining comments as follows:

a) We generally support the recognition and presentation of regulatory deferral accounts in the statement of financial position and the statement of profit or loss for a pure regulated entity, accompanied by certain disclosure requirements. For a reporting entity with integrated businesses the evaluation might be different (see above). We currently do not see a proper solution for presenting cash flows from RRA.

b) The German regulatory legal environment is very different in the individual industry sectors and so are the tasks of the regulator and the rate-setting frameworks (if any). We have provided some basic comments on the past and present accounting treatment of regulatory deferral balances in certain industries.

c) We agree with the IASB to focus on a defined type of rate regulation in order to provide a common starting point for a more focused discussion. In this context we have not received requests to develop specific accounting requirements for pure incentive-based types of schemes, such as market regulation.

d) Regarding the proposed definition of defined rate regulation we noticed that some of the items of that definition are not necessarily triggering the accounting impact. Instead they are of a more descriptive nature to elaborate on the motivations or reasons for the existence of a regulatory environment. We would instead define the scope of RRA transactions leading to specific accounting requirements as follows: *Defined rate regulation involves a regulatory pricing (i.e. rate-setting) framework that includes rights and obligations that are enforceable on the rate-regulated entity (ensuring that the entity recovers no more than its revenue requirement) and on the rate regulator or the customer of the regulated service (ensuring that the entity recovers no less than its revenue requirement).* Any other features proving a very high certainty of the future recoverability of the charged rate components from true-up mechanisms shall be evaluated as part of recognition or measurement principles.

e) From the alternative accounting approaches presented in the DP, we would like the IASB to further develop the thinking about specific IFRS requirements to defer/accelerate the recognition of costs and/or revenue in the context of our proposed definition. However, we see some merits to having a look into the accrual approaches in other IFRSs like IFRS 15 and IAS 12.

f) From our constituency we learned about specific operational issues the IASB should consider if it decides to develop any specific accounting guidance or requirements. Those particularly relate to the economic entity approach in a group with an integrated business model. We would like to refer to our response to Question 8 for the details.

g) We do not consider the existence of a regulator as a necessary feature for the accounting consequences of RRA. It is an important indicator to consider when analysing what rights and obligations established by the rate regulation are enforceable but the non-existence of a rate regulator is not relevant as long as there exist substantive rights or obligations.

h) We understand that it is premature to present an analysis of the interaction with other standards or suggestions for their resolution at this time. However we think that the list of interaction needs to be elaborated. We also see close interactions with at least IFRS 8, IAS 36, IFRS 5 and IAS 7.

For more details on the technical analysis we refer to our responses to the individual questions in the Appendix of this letter.

If you would like to discuss our comments further, please do not hesitate to contact me.

Yours sincerely,

Liesel Knorr

President

Appendix – Answers to the questions of the Discussion Paper

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?

General remarks

We have learned from our constituency that a main trigger for the actual discussion about misleading accounting of RRA is a presentation mismatch in financial performance over multiple periods resulting from so-called true-up mechanisms. (For more details we refer to our answer to Questions 5 and 6.). Based on that assumption, the starting point for any discussion about the desired accounting impact of RRA shall be the effect in the statement of profit or loss. However, we acknowledge that recognition of income and expense from RRA is interrelated to the accounting of some kind of regulatory balance sheet items as well.

We basically agree with the scoping ideas in the DP which might tentatively lead to a narrow-scoped standard (For more details on our comments on the proposed definition we refer to Questions 3 and 4.). However, a narrow scope by itself is not sufficient to argue for a new standard if it tends to ground on rules more than on principles. Therefore we would like the IASB to carefully reconsider whether the high hurdles to introduce specific accounting principles for a specific type of business activities are met in the case of RRA.

Although we basically agree with the scoping from a conceptual point of view as it fits to the above described accounting issue it might cause the following unintended consequences:

a) The new standard would most likely become an industry-specific standard on a country-by-country basis covering certain industries depending on the legal environment in one country but not in another. For the German environment we would like to give you a first indication in Question 2.

b) As a lot of regulatory frameworks are dynamic and might change from time to time, the scope of entities covered by the definition might change over the years. A scope-in/scope-out for certain industries every few years shall be avoided.

c) In most cases RRA as currently defined in the DP do not cover all but only a particular type of transactions of the reporting entity or group when it has an integrated business model. This is a very important factor when considering the cost/benefit-constraint of a proposed standard for RRA.

   Example: We have learned from our constituency that entities in the electricity sector are most likely affected in business models as transmission or distribution service operators (TSO and DSO). However, in large groups of vertically integrated electricity providers (which are also covering the rest of the value chain like production, storage, sales and trading) the RRA as currently defined might only cover a minor part of their overall activities, as all these other transactions in Germany are most likely not covered by the proposed definition if no true-up mechanism exists.

   We would like the IASB to carefully consider the benefit of a new standard on RRA in this context. This becomes even more important if the standard allows and requires a specific accounting treatment only – and only for the defined RRA without optionality.

   Furthermore we have identified some operational challenges for integrated businesses. We refer to our answer to Question 8. These issues might not only cause a significant burden on the preparer's side but also will not necessarily improve the quality of financial information about RRA on the user's side.

Having addressed our views with regard to integrated businesses, we would like to comment on the usefulness of financial information in the individual financial statements under the assumption of a reporting entity in a pure RRA environment, as follows:

Question a): Preparing financial information about rate-regulated activities

i. Statement(s) of profit or loss and other comprehensive income

Referring to our general remark at the beginning, the ASCG has the view that the RRA effects in the statement of profit or loss shall be at the center of discussion. We have learned that a proper presentation of the financial performance of a regulated entity is based on the 'allowable revenue' or 'authorised revenue'. They reflect the total consideration to which the entity is entitled in exchange for carrying out specified RRA over a period of time.

We share the DP's argument that the most distinguishable feature of defined rate regulation is the entity's right to recover the revenue requirement, using the rate-setting mechanism to adjust for under-billings or over-billings over time. Consequently, the rate-setting mechanism is an important aspect of the effectiveness of the defined rate regulation in ensuring that the entity recovers no more and no less than its revenue requirement.

Due to the fact, that current IFRS do not allow the recognition of regulatory positions, it is widely agreed within our constituency, that the statement of profit and loss of regulated entities is not presented fairly and in a proper way. Therefore, a recognition of the RRA revenues 'as allowed or authorised' seems reasonable.

A separate presentation of the revenue requirement within the statement of profit or loss allows interpreting how RRA affect the performance of the entity (e.g. items which are based on a 'pass-through' idea over multiple periods).

These effects depend on the useful life of assets and on the compensation schemes or amortisation periods set out by the regulatory framework. Effects of regulation, that have impact on regulated entities' figures often belong to periods of the past or – sometimes – to future periods. Some effects are realised long term, other short term, but all are following a strict and binding system set out by law or the regulator. A variety of different schemes exists in various regulated systems; therefore it has to be paid attention to their effects in a separate line item in the statement of profit or loss.

ii. Statement of financial position

If RRA true-up mechanisms have a significant impact on the reporting entity, the recognition of a corresponding asset or liability might be appropriate. A deferral asset or liability arising from RRA claims and obligations from a past event seems useful and important to show, how the regulatory framework will affect the overall financial position. This shall be limited to the right to recover the revenue requirement, ie not cover the exclusive right to supply essential goods or services. We refer to our answer to Question 6.

Furthermore a separate presentation within the statement of financial position of these items allows interpreting how RRA affect the entity in terms of working capital management. Separation of various effects can be important to determine and also to prove cost of capital towards users and the regulator. Furthermore this allows an entity to show these positions in comparison to other elements or it easily enables users to eliminate the figures if they are not important for specific purposes.

iii. Statement of cash flows

The ASCG would also support the separate presentation of cash flows from RRA in the Statement of Cash Flows. Several key performance indicators can be derived from cash flow

information and cash flows from RRA in particular might be important in the context of a regulated entity.

However, we acknowledge that a separation of cash flows from movements in regulatory deferral account balances might not be possible or does not provide useful information as it only reflects the accrued 'true up'-part in the business model of a regulated entity and does not even represent separate cash flows.

In general, it might be quite difficult to designate a specific type of cash flows as "RRA-related". For a regulated entity it might be argued that all operating, investing and financing cash flows relate to rate regulation. On the other hand, for integrated business a separation might provide additional information about regulated and non-regulated businesses, if the regulated part is significant.

We therefore encourage the IASB to further think about presentation principles on rate regulated activities.

iv. Note disclosures

Disclosures on rate regulation should give additional information about the items accounted for in the primary financial statements, i.e. should in our view be limited to disclosures on regulatory deferral accounts and the revenue requirement. They can deliver more details about the financial effects in the reporting period and give additional forecast information about future financial effects caused by the regulatory scheme.

For further details we would like to refer to our response to Question 9.

v. Management commentary

In its capacity as National Standard Setter, the ASCG is responsible for the development of reporting standards for statutory consolidated management commentaries under the German Commercial Code, including those of IFRS adopters. In this context we did not deliberate specific reporting requirements for RRA so far.

Question b): Using financial information about rate-regulated activities

Mirroring our comments on the preparer's side, we have the expectation that the same arguments are valid for the usage of financial information about RRA.

It is expected that financial information about the regulatory scheme and the revenue requirement in particular are relevant and important for long term investment decisions in a regulated entity as they are needed to evaluate its sustainable net result for a period. They will improve the financial reporting of that entity and the view on the entity and its value drivers.

However, we would like the IASB to remind our general remarks above. In the (in our environment common) case of integrated businesses we have mixed views:

a) On the one hand one could argue that the relevance of financial information provided might be unchanged or even lower under the ideas of the DP. Investors might have difficulties to understand all the various impacts in a large group of vertically integrated activities where only (minor) parts are subject to rate regulation.

b) On the other hand one could argue that because RRA and their impacts might be difficult to analyse in a complex situation with a lot of intra-group transactions a recognition and disclosure of deferral accounts as part of the consolidated financial statements might even help investors to understand the overall impact from RRA on group level (ie. reflecting only transactions of the group with third parties).

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 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?

Regulatory frameworks

The Federal Network Agency (Bundesnetzagentur – BNetzA) is working as a regulator for Germany's core regulatory frameworks and covers the four industry sectors: 'Energy and Gas', 'Tele-communications', 'Postal service' and 'Railway'. In its capacity it covers several regulatory tasks like accessability and quality control, as well as consumer protection with regard to the network infrastructure and rate-settings ex ante or rate-adjustments ex-post.

The regulatory legal environment is very different in the individual sectors and so are the tasks and the rate-setting frameworks (if any). At this stage we would like to provide some basic comments on the past and present accounting treatment of regulatory deferral balances (where they occur in these frameworks) under German GAAP which we have collected from our constituency:

i. Energy and Gas

The Energy Act assigned the task of regulating Germany's electricity and gas markets to the BNetzA. The purpose of regulation is to establish fair and effective competition in the supply of electricity and gas. The responsibilities of the BNetzA therefore include ensuring non-discriminatory third-party access to networks and policing the use-of-system charges levied by market players.

German electricity network operators are being regulated under an incentive-based regulation scheme since 2009. This scheme provides so called revenue-cap-regulation over regulation-periods of five years. The revenue-cap determines the allowed revenue of the network operator for one regulation period. It consists of imputed cost positions for influenceable and non-influenceable cost and several positions of cost compensation. In addition the revenue-cap covers the result of true-ups for past periods. Under certain criteria the network operator is allowed to adjust the revenue-cap for specific positions (incurred cost) to allow reasonable cost compensation for new or changed elements in future periods. Adjustments for inflation as well

as due to the result of efficiency benchmarks are to be initiated by the regulator. Besides prices for the use of the electricity networks (determined via the revenue-cap of the year) different types of pass through mechanisms – operated by the network operators – are also under observation of the Federal Network Agency. Variances between the allowable revenue and actuals of each calendar year will be monitored and have to be paid back to customers or lead into an increase of future tariffs. Such true-up mechanisms spread over 1 to 5 years depending on their origin and volume compared to the overall allowable revenue of the network operator.

The practical experience of our constituency with regulatory deferral account balances from net operations is basically limited to the provisions of German GAAP (Commercial Code and/or tax laws). There is a majority of preparers and auditors acknowledging that German GAAP does not allow the accounting of assets for such balances, liabilities only in cases of provisions for uncertain obligations from a past event or onerous contracts.

ii. Telecommunications

The central task of regulation of BNetzA in the area of telecommunication is to keep a check on the dominant provider's market power and to help new competitors enjoy the same opportunities. Hence the approach goes beyond just the "ex post" control of anti-competitive practices. The regulatory tasks are so specialised that they cannot be resolved with the tools of general competition law alone. That is why sector-specific regulation is necessary at least until workable competition has been established in the telecoms market.

The telecommunication industry in Germany is largely subject to national and European regulation, which is associated with extensive powers to intervene in the product design and pricing. The regulation covers mobile and fixed-network businesses. The primarily involvement of the regulator focuses on the wholesale services – in particular broadband wholesale services and investments in new networks and infrastructure as well as the corresponding rates, along with the allocation of mobile spectrum.

The rate regulation in the telecommunications industry in Germany covers the rates for unbundled local loop lines (ULLs) including the shorter connection from the cable distribution box (sub-loop unbundling) as well as the mobile and fixed-network termination rates. All rates in this regard are set by the Federal Network Agency (BNetzA) prospectively and are by nature post-paid monthly charges without any possibility of a true-up mechanism since every minute used will be charged with the regulated price per minute.

The only exception might be rate measures for bitstream products which are subject to “ex-post” price regulation by the Federal Network Agency, to whom they must be announced before they take effect. A bitstream access (BSA) is a wholesale service used by alternative telephone companies to provide broadband lines. BSA rates are based on a ex-ante calculation for certain traffic on broadband lines which are covered by a post-paid flat fee. In the event that the alternative telephone company has more traffic on the broadband line the excess traffic will be

charged to the alternative telephone company. Whereas there is a rate-setting mechanism to adjust for under-billings in the event of more traffic than the flat tariff covers there is no similar mechanism for any over-billings due to the flat fee. Even if the customers of the alternative telephone companies do not use the broadband lines the monthly flat fee has to be paid over the contract term. Hence there is no regulation mechanism to ensure that a company recovers only the amount of its revenue requirement and therefore is no true-up mechanism in accordance with DP/2014/2-4.72 in place.

iii. Postal service

We did not identify specific accounting issues or treatments in this industry sector under German GAAP regarding RRA.

[pending]

iv. Railway

The BNetzA supervises non-discriminatory access to rail infrastructure and non-discriminatory charges for its use. Another of its tasks is checking compliance with statutory pricing principles and price levels. It also monitors the market. The BNetzA covers the following areas: Legal policy issues, economic policy issues, market monitoring and statistics as well as operational tasks of rail regulation like access to rail infrastructure and services, access to service facilities and services and charges for networks, service facilities and services.

We did not identify specific accounting issues or treatments in this industry sector under German GAAP regarding RRA as the pricing mechanisms do not foresee multi-period true-up adjustments for past events.

Investment and lending decisions

Regarding the impact on users of financial statements when evaluating investment or lending decisions, it is worth mentioning that profits and losses accounted for under German GAAP measures form the legal basis for allowable dividends. However a lot of listed entities use IFRS measures and group profits for their actual dividend policies, so we cannot judge to which extent German GAAP accounting of RRA is relevant in practice.

However, there is clear evidence that in case of a business acquisition of a regulated entity the value of regulatory deferral accounts is taken into consideration when evaluating the entity value at the closing date. They reflect an economic advantage or disadvantage for the future, as the entity has the right or obligation with regard to an economic resource (future rates).

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 with the IASB to focus on a defined type of rate regulation 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.

In particular, we agree with the IASB seeking to determine whether rate regulation creates distinguishable rights and obligations that support recognition of 'regulatory assets' or 'regulatory liabilities' in addition to the assets and liabilities already recognised in accordance with IFRS for non-rate-regulated activities.

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?

The ASCG has not received requests to develop specific accounting requirements for pure incentive-based types of schemes, such as market regulation. We share the IASB's view 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.

Generally speaking, we do not support specific disclosure requirements for market regulation for the same reasons. However, a disclosure might provide useful information in the case where RRA transactions were made on terms not equivalent to those that prevail in arm's length

transactions (if such terms can be substantiated) or that are not equivalent to those of other regulated entities in the same regulatory framework.

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.

Considering the conceptual background as described in Section 3, the ASCG understands the basic reasoning for the proposed definition in Paragraphs 4.4-4.6. However, we noticed that some of the items of that definition are not necessarily triggering the accounting impact. Instead, they are of a more descriptive nature to elaborate on the motivations or reasons for the existence of a regulatory environment.

We are particularly thinking about the following three proposed criteria of a regulatory pricing (i.e. rate-setting) framework of defined rate regulation:

a) applying in situations in which *customers have little or no choice but to purchase* the goods or services from the rate-regulated entity (i.e. no effective competition to supply; and the rate-regulated goods or services are essential to customers).

b) establishing 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) establishing parameters for rates that *provide regulatory protections* (i.e. support greater stability of prices for customers; and support the financial viability of the rate-regulated entity.)

In our understanding, these parts were added to the definition to ask for a very high certainty of the future recoverability of the effect from true-up mechanisms. In our view, this recoverability threshold should not be part of the definition, but should instead be discussed as part of recognition and measurement of a regulatory asset or liability (like indicators for a recognition or measurement threshold).

On the other hand, we think that the existence of *rights and obligations that are enforceable* on the rate-regulated entity and on the rate regulator is the core criteria. Furthermore, we would like the definition limited on a specific type of right, which is the right to recover the revenue requirement as proposed in Paragraph 4.72.

Referring to our answer to Question 6, we think that this type of right is the basis for the current discussion about accounting mismatches and for the lack in faithful representation of the financial performance of a rate-regulated entity. We do not see a general information mismatch for all rate-regulated activities. This is why we would like the definition and the scope of the new standard to be focused on this specific item (true-up mechanism).

Regarding the criterion of "enforceability" we would like to raise the point that it might be needed to distinguish between the rights and obligations which are enforceable (e.g. the exclusive right to supply essential goods for a regulated rate or services and the obligations to achieve the defined minimum service level) and the right to recover the revenue requirement which – in isolation – might not be enforceable from a past event as it is linked to the ongoing rendering of services in the future. In any case we would like the IASB to carefully consider the fine dividing line between "enforceability" and "economic compulsion", the latter we think shall not be part of the basis for RRA accounting principles.

Summarising our comments, we would define the key features of defined rate regulation, i.e. the scope of RRA transactions leading to specific accounting requirements as follows:

> *Defined rate regulation involves a regulatory pricing (i.e. rate-setting) framework that includes rights and obligations that are enforceable on the rate-regulated entity (ensuring that the entity recovers no more than its revenue requirement) and on the rate regulator or the customer of the regulated service (ensuring that the entity recovers no less than its revenue requirement).*
>
> *Any other features proving a very high certainty of the future recoverability of the charged rate components from true-up mechanisms shall be evaluated as part of recognition or measurement principles.*

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?

The ASCG did not identify any additional rights or obligations that the IASB should consider.

Regarding the 'Exclusive right to supply essential goods or services', we share the IASB's evaluation that the essential nature of the rate-regulated goods or services and the lack of effective competition do not appear to create distinguishable rights or obligations for which specific accounting guidance is needed.

Similarly, regarding the 'Obligations to achieve the defined minimum service level' it seems reasonable to conclude that such obligations do not create a special environment for which specific accounting requirements need to be developed for rate-regulated entities. This is because these regulatory obligations can be found in many competitive environments and, therefore, are not exclusive to entities that are subject to defined rate regulation.

As envisaged in our response to Question 5, we would like the IASB to focus its further work on the 'Right to recover the revenue requirement'. We consider this as the most distinguishable feature of defined rate regulation, using the rate-setting mechanism to adjust for under-billings or over-billings over time:

a) This right ensures that the entity (and its capital providers) can rely on the rate regulation to recover its reasonable costs over the operational life of the assets that are used in providing the rate-regulated goods or services

b) However, defined rate regulation also ensures that the entity has a right to recover only the amount of its revenue requirement. Defined rate regulation seeks to do this by prohibiting the entity from retaining any excess amounts billed to customers.

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.

Question a): Approach which best portrays and is most relevant for investors/lenders

i. Conceptual Framework and the asset and liability debate

Noting the intense discussion and strong concerns within our constituency on whether the regulatory account balances meet the definition of an asset or a liability under the existing framework, we believe that the existing framework does not sufficiently support the recognition of these items. In our view, the Conceptual Framework should provide a clear basis for the assessment of whether regulatory deferral accounts meet the definition of assets and liabilities.

Notwithstanding any clarification or changes in the Conceptual Framework, an individual accounting standard might be required to address the complexity of the issue with sufficient clarity.

ii. The specific approaches suggested

'Recognising the package of rights and obligations established by the regulatory agreement as an intangible asset' (e.g. a licence) does in our view not best portray the financial effects of rate regulation. We agree with the counterarguments to this approach presented in the DP. The potential complexity and associated costs of applying such modified requirements to the regulatory licence, or components of it, raise questions about whether the benefits of such an approach would outweigh the costs.

Also, we do not believe that *'Reporting using regulatory accounting requirements'* best portrays the financial effects of rate regulation. Among other reasons presented in the DP, the different accounting regimes may be incomplete, substantially different from IFRS and incompatible or contradictory which will also result in less comparability of financial statements of companies.

Coming back to our comments on a reporting entity with integrated businesses, it is likely that these larger groups have rate-regulated entities with activities in different locations that are subject to defined rate regulation. The regulatory accounting requirements for similar items may differ, depending on the details of the rate regulation in each location.

In addition, the argument that preparing financial statements on two bases is onerous could be applied equally to many entities when the financial statements required for tax or other compliance purposes differ from general purpose financial statements. The regulatory accounting requirements for similar items may differ, depending on the details of the rate regulation, in each location.

From the alternative approaches presented in the discussion paper, we favour *'Developing specific IFRS requirements to defer/accelerate the recognition of costs and/or revenue'* and encourage the IASB to further elaborate on this approach.

We can see the advantages of developing specific IFRS requirements for reporting the financial effects of defined rate regulation, instead of relying on the regulatory accounting requirements. Retaining general IFRS requirements as the starting point, and using the principles of IFRS to identify the extent to which the general requirements of IFRS are modified to reflect the consequences of rate regulation, would help to maintain the quality, transparency and comparability of the information provided in general purpose financial statements.

However, we acknowledge that specific IFRS requirements will add complexity to dealing with the interactions between the regulatory requirements and the general IFRS requirements (e.g. adjustments to the revenue requirement related to the acquisition or construction of rate-regulated tangible assets), but this would not outweigh the benefits.

Furthermore, we do not believe that *‘Prohibiting the recognition of regulatory deferral accounts’* best portrays the financial effects. In our view it is not appropriate to focus on disclosures only. We do not share the arguments in the DP that suggest that the IASB should not develop any specific accounting requirements for defined rate-regulated activities.

iii. Other approaches

Considering the discussion in the DP on the interaction with IFRS 15, we see some merits in the idea that rate regulation may be considered to be an implied or quasi-contract between the rate-regulated entity and the collective customers (‘customer base’).

We would therefore encourage the IASB to spend further thinking on the core elements of the revenue recognition approach under IFRS 15 in an RRA context, which are the definition of a customer base, the quasi-contract, the regulated performance obligation and its way of satisfying as well as the transaction price.

On the other hand, if the IASB decides to develop specific IFRS requirements involving the deferral or acceleration of revenue, it should consider whether and, if so, how the principles of IFRS 15 could be adapted to form the basis of a tailored revenue recognition model for rate-regulated activities. In this context we would like to specifically mention the exception in paragraph B63 of IFRS 15 which contrary to the general requirements for variable considerations in paragraphs 56–59 allows the recognition of revenue for a sales-based or usage-based royalty promised in exchange for a licence of intellectual property only when certain events occur. We would like the IASB to consider whether this linkage of a past and future event is consistent with the proposed accounting principles for deferrals from RRA.

Furthermore, we wonder whether there are some similarities between timing concepts for deferred taxes and the accounting issues from revenue requirements in relation to RRA. These timing concepts in various accounting jurisdictions basically aim to reflect the effects from income tax as expenses from a ‘tax performance’ perspective (nominal tax rate vs. effective tax rate) and ask for corresponding deferral adjustments (DTA/DTL), as well as disclosures (tax reconciliation).

Although we acknowledge that IAS 12 is based on a temporary concept where the similarities might be less straight forward, we think it might be worth to consider the principles of deferred taxes in the further development, as it was not done so in the DP.

iv. Additional advantages or disadvantages

We did not identify additional advantages or disadvantages on a conceptual basis. However we would like to remind you that all the evaluation above is based on a reporting entity with all or at least a significant part of its business within the scope of the DP. E.g. for an entity with integrated businesses a disclosure-only approach might deliver appropriate information for materiality reasons. Also, for these entities it could be easier argued that the cost of a specifically developed IFRS requirement outweighs the benefits.

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 ASCG does not carry out activities subject to rate regulation. From our constituency we learned about specific operational issues the IASB should consider if it decides to develop any specific accounting guidance or requirements. Those relate to:

i. Economic entity approach in a group with an integrated business model

The DP is silent on any consolidation procedures. However, we would like the IASB to consider the impact of 'group-internal' regulatory assets and liabilities in a vertically integrated business. Under an economic entity approach one would expect any intra-group RRA transactions to be eliminated on group level. However, we have learned from our constituency that handling these items is not clear in every case and needs further guidance:

(a) While there is a 100% regulatory asset in the regulated subsidiary's separate financial statements, this might be significantly diluted from a group perspective (maybe to 10% or less). We question whether the complexity of recognising the asset and then considering all future intra-group services justifies the outcome which might be some sort of 'proportionate asset'. Furthermore, judgement will be needed in cases where the ratio of internal vs. external RRA revenue changes over the years.

(b) The measurement or even the existence of a regulatory asset from a group perspective is dependent on the pricing arrangements and risk sharing within the value chain of the group. For example:

    (i) Case 1: Pass-through arrangement, no market risk from RRA: Changes in rates of RRA can be charged to external customers when the regulated services are internally purchased (e.g. group DSO) and externally sold as part of an integrated services (e.g. supply of energy).

(ii) Case 2: Market risk from RRA: Fixed or market prices for the integrated services including the regulated services

ii. Segment reporting in an integrated business model

The DP is silent on segment reporting. Further guidance might be needed for the management of the reporting entity on how to deal with RRA within segment reporting. Again, we are thinking about intra-group RRA transactions between regulated and non-regulated segments in integrated businesses and the impacts on impairment testing as well as the reporting of segment revenue or segment assets and liabilities (reconciliation between internal Non-GAAP and IFRS measures).

iii. Interim or inter-period reporting

The DP is silent on interim reporting. Interim and even year-end reporting might require some guidance on the basis for estimates when recognising and measuring regulatory deferral balances. In our environment, we found many regulatory regimes providing only annual or even multi-annual revenue requirements.

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.

If the IASB decides to prohibit the recognition of regulatory deferral account balances, disclosures might be helpful to understand

(a) the extent to which the profit or loss in the current period was affected by regulatory deferrals; and

(b) the impact of regulatory deferrals on future periods' results.

Two cover these two objectives, it might be reasonable to disclose the development of the aggregate amount of regulatory account balances in the current and future periods (maturity analysis).

However, the complexity of regulatory regimes requires careful balancing between disclosure needs and the quality and reliability of information provided. We refer to our above comments on estimates and operational issues.

Again, disclosure requirements might be evaluated as more valuable for a pure regulated entity compared to a group with integrated businesses.

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.

Considering our other responses in this letter, the ASCG very much appreciates that 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.

So far we have no practical experience with IFRS 14, due to IFRS 14 not being endorsed in the EU. Generally speaking, we do not think that financial statements based on the exceptions and exemptions for first-time adopters meet the information needs of investors and lenders for more than a transition period. We would therefore maintain our recommendation to develop specific accounting requirements as a long-term solution. The requirements of IFRS 14 might be a starting point for the evaluation about adequate disclosures.

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?

Referring to our response to Question 1, we would support presenting regulatory deferral account balances and their movements as separate line items in the statement of financial position as well as in the statement of profit or loss as this presentation is necessary to get information about the financial effects of rate regulation on the face of the primary financial statements.

However, we are not convinced that a regulated entity should be required to present any regulatory deferral account balances that have been recognised separately from the assets and liabilities recognised in the statement of financial position in accordance with other standards. This is because – contrary to the principles in IFRS 14 – these regulatory assets and liabilities would be based on recognition and measurement principles of IFRSs and therefore need no extraordinary presentation. For the same reason we have doubts whether the net movements in regulatory deferral account balances shall be presented separately from the items of income and expense recognised in the statement(s) of profit or loss and other comprehensive income.

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?

In our response on Question 5 relating to the definition of rate regulation, we did not consider the existence of a regulator in our revised definition. In our view, the existence of a rate regulator whose role and authority is established by legislation or other formal regulations is an important indicator to consider when analysing what rights and obligations established by the rate regulation are enforceable. However, it is not a necessary feature. Putting it the other way round: The non-existence of a rate regulator is not relevant as long as there exist substantive rights or obligations. This is the case when the regulatory rate-setting framework is based on legal grounds (i.e. enforceable by law).

So far, we have limited experience with the accounting of cooperatives under IFRS. However, we have the view that the above principles should apply in a similar way for all entities. As long as there are substantive rights and obligations arising from a revenue requirement (‘true-up mechanism’) the accounting consequences should be the same when these rights and obligations are enforceable. In case of a cooperation, enforceability could be based on the individual contracts of the cooperation (i.e. again enforceable by law). On the other hand, it should be common sense that rates that can be changed or reversed by the management of the cooperation in its own judgement do not fulfill the enforceability criteria.

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 ASCG acknowledges the IASB's deliberations on the interaction of accounting principles for RRA with IFRIC 12, IAS 20 and IFRS 3. The IASB may indeed need to consider if, as a result of the feedback from the DP, it decides to develop proposals for amending these IFRSs.

We understand that it is premature to present an analysis of the issues or suggestions for their resolution at this time. However, we think that the list of interaction needs to be elaborated. We also see close interactions with at least IFRS 8, IAS 36, IFRS 5 and IAS 7.

Finally, we would like to refer to our answer to Questions 8. Some of the operational issues described there are also related to the interaction of RRA with other standards and they ask for amendments or guidance.