Deloitte.

August 2009

IAS Plus Update.

IASB Proposes Guidance on Rate-regulated Activities

On 23 July 2009, the IASB issued an Exposure Draft, *Rate-regulated Activities*, which would require the recognition of assets and liabilities resulting from certain rate-regulated activities and would provide guidance on the measurement of those asset and liabilities. The IASB added the project to its agenda after receiving ongoing requests for guidance and because of the importance of rate regulation in many jurisdictions that are in the process of adopting IFRSs. The Exposure Draft's comment period ends on 20 November 2009, and the IASB plans to issue a final standard in 2010.

Rate regulation is designed to ensure that customers are charged a reasonable rate for services or products while giving entities an opportunity to earn a fair return on their investments. This is generally achieved through price setting by a governmental regulator on the basis of the regulated entity's cost of providing the product or service. Requirements already exist in some jurisdictions addressing this issue. For example, under U.S. GAAP, Statement 71[1] (codified in ASC 980[2]) provides guidance on the recognition of regulatory assets and liabilities that result from the actions of regulatory bodies that direct the rate-making process of the entity.

Scope

An entity would be required to apply the proposal's guidance if its operating activities meet the following two criteria: (1) an authorised body establishes the price an entity **must** charge its customers and (2) the rate is set to recover the specific costs the entity incurs to provide the regulated goods or services plus a specified return that need not be fixed or guaranteed.

In the absence of these two criteria (which would be evaluated initially and at the end of every reporting period), an entity would not be able to apply the proposed guidance and would be required to derecognise any previously recognised regulatory assets or liabilities.

The Exposure Draft emphasises that the regulated rate **must** be charged to all customers (or, if regulation establishes different rates for different categories of customers, the same rate must be charged to all customers within each category). As a result, situations in which the entity is permitted charge rates, even by negotiation with specific customers that are less than the maximum rate approved by the regulator would appear not to be within the scope of draft standard.

Recognition and measurement

According to the proposal, regulatory assets are recognised for an entity's "right to recover specific previously incurred costs and to earn a specified return," while regulatory liabilities are recognised for the entity's "obligation to refund previously collected amounts and to pay a specified return." Such assets and liabilities would be recognised when the entity "has the right to increase or the obligation to decrease rates in future periods as a result of the actual or expected actions of the regulator." The proposed IFRS does not contain separate recognition criteria other than those mentioned in the *Scope* section above, but it notes that if an entity's activities are within the scope of the proposal, "the entity shall recognise regulatory assets and regulatory liabilities in addition to the assets and liabilities recognised in accordance with other IFRSs."

IAS Plus website

We have had more than 8 million visits to our **www.iasplus.com** website. Our goal is to be the most comprehensive source of news about international financial reporting on the Internet. Please check in regularly.

IFRS global office
Global IFRS leader
Ken Wild
kwild@deloitte.co.uk

IFRS centres of excellence

Americas		
New York	Robert Uhl	iasplusamericas@deloitte.com
Montreal	Robert Lefrancois	iasplus@deloitte.ca
Asia-Pacific		
Hong Kong	Stephen Taylor	iasplus@deloitte.com.hk
Melbourne	Bruce Porter	iasplus@deloitte.com.au
Europe-Africa		
Copenhagen	Jan Peter Larsen	dk_iasplus@deloitte.dk
Frankfurt	Andreas Barckow	iasplus@deloitte.de
Johannesburg	Graeme Berry	iasplus@deloitte.co.za
London	Veronica Poole	iasplus@deloitte.co.uk
Paris	Laurence Rivat	iasplus@deloitte.fr

1 FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation.*

2 FASB Accounting Standards Codification Topic 980, *Regulated Operations.*

However, an entity would not apply the proposed IFRS if "items related to regulated operating activities have been recognised as assets or liabilities in accordance with other IFRSs."

In certain situations, a regulator requires capitalisation of amounts as part of the cost of self-constructed property, plant, and equipment or internally generated intangible assets that would otherwise be recognised as regulatory assets under the proposed IFRS. If including those amounts in the costs for rate-making purposes is "highly probable," the entity would include them in the cost of the property or intangible asset for financial reporting purposes. Otherwise, those amounts would be accounted for as regulatory assets in accordance with the proposed IFRS. The basis for conclusions indicates that proponents of this approach believe that "when regulatory assets are complimentary to other assets and have similar useful lives, there is no need to incur the costs of separate accounting." The IASB concluded that an exception to the principles of the proposal was justified on cost-benefit grounds.

The assets and liabilities stemming from regulated operating activities would be measured at their expected present value at initial recognition as well as at each subsequent reporting period. The proposal requires the use of a probability-weighted cash flow approach and indicates that the following elements should be considered in the measurement:

(a) an estimate of the future cash flows that will arise in a range of possible outcomes;

(b) an estimate of the probability of each outcome occurring;

(c) the time value of money, represented by the current market risk-free rate of interest;

(d) the price for bearing the uncertainty inherent in the regulatory asset or regulatory liability.

Entities would be required to assess the effects of rate regulation on existing regulatory assets and liabilities at the end of each reporting period. The proposed IFRS includes guidance on recoverability of regulatory assets. According to the proposal, when an "entity concludes that it is not reasonable to assume that it will be able to collect sufficient revenues from its customers to recover its costs" this would be an indicator of impairment. Consequently, the cash-generating unit to which the regulatory assets and liabilities belong should be tested for impairment in accordance with IAS 36[3]. Any impairment loss would then be allocated to the assets of the cash-generating unit in accordance with IAS 36.

Presentation and disclosure

The Exposure Draft requires that regulatory assets and liabilities be presented separately from other assets and liabilities (other than costs permitted to be included the cost of property, plant, and equipment or intangible assets, as noted above), as current and noncurrent items in the statement of financial position without offsetting. However, the proposal notes that "a net regulatory asset or a net regulatory liability for each category of asset or liability subject to the same regulator" may be presented.

An entity must provide information that allows users to understand the nature and financial effects of rate regulation on its activities and that identifies and explains the amounts of regulatory assets and liabilities, and related income and expenses, recognised in its financial statements. In addition to other disclosures, the proposal requires a tabular reconciliation of each category of regulatory asset or liability from the beginning of the period to the end, responding to the Board's observation that information on an entity's rate-regulated activities often appears in various places in the financial statements. According to the proposal's basis for conclusions, "such a table would be useful in helping users to understand how the entity's reported financial results and position have been affected by rate regulation."

Effective date and transition

The effective date will be determined upon issuance of a final standard, with early application permitted. The proposal notes that entities would apply the standard to "regulatory assets and regulatory liabilities that exist at the beginning of the earliest comparative period presented" upon application of the final IFRS. Any adjustments that result from the applying the final standard would be reflected in the opening balance of retained earnings.

3 IAS 36, *Impairment of Assets.*

Designed and produced by The Creative Studio at Deloitte, London. 32130