27 January 2015

Mr Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UNITED KINGDOM

Dear Hans

AOSSG comments on IASB Discussion Paper DP/2014/2
Reporting the Financial Effects of Rate Regulation

The Asian-Oceanian Standard-Setters Group (AOSSG) is pleased to provide comments on the IASB Discussion Paper (DP) *Reporting the Financial Effects of Rate Regulation*. In providing this feedback, the AOSSG sought inputs from its constituents within each jurisdiction.

The AOSSG currently has 26 member standard-setters from the Asia-Oceania region: Australia, Brunei, Cambodia, China, Dubai, Hong Kong, India, Indonesia, Iraq, Japan, Kazakhstan, Korea, Macao, Malaysia, Mongolia, Nepal, New Zealand, Pakistan, Philippines, Saudi Arabia, Singapore, Sri Lanka, Syria, Thailand, Uzbekistan, and Vietnam.

To the extent feasible, this submission to the IASB reflects in broad terms the collective experiences of AOSSG members. Each member standard-setter may also choose to make a separate submission that is consistent or otherwise with aspects of this submission. The intention of the AOSSG is to enhance the input to the IASB from the Asia-Oceania region and not to prevent the IASB from receiving the variety of inputs that individual member standard-setters may wish to submit. This submission has been circulated to all AOSSG members for their feedback after having initially been developed through the AOSSG Rate-regulated Activities Working Group.

Rate regulation is a significant industry in many AOSSG member jurisdictions, some of which have already adopted IFRS and some are in the process of adopting IFRS. Accordingly, AOSSG members are supportive of the IASB's efforts in conducting a comprehensive research project that considers the need for a standard or guidance for the accounting of rights or obligations arising from rate regulated activities.

AOSSG members expressed mixed views on the issues raised in the DP:

- Some members recommend that rate regulated entities should recognise in the financial statements the regulatory deferral account balances and provide information that explains the effects of the rate-regulatory framework in the financial statements. On the other hand, there are members who do not support special recognition and measurement requirements to address issues relating to rate regulation.

- Some members agree that the DP adequately focuses on the defined rate regulation, but some other members consider that the IASB should keep a broad focus on this project.

- Several members agree with the proposed characteristic of defined rate regulation, but some members consider that a key characteristic of defined rate regulation is that it gives rise to enforceable rights and/or obligations between the regulated entity and its customers to justify the recognition of regulatory deferral balances.

AOSSG members consider the more important question should be whether rights and obligations under defined rate regulation would meet the definition and the recognition criteria of assets and liabilities in accordance with the existing *Conceptual Framework* or a revised *Conceptual Framework* (as explained in the DP).

Our views are explained in more detail in the Appendix. Please note that the AOSSG has deliberately decided to focus our responses on questions that we are better placed to answer, that is, Questions 1, 3, 5, 6, 7 and 10 of the DP. If the IASB would like our views on the other questions, we would be happy to provide them at a later stage.

If you have any questions regarding any matters in this submission, please contact either one of us.

Yours sincerely,

Clement Chan
AOSSG Chair

Jee In Jang
AOSSG Rate-regulated Activities Working Group Leader

APPENDIX - Detailed comments in relation to DP/2014/2[1]

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?

1 Some members recommend that rate regulated entities should recognise in the financial statements the regulatory deferral account balances and provide information that explains the effects of the rate regulatory framework in financial statements. This information would help investors and lenders to understand the rate-regulatory factors that affect the amount, timing and certainty of the revenue, profit and cash flows related to an entity's rate-regulated activities.

2 One of these members highlights that rate regulatory frameworks of some developing/emerging countries might prohibit entities to disclose certain key information about rate-regulated activities in those jurisdictions. Therefore, the IASB should bear in mind such a restriction if it decides to progress the project on rate regulated activities.

3 A guidance note on the accounting for rate regulated activities, which prescribes the recognition of regulatory assets and liabilities, is applied in one member jurisdiction. The specific guidance can be referred here: http://220.227.161.86/25919asbrra170212.pdf.

4 One member, however, does not support special recognition and measurement requirements to address issues relating to rate regulation, taking the view that any effort to address rate

1 The AOSSG has deliberately decided to focus our responses on questions that we are better placed to answer, that is, Questions 1, 3, 5, 6, 7 and 10 of the DP. If the IASB would like our views on the other questions, we would be happy to provide them at a later stage.

regulation accounting should be a part of the wider issue, such as a project to revise the requirements relating to intangible assets.

5 A few members believe that the IASB is likely to conclude that the 'disclosure-only approach' is most appropriate in light of the cost and benefit consideration. In this regard, one of these members notes that IAS 1 *Presentation of Financial Statements* already requires information about the assumptions an entity makes about the future and other major sources of estimation uncertainty that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities. This member considers that additional disclosures on the financial effects of rate regulation could be provided in meeting the requirements of IAS 1.

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?

6 Some members are of the view that a targeted scope should be set out 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 should be developed. Accordingly, these members agree with the IASB's approach to focus on a defined type of regulation.

7 On the other hand, some members consider that the IASB should keep a broad focus on this project. These members believe that defined rate regulation and market regulation should be considered in the context of the project. They are concerned that, by focusing on a particular type of rate regulation, there is a risk that special accounting requirements may be developed, which would result in different accounting treatments for economically similar situations.

8 One member understands how difficult it is for the IASB to try and discuss issues on a project that has a potentially indeterminate scope and considers that identifying a defined type of rate regulation might help. However, the approach signals that scoping is a major problem with the project. Even with a defined type of rate regulation, interpreting the pre-conditions such as 'customers having little or no choice' could be problematic. In parts of the DP (for example, paragraph 3.10), the notion of a good or service being 'essential' is considered as a pre-condition for 'customers having little or no choice'. The DP acknowledges that 'essential' is hard to define – it could be highly jurisdiction-specific. For example, in some societies, public liability insurance might be considered essential while in other societies it would not.

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.

9 Some members agree that the description of defined rate regulation captures an appropriate population of rate-regulatory schemes within its scope.

- One of these members agrees with the proposed characteristic of defined rate regulation, but believes that careful consideration would be necessary so as to capture the appropriate population of rate-regulated activities; otherwise there will be no rate-regulated activities within the scope if the criteria are too robust.
- Another member points out that sometimes rate regulation exists only when one (or very few) "nominated" buyer(s) [by law/regulation] purchases products or services from numerous producers at a regulated rate. This member thinks that this type of rate regulation should also be covered by the IASB's project.

10 Some members consider that a key characteristic of defined rate regulation is that it gives rise to enforceable rights and/or obligations between the regulated entity and its customers, otherwise the entity should not recognise regulatory deferral balances. This member considers that a specific standard on rate regulation accounting should only be applied after an entity has exhausted all other avenues in IFRS in determining an accounting treatment for the relevant transactions.

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?

11 Some members agree with the rationale stated in the DP with regards to rights and obligations that arise from the features of defined rate regulation. They believe that the relevant rights and obligations to consider are rights to recover or obligations to reverse regulatory differences between revenue requirements and amounts charged to customers. They think that these rights and obligations under defined rate regulation would meet the definition and the recognition criteria of assets and liabilities in accordance with the existing *Conceptual Framework* or a revised *Conceptual Framework* (as explained in paragraphs 5.14–5.31 of the DP). Accordingly, additional guidance to existing IFRSs may be sufficient to resolve the issues/questions on the accounting of the effects of rate-regulated activities. However, if the application of existing IFRSs is found to be difficult due to the specific nature of rights and obligations, it might be necessary to develop a specific standard to accommodate the specific nature of those rights and obligations.

12 Some members do not consider that regulatory deferral balances, by themselves, meet the definitions of assets and liabilities. One of these members thinks that a key focus of ‘defined rate regulation’ in the DP is a ‘right to recover the revenue requirement, using the rate-setting mechanism to adjust for under-billings or over-billings over time’ (DP paragraph 4.72). However, this member considers that, while such a right might add to the level of assurance about the recoverability of an entity’s costs, it is not a right to a particular amount of revenue and is not a sufficiently distinct feature to justify regulatory deferral accounting or a specific IFRS on rate regulation accounting. The customers may be locked into a rate at which they buy the relevant goods or services, but they are not locked in to particular quantities of those goods or services. Customers may not buy the quantity of goods or services assumed when the rate regulation arrangement was established.

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.

13 AOSSG members think that the more important question is whether rights to recover or obligations to reverse regulatory differences between revenue requirements and amounts charged to customers would meet the definitions and the recognition criteria of assets and liabilities in the *Conceptual Framework*.

14 One of these members considers that the accounting requirements should be consistent with the *Conceptual Framework* – ie the IASB should not permit recognition of items that do not meet the definition of assets and liabilities. In the event that the right to recover and obligation to reverse the regulatory differences do not satisfy the *Conceptual Framework*, the IASB could prescribe disclosures that would provide relevant information to users of financial statements. This member also observes that in accordance with IFRS 15 *Revenue from Contracts with Customers*, revenue is recognised only when an entity satisfies a performance obligation. However, in defined rate regulation, many of the rate-regulated activities for which the consideration is included in the 'revenue requirement' do not involve the transfer of goods/services to the rate regulator or the customers (see paragraphs 7.15-7.17 of the DP).

15 One member thinks that the approach of deferring/accelerating the recognition of costs portrays the financial effects of defined rate regulation. This approach reflects well the financial effects of defined rate regulation in accordance with a 'matching' principle for the

revenue requirement of the regulated entities. This member is aware that users and preparers of financial statements are familiar with the matching principle as it is used in US GAAP. However, another member does not support deferral or acceleration of recognizing costs or revenue from customers, or a combination of both. This member thinks that revenues from customers should be recognized when goods or services are provided to the customers.

16 Another member considers that a right to charge a higher price on future sales should not be recognised as an asset because the entity has yet to satisfy the relevant performance obligations (supplying the relevant goods or services). This member notes that a multi-period contract (covering both 'low' and 'high' prices) under paragraph 17 of IFRS 15, might give rise to assets and liabilities. However, the contracts contemplated in paragraph 17 of IFRS 15 (which may result in the recognition of assets and liabilities) are between the supplier and customer (not a regulator). Under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, a liability would generally only be recognized if the future supply constitutes an onerous contract. That is, a squeeze on margins on future sales should not trigger liability recognition. If the onerous contract requirements in IAS 37 are not considered satisfactory, they should be considered for revision in respect of all types of contracts, not just in the context of rate regulation. This member thinks that it would probably be beneficial for the IASB to consider a wider project of reviewing IAS 38 *Intangible Assets*, which could include consideration of the accounting for regulatory licenses.

17 Another member believes the most effective approach to making users aware of the effects of rate regulation on an entity would be to require appropriate disclosure of information regarding activities subject to rate regulation. Such information is relevant for all entities subject to rate regulation, not only entities subject to regulation that meets specific criteria.

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

Question 10
decisions? If so, please specify and explain the reasons for your answer.

18 Some members think that the requirements of IFRS 14 *Regulatory Deferral Accounts* are appropriate in meeting the information needs of users. One of these members thinks that the IASB ought to consider the restrictions in disclosing of information in relation to rate regulated activities in developing/emerging countries (as explained in our response to Question 1 above).

19 Some members consider that information about an entity's rate-regulated activities is already being provided in accordance with existing IFRS disclosure requirements, and there is a need to consider whether the current disclosures are adequate or whether enhancements are needed. One of these members considers that investors and others would regard knowledge of the rate regulation of a material aspect of an entity's operations to be important in analysing an entity's financial position and performance. Broader disclosure requirements about the key elements of the business environment in which an entity operates might achieve that outcome without the need for specific disclosure requirements about rate-regulated activities. In this respect, this member notes that IFRS 8 *Operating Segments* includes broad disclosure requirements about the business and product environments in which an entity operates (even for entities with only one operating segment), including:

> An entity shall disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates. [paragraph 20]
>
> An entity shall report the revenues from external customers for each product and service, or each group of similar products and services, unless the necessary information is not available and the cost to develop it would be excessive, in which case that fact shall be disclosed. The amounts of revenues reported shall be based on the financial information used to produce the entity's financial statements. [paragraph 32]