

To:	AOSSG members	Date:	27 November 2014
From:	Korea Accounting Standards Board	Agenda Item:	15.2
Subject:	Rate-regulated Activities	File:	

Introduction

1. In July 2009, the IASB published for public comment the Exposure Draft (ED) *Rate-regulated Activities*. After reviewing the responses to that ED, the IASB decided that it could not resolve, in a timely manner, the complex, fundamental issues involved. The IASB suspended the project in September 2010.
2. As a result of the views received from its 2011 Agenda Consultation, the IASB, in September 2012, initiated a revised Rate-regulated Activities research project.
3. The IASB has published the Discussion Paper *Reporting the Financial Effects of Rate Regulation* as part of its active research programme. The Discussion Paper considers the common features of rate regulation and explores which of them, if any, create a combination of rights and obligations distinguishable from the rights and obligations arising from activities that are not rate-regulated. The Discussion Paper does not include specific accounting proposals. Instead, it explores several possible approaches that the IASB could consider when deciding how best to report the financial effects of a defined type of rate regulation. The deadline for comments on the Discussion Paper is 15 January 2015.

Objectives of this paper

4. In preparation for the AOSSG annual meeting, the KASB (WG leader) asked the WG members¹ to provide their views on respective questions of the DP having acknowledged that views are subject to change before the comment period deadline.
5. But, this paper includes only the comments of two countries and can be a basis for a lively discussion of members on these questions at the AOSSG annual meeting.

¹ Korea, India, Indonesia, Japan, Malaysia, Nepal, Sri Lanka

6. The KASB will endeavour to incorporate the views of the AOSSG members into the paper, reflecting on the views expressed during the AOSSG annual meeting in Hong Kong. After receiving comments from the AOSSG members, the final comments on the DP will be submitted to the IASB by AOSSG.

Summary of the Discussion Paper

7. Many governments regulate the supply and pricing of particular types of activity by entities. These activities usually involve providing goods or services that are considered in that jurisdiction to be essential to customers, including transport services, some types of insurance policies, and utilities such as gas, electricity and water. Some forms of rate regulation can significantly affect not only the amount of revenue and profit that a rate-regulated entity can earn, but also the timing of the related cash flows.
8. The Discussion Paper describes a type of rate regulation that contains elements of both cost recovery and incentive approaches—this type of rate regulation is termed *defined rate regulation*. The Discussion Paper seeks comments on whether or not the distinguishing features of defined rate regulation, as identified by the IASB, sufficiently capture the type(s) of rate regulation that have the most significant financial effects.
9. The Discussion Paper does not include any specific accounting proposals. Instead, it explores what information about rate-regulated activities is most useful to users of financial statements and outlines possible approaches (and the accompanying advantages and disadvantages) that the IASB could consider in deciding how best to report the financial effects of rate regulation.
10. The Discussion Paper also seeks comments on whether the presentation and disclosure requirements of IFRS 14 *Regulatory Deferral Accounts* should form the basis of any future proposals that the IASB may develop as a result of feedback from this consultation. IFRS 14 was issued in January 2014 as a temporary measure until the IASB concludes this project.

Key issues to be discussed during the AOSSG annual meeting

11. Following are six issues planned to be discussed during the session in the AOSSG annual meeting in order to consult about the important questions of DP.

- (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?
- (b) Do you agree that, to progress this project, the IASB should 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?
- (c) Do you think that the description of defined rate regulation captures an appropriate population of rate-regulatory schemes within its scope?
- (d) Are there any additional rights or obligations that you think the IASB should consider? Do you think that the IASB should develop specific accounting guidance or requirements to account for the combination of rights and obligations described?
- (e) 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?
- (f) 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?

Summary of comments received from AOSSG WG members to questions in the DP

Question 1
<p>(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:</p> <ol style="list-style-type: none"> (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?

[AOSSG WG member's comment]

- (a) We think that it is necessary to present the regulatory deferral account balances associated with the rate-regulated activities and provide information related to income effects and cash flows.
- (b) This information would help them 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.

Question 2

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?

[AOSSG WG member's comment]

- We are of a 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. From this perspective, we agree with the IASB's approach to focus on a defined type of regulation.

Question 3

This Section describes a number of features that are common to a wide variety of rate-regulatory schemes around the world, which have been identified from responses to the RFI. Some suggest that the combination of rights and obligations that are created by these features create economic conditions that support developing specific accounting guidance or requirements.

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.

[AOSSG WG member’s comment]

- One member agrees that the description of defined rate regulation captures an appropriate population of rate-regulatory schemes within its scope.

And the other member also 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, because if the characteristic is too robust, there will be no rate regulation within the scope.

Question 4

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?

[AOSSG WG member's comment]

- (a) We are of a view that the DP explained rights and obligations that arise from the features of defined rate regulation well.
- (b) We believe that the relevant rights and obligations to consider are rights to recover or obligations to reverse regulatory differences between revenue requirements and amount to be claimed to customers. Our initial analysis shows 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 those explained in the Discussion Paper on the *Conceptual Framework*.

Accordingly, simply providing additional guidance to existing standards of IFRSs may be sufficient to resolve the questions around rate regulated activities. However, if the application of the existing standard 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 specific nature of those rights and obligations.

Question 5

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

[AOSSG WG member's comment]

- 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 'match' principle for the revenue requirement of the regulated entities. And this approach is very familiar to the users and preparers of financial statements because of its similarity with the approach of the existing US GAAP.

The other member believes that the first question to ask is whether rights to recover or obligations to reverse regulatory differences between revenue requirements and amount to be claimed to customers would meet the definitions and the recognition criteria of assets and liabilities in the *Conceptual Framework*. Therefore, they believe it would be necessary to consider this issue based on the asset/liability approach. Given that it is unlikely that we will use OCI for this accounting requirement, determining recognition and measurement of assets and liabilities would be tantamount to the determination of profit and loss.

Question 6

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.

[AOSSG WG member's comment]

- We think that the requirements of IFRS 14 are appropriate in meeting the information needs of users.

Summary and step forward

11. In summary, the comments indicated that the financial effects of a defined type of rate regulation can provide the users of financial statements with useful information, although the comments came from only two members.

We agree that the discussion paper adequately focuses on the defined rate regulation and we need to develop a new approach if there is not an appropriate approach to portray the financial effects of defined rate regulation. We are of a view that recognition of regulatory assets and liabilities can reflect the financial effects of defined rate regulation.

12. It is necessary to form an opinion of all AOSSG members through active discussions.

AOSSG's final comments on the discussion paper will be submitted to the IASB based on the below action plan by 15 January 2015.

AOSSG Rate-regulated Activities WG: Action Plan

Timing	Proposed Actions	Responsible party
17 Sep, 2014	Publication of DP	IASB
15 Oct	The KASB will send e-mail, to encourage the AOSSG WG members to consider and formulate the views on the DP's questions.	KASB and ICAI
24 Oct	The AOSSG WG members are asked to send preliminary views to the KASB by 24 Oct.	AOSSG WG members
31 Oct	Based on the comments received, the KASB will formulate the AOSSG WG's view and circulate draft comments to the AOSSG WG members.	KASB and ICAI
6 Nov	The AOSSG WG members are asked to send their comments on the draft to the KASB by 6 Nov.	AOSSG WG members
7 Nov	Send the agenda paper to the Secretariat of the AOSSG	KASB and ICAI
25~27 Nov	Presentation at the AOSSG annual meeting	KASB and ICAI
5 Dec	Based on the comments at the AOSSG annual meeting, The KASB will circulate revised draft comments to the AOSSG WG members.	KASB and ICAI
12 Dec	The AOSSG WG members are asked to send their comments on the draft to the KASB by 12 Dec.	AOSSG WG members
22 Dec	The KASB will circulate the near-final draft to all AOSSG members.	KASB and ICAI
5 Jan, 2015	All AOSSG members are asked to send their comments on the near-final draft by 5 Jan, 2015.	All AOSSG members
15 Jan, 2015 (<i>Comment period</i>)	Submission to the IASB	KASB and ICAI