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Exposure Draft ED/2009/8

Rate-regulated Activities

Comments to be received by 20 November 2009



International
Accounting Standards
Board®

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RATE-REGULATED ACTIVITIES

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Introduction and invitation to comment

Reasons for publishing the exposure draft

The International Accounting Standards Board has developed the proposed IFRS to define regulatory assets and regulatory liabilities, set out criteria for their recognition, specify how they should be measured and require disclosures about their financial effects.

The Board added this project to its agenda in December 2008 because of differences of views in practice about whether it was appropriate for entities to recognise assets and liabilities arising from rate regulation and ongoing requests for guidance on this issue. IFRSs do not currently provide guidance on the recognition and measurement of such assets and liabilities. Consequently, preparers of financial statements must develop accounting policies in accordance with the hierarchy in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, considering the definitions in the *Framework*.

Rate regulation is a restriction on the setting of prices that can be charged to customers for services or products. A number of regulatory methodologies exist and, for each, application can vary by regulator, the entity being regulated and the particular circumstances.

The Board's objectives for the proposed IFRS are:

- (a) to establish criteria for the recognition of assets and liabilities arising from rate regulation
- (b) to clarify that regulated entities follow the requirements of all other IFRSs in addition to the proposed IFRS
- (c) to require disclosures to enable users to understand the nature and financial effects of rate regulation on an entity's activities.

Main features of the draft IFRS

The draft IFRS specifically addresses rate-regulated activities that meet the following two criteria:

- (a) an authorised body is empowered to establish rates that bind customers.
- (b) the price established by regulation (the rate) is designed to recover the specific costs the entity incurs in providing the regulated goods or services and to earn a specified return (cost-of-service regulation).

When the scope criteria are met, the entity recognises regulatory assets and regulatory liabilities in addition to the assets and liabilities recognised in accordance with other IFRSs. The effect of this requirement is initially to recognise as an asset (liability) an amount that would otherwise be recognised in that period in the statement of comprehensive income as an expense (income).

On initial recognition and at the end of each subsequent reporting period regulatory assets and regulatory liabilities are measured at their expected present value. Regulatory assets are assessed for impairment when the 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.

Invitation to comment

The Board invites comments on any aspect of the exposure draft of its proposed IFRS *Rate-regulated Activities*. It would particularly welcome answers to the questions set out below. Comments are most helpful if they:

- (a) respond to the questions as stated,
- (b) indicate the specific paragraph or paragraphs to which the comments relate,
- (c) contain a clear rationale, and
- (d) describe any other approaches the Board should consider, if applicable.

Respondents need not comment on all of the questions and are encouraged to comment on any additional issues.

The Board will consider all comments received in writing by **20 November 2009**. In considering the comments, the Board will base its conclusions on the merits of the arguments for and against each approach, not on the number of responses supporting each approach.

Scope

Question 1

The exposure draft proposes two criteria that must be met for rate-regulated activities to be within the scope of the proposed IFRS (see paragraphs 3–7 of the draft IFRS and paragraphs BC13–BC39 of the Basis for Conclusions).

Is the scope definition appropriate? Why or why not?

Recognition and measurement

Question 2

The exposure draft proposes no additional recognition criteria. Once an activity is within the scope of the proposed IFRS, regulatory assets and regulatory liabilities should be recognised in the entity's financial statements (see paragraphs BC40–BC42 of the Basis for Conclusions).

Is this approach appropriate? Why or why not?

Question 3

The exposure draft proposes that an entity should measure regulatory assets and regulatory liabilities on initial recognition and subsequently at their expected present value, which is the estimated probability-weighted average of the present value of the expected cash flows (see paragraphs 12–16 of the draft IFRS and paragraphs BC44–BC46 of the Basis for Conclusions).

Is this measurement approach appropriate? Why or why not?

Question 4

The exposure draft proposes that an entity should include in the cost of self-constructed property, plant and equipment or internally generated intangible assets used in regulated activities all the amounts included by the regulator even if those amounts would not be included in the assets' cost in accordance with other IFRSs (see paragraph 16 of the draft IFRS and paragraphs BC49–BC52 of the Basis for Conclusions). The Board concluded that this exception to the requirements of the proposed IFRS was justified on cost-benefit grounds.

Is this exception justified? Why or why not?

Question 5

The exposure draft proposes that at each reporting date an entity should consider the effect on its rates of its net regulatory assets and regulatory liabilities arising from the actions of each different regulator. If the 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, it tests the cash-generating unit in which the regulatory assets and regulatory liabilities are included for impairment in accordance with IAS 36 *Impairment of Assets*. Any impairment determined in accordance with IAS 36 is recognised and allocated to the assets of the cash-generating unit in accordance with that standard (see paragraphs 17–20 of the draft IFRS and paragraphs BC53 and BC54 of the Basis for Conclusions).

Is this approach to recoverability appropriate? Why or why not?

Disclosures

Question 6

The exposure draft proposes disclosure requirements to enable users of financial statements to understand the nature and the financial effects of rate regulation on the entity's activities and to identify and explain the amounts of regulatory assets and regulatory liabilities recognised in the financial statements (see paragraphs 24–30 of the draft IFRS and paragraphs BC59 and BC60 of the Basis for Conclusions).

Do the proposed disclosure requirements provide decision-useful information? Why or why not? Please identify any disclosure requirements that you think should be removed from, or added to, the draft IFRS.

Transition

Question 7

The exposure draft proposes that an entity should apply its requirements to regulatory assets and regulatory liabilities existing at the beginning of the earliest comparative period presented in the period in which it is adopted (see paragraph 32 of the draft IFRS and paragraphs BC62 and BC63 of the Basis for Conclusions). Any adjustments arising from the application of the draft IFRS are recognised in the opening balance of retained earnings.

Is this approach appropriate? Why or why not?

First-time adoption

The exposure draft includes proposed amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards* (see paragraph C1 of the draft IFRS). These amendments are the result of the Board's exposure draft *Additional Exemptions for First-time Adopters* published in September 2008. These amendments reflect the comments received on that exposure draft and the Board's redeliberations.

Other comments

Question 8

Do you have any other comments on the proposals in the exposure draft?

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[Draft] International Financial Reporting Standard X *Rate-regulated Activities* ([draft] IFRS X) is set out in paragraphs 1–32 and Appendices A–C. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Terms defined in Appendix A are in *italics* the first time they appear in the [draft] IFRS. Definitions of other terms are given in the Glossary for International Financial Reporting Standards. [Draft] IFRS X should be read in the context of its core principle and the Basis for Conclusions, the *Preface to International Financial Reporting Standards* and the *Framework for the Preparation and Presentation of Financial Statements*. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

[Draft] International Financial Reporting Standard X ***Rate-regulated Activities***

Core principle

- 1** An entity shall recognise the effects on its financial statements of its operating activities that provide goods or services whose prices are subject to *cost-of-service regulation*.
- 2** In particular, this [draft] IFRS requires an entity:
 - (a) to recognise a *regulatory asset* or *regulatory liability* if the *regulator* permits the entity to recover specific previously incurred costs or requires it to refund previously collected amounts and to earn a specified return on its regulated activities by adjusting the prices it charges its customers.
 - (b) to measure a regulatory asset or regulatory liability at the *expected present value* of the cash flows to be recovered or refunded as a result of regulation, both on initial recognition and at the end of each subsequent reporting period.
 - (c) to provide disclosures that identify and explain the amounts recognised in the entity's financial statements arising from a regulatory asset or regulatory liability and assist users of those financial statements to understand the nature and financial effects of its rate-regulated activities.

Scope

- 3** An entity shall apply this [draft] IFRS to its operating activities that meet the following criteria:
 - (a) an authorised body (the regulator) establishes the price the entity must charge its customers for the goods or services the entity provides, and that price binds the customers; and
 - (b) the price established by regulation (the rate) is designed to recover the specific costs the entity incurs in providing the regulated goods or services and to earn a specified return (cost-of-service regulation). The specified return could be a minimum or range and need not be a fixed or guaranteed return.

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- 4 If regulation establishes different rates for different categories, such as different classes of customers or volumes purchased, the related operating activities of an entity are within the scope of this [draft] IFRS provided that the regulator approves the definition and the rate for each of those categories and that all customers of the same category are bound by the same rate.
- 5 An entity shall determine at the end of each reporting period whether its operating activities meet the criteria in paragraph 3.
- 6 Some regulation determines rates based on targeted or assumed costs, for example industry averages, rather than the actual costs incurred or expected to be incurred by the entity. Activities regulated in this way are not within the scope of this [draft] IFRS.
- 7 This [draft] IFRS does not apply to financial assets and financial liabilities, as defined in IAS 32 *Financial Instruments: Presentation*.

Recognition and measurement

- 8 **An entity shall recognise:**
 - (a) **a regulatory asset for its right to recover specific previously incurred costs and to earn a specified return, or**
 - (b) **a regulatory liability for its obligation to refund previously collected amounts and to pay a specified return****when it 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.**
- 9 Regulated entities comply with the requirements of IFRSs in the same way as other entities. Although regulators can determine the timing of recovery of costs or settlement of refunds in rates, they cannot change the characteristics of assets and liabilities that would exist in accordance with IFRSs. Therefore, if the criteria in paragraph 3 are satisfied, the entity shall recognise regulatory assets and regulatory liabilities in addition to the assets and liabilities recognised in accordance with other IFRSs.

- 10 An effect of applying the requirements in paragraph 8 is to recognise as an asset (liability) initially amounts that would otherwise be recognised in that period in the statement of comprehensive income as an expense (revenue). Consequently, this [draft] IFRS is not applicable when items related to regulated operating activities have been recognised as assets or liabilities in accordance with other IFRSs.
- 11 When an entity recognises a regulatory asset or regulatory liability, it shall determine whether a temporary difference exists that requires the recognition of a deferred tax asset or a deferred tax liability in accordance with IAS 12 *Income Taxes*.
- 12 **On initial recognition and at the end of each subsequent reporting period, an entity shall measure a regulatory asset or regulatory liability at its expected present value.**

Components of an expected present value measurement

- 13 **An entity shall reflect the following elements in the measurement of the expected present value of a regulatory asset or a regulatory liability:**
- (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.**
- 14 An entity shall determine a range of possible outcomes and estimate the cash flows that it will recover or refund for each outcome. It shall also estimate the probability that each outcome will occur, including the probability that in the entity's future rates the regulator will allow the entity to include the actual costs incurred or require the entity to include amounts collected.
- 15 Interest rates used to discount the estimated cash flows shall reflect assumptions that are consistent with those inherent in the estimated cash flows. In other words, the discount rates used shall not reflect risks for which the estimated cash flows have been adjusted. However, the fact that the estimated future cash flows have been adjusted for the probability of different outcomes occurring does not eliminate the need

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to include in the discount rate the price for bearing the uncertainty inherent in the regulatory asset or regulatory liability. The price for uncertainty relates to the entity's estimates of both the amount and the timing of the cash flows and the probabilities of different outcomes.

- 16 In some cases, a regulator requires an entity to capitalise, as part of the cost of self-constructed property, plant and equipment or internally generated intangible assets, amounts that would otherwise be recognised as regulatory assets in accordance with this [draft] IFRS. After the construction or generation is completed, the resulting capitalised cost is the basis for depreciation or amortisation and unrecovered investment for rate-making purposes. In such cases, the amounts included in the cost of the asset for rate-making purposes shall also be included in its cost for financial reporting purposes, even if IAS 16 *Property, Plant and Equipment*, IAS 23 *Borrowing Costs* or IAS 38 *Intangible Assets* would not permit the entity to do so. Those amounts shall be included in the cost of the asset only if their inclusion in the cost for rate-making purposes is highly probable. Otherwise, they shall be accounted for as regulatory assets in accordance with this [draft] IFRS.

Recoverability

- 17 In some cases, regulatory assets recognised individually in accordance with this [draft] IFRS are not partially or fully recoverable when considered in total. A particular regulator may permit a variety of specific costs to be recovered. However, when the entity considers the net effect on its future rates of all the regulatory assets and regulatory liabilities arising from the actions of that regulator, it may conclude that rates set at those levels would affect demand. In particular, significant increases in rates to recover the net regulatory assets may result in customers reducing the number of units consumed either by conservation or by switching to alternative sources.
- 18 At each reporting date, an entity shall consider the net effect on its rates of its regulatory assets and regulatory liabilities arising from the actions of each regulator for the periods in which the regulation is expected to affect rates. The entity shall determine whether it is reasonable to assume that rates set at levels that will recover the entity's costs can be collected from customers. In making this determination, the entity shall consider estimated changes in the level of demand or competition during the recovery period.

- 19 If 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 is an indication that the cash-generating unit in which the regulatory assets and regulatory liabilities are included may be impaired. Accordingly, the entity shall test that cash-generating unit for impairment in accordance with IAS 36 *Impairment of Assets*.
- 20 An entity shall recognise any impairment loss determined in accordance with IAS 36 and shall allocate it to the assets of the cash-generating unit in accordance with that standard. An entity shall reflect the impairment loss allocated to each regulatory asset by reducing the entity's estimate of the future cash flows that it will receive from the regulatory asset as required by paragraphs 13(a) and 14 of this [draft] IFRS.

Derecognition

- 21 An entity shall derecognise the entire carrying amount of regulatory assets and regulatory liabilities when the underlying activities fail to meet the criteria in paragraph 3.

Presentation

- 22 **An entity shall present in the statement of financial position current and non-current regulatory assets and regulatory liabilities, without offsetting, separately from other assets and liabilities.**
- 23 An entity may present a net regulatory asset or a net regulatory liability for each category of asset or liability subject to the same regulator.

Disclosures

- 24 **An entity shall disclose information that:**
- (a) **enables users of the financial statements to understand the nature and the financial effects of rate regulation on its activities; and**
 - (b) **identifies and explains the amounts of regulatory assets and regulatory liabilities, and related income and expenses, recognised in its financial statements.**
- 25 An entity shall disclose the fact that some or all of its operating activities are subject to rate regulation, including a description of their nature and extent.

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- 26 For each set of operating activities subject to a different regulator, an entity shall disclose the following information:
- (a) if the regulator is a related party (as defined in IAS 24 *Related Party Disclosures*), a statement to that effect, together with an explanation of why the regulator is related to the entity.
 - (b) an explanation of the approval process for the rate subject to regulation (including the rate of return), including information about how that process affects both the underlying operating activities and the specified rate of return.
 - (c) the indicators that management considered in concluding that such operating activities are within the scope of this [draft] IFRS, if that conclusion requires significant judgement.
 - (d) significant assumptions used to measure the expected present value of a recognised regulatory asset or regulatory liability including:
 - (i) the supporting regulatory action, for example, the issue of a formal approval for costs to be recovered pending a final ruling at a later date and that date, when known, or
 - (ii) the entity's assessment of the expected future regulatory actions.
 - (e) the risks and uncertainties affecting the future recovery of the regulatory asset or final settlement of the regulatory liability, including the expected timing.
- 27 An entity shall disclose the following information for each category of regulatory asset or regulatory liability recognised that is subject to a different regulator:
- (a) a reconciliation from the beginning to the end of the period, in tabular format unless another format is more appropriate, of the carrying amount in the statement of financial position of the regulatory asset or regulatory liability, including at least the following elements:
 - (i) the amount recognised in the statement of comprehensive income relating to balances from prior periods collected or refunded in the current period.
 - (ii) the amount of costs incurred in the current period that were recognised in the statement of financial position as

regulatory assets or regulatory liabilities to be recovered or refunded in future periods.

- (iii) other amounts that affected the regulatory asset or regulatory liability, such as items acquired or assumed in business combinations or the effects of changes in foreign exchange rates, discount rates or estimated cash flows. If a single cause has a significant effect on the regulatory asset or regulatory liability, the entity shall disclose it separately.
 - (b) the remaining period over which the entity expects to recover the carrying amount of the regulatory asset or to settle the regulatory liability.
 - (c) the amount of financing cost included in the cost of self-constructed property, plant and equipment and internally developed intangible assets in the current period in accordance with paragraph 16 that would not have been capitalised in accordance with IAS 23.
- 28 When an entity recognises an impairment loss in accordance with paragraph 20, it shall provide the disclosures required by IAS 36.
- 29 When an entity derecognises regulatory assets and regulatory liabilities in accordance with paragraph 21 because the related operating activities fail to meet the criteria in paragraph 3, it shall disclose a statement to that effect, the reasons for the conclusion that the criteria in paragraph 3 are not met, a description of the operating activities affected and the amount of regulatory assets and regulatory liabilities derecognised.
- 30 If the disclosures required by paragraphs 25–29 of this [draft] IFRS do not meet the objectives set out in paragraph 24, the entity shall disclose whatever additional information is necessary to meet those objectives.

Effective date and transition

Effective date

- 31 An entity shall apply this [draft] IFRS for annual periods beginning on or after [date to be inserted after exposure]. Earlier application is permitted. If an entity applies this [draft] IFRS for an earlier period, it shall disclose that fact.

Transition

- 32 An entity shall apply this [draft] IFRS to regulatory assets and regulatory liabilities that exist at the beginning of the earliest comparative period presented when it applies this [draft] IFRS. The entity shall reflect any adjustments required as a result of applying this [draft] IFRS in the opening balance of retained earnings of that comparative period.

Appendix A Defined terms

This appendix is an integral part of the [draft] IFRS.

Cost-of-service regulation	A form of regulation for setting an entity's prices (rates) in which there is a cause-and-effect relationship between the entity's specific costs and its revenues.
Expected cash flow approach	A measurement method that weights the expected cash flows of possible outcomes by the probabilities associated with those outcomes.
Expected present value	The estimated probability-weighted average of the present value of the expected cash flows related to an asset or liability.
Regulator	An authorised body empowered by statute or contract to set rates that bind an entity's customers. The regulator may be a third-party body or may be the entity's own governing board if the board is required by statute or contract to set rates both in the interest of the customers and to ensure the overall financial viability of the entity.
Regulatory asset	An entity's right to recover specific previously incurred costs and to earn a specified return by increasing rates in future periods as a result of the actual or expected actions of its regulator .
Regulatory liability	An entity's obligation to refund previously collected income and to pay a specified return by decreasing rates in future periods as a result of the actual or expected actions of its regulator .

Appendix B Application guidance

This appendix is an integral part of the [draft] IFRS.

Scope

Prices that bind customers

- B1 The first criterion to consider in determining if the regulated operating activities are within the scope of the [draft] IFRS is whether the regulator is empowered to determine prices that bind the entity's customers. The regulator's ability to determine rates is established by statute or by a contract delegating such authority. For example, a public utility commission may be elected or appointed to establish prices that are intended to be fair to both the entity and its customers.
- B2 In a co-operative utility, the members of the entity's governing board may be empowered to set its rates in a manner consistent with the purpose and governance of the organisation. This would satisfy the first criterion provided that the board is similarly required by statute or contract to set rates both in the interest of the customers and to ensure the overall financial viability of the entity.

Cost-of-service regulation

- B3 The second criterion to consider in determining if the regulated operating activities are within the scope of the [draft] IFRS is whether the rate established by regulation is designed to recover the specific costs the entity incurs in providing the regulated goods or services and to earn a specified return, ie whether the entity is subject to a cost-of-service form of regulation. This criterion requires a cause-and-effect relationship between an entity's costs and its rate-based revenue stream.
- B4 In many cases, determining whether the entity is subject to cost-of-service regulation will be straightforward. In others, significant judgement will be required. The following circumstances are indicators of cost-of-service regulation:
- (a) The regulation is designed to provide recovery of the specific entity's costs.
 - (b) If actual costs are not used to establish rates, the regulation provides for a 'true-up' to actual costs incurred.

- (c) In the case of a 'price cap' plan, there is a true-up to actual costs through a rate of return sharing mechanism.
 - (d) If the entity is required to provide a rate discount, the rate discount is temporary rather than permanent.
 - (e) If a short moratorium on rate increases is imposed, it will be followed by a return to direct cost-based regulation.
- B5 The first three indicators relate to whether the plan is intended to permit the entity to recover its specific costs rather than industry averages, costs based on other indices or targets. The last two indicators relate to whether the entity is permitted to recover its costs (including financing costs) and earn an adequate return on its shareholder's investment.
- B6 Concluding that a regulatory plan does not provide a sufficient return for shareholders to justify the application of the [draft] IFRS requires judgement. One or a combination of the following indicators could lead to that conclusion:
- (a) Abnormal excess capacity exists.
 - (b) The rates per unit are currently higher (or are forecast to be higher in the future) than those of entities in neighbouring jurisdictions or alternative competitive sources. This may indicate that the regulator will disallow costs.
 - (c) The regulatory environment has changed, as indicated by:
 - (i) the existence of unrecoverable investments.
 - (ii) substantial regulatory disallowances.
 - (iii) the establishment of phase-in plans or a trend towards increasing amounts of regulatory assets.
 - (iv) proposed or actual rate-making that is designed to stimulate competition or rates set based on other than a pure cost-of-service concept.
 - (v) rate freeze periods that extend beyond a reasonable time.

Recognition and measurement

Permitted costs

- B7 In the form of regulation described in the scope of the [draft] IFRS, the rates set by the regulator are designed to recover an entity's specific costs of providing the goods and services.

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- B8 Not all costs that an entity incurs are automatically recoverable from its customers. Regulators typically review entities' costs to ensure that they were appropriately incurred to provide the regulated service and were 'prudent'. Consequently, a cost must be permitted by the regulator to be included in the determination of rates. In cost-of-service regulation, such costs are the actual or estimated costs for which revenue is intended to provide recovery and include costs of debt and a reasonable return on shareholders' investments.
- B9 Cost-of-service rate-making does not necessarily equal a one-for-one pass-through of costs. Rate-making involves projections and assumptions; as a result actual costs will differ from estimated amounts assumed in the rate-making process itself, commonly referred to as regulatory lag. Rates should be established to provide that the entity will recover its costs using reasonable assumptions regarding demand as well as normal expenditures.

Probability of cost recovery

- B10 Paragraph 14 requires an entity to consider the probability that the regulator will allow or require the entity to include in the entity's future rates the costs incurred or amounts collected. In practice, an entity may incur costs several periods before the regulator formally considers them. Consequently, the entity considers a variety of evidence in determining the probability that the regulator will allow particular costs when it reviews them.
- B11 Indicators that an entity shall consider in assessing the probability of recovery include:
- (a) statutes or regulations that specifically provide for the recovery of the cost in rates that cannot be overturned by future regulatory decisions;
 - (b) formal approvals from the regulator specifically authorising recovery of the cost in rates;
 - (c) previous formal approvals from the regulator allowing recovery for substantially similar costs (precedents) for a specific entity or other entities in the same jurisdiction;
 - (d) written approval from the regulator (although not a formal approval) approving future recovery in rates;

- (e) uniform regulatory accounting guidance providing for the accounting treatment of various costs that the regulator typically follows in setting rates;
- (f) written confirmation from the regulator's staff that they will recommend approval of the cost that is not legally binding on the regulatory body that sets rates; and
- (g) analysis of recoverability of the cost from internal or external legal counsel on the basis of regulations and past practice.

Expected present value

- B12 If the timing of the estimated cash flows is the same for all outcomes, the discount rate can be applied to the probability-weighted estimated cash flows to determine their present value. Otherwise, the present value for each possible outcome must be determined before the probability factor is applied. The results are then accumulated to determine the probability-weighted average of the present value of the cash flows.
- B13 In some situations, the rate of return set by the regulator may be a reasonable approximation of the discount rate that would be appropriate to use in the measurement of the regulatory assets and regulatory liabilities in accordance with paragraph 15. However, this cannot always be assumed to be the case. In addition, the entity would have to consider whether the cash flows have already been adjusted for any of the risks included in the regulatory rate of return (see paragraph 15).

Recoverability

- B14 In accordance with paragraphs 17–20, an entity considers the net effect on its rates of all the regulatory assets and regulatory liabilities arising from the actions of a particular regulator. For example, an entity might expect that if it were to charge the electricity rates necessary to recover all the costs permitted by the regulator, its customers would have a strong incentive to reduce their consumption of electricity or to switch to less expensive sources of energy. A conclusion that the reduction in demand would result in total revenue not recovering the entity's net regulatory assets and regulatory liabilities is an indication of impairment. The entity shall include the regulatory assets and regulatory liabilities with the other assets and liabilities of the cash-generating unit and test them for impairment in accordance with IAS 36.

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- B15 Given the characteristics of the regulatory environment within the scope of the [draft] IFRS, entities will be able to determine when the costs of all the assets in the cash-generating unit are expected to affect rates and by how much. Consequently, the entity's estimates will identify the periods in which changes in demand will affect future cash flows to such an extent that the entity will not recover its costs. The entity uses this information to comply with the requirement in paragraph 18 to reflect the impairment loss determined and allocated in accordance with IAS 36 to each regulatory asset.
- B16 In accordance with paragraph 105 of IAS 36, in allocating an impairment loss for a cash-generating unit to the assets in that unit, an entity shall not reduce the carrying amount of an asset below the highest of:
- (a) its fair value less costs to sell (if determinable);
 - (b) its value in use (if determinable); and
 - (c) zero.
- B17 Because the entity is able to estimate both the amount and timing of the cash flows of the regulatory asset, the entity is able to estimate the asset's value in use. An entity may determine that the value in use of an individual regulatory asset equals the amount previously determined in accordance with paragraph 12. In this case, the entity shall allocate no impairment loss to the regulatory asset. Conversely, changes in the amount or timing of cash flows to be received may result in the current value in use being less than the amount previously determined in accordance with paragraph 12. In these instances, an impairment loss shall be allocated to the regulatory asset.
- B18 If a recognised impairment loss is allocated to a regulatory asset, in subsequent periods the entity shall continue to measure the asset in accordance with paragraph 12 using the amount and timing of the estimated cash flows used in determining the amount of the impairment loss.
- B19 If an entity subsequently determines that impairment indicators no longer exist, the entity shall follow the provisions of IAS 36 for reversing an impairment loss for a cash-generating unit.

Regulatory liabilities

- B20 Regulation can establish three types of regulatory liabilities:
- (a) The regulator requires refunds to be made to customers in the form of reduced future rates. However, if the refunds are to be made in

determinable amounts to specific customers, they are financial liabilities and are not within the scope of this [draft] IFRS.

- (b) The regulator provides current rates intended to recover costs that are expected to be incurred in the future with the understanding that if those costs are not incurred, future rates will be reduced accordingly. A liability is recognised only if the entity will be required to refund amounts collected in advance of expenditure.
- (c) The regulator requires a realised gain or other reduction of cost to be refunded to customers in the form of reduced rates over future periods.

B21 In accordance with paragraph 9, a regulator cannot eliminate or change the measurement of a liability that was not created by that regulator.

Appendix C

Amendments to other IFRSs

The amendments in this [draft] appendix shall be applied for annual periods beginning on or after [date to be inserted after exposure]. If an entity applies this [draft] IFRS for an earlier period, these amendments shall be applied for that earlier period. Amended paragraphs are shown with new text underlined and deleted text struck through.

IFRS 1 *First-time Adoption of International Financial Reporting Standards*

- C1 Paragraph D1 is amended and paragraph D25 is added.
- D1 An entity may elect to use one or more of the following exemptions:
- (a) ...
 - (n) borrowing costs (paragraph D23); ~~and~~
 - (o) transfers of assets from customers (paragraph D24); and
 - (p) regulatory assets (paragraph D25).
- D25 Entities with rate-regulated activities as defined in [draft] IFRS X *Rate-regulated Activities* may hold, or have previously held, items of property, plant and equipment or intangible assets for use in those activities. The carrying amount of such items sometimes includes amounts that were included in accordance with previous GAAP that would be recognised separately as regulatory assets in accordance with [draft] IFRS X. If this is the case, a first-time adopter may elect to use the carrying amount of such an item at the date of transition to IFRSs as deemed cost. An entity may use this election or that relating to borrowing costs in paragraph D23 but not both.

IAS 36 *Impairment of Assets*

- C2 Paragraph 5 is amended as follows.
- 5 This Standard does not apply to financial assets within the scope of IAS 39, investment property measured at fair value in accordance with IAS 40, ~~or~~ biological assets related to agricultural activity measured at fair value less costs to sell in accordance with IAS 41, or individual regulatory assets measured at their expected present value in accordance with [draft] IFRS X *Rate-regulated Activities*.

However, this Standard applies to assets that are carried at revalued amount (ie fair value) in accordance with other IFRSs, such as the revaluation model in IAS 16 *Property, Plant and Equipment*. Identifying ...

C3 Paragraph 67A is added before paragraph 68.

67A Individual regulatory assets are not subject to impairment testing because they are measured at their expected present value. However, when the conditions in paragraphs 19 and 20 of [draft] IFRS X exist, regulatory assets and regulatory liabilities shall be included in the cash-generating unit containing the assets used to provide the regulated goods and services.

IAS 37 Provisions, Contingent Liabilities and Contingent Assets

C4 Paragraph 5 is amended as follows.

5 When another Standard deals with a specific type of provision, contingent liability or contingent asset, an entity applies that Standard instead of this Standard. For example, some types of provisions are addressed in Standards on:

- (a) ...
- (d) employee benefits (see IAS 19 *Employee Benefits*); ~~and~~
- (e) insurance contracts (see IFRS 4 *Insurance Contracts*). However, this Standard applies to provisions, contingent liabilities and contingent assets of an insurer, other than those arising from its contractual obligations and rights under insurance contracts within the scope of IFRS 4; ~~and~~
- (f) rate-regulated activities (see [draft] IFRS X *Rate-regulated Activities*).

IAS 38 Intangible Assets

C5 Paragraph 2 is amended as follows.

2 **This Standard shall be applied in accounting for intangible assets, except:**

- (a) ...

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- (c) **the recognition and measurement of exploration and evaluation assets (see IFRS 6 *Exploration for and Evaluation of Mineral Resources*); ~~and~~**
- (d) **expenditure on the development and extraction of minerals, oil, natural gas and similar non-regenerative resources; ~~and~~**
- (e) **the recognition and measurement of regulatory assets (see [draft] IFRS X *Rate-regulated Activities*).**

C6 Paragraph 3 is amended as follows.

- 3 If another Standard prescribes the accounting for a specific type of intangible asset, an entity applies that Standard instead of this Standard. For example, this Standard does not apply to:
 - (a) ...
 - (i) regulatory assets (as defined in [draft] IFRS X).

IFRIC 12 *Service Concession Arrangements*

C7 Paragraph 9A is added.

- 9A An entity that operates a public-to-private service concession arrangement that is within the scope of this Interpretation should also consider whether its operating activities provided using the infrastructure in accordance with the concession arrangement are within the scope of [draft] IFRS X *Rate-regulated Activities*.

Approval by the Board of *Rate-regulated Activities* published in July 2009

The exposure draft *Rate-regulated Activities* was approved for publication by twelve of the fourteen members of the International Accounting Standards Board. Messrs Cooper and Zhang voted against its publication. Their alternative views are set out after the Basis for Conclusions.

Sir David Tweedie	Chairman
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