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Reporting the financial effects of rate regulation

IASB consults on rate-regulated activities

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IN THE HEADLINES

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> “Reporting on rate-regulated activities has been a hotly debated issue for years. As a basis for future discussion, this consultation seeks a common understanding of rate regulation.”
>
> – Mark Vaessen
> KPMG’s global IFRS network leader

A comprehensive project

Although some national accounting bodies provide specific guidance on accounting for the effects of rate regulation, IFRS does not contain any equivalent comprehensive guidance. IFRS 14 *Regulatory Deferral Accounts*, published earlier this year, provides only temporary relief to first-time adopters of IFRS that are subject to rate regulation. The recent release of the rate regulation discussion paper (DP) is an important step in determining whether regulatory deferral account balances will be recognised under IFRS in the future by *all* entities that are subject to rate regulation – not just first-time adopters.

This *In the Headlines* highlights the key topics on which the IASB is seeking input. While they will not affect rate-regulated entities immediately, they could significantly affect IFRS in the future.

Ongoing debate

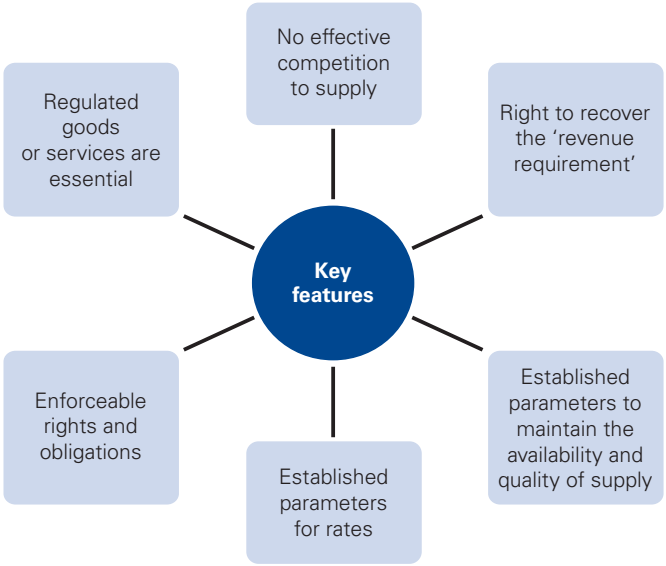
The debate as to whether regulatory timing differences should be reflected in IFRS financial statements has revealed strongly held but diverse views. The IASB believes that diversity arises in part due to the wide variety of types of rate-regulatory frameworks and schemes in different countries, industries and geographical areas. To provide a common starting point for discussion, the DP focuses on one type of rate regulation – termed ‘defined rate regulation’ – and seeks input to:

- identify what information about the financial effects of rate regulation is most relevant to users in making investment and lending decisions;
- confirm whether the description of defined rate regulation appropriately identifies the type of rate regulation that has the biggest effect on the amount, timing and certainty of revenue, profit and cash flows; and
- provide the IASB with insight into the advantages and disadvantages of possible financial reporting approaches, and whether there are any other approaches it should consider (see ‘Potential financial reporting approaches’ on the opposite page).

The IASB will consider responses in deciding whether to develop proposals for guidance on accounting for rate-regulated activities.

Defined rate regulation

Defined rate regulation balances the needs of customers to purchase rate-regulated goods or services with the needs of entities to attract capital and remain financially viable. Emphasis has been placed on the features considered most likely to create a combination of rights and obligations that distinguish between activities that are and are not rate-regulated.



Defined rate regulation is designed to ensure that the entity recovers a determinable amount of consideration (the ‘revenue requirement’) in exchange for performing rate-regulated activities. In addition, through the rate per unit chargeable to customers, the rate regulator establishes when the entity can bill customers for that consideration.

The rate-setting mechanism seeks to ensure that the entity earns no more or less than the revenue requirement through the use of an adjustment mechanism that reverses specified differences between the amount of the revenue requirement accrued to date and the amounts billed to customers.

Need for specific accounting guidance?

The IASB has not reached a preliminary view on whether there is a need for specific guidance on accounting for activities that are subject to defined rate regulation. However, the DP explores whether defined rate regulation creates a distinguishable combination of rights and obligations for which specific accounting guidance or requirements should be developed. It also seeks input on how the information that is most useful to users could best be reflected in IFRS financial statements.

Potential issues for future consideration

The DP highlights some issues that will need to be considered if the IASB decides to further consider developing specific accounting requirements for rate-regulated activities. These include:

- interaction with the *Conceptual Framework* project;
- whether self-regulated bodies – e.g. co-operatives – could be considered to be subject to defined rate regulation; and
- interactions with other standards, including IFRIC 12 *Service Concession Arrangements*, IFRS 15 *Revenue from Contracts with Customers*, IAS 12 *Income Taxes*, IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* and IFRS 3 *Business Combinations*.

Potential financial reporting approaches

Approach	Description
Recognise the package of rights and obligations as an intangible asset	Recognise aspects of the rate-setting process in changes to the carrying amount of the regulatory licence or other agreement
Report using regulatory accounting requirements	Permit or require the accounting prescribed by the rate regulator to be used in general-purpose IFRS financial statements
Develop specific IFRS requirements	Modify IFRS requirements to defer or accelerate the recognition of costs, revenue or a combination of both
Prohibit the recognition of regulatory deferral account balances	Do not develop specific recognition or measurement requirements, but consider disclosures to explain the impact of rate regulation

Have your say …

In responding to the DP, rate-regulated entities should ask themselves who their primary users are, and what information about the financial effects of rate regulation is most relevant to those users in making investment and lending decisions. Similarly, primary users of the financial statements – e.g. investors, lenders or analysts – can provide valuable feedback about what information is particularly useful and their preferred presentation of that information.

Comments are due to the IASB by 15 January 2015. For more information on the DP, please go to the IASB press release or speak to your usual KPMG contact.

> “A new standard on this topic will potentially affect all IFRS entities subject to rate regulation. The time to engage is now.”
>
> – Phil Dowad
> KPMG’s global IFRS revenue recognition and provisions leader

Requirements of IFRS 14

In January 2014, IFRS 14 was issued to provide temporary relief to first-time adopters of IFRS that are subject to rate regulation. IFRS 14 permits those entities to continue using previous GAAP to account for regulatory deferral account balances while the comprehensive project is completed. This interim standard requires regulatory deferral account balances and movements therein to be presented as separate line items on the face of the financial statements, distinguished from assets, liabilities, income and expenses that are recognised under other IFRSs. Although the requirements of IFRS 14 may not be retained in the future, they may be a useful basis for discussion of how best to present information that would help users of IFRS financial statements understand the financial effects of rate regulation.

Timeline

17 September 2014
DP published and comment period begins

15 January 2015
Comment period ends

Not established
Date of follow-up DP or exposure draft

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