

Power and Utilities Alert

Accounting for rate-regulated activities under IFRS



*Alert 2013-7
August 22, 2013*

*The IASB's
Consultative
Group met for the
first time in July
to discuss the
responses to the
Request for
Information on
the rate
regulation project*

This Power and Utilities Alert describes recent developments regarding accounting for rate-regulated activities under International Financial Reporting Standards (IFRS).

In March 2013, the International Accounting Standards Board (IASB) issued a Request for Information (RFI) related to its project on rate regulation that was proposed in December 2012. The primary objective of the RFI is to identify the range of rate-regulatory schemes and the common features of rate regulation to help determine the scope of the project on rate regulation. The responses to the RFI are being used to develop a Discussion Paper which will analyze the common features of rate regulation. The IASB also formed a Consultative Group to assist in developing the Discussion Paper.

The following Alert provides a summary of the responses to the RFI and highlights our observations from the first Consultative Group meeting.

Summary of RFI responses

The IASB received a total of 79 responses that describe aspects of rate regulation in 37 countries. Of the responses, 64 came from jurisdictions that currently use IFRS or from respondents where some, but not all, of the rate regulation described relates to jurisdictions reporting in accordance with IFRS. The majority of the respondents (65%) were preparers of financial statements and preparer representative bodies. Other respondents included rate regulators (12%), accounting firms (9%), and standard-setters (12%).

Responses to the RFI indicated that, in many jurisdictions, rate regulation is evolving beyond a pure cost recovery model and the nature of rate regulatory mechanisms is changing to capture a wider range of regulatory objectives. Almost all ratemaking schemes described in the responses incorporate some aspects of cost-based and incentive-based rate regulation. Refer to the IASB website at www.ifrs.org/Current-Projects/IASB-Projects/Rate-regulated-activities/Pages/Discussion-and-papers-stage-3.aspx for the complete RFI response summary.

Consultative Group meeting

The Consultative Group was formed in April 2013 to provide a variety of expert perspectives, including those of preparers, auditors and users of financial statements,

and regulators. The group consists of 15 senior professionals from 11 different countries with extensive practical experience in the operation of a variety of rate-regulatory schemes.

The Consultative Group's first meeting was held on July 26, 2013. The primary focus of the meeting was to consider various issues and findings highlighted through the RFI process, particularly focusing on the scope of the project. In their discussions, members of the Consultative Group suggested that the scope of the project should focus more on specific features of rate regulation than a specific type of rate regulation. Some of the characteristics of rate regulation that Consultative Group members believed should be included as criteria in establishing the scope of the project include:

- Public service or essential goods nature of the industries;
- Lack of choice of supplier available to customers and the monopoly right to provide the service or goods, granted or supported by rate regulation;
- Type or level of infrastructure needed to supply the service or goods and whether it could be redeployed or substituted;
- Inability of customers to negotiate prices or for suppliers to modify prices without approval by a rate regulator; and
- Authority of the rate regulator, and how it is supported by statute.

Overall, members were generally in agreement that there should be a distinction between 'market regulation' and 'rate regulation'. Most expressed a view that there is a fundamental difference between situations where a price-cap applies to all suppliers in a competitive market and those where there are restrictions on prices to be charged by a specific (and usually monopolistic) supplier of goods or services. Additionally, the existence of established rate-setting mechanisms and a defined process for recovering costs were characteristics considered important in defining activities that should be within the scope of the project.

The Consultative Group also discussed what information is considered necessary for financial statements users to understand rate regulation and how it affects the reporting entity. The following disclosures that may achieve this objective were discussed:

- Transparency about the rate-regulated environment and how it impacts the amounts, timing and certainty of future cash flows;
- Information that would allow users to reconcile the earnings reported in the financial statements to the rate of return allowed through rate regulation;
- Qualitative information about the structure of the rate regulation and how it is enforced; and
- The relationship between the rate regulator and the entity, including the entity's historical experience recovering costs and earning the return allowed by the rate regulation.

Refer to the agenda papers, including audio replay of the meeting, at www.ifrs.org/Meetings/Pages/RRA-Consultative-Group-July-13.aspx. Additionally, we have included the IASB staff's summary of this meeting within the Alert.

Next steps

The IASB staff will consider the Consultative Group discussions as it develops proposals for the Discussion Paper. The IASB is expected to begin to consider those proposals during its next meeting, which will be held in September 2013. The staff plans to seek further input from the Consultative Group in late 2013.

Additionally, the comment period for the IASB's related interim standard exposure draft, *Regulatory Deferral Accounts*, ends on September 4, 2013. If adopted, this would allow certain entities to continue recognizing regulatory deferral accounts in accordance with their local accounting requirements until the more comprehensive project on rate-regulated accounting is complete. See Alert 2013-6 for further information.

Questions

Clients of PwC that have questions about this Power & Utilities Alert should contact their engagement partner. Engagement teams that have questions about this Alert should contact Casey Herman, Heather Horn, David Humphreys, or Steve Krump.

Authors

Heather Horn

Partner

heather.horn@us.pwc.com

(973) 236 4230

David Humphreys

Partner

david.humphreys@us.pwc.com

(617) 530 7332

Steve Krump

Senior Manager

steven.krump@us.pwc.com

(646) 471 1032

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