Federation of European Accountants
Fédération des Experts comptables Européens

Sir David Tweedie
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Ref.: ACC/HvD/LF/ID

Dear Sir David,

Re: FEE Comments on IASB Exposure Draft *Rate-regulated Activities*

(1) FEE (the Federation of European Accountants) is pleased to provide you below with its comments on the IASB Exposure Draft *Rate-regulated activities* (the "ED").

(2) As a founding organisation of EFRAG we have also contributed to the EFRAG consultation process by submitting on 27 November 2009 the FEE comments on EFRAG's Draft Comment Letter of 20 October 2009. EFRAG has issued its final comment letter on 18 December 2009. We have considered the EFRAG Final Comment Letter in our response and made reference to the EFRAG comments where relevant.

(3) In summary,

- Like EFRAG, we believe that the proposed scope is too narrow since it would exclude de facto most rate-regulation regimes in Europe. Given the narrow scope, in our view, the results might not be as useful as would be expected from a standard aimed at addressing assets and liabilities arising from rate-regulations.

- Furthermore, we are also concerned like EFRAG that entities might apply the proposed standard by analogy and as a result the standard may end up being applied to circumstances for which it was not intended.

- For these reasons, we believe that it might be preferable to widen the proposed scope to all entities subject to rate-regulations but compensate this wider scope with clear recognition principles that would ensure that regulatory assets and liabilities are recognised only when this is justified (and every time this is justified).

- Like EFRAG, we disagree with the omission from the proposed standard of recognition principles that are consistent with the recognition criteria of assets and liabilities in the Framework. We are concerned that the lack of specified recognition principles may lead to the development of "implicit" principles that may then be extended to assets and liabilities other than those arising from rate-regulation. We believe that establishing clear recognition criteria is a fundamental step in the development of any principle-based standard to ensure consistent application in respect of assets and liabilities in general, and those arising from rate-regulations, in particular. The need for recognition criteria would become even more crucial if, as we suggest, the proposed scope is widened.

- Like EFRAG, we do not support the expected present value approach proposed in the ED and we support EFRAG's views that an entity should base the measurement of regulatory assets and liabilities on management's best estimate (the "most likely" approach) of the cash flows that are expected to occur.

- We would have a slight preference for using an "asset/liability-specific" discount rate because this appears to be the rate that most closely reflects the risk inherent to the assets and liabilities being measured.

- Like EFRAG, we disagree with the proposal 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 other amounts included by the regulator. Once the Board has defined the principles establishing when and how regulatory assets are recognised, we believe that the resulting amounts would represent assets in their own right and as such would be presented separately. We do not believe that it would be appropriate to include these amounts as part of other assets such as property, plant and equity or intangible assets. Further, in our view, property, plant and equipment and intangible assets should be recognised based on the requirements of IAS 16 and IAS 38, respectively, and should not be affected by assets that arise as a result of a different standard. Including additional costs arising for the rate-regulations as part of property, plant and equipment (or intangible assets) would result in the same asset acquired in the same circumstances being measured at different amounts depending on whether the entity is subject or not to rate-regulations. This consequence would diminish the comparability between entities.

- Like EFRAG, we are not convinced that an issue of impairment would arise subsequent to measurement, particularly as the regulatory assets and liabilities would be required to be remeasured at each reporting date to reflect a current value.

- In general, we do not believe that additional disclosures are required unless the usefulness of such disclosures can be clearly established.

- We acknowledge that there are circumstances in which retrospective application is not possible or does not carry sufficient benefits to justify the costs of a retrospective application. We suggest that the Board should determine whether to perform further analysis to assess the costs and efforts involved in a retrospective application. If such an application proves to be burdensome, the Board may want to consider permitting a prospective application or at least, not requiring restatement of the comparative period(s).

Our responses to the questions in the Invitation to comment of the ED are included as an Appendix to this letter.

For further information on this letter, please contact Leyre Fuertes, Project Manager.

Yours sincerely,

Hans van Damme
President

Appendix - Responses to the questions in the Invitation to comment of the IASB Exposure Draft *Rate-regulated Activities*

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?

(4) Like EFRAG, we believe that the proposed scope is too narrow since it would de facto exclude most rate-regulation regimes in Europe, where rate-regulations are often based on a hybrid model in which the cost recovery model is only applicable to certain types of costs or where the rates are subject to capping and flooring mechanisms. Given, the narrow scope, in our view, the results might not be as useful as would be expected from a standard aimed at addressing assets and liabilities arising from rate-regulations.

(5) Furthermore, we are concerned like EFRAG that entities might apply the proposed standard by analogy and as a result the standard may end up being applied to circumstances for which it was not intended.

(6) For these main reasons, we believe that it might be preferable to widen the proposed scope of the standard to all entities subject to rate-regulations but compensate this wider scope with clear recognition principles that would ensure that regulatory assets and liabilities are recognised only when this is justified (and every time this is justified).

(7) We believe that if the standard was to retain its very narrow scope, it might be more appropriate to deal with the accounting treatment of regulated assets and liabilities via an IFRIC interpretation.

(8) However, such an outcome would not represent our preference. We believe that it would be preferable for the Board to develop a standard that is wide enough and based on robust recognition and measurement principles that would ensure comparability between entities subject to economically similar rate-regulations.

(9) In addition, we would like to note that we do not have a definite opinion on whether entities have indeed "control" over the regulatory asset. Hence, we cannot conclude definitely on whether or not regulatory assets meet the definition of assets in the Framework. From an "economic" point of view, a form of control might exist due to the fact that the customer base is captive in a monopolistic environment. However, this control does not represent legal or contractual control. As such, the ED appears to open the door to recognition of assets and liabilities on the basis of economic compulsion. This represents a significant shift from the position previously taken by the Board.

(10) The Board has not clearly established how the regulator's promise can be viewed as a resource for which future benefits are expected, i.e. how is it that this promise meets the recognition criteria for assets in the Framework. The Board's conclusion appears to be based, at least in part, on the link that exists between the regulator's promise and the aggregate customer. Given that the customer base may change its overall demand, it would be useful for the Board to more clearly establish why the regulator's promise meets the recognition criteria for an asset in the Framework despite the fact that the entity does not have control over the demand expected from the customer base. In the absence of a clearer demonstration, a legitimate alternative view may be that the regulator's promise is merely a mechanism facilitating future rate increases (a mean to obtain an asset in the future) rather than an asset that exists before future services are rendered. Similar considerations should be given with respect to establishing more clearly how it is that "regulatory liabilities" meet the recognition criteria for liabilities in the Framework.

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?

(11) In our response to Question 1 we have noted our preference for widening the proposed scope in the ED.

(12) Like EFRAG, we disagree with the proposal not to include in the standard recognition principles that are consistent with the recognition criteria of assets and liabilities in the Framework.

(13) We are concerned that the lack of specified recognition principles may lead to the development of "implicit" principles that may then be extended to assets and liabilities other those arising from rate-regulation. We believe that establishing clear recognition criteria is a fundamental step in the development of any principle-based standard to ensure consistent application in respect of assets and liabilities, in general, and those arising from rate-regulations, in particular. The need for recognition criteria would become even more crucial if, as we suggest, the proposed scope is widened.

(14) We also believe that the Basis for Conclusions should detail the reasoning followed by the Board to conclude that it is appropriate for entities to recognise regulatory assets and liabilities.

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?

Expected present value approach

(15) Like EFRAG, we do not support the expected present value approach proposed in the ED. Consistently with the position FEE expressed in its comment letter on the ED Income Tax, we believe that a probability-weighted average approach is unlikely to produce a precise figure, despite the onerous requirements that an entity is likely to observe to get to that number.

(16) Accordingly, we support EFRAG's views that an entity should base the measurement of regulatory assets and liabilities on management's best estimate (the "most likely" approach) of the cash flows that are expected to occur.

(17) We also acknowledge and agree with EFRAG that in circumstances where a wide variety of divergent possible outcomes and probabilities exist, an entity might need to consider the various outcomes and the probability of occurrence attached to those outcomes. We agree with EFRAG that however, that should be a natural consequence of applying a principle-based measurement attribute.

Discount rate

(18) Like EFRAG, we believe that the discount rate should reflect the risk associated with the specific asset and liability, because this appears to be the rate that most closely reflects the risk inherent to the assets and liabilities being measured. Having said this, we believe that in some cases, the rate of return provided by the regulator may approximate this discount rate. As a practical expedient, we believe that it would be useful for the Board to acknowledge that in those situations, it would be appropriate for entities to simply ignore the discounting of the cash flows and omit the expected return in these cash flows. Given that both the expected rate of return and the discount rate are subject to significant judgement, omitting these two factors to the extent that they are expected to largely cancel each other would greatly simplify the application of the measurement methodology proposed in the ED without significantly affecting the relevance of the resulting information.

(19) To the extent that the Board retains its proposal that the present value of a regulatory asset or liability should reflect the time value of money (represented by the current risk-free rate of interest) and the price for bearing the uncertainty inherent in the asset or liability, we believe that the Board should provide additional guidance on how to apply this principle.

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?

(20) Like EFRAG, we disagree with the proposal 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 other amounts included by the regulator. Once the Board has defined the principles establishing when and how regulatory assets are recognised, we believe that the result amounts would represent assets in their own right and as such would be presented separately. We do not believe that it would be appropriate to include these amounts as part of other assets such as property, plant and equity or intangible assets.

(21) Further, in our view, property, plant and equipment and intangible assets should be recognised based on the requirements of IAS 16 and IAS 38, respectively, and should not be affected by assets that arise as a result of a different standard. Including additional costs arising for the rate-regulations as part of property, plant and equipment (or intangible assets) would result in the same asset acquired in the same circumstances being measured at different amounts depending on whether the entity is subject or not to rate-regulations. This consequence would diminish the comparability between entities.

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?

(22) Like EFRAG we are not convinced that an issue of impairment would arise subsequent to measurement, particularly as the regulatory assets and liabilities would be required to be remeasured at each reporting date to reflect a current value.

(23) Given that regulatory assets do not generate cash inflows that are largely independent from other assets, we believe that the regulatory assets should be included in cash generating units along with the related assets. If an impairment loss arises with respect to a cash generating unit that includes regulatory assets, we believe that the loss would be allocated to the assets of the cash generating unit in accordance with IAS 36. Based on the requirements of IAS 36.105 no loss would be allocated to the regulatory assets since they are already measured using a current value.

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.

(24) In our view, it would be important to understand whether the proposed disclosure requirements are considered useful, or in contrast excessive and burdensome. Accordingly, we encourage the Board to seek views of preparers and users on this matter.

(25) In general, we do not believe that additional disclosures are required unless the usefulness of such disclosures can be clearly established. In addition, we would be supportive of paragraph 40 in the EFRAG final comment letter regarding the fact that there might be conflicting requirements in the ED (between paragraph 24 and 30 of the ED).

Appendix - Responses to the questions in the Invitation to comment of the IASB Exposure Draft *Rate-regulated Activities*

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?

(26) Like EFRAG, FEE's view is that retrospective application of IFRS is generally preferable to other transition arrangements.

(27) However, we acknowledge that there are circumstances in which retrospective application is not possible or does not carry sufficient benefits to justify the costs of a retrospective application.

(28) We suggest that the Board should determine perform further analysis to assess the costs and efforts involved in a retrospective application. If such an application prove to be burdensome, the Board may want to consider permitting a prospective application or at least, not requiring restatement of the comparative period(s).

(29) Additionally, we note that an entity applying the new standard may have carried out business combinations in prior periods and recognised goodwill. Where the recognition of regulatory assets would have had an effect on the purchase price allocation (ie reduced the goodwill initially recognised), the Board should provide guidance on what adjustments, if any, would be necessary upon adoption of the new standard.

Other comments

Question 8

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

(30) We recommend that the Board clarifies whether the recognition of regulatory assets/liability is reflected through an adjustment to "revenue" or to "cost of sale". We note that paragraph IE21 of the exposure draft indicates that "the recognition of the regulatory asset reduces the amount Company C recognises as expense in profit or loss in period". This appears to indicate that recognition of a regulatory asset affects "costs of sale". Given that the ED proposes that regulatory assets and liabilities be measured based on future cash flows, included expected return, we would have expected that the recognition of a regulatory assets would have resulted in a credit to revenue in order to be consistent with the measurement basis.