AFRAC
AUSTRIAN FINANCIAL REPORTING AND AUDITING COMMITTEE

c/o KAMMER DER WIRTSCHAFTSTREUHÄNDER
SCHOENBRUNNER STRASSE 222–228/1/6
A-1120 VIENNA
AUSTRIA

TEL +43 (1) 81173 228
FAX +43 (1) 81173 100
E-MAIL office@afrac.at
WEB http://www.afrac.at

Mr Hans Hoogervorst, Chairman
International Accounting Standards Board (IASB)
30 Cannon Street
London EC4M 6XH
United Kingdom

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Dear Mr Hoogervorst,

On behalf of the Austrian Financial Reporting and Auditing Committee (AFRAC), the privately organised standard-setting body for financial reporting and auditing standards in Austria, we appreciate the opportunity to comment on the Discussion Paper DP/2014/2 *Reporting the Financial Effects of Rate Regulation*.

Principal authors of this comment letter were Konrad Fuhrmann, Werner Gedlicka, Peter Geyer, Christian Höllerschmid, Marcus Karger, Gerhard Marterbauer, Aslan Milla, Thomas Possert and Robert Reiter. In order to assure a balanced Austrian view on the DP, the professional background of these authors is diverse.

Question 1

(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:

(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?

(a)(i): The statement of financial position should present the sum of all differences between the amounts of revenue billed and the revenues that under the regulatory system have not at the reporting date been compensated or reimbursed. For greater transparency, asset and liability differences should be shown separately.

(a)(ii): The statement(s) of profit or loss and other comprehensive income should present the profit or loss for the regulated period on an accruals basis.

(a)(iii): Rate regulation often leads to deferred cash collection. Significant non-cash effects from regulatory measures should be adjusted or disclosed.

(a)(iv): The note disclosures should explain the regulatory system, including the basis of allowable costs. Information about changes in regulatory assets and liabilities should be given. In particular, maturities are of critical importance, as most of the regulatory differences represent time lag effects in revenue recognition.

(a)(v): The management commentary should only provide information about an entity's rate-regulated activities if no other information disclosures have to be provided in (a) (i-iv).

(b): A rate-regulated entity can only outperform regulatory system targets in the short-term. A regulator is interested in projectable and stable rates for consumers, while investors and lenders are interested in projectable and stable returns. In order to meet these expectations, regulatory deferrals specified by national legislation are to be recognised in separate accounts based on local GAAP. Unless information about these regulatory deferrals is provided in IFRS accounts, however, investors, lenders and rating agencies do not have sufficient information to develop a true and fair view of a company that is subject to rate regulation.

Question 2

Are you familiar with using financial statements that recognise regulatory deferral account balances as regulatory assets or regulatory liabilities, for example, in accordance with US generally accepted accounting principles (GAAP) or other local GAAP or in accordance with IFRS 14? If so, what problems, if any, does the recognition of such balances cause users of financial statements when evaluating investment or lending decisions in rate-regulated entities that recognise such balances compared to:

(a) non-rate-regulated entities; and

(b) rate-regulated entities that do not recognise such balances?

(a): We could not identify any additional problems of recognising regulatory deferral accounts compared with non-rate-regulated entities. On the contrary, we think that *not* recognising regulatory assets/liabilities reduces comparability between regulated and unregulated entities (with dissimilar companies being portrayed alike).

(b): For the comparison of rate-regulated entities that do and do not recognise regulatory assets/liabilities, we refer to our answer to question 1(b): we think that firms that are subject to rate regulation and do not show regulatory deferral accounts in their IFRS accounts are harder for investors to value. If some firms recognise regulatory assets/liabilities while others do not, comparability is at stake again: similar entities will be portrayed differently.

Question 3

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?

Regulation differs in different countries and industries, as well as for different regulatory regimes (they may be based on costs of service, incentives, or both). To start by focusing on a defined type of regulation may raise a number of questions:

- How is a defined type of rate regulation defined?
- What will be included in the definition, and what excluded?
- What will be done about entities not covered by the definition?

Question 4

Paragraph 2.11 notes that the IASB has not received requests for it to develop special accounting requirements for the form of limited or 'market' rate regulation that is used to supplement the inefficient competitive forces in the market (see paragraphs 3.30–3.33).

(a) Do you agree that this type of rate regulation does not create a significantly different economic environment and, therefore, does not require any specific accounting requirements to be developed? If not, why not?

(b) If you agree that this type of rate regulation does not require any specific accounting requirements, do you think that the IASB should, alternatively, consider developing specific disclosure requirements? If so, what would you propose and why?

(a): Yes, we agree.

(b): A description in the notes of the type of regulation would be useful to give a picture of specific characteristics of the particular market.

Question 5

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.

(a): Yes, we are of the opinion that the description of defined rate regulation is sufficient, because the essential features are covered, in particular, the legal regulatory regime, the legitimate enforceability, the precise calculation methods and the adequately detailed estimation of the future cash flows.

(b): No.

(c): No.

Question 6

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?

(a): The currently identified rights and obligations are adequate and we think that all relevant rights and obligations have been considered.

(b): As the variety of regulatory activities and regimes is very large, a future standard on rate regulation should remain principles-based. Accounting guidance on specific combinations of rights and obligations could result in a rules-based standard that might be more relevant for some regulatory regimes than for others.

Question 7

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.

(a): We conclude that a specific IFRS pertaining to revenue adjustment in combination with asset/liability recognition is the proper way to prescribe a method of accounting for the regulatory deferral account, at least in financial statements of an energy sector entity. We base this argument on the reasoning in paragraph 5.73 of the DP: "*(…) the revenue adjustment approach allows users of the financial statements to see, more readily than using the cost deferral approach, the impact of the rate-regulatory adjustment, because it provides greater transparency and comparability with similar entities that are not subject to defined rate regulation. (…) the users of financial statements would see how the rate regulation compensates the entity for the activities that it performs in accordance with the rate regulation. Disclosure requirements could provide additional information (…).*" as well as the reasoning in paragraph 5.75: *"(…) reflecting the reward (or penalty) in the same period in which the performance target is met (or not) provides relevant information about performance of the entity during the period.*"

Austrian regulation in the energy sector is based on adjustment of tariffs, i.e., an adjustment of relevant revenue positions. Hence, the revenue adjustment approach would correctly portray this local regulation. In our opinion, a mixture of the revenue and cost adjustment approach would in this case lead to more complexity, and would therefore not create the most useful view for financial statement users.

(b): In our view, all relevant options are listed.

(c): There are no additional advantages for users, and clear disadvantages, if financial statements omit regulatory assets/liabilities.

The details of asset/liability recognition in Austria resulting from the ex-post revenue regulation in the local energy sector are shown in regulatory deferral accounts. This balance sheet approach is statutorily required by local regulation law. Currently, local legislation provides for the right to recover amounts that have been under-billed and the obligation to refund over-billed amounts via future price modifications. By statute, the regulatory account is not classified as a contingent asset or liability. The economic benefit in the present period has an influence on future cash flows. In our view, therefore, these regulatory accounts are of economic and legal substance.

Taking into account the accrual principle and users' interest in full information, the approach to accounting for regulatory assets and liabilities in the financial statements seems to provide useful information to financial statement users.

Regulatory assets come within the definition of assets in the Conceptual Framework Discussion Paper, where an asset is defined as a 'present economic resource'. However, since – as pointed out in the present DP in paragraph 5.15 – the term 'present' is implicit in the existing definition the definition of assets in the new Conceptual Framework has not changed. Similarly, the emphasis on controlling resources as opposed to the resulting cash flows does not affect our support for the recognition of regulatory assets.

Question 8

Does your organisation carry out activities that are subject to defined rate regulation? If so, what operational issues should the IASB consider if it decides to develop any specific accounting guidance or requirements?

AFRAC carries out no such activities.

Question 9

If, after considering the feedback from this Discussion Paper and the Conceptual Framework project, the IASB decides to prohibit the recognition of regulatory deferral account balances in IFRS financial statements, do you think that the IASB should consider developing specific disclosure-only requirements? If not, why not? If so, please specify what type of information you think would be relevant to investors and lenders in making their investing or lending decisions and why.

Additional disclosures are important to help users understand rate regulation better. However, we think that disclosures without recognition in the statement of financial position do not provide sufficiently useful information to financial statement users. We think that for rate-regulated entities regulatory deferral accounts are a necessary part of financial statements, and are necessary to guarantee comparability with unregulated as well as other regulated entities.

Question 10

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.

(a): Appropriate disclosures should form an integral part of any new standard on rate-regulated activities, as rate regulation systems differ in different countries and industries, and these differences tend to reduce comparability. Disclosures that help to understand these differences are likely to enhance the usefulness of financial reports. Rate regulation systems often include complex mechanisms that require disclosures if they are to be understood. On the other hand, the volume of disclosures must not lead to information overload, which would impair decision-usefulness.

In our view, the current set of disclosures in IFRS 14, particularly the description of the activities that are subject to rate regulation and of the rate-setting process, the information on risks and uncertainties with regards to the future recovery or reversal of regulatory deferral account balances, and the other quantitative disclosure requirements, are of an appropriate extent. Using these disclosures, users of financial statements should be able to gather sufficient information to understand the applied rate regulation as well as the effects on the entity concerned.

(b): In our view, the current IFRS 14 disclosures are appropriate in extent for users of financial statements (see our remarks in the paragraph above). Depending on the actual content of any future standard on rate-regulated activities, this could change, as different or additional disclosures became necessary.

<u>Question 11</u>

IFRS 14 requires any regulatory deferral account balances that have been recognised to be presented separately from the assets and liabilities recognised in the statement of financial position in accordance with other Standards. Similarly, the net movements in regulatory deferral account balances are required to be presented separately from the items of income and expense recognised in the statement(s) of profit or loss and other comprehensive income.

If the IASB develops specific accounting requirements that would apply to both existing IFRS preparers and first-time adopters of IFRS, and those requirements resulted in the recognition of regulatory balances in the statement of financial position, what advantages or disadvantages do you envisage if the separate presentation required by IFRS 14 was to be applied?

Even though presentation of the overall regulatory carrying amount as a single item in the statement of financial position might seem to be more advantageous for users of financial statements, it also leads to a mixed presentation of different classes of assets and deferral accounts, which we do not find useful. In order to give users information on the entire asset base for the purposes of rate regulation, we would recommend disclosure of these carrying amounts in the notes. Such disclosures could help financial statement users to identify the overall effects of rate regulation on an entity.

Question 12

Section 4 describes the distinguishing features of defined rate regulation. This description is intended to provide a common starting point for a more focused discussion about whether this type of rate regulation creates a combination of rights and obligations for which specific accounting guidance or requirements should be developed.

Paragraph 4.73 suggests that the existence of a rate regulator whose role and authority is established in legislation or other formal regulations is an important feature of defined rate regulation. Do you think that this is a necessary condition in order to create enforceable rights or obligations, or do you think that co-operatives or similar entities, which operate under self-imposed rate regulation with the same features as defined rate regulation (see paragraphs 7.6–7.9), should also be included within defined rate regulation? If not, why not? If so, do you think that such co-operatives should be included within the scope of defined rate regulation only if they are subject to formal oversight from a government department or other authorised body?

Entities operating under self-imposed rate regulation should only be included within defined rate regulation where there is formal oversight by a government body.

Question 13

Paragraphs 7.11–7.22 highlight some of the issues that the IASB may consider if it continues to progress this project.

Do you have any comments or suggestions on these or any other issues that may or may not have been raised in this Discussion Paper that you think the IASB should consider if it decides to develop proposals for any specific accounting requirements for rate-regulated activities?

No, we think that the DP covers the main issues to be considered.

Kind regards

Romuald Bertl

Chairman