Project	***Rate-regulated Activities***
Topic	**Comparison of RRA project to current IFRSs**

Purpose of this agenda paper

1. This paper compares the staff's rationale (detailed in Paper 11A of the July 2010 Board meeting) both supporting and not supporting the recognition of regulatory assets and liabilities in financial statements prepared in accordance with IFRSs to current IFRSs and the current *Framework for the Preparation and Presentation of Financial Statements* (Framework).

2. This paper should be read in conjunction with the other agenda papers 11–11H of the July 2010 Board meeting to assist the Board in its deliberations of the *Rate-regulated Activities* project (RRA project).

3. Appendix A to this paper lists all current IFRSs and provides a summary of the rationale within each of the IFRSs separated by the arguments that support versus the arguments that do not support the recognition of regulatory assets and liabilities.

4. Some IFRSs do not address events and transactions similar to regulatory assets and liabilities. If there is no correlation, the staff have included that IFRS for completeness, but noted it as 'N/A'.

5. In the staff's opinion, the primary points supporting each view are as follows:

View 1 – recognition of regulatory assets and liabilities

(a) The entity has effective control over the future economic benefits associated with incremental increase in the rate that will be charged for the sale of goods and services in the future period. This control is a result of the concept of an ‘aggregate customer base’, regulations that create a restraint of trade by other entities and the essential nature of the goods and services. (IAS 38)

(b) The entity has provided the goods and services in the current period and should recognise the full amount of the revenue to be collected as a result of the current period transactions. The amount of revenue to be collected is determined by the regulations that provide for the recovery similar to a ‘cost plus contract’ when reviewed at the aggregate customer base level. (IAS 11)

View 2 – disclosure only (ie no recognition of regulatory assets and liabilities)

(c) There is no contract between the entity and the individual customer that gives the entity the ability to force the customer to provide reimbursement of current period costs in excess of the anticipated costs used to determine the current rate. (IFRS 4, IAS 11, IAS 17, IAS 18, IAS 32, IAS 39)

(d) The ability of the entity to obtain future economic benefits is dependent (ie contingent) on future events that involve the delivery of goods and services in a future period. That future period sale should be recognised in the future period. (IAS 37)

Appendix A – Comparison of RRA project to current IFRSs

Title	Supportive of RRA recognition	Not supportive of RRA recognition
Framework for the Preparation and Presentation of Financial Statements	• ‘Control’ of future economic benefits is viewed at the aggregate customer base with a presumption that the aggregate customers will purchase goods and services in a future period due to nature of those goods and services and the delimited jurisdiction that has the effect of creating a captive customer base. (Framework.49)	• ‘Control’ does not exist as the entity cannot force any customers (individually or in aggregate) to reimburse the entity for excess costs incurred in the current period. • Rates charged for the delivery of future goods and services is a transaction that should be recognised in the future period. (Framework.49)
IFRS 3 *Business Combinations*	• Recognition of customer lists, favourable/ unfavourable variances on construction contracts, etc.; however, only upon a business combination and then all items are recognised (and generally measured at fair value).	• In the absence of a business transaction whereby all assets and liabilities are recognised and the fair value of the entire entity is remeasured, no other assets or liabilities are recognised unless appropriate by another IFRS.
IFRS 4 *Insurance Contracts*	•	• Recognition is based on a contractual obligation.
IFRS 6 *Exploration for and Evaluation of Mineral Resources*	• Expenditures incurred when an entity has legal rights to explore are capitalised.	• No specific customer contract may be recognised as exploration and evaluation assets.
IFRS 9 *Financial Instruments*	• The International Swaps and Derivatives Association (ISDA) Master Agreement is an overarching set of terms (an agreement) used extensively in the derivatives market; these terms are referenced/ to permit consistency of transactions and could be viewed similarly to the overarching regulations/ statues between the entity and the regulator.	• Financial instruments require a contract between two (or more) specified parties in order to meet the definitions in IAS 32 and referenced for all financial instrument standards.

IAS 2 *Inventories*	• IAS 2 requires that 'when inventories are sold, the carrying amount of those inventories shall be recognised as an expense in the period in which the related revenue is recognised' implying a concept of 'matching' (which is not formally stated anywhere in IFRSs) the expenses with the related revenues.	• The use of an IAS 2 rationale presupposes that costs incurred in a prior period should be recognised as assets in that prior period and not expensed as incurred. The concept of an RRA asset is that excess expenses have been incurred (above original expectations) in providing the current period goods and services for which revenue was recognised.
IAS 10 *Events after the Reporting Period*	• Subsequent billing of previously incurred costs in accordance with regulation could be viewed as an 'adjusting event after the reporting period'. It provides evidence that the aggregate customer group act after the reporting period in a way that supports recognition of regulatory assets and regulatory liabilities at the reporting date.	• Subsequent billing of previously incurred costs in accordance with regulation could be viewed as a 'non-adjusting event after the reporting period'. It provides evidence that a subsequent event, (future sales to the aggregate customer group) are required after the reporting period and the rate charged in that future period should be recognised in that future period.
IAS 11 *Construction Contracts*	• '…contracts with the customers together with the cost-of-service regulation have, in substance, economic effects similar to cost plus contracts directly negotiated with customers in a non-regulated environment. In the case of regulated entities, the regulator acts on behalf of the customers as a group to identify which costs are allowable.' (RRA ED.BC36)	• IAS 11 requires a contract between two (or more) specified parties to determine the rights and obligations of each specified party. • The absence of a contract with any of the customers results in the absence of the entity's ability to force any of the customers to pay in a future period for the excess costs incurred in the current period.
IAS 12 *Income Taxes*	• Inherent in the recognition of a deferred tax asset is that its carrying amount will be recovered in the form of probable economic benefits that flow to the entity in future periods consistent with rationale proposed for the recognition of regulatory assets.	•

IAS 16 *Property, Plant and Equipment*	• Recognition of an IAS 16 asset focuses on whether it is 'probable that future economic benefits associated with the item will flow to the entity' as a result of the entity purposefully incurring costs in the current period for the creation of another asset for use in its business.	• The use of an IAS 16 rationale presupposes that costs incurred in a prior period should be recognised as assets in that prior period and not expensed as incurred. The concept of an RRA asset is that excess expenses have been incurred (above original expectations) in providing the current period goods and services for which revenue was recognised. • Any assets that should be recognised are created by the provision of goods and services to customers in the current period, rather than by the (excess) costs incurred to provide the goods and services in that current period. • Returns to equity holders are not 'amount that would otherwise be recognised in that period in the statement of comprehensive income as an expense (revenue).' (RRA ED.10 and .16)
IAS 17 *Leases*	•	• Recognition as a finance or operating lease depends on whether a lease 'transfers substantially all the risks and rewards'. In RRA, risks and rewards are not transferred between the rate-regulated entity and the customer until the occurrence of a contingent event (the individual customer taking delivery of a future service that includes a contract to pay for previously incurred costs).
IAS 18 *Revenue*	• The regulatory relationship between and environment of the entity and the aggregate customers supports that it is probable that any 'billing adjustments' in future periods will result in the recovery of all excess costs incurred in the current period. • 'In other respects, regulatory liabilities resemble obligations to perform future services recognised in accordance with IAS 18'. (RRA ED.BC43)	• The conditions for revenue recognition related to the increased rates that provide for recovery of the excess costs incurred in the current period are not satisfied until the customer has taken delivery of the future goods and services. • There is no contract that requires a current period customer to purchase goods and services in a future period or even to provide for the recovery of current period expenses incurred in excess of current period rates.

IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*	• RRA assets are similar to government grants because of the regulatory relationship in that they 'transfer resources to an entity in return for past or future compliance with certain conditions' and the 'reasonable assurance that the entity will comply' with the terms of the regulator.	• Government grants are provided directly by a specified party (the government) and the grant is subject to the contract between the two specified parties. However, in RRA, the government does not provide the future economic benefits (ie cash inflows or other resources). • The entity's compliance with the requirements of the government grant does not ensure recovery of the future economic benefits. Instead it is only if customers purchase goods or services in future periods that the entity will receive the future economic benefits (which should be recognised in that future period).
IAS 23 *Borrowing Costs*	•	• Regulatory assets and liabilities are not 'directly attributable to the acquisition, construction or production' of other assets of the regulated entity. • Returns to equity holders are not 'amount that would otherwise be recognised in that period in the statement of comprehensive income as an expense (revenue).' (RRA ED.10 and .16)
IAS 32 *Financial Instruments: Presentation*	•	• Regulatory assets and liabilities do not meet the definition of financial instruments because there is no contract between two (or more) specified parties. (IAS 39.8 and IAS 32.11)
IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*	•	• The regulatory relationship does not create 'a legal or constructive obligation' that results in the entity recognising regulatory liabilities. Specifically the entity does not have an obligation to perform in subsequent reporting periods (unless the customer purchases goods and services in a future period and that transaction should then be recognised in that future period).

IAS 38 *Intangible Assets*	• Regulatory assets are identifiable and controlled through the regulatory relationship that restrains the free trade of potential competitors. (IAS 38.14) • Separately acquired intangible assets are recognised even though an entity may not have the power to force its existing customers to do business with the entity. RRA assets are similar to established customer relationships.	• Regulatory assets are monetary in nature and consequently do not meet the definition of an intangible asset (an 'identifiable non-monetary asset without physical substance'). • The regulatory relationship does not enable the entity to control the future economic benefits.
IAS 39 *Financial Instruments: Recognition and Measurement*	•	• Regulatory assets and liabilities do not meet the definition of financial instruments because there is no contract between two (or more) specified parties. (IAS 39.8 and IAS 32.11) • 'The entity does not have the right to request reimbursement from, or the obligation to make payments to, individual customers for fixed or determinable amounts.' (RRA ED.BC43)
IFRIC 6 *Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment*	•	• The 'liability for waste management costs for historical household equipment does not arise as the products are manufactured or sold'. The obligation for historical household equipment is linked to participation in the market during the measurement period'. This indicates that the obligating event for RRA liabilities relates to the provision of future services. (IFRIC 6.9)
IFRIC 12 *Service Concession Arrangements*	• RRA is similar to when 'the operator recognises as an intangible asset the right it receives (a licence) to charge users of the public service, even though the amount to be received under the licence is contingent on the public's use of the service.' (RRA ED.BC21)	• IFRIC 12 addresses only the day-one effects of entering into a service concession arrangement. • 'The operator shall account for revenue and costs relating to operation services in accordance with IAS 18.' (IFRIC 12.20)

IFRIC 18 *Transfers of Assets from Customers*	•	• 'An entity that controls an asset can generally deal with that asset as it pleases.' (IFRIC 18.10) In RRA, the entity must deliver goods or services in a future period in able to obtain the right to charge for the goods and services delivered in the current period plus the additional amount included in the current period rate intended to recover excess costs incurred in a prior period.
IFRS 1 *First-time Adoption of International Financial Reporting Standards*	N/A	N/A
IFRS 2 *Share-based Payment*	N/A	N/A
IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*	N/A	N/A
IFRS 7 *Financial Instruments: Disclosures*	N/A	N/A
IFRS 8 *Operating Segments*	N/A	N/A
IAS 1 *Presentation of Financial Statements*	N/A	N/A
IAS 7 *Statement of Cash Flows*	N/A	N/A
IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*	N/A	N/A
IAS 19 *Employee Benefits*	N/A	N/A
IAS 21 *The Effects of Changes in Foreign Exchange Rates*	N/A	N/A
IAS 24 *Related Party Disclosures*	N/A	N/A
IAS 26 *Accounting and Reporting by Retirement Benefit Plans*	N/A	N/A
IAS 27 *Consolidated and Separate Financial Statements*	N/A	N/A
IAS 28 *Investments in Associates*	N/A	N/A
IAS 29 *Financial Reporting in Hyperinflationary Economies*	N/A	N/A

IAS 31 *Interests in Joint Ventures*	N/A	N/A
IAS 33 *Earnings Per Share*	N/A	N/A
IAS 34 *Interim Financial Reporting*	N/A	N/A
IAS 36 *Impairment of Assets*	N/A	N/A
IAS 40 *Investment Property*	N/A	N/A
IAS 41 *Agriculture*	N/A	N/A
IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities*	N/A	N/A
IFRIC 2 *Members' Share in Co-operative Entities and Similar Instruments*	N/A	N/A
IFRIC 4 *Determining whether an Arrangement contains a Lease*	N/A	N/A
IFRIC 5 *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds*	N/A	N/A
IFRIC 7 *Applying the Restatement Approach under IAS 29* Financial Reporting in Hyperinflationary Economies	N/A	N/A
IFRIC 9 *Reassessment of Embedded Derivatives*	N/A	N/A
IFRIC 10 *Interim Financial Reporting and Impairment*	N/A	N/A
IFRIC 13 *Customer Loyalty Programmes*	N/A	N/A
IFRIC 14 *IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*	N/A	N/A
IFRIC 15 *Agreements for the Construction of Real Estate*	N/A	N/A
IFRIC 16 *Hedges of a Net Investment in a Foreign Operation*	N/A	N/A

IFRIC 17 *Distributions of Non-cash Assets to Owners*	N/A	N/A
IFRIC 19 *Extinguishing Financial Liabilities with Equity Instruments*	N/A	N/A
SIC 7 *Introduction of the Euro*	N/A	N/A
SIC 10 *Government Assistance – No Specific Relation to Operating Activities*	N/A	N/A
SIC 12 *Consolidation – Special Purpose Entities*	N/A	N/A
SIC 13 *Jointly Controlled Entities – Non-Monetary Contributions by Venturers*	N/A	N/A
SIC 15 *Operating Leases – Incentives*	N/A	N/A
SIC 21 *Income Taxes – Recovery of Revalued Non-Depreciable Assets*	N/A	N/A
SIC 25 *Income Taxes – Changes in the Tax Status of an Entity or its Shareholders*	N/A	N/A
SIC 27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*	N/A	N/A
SIC 29 *Service Concession Arrangements: Disclosures*	N/A	N/A
SIC 31 *Revenue – Barter Transactions Involving Advertising Services*	N/A	N/A
SIC 32 *Intangible Assets – Web Site Costs*	N/A	N/A