Project	***Rate-regulated Activities***
Topic	**Comparison of RRA project to other current IASB projects**

Purpose of this agenda paper

1. This paper compares the rationale proposed by the Board in the exposure draft *Rate-regulated Activities* (RRA ED) for recognition of regulatory assets and liabilities in financial statements prepared in accordance with IFRSs to other current IASB projects.
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* (RRA) project.
3. The staff met the respective project teams for all current IASB projects to discuss the rationale surrounding each of those projects and their similarities (or differences) to the RRA project.
4. Appendix A to this paper lists all current IASB projects and provides a summary of the rationale both supporting and not supporting the recognition of regulatory assets and liabilities.
5. Some active projects do not address events and transactions similar to regulatory assets and liabilities. If there is no correlation, the staff have included that active project for completeness, but noted it as ‘N/A’.
6. In the staff’s opinion, the primary points supporting each view are as follows:

This paper has been prepared by the technical staff of the IFRS Foundation for discussion at a public meeting of the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IASB.

Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination.

The tentative decisions made by the IASB at its public meetings are reported in IASB *Update*. Official pronouncements of the IASB, including Discussion Papers, Exposure Drafts, IFRSs and Interpretations are published only after it has completed its full due process, including appropriate public consultation and formal voting procedures.

View 1 – recognition of regulatory assets and liabilities

(a) The entity should recognise probable future economic benefits that will be realised if contingent actions events are satisfied. (*Leases, Insurance*)

(b) The entity should defer current period costs for which it is determined that the costs will be recovered in a future period. (*Extractive Activities*)

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. (*Insurance*, *Financial Instruments*, *Revenue Recognition*, *Liabilities*)

(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. (*Liabilities*, *Emission Trading Schemes*)

Appendix A – Comparison of RRA project to other current IASB projects

Title	Supportive of RRA recognition	Not supportive of RRA recognition
Consolidation – Replacement of IAS 27	•	•
Derecognition – Disclosures	•	• Several alternatives have been considered by the Board to most accurately reflect the economics of derecognition events/ transactions; to date, the Board has decided that the current IAS 39 derecognition requirements should continue to be applied and comprehensive disclosures will best satisfy the needs of the primary users of general purpose financial statements.
FI – Classification and measurement – financial liabilities	•	• Financial instruments require a contract between two (or more) specified parties and the recognition of RRA assets and liabilities does not have a contract as defined by IAS 32.13 where both parties have little discretion to avoid.
FI – Impairment	• While the impairment project requires the determination of expected losses at acquisition of the financial asset, the expected loss model (similar to the impaired loss model) can be applied at the portfolio (ie aggregate) level; However, a portfolio level assessment is mainly about using a broader basis to better determine statistical loss parameters rather than a different unit of account intended to have different consequences. In any case, the estimate relates to the subsequent measurement of a contractually based asset that already has been recognised (not the recognition of the asset).	• A determination of the expected credit losses on a financial asset is required when an asset is first obtained. • Impairment testing requires a review of the contractual terms of the financial asset (which by definition must include a contract between two or more specified parties).

Income taxes	• Income taxes require the recognition of all taxable temporary differences between general purpose financial statement reporting (ie IFRSs) and the requirements of the tax regulator by using the balance sheet approach.	• Generally speaking, income taxes apply to all entities regardless of the type of business activities/ operations and is not activity or industry specific. • Deferred tax accounting has often been criticized for its appropriateness in general purpose financial statement reporting.
Leases	• Ability to recognise an uncertain future economic benefit that might be realised if contingent actions/ events are satisfied (ie contingent rental income and lease renewals at the option of the lessee). • Review of all legal rights when considering the lease agreement (could be viewed similar to a review of the historical precedent of recovery of costs incurred in RRA that are not mandated by regulations and not provided for by a contract, as defined in IAS 32).	• Lease accounting involves a contract between two (or potentially more) individual parties that are specifically known (contradictory to the concept of an ‘aggregate customer base’ for RRA). • There are known future cash flows (and potentially contingent cash flows as well) from specific a counterparty. • The leases project is incorporating the guidance in IFRIC 4 that needs to be specific identification of the different parties/ items in the transaction in order to call the transaction a lease.
Revenue recognition	•	• The revenue recognition model focuses on the recognition of assets and liabilities arising directly from contracts (as defined in IAS 32) with customers. Accordingly, because there is no contract with a customer, RRA assets and liabilities would not be recognised in accordance with the revenue recognition model. • The ability to charge a variance (that results from excess costs to provide a current period good or service) in a future period is simply the lifting of a previous price ceiling that is mandated by the regulator and the increased price that will be charged in a future period should be recognised in that future period that future goods and services are provided. That is, costs incurred in fulfilling a contract are not eligible for capitalisation in the revenue recognition project unless the costs (1) directly relate to a contract, (2) generate or enhance resources that will be used in satisfying performance obligations in the future, and (3) the costs are expected to be recovered.

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<td>Emissions Trading Schemes (ETS)
• Early in project timeline
• No definitive decisions taken to date.
• Cap and trade schemes are widely used. The staff have initially focused on these schemes.
• Baseline and credit schemes are still being considered. The issue is whether and when assets and liabilities should be recognised. (Similar to the cap and trade, with some difference in the analysis due to differences in the schemes.)</td>
<td>• The Board has tentatively decided that all emission allowances in a cap and trade scheme, including those allocated for no monetary consideration by the scheme administrator (the government in a statutory scheme) should be recognised as assets.
• Statutory schemes have no individual contracts; the scheme is a law that is enforced by the government.
•</td>
<td>• Allowances in a cap and trade scheme are freely tradable and there’s often an active market where the allowances can be sold for cash. Regulatory assets are rarely sold/ factored and there is no active market for regulatory assets or liabilities.
• Allowances may be received from the scheme administrator (the government, in the case of statutory schemes) before the entity performs it’s normal business activities whereas a regulatory asset or liability captures variances on the statement of comprehensive income after the entity has performed it’s normal business activities.
• The most controversial issue in the ETS project is whether and when a liability arises. In particular is there a liability at the time an entity receives allowances (assets) from the scheme administrator (for no monetary consideration)? This issue is particularly challenging, because there is no formal contract that defines the entity’s rights and obligations of the entity, but rather the imposition of a law or statute. If the ETS project is determined to be similar to the RRA project, then if the ETS project determines a liability does exist, it would appear reasonable that a liability would exist for the RRA project (resulting in both sides of the journal entry ‘grossing up’ the statement of financial position and no impact being recognised in the statement of comprehensive income).</td>
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Extractive activities • This project is early in its life and currently has a discussion paper published for comment; therefore, this information is based on 'staff views' included in the discussion paper.	• The initial focus for accounting for minerals or oil and gas properties should be the legal rights to that property. These rights could be exploration rights or extraction rights. The property is recognised as an asset when these legal rights are acquired. • Information obtained from exploration and evaluation activities, and the development work that is undertaken to access the minerals or oil and gas deposit, are both enhancements to the property, and should be accounted for as additions to the minerals or oil and gas property recognised.	•
Insurance contracts	• Incorporation into the measurement of an insurance contract of the anticipated future economic benefit of contingent future contract renewals.	• To be within the scope of the insurance contracts project, there must be a contract between two (or more) specified parties. • An existing insurance contract ends when the insurer is able to reprice or renegotiate a price or is able to terminate a contract. • Discretionary payments (participating features) are included in the measurement of insurance contracts as incremental cash flows arising from the insurance contract

Liabilities (IAS 37 amendments)	• The liabilities project staff has noted that the issues in the RRA project are similar to those in the emissions trading scheme project. In both cases, the entity has received assets in the past, as a result of which it is likely to incur outflows, or receive lower inflows, in the future. In the ETS project, the IASB has questioned whether the entity has a present obligation; however, ETS is the accounting for a newly received credit before the entity performs its normal business activities whereas in RRA the accounting is capturing the unanticipated variances after the entity has performed its normal business activities.	• The liabilities project team thinks that there are two reasons why an entity might not recognise a regulatory liability applying the proposed IFRS that will replace IAS 37 (or the requirements in current IAS 37): o IAS 37 clarifies that a 'present' obligation exists independently of the entity's future actions. o IAS 37 does not identify as liabilities any situations that would involve reductions in future inflows. The Framework, and IAS 37, define a liability as a present obligation that 'is expected to result in an outflow from the entity of resources embodying economic benefits'. • In the liabilities project staff opinion, the receipt of an ETS credit results in the reduction of the intrinsic value (goodwill or other assets such as a license to operate) of the entity. If this reduction were recognised, there would be no need to recognise the credit as either a liability or a gain in the statement of comprehensive income. • With a customer refund obligation in a non-regulated entity, there is a specific counterparty; in the RRA project there is no obligation to 'pay it back' unless/ until the entity sells goods or services in a future period. • The liabilities project (and current IAS 37) do not permit the recognition of a liability in instances where a contract is earning a lower profit margin than desired by management; a liability is recognised only a specific contract is determined to be 'onerous'. • IFRIC 6 provides similar guidance to IAS 37 in that an obligation for historical household equipment waste is linked to participation in the market during the measurement, rather than to production or sale of the items to be disposed of; there is no obligation unless and until a market share exists during the measurement period.

Conceptual Framework – Phase A: Objectives and qualitative characteristics	• 'Accrual accounting depicts the effects of transactions and other events and circumstances on a reporting entity's economic resources and claims in the periods in which those effects occur, even if the resulting cash receipts and payments occur in a different period' (OB17) supports the view that regulatory assets and regulatory liabilities represent deemed unbilled accounts receivable/ payable at the aggregate customer base level. • 'Decisions by existing and potential investors about buying, selling or holding an equity or debt instrument depend on the returns that they expect from an investment in those instruments, for example dividends, principal and interest payments or market price increases. Similarly, decisions by existing and potential creditors about providing or settling loans or other forms of credit depend on the principal and interest payments or other returns that they expect. Investors' and creditors' expectations about returns depend on their assessment of the amount, timing, and uncertainty of (the prospects for) future net cash inflows to the entity. Consequently, existing and potential investors and creditors need information to help them assess the prospects for future net cash inflows to an entity'(OB3).	• 'Accrual accounting depicts the effects of transactions and other events and circumstances on a reporting entity's economic resources and claims in the periods in which those effects occur, even if the resulting cash receipts and payments occur in a different period' (OB17) supports the view that current period transactions should be recognised in the current period statement of financial position and increases/ decreases in future period rates should be reflected in the financial statements in the future period that those transactions occur. • 'General purpose financial reports are not designed to show the value of a reporting entity; but are likely to help existing and potential equity investors, lenders and other creditors who wish to estimate the value of the reporting entity' (OB7) • 'Other parties, such as regulators and members of the public other than investors and creditors, may also find general purpose financial reports useful. However, those reports are not primarily directed to these other groups' (OB10). • 'The Board acknowledged that the interests of investors, lenders and other creditors often overlap with those of regulators. However expanding the objective of financial reporting to include maintaining financial stability could at times create conflicts between the objectives that the Board is not well-equipped to resolve. For example, some may view that the best way to maintain financial stability is to require entities not to report or to delay reporting some changes in asset or liability values. That requirement would almost certainly result in depriving investors, lenders and other creditors of information that they need. The only way to avoid conflicts would be to eliminate or de-emphasise the existing objective of providing information to investors, lenders and other creditors. The Board concluded that eliminating that objective would be inconsistent with its basic mission, which is to serve the information needs of participants in capital markets. The Board also noted that providing relevant and faithfully-represented financial information can improve users' confidence in the information, and thus contribute to promoting financial stability' (BC1.19).

Conceptual Framework – Phase B: Elements and recognition	• Undetermined as project is in early stages of analysis by staff.	• Undetermined as project is in early stages of analysis by staff.
Consolidation – Disclosures about unconsolidated SPEs/ structured entities	N/A	N/A
Consolidation – Investment companies	N/A	N/A
FVM – Guidance	N/A	N/A
FVM – Measurement uncertainty analysis disclosure for fair value	N/A	N/A
FI – Hedging	N/A	N/A
FI – Asset and liability offsetting	N/A	N/A
FSP – Discontinued operations	N/A	N/A
FSP – Presentation of items of other comprehensive income	N/A	N/A
FSP – Replacement of IAS 1 and IAS 7	N/A	N/A
FI with characteristics of equity	N/A	N/A
Joint ventures	N/A	N/A
PEB – Defined benefit plans	N/A	N/A
PEB – Termination benefits	N/A	N/A
Annual improvements – 2009-2011	N/A	N/A

Management commentary	N/A	N/A
Rate-regulated activities	This project	This project
Conceptual Framework – Phase C: Measurement	N/A	N/A
Conceptual Framework – Phase D: Reporting entity	N/A	N/A