



## **Rate-regulated Activities**

### **September 2009**

**COMMENTS TO THE IASB AND THE AcSB  
MUST BE RECEIVED BY  
NOVEMBER 20, 2009**

This Exposure Draft of proposed International Financial Reporting Standards reflects proposals made by the IASB that the AcSB intends to adopt as Canadian generally accepted accounting principles.

Individuals and organizations are invited to send written comments on the Exposure Draft proposals. Comments are requested from those who agree with the Exposure Draft as well as from those who do not.

Comments are most helpful if they are related to a specific paragraph or group of paragraphs, and, when expressing disagreement with the Exposure Draft, they clearly explain the problem, and include a suggested alternative supported by specific reasoning. All comments received will be available on the website at [www.acsbcanda.org](http://www.acsbcanda.org) 10 days after the comment deadline, unless confidentiality is requested.

**To be considered, comments to the AcSB must be received by November 20, 2009, addressed to:**

**Peter Martin, CA  
Director, Accounting Standards  
Accounting Standards Board  
277 Wellington Street West  
Toronto, Ontario M5V 3H2**

**For ease of handling, we prefer comments to be sent by e-mail (in Word format) to:**  
[ed.accounting@cica.ca](mailto:ed.accounting@cica.ca)

## Highlights

The Accounting Standards Board (AcSB) proposes, subject to comments received following exposure, to incorporate into Canadian GAAP the standard on rate-regulated activities that results from the Exposure Draft recently issued by the International Accounting Standards Board (IASB). This standard is expected to form part of the International Financial Reporting Standards (IFRSs) to be adopted by publicly accountable enterprises.

### Background

Currently, IFRSs do not provide specific guidance on the recognition and measurement of assets and liabilities arising from rate regulation. The IASB recently issued for comment a proposed standard intended to establish such guidance, and to require disclosures explaining the nature and financial effects of rate regulation.

### IASB Exposure Draft

The IASB's Exposure Draft, "[Rate-regulated Activities](#)" (the ED) is available at [www.iasb.org](http://www.iasb.org).

### Main features of the proposals and implications for Canada

Similar to IFRSs, Canadian GAAP does not currently include a comprehensive standard on accounting for rate-regulated activities. However, several Sections in the CICA Handbook – Accounting address the application of their requirements to such activities. These Sections permit or require the recognition of regulatory assets and regulatory liabilities, as defined in the ED, when certain criteria are met, and produce the same results in each area as would be obtained by applying US Statement of Financial Accounting Standards No. 71, *Accounting for the Effects of Certain Types of Regulation*. When dealing with issues outside these Sections, Canadian entities with regulated operating activities have often analogized from the requirements of these Sections or looked to FINANCIAL STATEMENT CONCEPTS, Section 1000, or US GAAP for guidance. The proposed standard would make this unnecessary by establishing a core principle for the recognition, measurement and disclosure of regulatory assets and regulatory liabilities that would apply in all circumstances for operations meeting the scope criteria.

#### *Scope*

The proposed standard would apply to regulated operating activities when:

- a regulator is empowered to set binding rates; and
- the entity is subject to a cost-of-service form of regulation.

The ED describes cost-of-service regulation and provides indicators of its existence.

#### *Recognition*

In accordance with the proposed standard, an entity with operations meeting the scope criteria would recognize regulatory assets and regulatory liabilities when it has the right to increase, or the obligation to decrease, rates in future periods as a result of a regulator's actions. No additional recognition criteria are proposed. The ED makes clear that an entity would first apply all other IFRSs, and then the proposed standard. As a result, any regulatory assets and regulatory liabilities recognized would be in addition to the assets and liabilities recognized in accordance with other IFRSs.

Currently, in accordance with Canadian GAAP, an entity is permitted or required to recognize a regulatory asset or regulatory liability when it has operating activities meeting the Handbook definition of rate-regulated operations. This definition includes essentially the two scope criteria proposed in the ED and an additional requirement that it must be reasonable to assume that rates intended to recover costs can be charged to and recovered from customers. When developing the proposed standard, the IASB decided against adding a scope criterion based on the degree of assurance that the economic benefit associated with a regulatory item will flow to or from the entity. Instead, the IASB proposes that the probability of this economic benefit being realized be factored into the measurement of the regulatory asset or regulatory liability.

In the absence of an IFRS specifically addressing their circumstances, Canadian entities with regulated operating activities have been unsure whether particular items they have previously recognized as assets and liabilities in accordance with Canadian GAAP will qualify for recognition in accordance with IFRSs. The effect of the proposed standard is that in many cases such items will qualify, provided an entity's regulated operating activities meet the proposed scope criteria. A key factor is whether the entity is subject to a cost-of-service form of regulation. When responding to Question 1 in the Invitation to Comment in the IASB's ED, Canadian entities are encouraged to pay particular attention to the indicators of cost-of-service regulation included in Appendix B.

#### *Measurement*

The ED proposes that regulatory assets and regulatory liabilities be measured at their expected present value on initial recognition and at the end of each subsequent reporting period. The proposed standard sets out the components of an expected present value measurement, including the interest rates used to discount estimated cash flows. It also requires an entity to 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 for rate-making purposes.

Currently, Canadian GAAP does not provide explicit guidance on the measurement of regulatory assets and regulatory liabilities. Typically, Canadian entities have recognized the entire regulatory amount initially as if it were certain, and amortized or depreciated it over the period specified by the regulator for rate-making purposes. Measuring regulatory assets and regulatory liabilities at the estimated probability-weighted average of the present value of expected cash flows would be a significant change in practice.

#### *Testing for impairment*

The ED states that rates set at levels accommodating the recovery of a variety of specific costs may affect the demand for an entity's goods or services. Therefore, the proposed standard would require an entity to consider the recoverability of its regulatory assets in total. When it is not reasonable to assume that sufficient revenues can be collected from customers to recover costs, the entity would test the cash-generating unit that includes the regulatory assets and regulatory liabilities for impairment in accordance with IAS 36 *Impairment of Assets*.

Currently, Canadian GAAP does not provide specific guidance on assessing the recoverability of regulatory assets.

### *Disclosures*

The ED proposes a number of disclosure requirements intended to provide users of an entity's financial statements with information about the nature of rate regulation and its financial effects, including the amounts of regulatory assets and regulatory liabilities that have been recognized.

Canadian entities applying Accounting Guideline AcG-19, Disclosures by Entities Subject to Rate Regulation, are providing most of the disclosure required by the proposed standard. However, the proposed standard would introduce a requirement to present this information in tabular format (unless another format is more appropriate) in order to make it more useful for users of an entity's financial statements.

### *First-time adoption*

The ED proposes amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards* that incorporate proposals from the IASB's September 2008 Exposure Draft, "Additional Exemptions for First-time Adopters: Proposed Amendments to IFRS 1." Many Canadian entities with regulated operating activities provided comments to the IASB on that Exposure Draft. In accordance with the proposed amendments, a first-time adopter could elect to use the carrying amount of an item at the date of transition to IFRSs as deemed cost, when it includes amounts in accordance with previous GAAP that would be recognized separately as regulatory assets in accordance with the proposed standard.

### **Timing of adoption**

The IASB will determine the effective date of the proposed standard after exposure. The IASB currently expects to issue the standard in final form some time in 2010, and proposes to permit early adoption. As proposed by the IASB, the standard would apply to regulatory assets and regulatory liabilities that exist at the beginning of the earliest comparative period presented when an entity applies the standard. Any adjustments required as a result of applying the standard would be reflected in the opening balance of retained earnings of that comparative period.

### **Comments requested**

The AcSB encourages Canadian stakeholders to respond to the IASB on its ED. The Invitation to Comment in the ED lists specific questions on which the IASB would like input. The AcSB requests that comment letters be sent directly to the IASB with a copy to the AcSB.

The AcSB has identified additional questions regarding the proposed standard on which it would like input from Canadian respondents.

1. The proposed standard has been developed by the IASB for application by entities around the world. Assuming the ED proposals are approved by the IASB, do you believe that there are aspects of the proposed standard that make some or all of it inappropriate for Canadian entities, even though it is appropriate for entities in the rest of the world? If so, please specify which aspects and what circumstances make the accounting requirements proposed in the ED inappropriate for Canadian entities.
2. The AcSB has determined that it will generally not issue application or interpretative guidance on IASB standards. An exception might be when an aspect of a standard needs interpreting in light of specific Canadian legal, tax,

regulatory or other circumstances that do not apply in other countries and, therefore, will not be addressed by the IASB. Do the proposals in the ED require such application or interpretative guidance? If so, please specify the issue giving rise to the need for additional material, the reasons additional guidance is required and the nature of that guidance.

Responses to these additional questions should be sent directly to the AcSB.

The deadline for commenting to the IASB on its ED is November 20, 2009. Responses to the AcSB on the additional questions set out above are due on the same date.