



December 22, 2014

European Financial Reporting Advisory Group

To the attention of Isabel Batista, Sapna Heeralall and Giorgio Acunzo
35 Square de Meeûs
1000 Brussels
Belgium

Re: DP/2014/2 Reporting the Financial Effects of Rate Regulation

Dear Isabel, Sapna and Giorgio

IBERDROLA is pleased to submit its comments concerning the EFRAG draft Comment Letter on International Accounting Standards Board's *Discussion Paper DP/2014/2 Reporting the Financial Effects of Rate Regulation Activities*.

IBERDROLA, a corporation organized under the laws of the kingdom of Spain, is the Spain's largest energy group, one of the five largest European electricity companies by market capitalization and the world leader in operating wind energy. IBERDROLA is an international energy services with regulated activities of power and gas in Spain, United Kingdom, Brazil, and United States of America in addition to being one of the leading operators in the UK, one of the largest producers of wind energy in the USA, the main private generator of Mexico and with a consolidated position as supplier of electricity in Brazil.

We sincerely appreciate the time and consideration the EFRAG has taken in developing the draft Comment Letter on the discussion paper referred to above issued on October 27th 2014.

This comment letter is the view of IBERDROLA and focus only on a limited number of elements of the EFRAG letter. IBERDROLA will also reply directly to the IASB on the discussion paper.

Overall Comments

We broadly support the EFRAG comments to the questions in the DP but before addressing the specific comments on the draft letter prepared by EFRAG, we have some overall comments.

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We agree with the support given to the IASB's to initiate a debate on accounting for rate-regulated activities and also that this can only be a first stage of the project.

As a general idea we firmly believe rate regulation create enforceable rights and obligations that should be shown in the primary financial statements and that the practice of not recognizing these rights and obligations produce information which is not useful for users as well as hides the performance of entities with rate regulated activities and the underlying economics of this activities.

For us the main points are:

- Although there may be various features that help the identification of rate regulation from our point of view the key one is that it creates enforceable rights and obligations;
- Guidance should be principle based and wide enough so that different regulatory regimes may apply it ;
- Guidance should maintain consistency with other IFRSs;
- Guidance does not necessarily mean the issuance of an activity specific standard, we presume that rate regulated activities could fit in current standards, although some clarification might be needed to fit rate- regulation activities within IFRS 15 for example. At the same time it should not be forgotten that there are interactions with other standards and interpretations (e.g. IFRIC 12) that should be taken in consideration.
- We support a revenue recognition model.

In case you need any clarification on our comments, please don't hesitate to contact us.

Yours faithfully.

On behalf of IBERDROLA

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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?

Question 1(a)

Paragraph 6 to 12.

We answer as preparers of financial information therefore our view is limited to what the user want us to include in our financial statements but we think that including the financial effects of rate-regulated activities in the financial statements would help users understand how rate regulation affects an entity's financial position and return on assets generated by rate-regulated activities, and consequently the performance of the entity.

This will help alignment of the information used by management with that provided to users, which, usually, is not only IFRS financial statements, because rate-regulated activities are economically different from commercial activities and these differences are not reflected in the IFRS financial statements.

In general terms, rate regulation has impact in both the statement of financial position, through the deferral accounts, the income statement and other comprehensive income and the statement of cash flows. We think it is important than the notes explain what effects the regulation has had on these statements, and changes from previous periods.

The management commentary could be used by the entity to explain regulatory risks and to assess how reliable the rate regulation is, and changes in regulation.

We agree that there will be a need of both a qualitative and a quantitative description of the different regulatory frameworks in which the entity operates, sometimes by jurisdiction others it may be possible to aggregate various jurisdictions if similar.

What we think it is important to consider is that the financial statements and the notes are not the place to include the regulation. Regulation is usually available through other sources, e.g. the regulator or the entities website. Entities can provide the main



characteristics of that regulation and the fundamental rate setting mechanisms but not reproduce information that is already public by other means.

Paragraphs 13 to 20.

We support the considerations in paragraph 13 and 14, 'Regulatory deferral balances' represent the differences if when revenue or costs are considered for regulatory purposes and when are they billable or refunded to customers. So this time mismatch is relevant for users and they should have that information.

We also acknowledge, that what the EFRAG letter describes in this section regarding the "Regulatory Asset Base (RAB)" is relevant for users as it is for the entity's management in those schemes that base the rates on it, but we disagree with the proposal in paragraph 17 (a) to (d). A reconciliation between the asset base and the IFRS figures is many times impracticable. The RAB uses regulatory criteria which, in our experience differ significantly from IFRS standards, e.g. uses replacement costs or is indexed to price index.

Paragraphs 21 to 23.

We agree with the comments in the EFRAG letter, in particular 21 and 22 describe the relevance of the 'deferral balances' in order to understand the performance of a rate regulated entity and the importance of presenting these balances in the primary financial statements.

- 21 *'Defined rate regulation', as described in the DP, is designed to ensure that the rate-regulated entity recovers a determinable amount of consideration (revenue) referred to in the DP as the 'revenue requirement' in exchange for the rate-regulated activities that it performs. In addition, the rate regulation establishes, through the rate/tariff per unit chargeable to customers, the time at which the entity can bill customers for that consideration (the regulatory period).*
- 22 *Revenue is impacted because, rate regulation affects the amount of revenue an entity is entitled to charge its customers, under the regulatory agreement, over a period of time (i.e. the regulatory period) for a rate-regulated good or service. Some users argue that it is relevant to have information in profit or loss on revenue numbers that are linked to the cash flows that an entity is entitled to receive under the regulatory agreement and determined through the 'revenue requirement'.*

Regarding disclosures, we think rate regulated activities are part of the activities of the entity and should not be presented separated from the others activities. In addition we do not support disclosures of items that are not presented in the financial statements. We have briefly described above our main views on how to present the impacts of 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?

No comments.

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 of the DP)? If not, how do you suggest that the IASB should address the diversity in the types of rate regulation summarised in Section 3 of the DP?

IBERDROLA agrees with the IASB and EFRAG that *'defined rate regulation' forms a good basis to identify which features of rate-regulatory schemes distinguish rate-regulated activities from other commercial activities and create a combination of rights and obligations for which specific accounting guidance or requirements might need to be developed.*

We also support that, in our view, the main feature of defined rate regulation is that it creates **'enforceable rights and obligations'** which are different from commercial activities.

We also agree that IASB should focus on rate regulated activities and not on rate regulated entities.

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?

We agree with the conclusion of the EFRAG, that '*market rate regulation*' does not create '**enforceable rights and obligations**' that, as mentioned above, is from our perspective the key characteristic of rate regulated activities. Therefore is not in the scope of the DP and does not need guidance.

Question 5

Paragraphs 4.4–4.6 of the DP 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

Question 5(a)



We agree with the description of ‘defined rate regulation’ although we think not all the features have the same relevance for distinguishing and define rate regulation. In our view the main features to be considered are:

- Regulation creates enforceable rights and obligations on the entity, the regulator, and the customers; this feature, as stated during this letter, is the most important element and support, in our view, the recognition of regulatory assets and liabilities.
- Regulation protects and supports the financial viability of the rate-regulated entity;
- The rate setting mechanism provides an authorized revenue for the rate-regulated entity.
- There are mechanism in the rate regulation for over or under billings that ensure that entity recover the revenue requirement.

Being said the above, we consider the other characteristics described in paragraph 4.4(a) – (c) of the DP as indicators for identifying rate regulations or context that usually appear and lead to defined rate regulations. Not all the features as described by the DP are present in all regulations, e.g. quality of the supply sometimes is a bonus or penalties but not part of the rate setting mechanism that defines the authorized revenue.

We also think that the so called *regulatory adjustment mechanism* needs further development. It is true that this type of mechanism are defined to ensure that the entities with rate regulated activities adjust the revenue requirements to the billings to customers but some jurisdictions have established what they call ‘earning sharing mechanisms’ from which the rate regulated entity and the customer base share improvements in the performance.

Finally we do not agree with the reference in paragraph 86 (a) of the EFRAG and the reference IFRS 15.56 that adjustments are similar to variable considerations. Adjustments are just reconciliation between billing to customers to the authorized revenue as has been described in the document and are not dependent on new or future performance obligations.

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?



We agree with the response of the EFRAG and we have not identified additional rights or obligations to be considered.

Regarding the second question we think that the most appropriate approach to give guidance within current IFRS, we don't think that specific accounting guidance is the way as it would create specific industry standards. We think IASB clarification of IFRS 15 application for rate regulated activities is required.

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.

We firmly support the argument exposed in paragraph 108 of EFRAG's letter, reproduced below:

Those who support recognising regulatory deferral account balances as regulatory assets and regulatory liabilities disagree with the view that these are contingent amounts. The regulatory deferral account balances constitute differences between the amount of consideration to which the entity is entitled in exchange for performing its rate-regulated activities and the amount of revenue billed to customers. Consequently some suggest that the entity has a present right to recover, or an obligation to refund, amounts that have been under-billed or over billed

As a consequence of this argument we face assets for under-billing and liabilities for over-billing, which derives from the regulation and contracts with the customer based. And think this approach is principle based.

We agree with the EFRAG and do not support:



- Recognising the package of rights and obligations as an intangible asset;
- Reporting using regulatory accounting requirements; and
- Prohibiting the recognition of regulatory deferral account balances and assessing whether only disclosures requirements could be developed.

We also disagree that recognition is the result of an acceleration or deferral of cost or revenues we think that is the result of recognizing the revenues when the entity performs its obligations under the regulatory regime. It could be close to the revenue approach as described in the DP.

We disagree with the cost deferral approach and as the EFRAG states in the letter is difficult to see under which circumstances this model is in compliance with current IFRS, so we don't support a model combining deferring/accelerating the recognition of costs and revenues.

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.

We support the EFRAG position that IFRS financial statements should include relevant disclosure where an entity is impacted by rate regulation but we don't support any disclosure of information that is not included in the primary financial statements.

If the regulatory deferral balances are relevant to justify a disclosure it is probably because they should be part of the financial statements and if they are not we don't see a reason to require a disclosure.

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.

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.

We agree with the EFRAG that IFRS 14 provide a good starting point for comprehensive disclosures, but consider also our answer to question 1 regarding regulation disclosures and to question 9.

Question 11

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?

We disagree with EFRAG position that regulatory deferral balances and their impacts should follow IFRS 14 which requires separate presentation.

We support and agree that impacts of rate regulation in the financial statements have to be disclosed as well as their movements in the reported period but require separate presentation is like considering an exception to IFRS.

Rate regulated activities are no different from the rest of the activities and separating them will not help users understand the performance of an entity.

Our preference is not to separate the regulatory balances and provide the appropriate disclosures.



Our argument is the one exposed in paragraph 152 of the letter:

'believe that presentation should follow their inherent nature that stems from the revenue requirement. In their view, regulatory revenue and expenses should be presented together with other revenue and expenses that arise from the ordinary/trading activities of the rate-regulated 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?

We agree with the EFRAG response that the existence of a rate regulator external to the entity and whose role and authority is established by law or other enforceable acts is a necessary feature of 'defined rate regulation' as considered in the DP.

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?

We agree with the EFRAG response that the IASB should consider interactions with current IFRS in advancing this project.



We agree also that interaction with *IFRIC 12 Service Concession Arrangements* is probably one of the most evident and this project must maintain consistency.

Notwithstanding that our preference is that IFRS 15, with the guidance the IASB might develop, is the best way for the accounting rate regulation balances.