



# Foreningen af Statsautoriserede Revisorer

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Dear Sirs

## **Comments from FSR on Exposure Draft ED/2009/8, Rate-regulated Activities**

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The Danish Accounting Standards Committee has in cooperation with representatives from the Utility Working Group of FSR discussed the above mentioned exposure draft on financial reporting for utility activities.

During recent years it has been discussed in Denmark whether regulatory assets and liabilities can and shall be recognised in the balance sheet. There are different opinions as to whether such assets and liabilities fall within the current standards. The overall opinion seems to be that regulatory assets normally fall outside current standards and that a standard covering this area would be relevant and appreciated.

Our subsequent remarks reflect the problems we see in relation to Danish utility affairs, i.e. businesses under Danish regulation.

### ***1. Does rate-regulation create assets and liabilities as defined in the framework?***

As EFRAG discuss in their comment letter it can be argued whether the assets and liabilities created in rate-regulated industries meets the definitions of assets and liabilities. One could argue that they do due to the fact that the rate-regulated entity has a right to demand future economic benefits or resources from their customers and therefore has an asset or liability towards these customers that meets the definition.

On the other hand one could argue that the right to future resources is not against a certain customer but a future group of customers and the right therefore does not meet the control criteria and can't be recognised in the financial statement. In Denmark customers of rate-regulated entities will often not be able just to change the supplier of resources and they are therefore often customers of the rate-regulated entity for a substantial period. Therefore the control problem will normally not be a situation to be considered and a market will exist for the rate-regulated entity the following years. Even if control is an issue one could in such a situation argue that the asset or liability should be recognised even though rate-regulated assets and liabilities might not meet the definition of assets or liabilities in the framework due to the fact that this is a special industry which requires specific guidance and the rate-regulated

assets and liabilities is a substantial part of the business, where no one can argue that future resources will flow to the entity if a future market exists where the entity can demand payment from their customers. The view could therefore be that even if rate-regulated assets and liabilities do not meet the definitions (control) in the framework, IASB should allow a departure from the framework definitions specific for this industry.

Our view is therefore in both situations that the rate-regulated assets or liabilities should be recognised in the statements as they are substantial assets and liabilities in this particular industry. Therefore we agree with the majority of the EFRAG members that these assets and liabilities should be recognised in the financial statements in this industry.

## **2. Question 1: Generally we find the criteria of being in scope too narrow**

Probably, only a few earnings-related Danish businesses fall undoubtedly within the scope of the exposure draft. For most businesses it will be unclear whether they are included and for other businesses it is clear they will not be included.

### **(a) Regulators' fixing of rates**

The exposure draft stipulates that a criterion for being within the scope (section 4) is "that the regulator approves the definition and the rate for each of those categories and that all customers of the same category are bound by the same rate".

This definition seems too narrow in relation to Danish regulation practice. There are examples of rate-regulated activities that are intended for compensation of the actual costs, but where the regulator does not approve the actual rates. Regulator or legislation stipulates the detailed limits for the rate regulation, and on this basis the rate-regulated entities set the rates for the next period. These rates must be reported and published, but are not necessarily explicitly approved by the regulator. The consumers are free to complain to the regulator or the regulator can make their own control, but in practice the control is primarily based on the fixation of the total revenue, not the individual rates.

The standard should be expanded to also include regulation where the rate of the individual user can be set precisely by means of generally stipulated guidelines. The definition of scope in section 4 should be expanded accordingly.

Elasticity of demand is often low on regulated activities, i.e. the consumers have in fact a limited possibility of reducing the demand on the basis of changed prices. There is a natural inherent risk of volume attached to the occasional deviations in consumption and cyclical impacts, but that should not influence the possibility of recognising regulatory assets. Risk of volume should be included as an element in the measurement of the regulatory asset. In certain industries the risk of volume can be so considerable that the conditions for recognising an asset are not available.

Furthermore, we agree to EFRAG's remark that a regulated business under scope should have a certain degree of freedom to negotiate individual rebates. What is important is that the entities are more or less allowed to set the prices (by giving rebates) so that these eventually lead to recognition of the maximum allowed revenue.

We agree to the view that entities should have a certain degree of freedom to lower the rates for the individual customer or groups of customers in the form of rebates.

***(b) Cost of service regulation***

We find it unclear whether businesses subjected to efficiency benchmarking fall within the scope. Section 6 and the illustrated example 2 seem to lead to the conclusion that such businesses generally fall outside the scope.

In Denmark we have businesses in which the maximum allowed revenue aim at covering the actual costs under the explicit condition that the business is run efficiently – i.e. only “necessary costs” are covered. There are few examples of businesses paying costs that are not considered “necessary”. Such businesses seem to fall within the scope.

Other businesses have a fixed limit of revenue based on the specifically paid costs of the business with additional possible interest payment. The size of the interest payment depends on how effectively the businesses are run based on benchmarking with other businesses in the profession, i.e. based on the actual costs of other businesses. In principle, the payment of interest can be negative which means that it is not possible to get compensation for all costs. It may be discussed whether this price regulation is intended to cover the costs of the business or to cover the generally assessed costs of the sector thereby deciding whether the businesses are inside or outside the scope. Our opinion is that the scope should also include businesses subjected to the efficiency benchmark.

There are businesses whose individually calculated revenue limit is fixed on the basis of cost targets that are based on analyses of the sector in general, and therefore it can be discussed whether the total revenue limit is fixed with regard to the individual situation of the business or more generally by the sector.

The uncertainty a specific business is subjected to in this situation should be part of the assessment of the value of the regulatory asset.

We therefore agree with EFRAG that the scope should be clarified more and has to cover more specific rate-regulated industries which are not only subject to a specific cost of service regulation but also include other regulation criteria.

***3. Question 2: Recognition Criteria***

We agree with EFRAG. The normal recognition criteria for assets or liabilities i.e. probability and reliability should be met before the rate-regulated asset or liability can be recognised. For most entities in the rate-regulated industry, we would not expect that these criteria will be difficult to fulfil and therefore does not expect that the criteria will lead to non-recognition of rate-regulated assets and liabilities.

***4. Question 3: Measurement of regulatory assets and liabilities***

We agree with EFRAG that the proposed method for measuring the assets and liabilities is too difficult to use and does probably not produce more useful information.

In our view management’s best estimate should be used without stating specific that all possibly outcomes should be weighted and taken into consideration. If several possibly outcomes is present we expect that management takes them into consideration when they are producing management’s best estimate but we don’t see any reason to require that they should be taken into consideration in all situations.

We also agree that regulatory assets and liabilities should be remeasured at each reporting date.

With regard to setting the discount rate we understand that EFRAG is divided between a rate-regulated asset and liability specific discount rate and a general discount rate. In our view it is important that the standards are as easy to use as possible and we therefore support the use of a general discount rate. Our view is based on the costs used in setting the discount rate and the benefits created from using it. In our view the benefit from setting a specific discount rate does not outweigh the costs and therefore there is no reason to demand that a specific rate should be used. Furthermore we are not sure that a specific rate produces more relevant information for the users of financial statements. We therefore support the EFRAG members who do not support the proposal from IASB.

**5. *Question 4: Classification - Cost of self constructed PPE or internally generated intangible assets***

In our view rate-regulated assets and liabilities are different from other assets and liabilities including PPE. If a regulator requires an entity to capitalise other costs than other standards for such assets allow, it is in our view important to divide such assets from other PPE. This can be done either in the note or directly in the statement of financial position. We therefore support view 2 of the EFRAG members.

**6. *Question 5: Recoverability of regulatory assets and liabilities***

We support the EFRAG view. It is also unclear to us why specific impairment requirements are needed for regulatory assets and liabilities as they are measured at each reporting date.

**7. *Question 6 and 7: Disclosures and Transition***

EFRAG points out that the disclosures seem very extensive. We agree in this view and the EFRAG response. Furthermore we agree in the proposal of transition.

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If you have questions to the above, please do not hesitate to contact us.

Yours sincerely

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Standards Committee

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