Association pour la participation des entreprises françaises à l'harmonisation comptable internationale

IASB
30 Cannon Street
London EC4M 6XH
UK

Paris, November 24, 2009

Re: IASB ED Rate-Regulated Activities

We welcome the opportunity to comment on the exposure draft dealing with Rate Regulated Activities.

Overall, we disagree with the accounting requirements proposed in this exposure-draft and believe that users' needs for information related to rate-regulation are best fulfilled with appropriate disclosures.

Conceptually, though, we believe that the IASB could have a case for reflecting the underlying economics of rate-regulated activities using accrual accounting. Indeed we believe that whenever the regulator has indeed the power to determine prices on behalf of end consumers, contracts with the individual consumers are interdependent and should be assessed as a whole. We therefore agree with the customer base being considered as a whole. Revenue should be recognised, we believe, on the basis of the price agreed in the contract with the customer. Such a price stems from the economic basis included in the regulation, not from the amount determined on a forecast basis in order to invoice, and cash in from, the individual end customer.

This verifies, we believe, whenever regulations set formula that govern regulated prices, with prices being determined on a forecast basis with some form of truing up looking ahead into future periods. If similar transactions are to be accounted for similarly, a consequence of our analysis is that any formula would do, whether based on the entity's specific incurred costs or any other basis that is first estimated and become observable by the end of the period. We therefore observe that a scope narrowed down to cost-of-service regulations is not consistent with the possible conceptual basis for the project.

If information related to rate regulated activities is to be reliable and useful –either through accruals or disclosures - , there should be close to no uncertainty in the way regulations are complied with, i.e. future prices should be easily predictable. In other words, rate regulations must have proven to be efficient in the past, i.e. price setting must have proven to reflect the regulation agreement and be exempt from, for example, repeated political interference.

Furthermore, we disagree that new standards would contradict, or form exception to, other effective standards. We believe that:

- tangible and intangible assets, and all operating assets, should remain valued in strict accordance to existing IFRS, whatever the regulation permits. Any exception to the existing IFRS requirements would damage comparability in an unacceptable way;
- the IFRS framework's recognition criteria should apply, and in the case of rate-regulated activities, the reliability criterion is, in our view, a particularly relevant hurdle;
- assets and liabilities that are in substance amounts due from – or to – customers should be measured in accordance with existing revenue recognition principles. We therefore disagree that any valuation on the basis of expected value be introduced for such assets and liabilities;
- any final standard should be prevented from forming any exception to, or bringing any change in, IFRIC 12 "Concessions". IFRIC 12 has provided welcome and robust guidance in the area of concession agreements. We would welcome nonetheless clarifications of how IFRIC 12 and a final standard on rate-regulated activities would inter-act in practice.

That being said, we believe that the primary objective of financial reporting is to bring as useful information to users as possible, optimising the cost/benefit trade off. Where rate regulated activities are concerned, we believe that accrual accounting, although conceptually sound, would trigger significant costs while as great if not greater benefit could be derived from appropriate disclosures.

We therefore recommend the Board to eliminate accounting requirements proposed in the ED, revisit disclosures necessary to truly bring useful information to users, and on that basis, widen the scope of the standard

In that circumstance substituting disclosures to accounting should be accepted, as it results in a much more favourable cost/benefit trade off and therefore should benefit more to present and potential capital providers.

In addition to the comments expressed above, we provide detailed answers to the questions raised in the review in the appendix to this letter.

Should you wish any supplementary comment or explanation, please do not hesitate to contact us.

Patrice MARTEAU
Chairman

Appendix to our letter commenting on ED "Rate Regulated Activities". Answers to the specific questions raised in the invitation for comments.

Preliminary comment: we respond to each question in the context of accounting requirements having to be defined for Rate Regulated Activities. We however believe that more efficient and effective financial reporting would be achieved for Rate Regulated Activities in relying on proper disclosures only.

Question 1 - Scope

The exposure draft proposes two criteria that must be met for rate-regulated activities to be within the scope of the proposed IFRS (see paragraphs 3–7 of the draft IFRS and paragraphs BC13–BC39 of the Basis for Conclusions).

Is the scope definition appropriate? Why or why not?

An appropriate definition of the scope of any standard ensures that similar economic transactions are accounted for similarly.

The scope of the proposed standard relies on two criteria: 1) the regulator can set prices that bind the end customer, in other words the regulator has authority to set prices on behalf of end customers; 2) the entity is subject to cost-of-service regulation. We believe that criterion 1 is relevant to the issue under consideration. We believe that criterion 2 is not. The scope as defined would not meet basic comparability requirements.

Criterion 1 is relevant in the analysis, we believe, because the regulator's authority for setting prices creates the commercial interdependency between individual customers' contracts. IAS 11 and IAS 18 today, and segmentation/ grouping requirements that the Board is considering in its Revenue Recognition project, acknowledge pricing interdependency as a critical factor. The amount invoiced to individual end customers on a day to day basis in exchange for regulated goods or services is tentative, as it is designed to approximate the agreed price in the contract. The agreed price in the contract, however, stems from the formula set up in the regulation agreement, and any discrepancy between the agreed price (as determined ex post) and the amount invoiced (and cashed in) at the time of delivery creates, we agree, regulatory assets or liabilities. We agree that considering the whole customer base is relevant, and agree that regulatory assets or liabilities are created, and could be recognized in accordance with the IFRS framework, as long as future deliveries to end customers remain probable.

We however diverge from the Board's analysis as we disagree that the past event creating those assets and liabilities are the costs incurred by the entity. We believe that the past events are the regulation and the delivery to end customers. We believe that any regulation agreement that sets up prices on a basis of a formula, and that sets those prices first on a forecast basis and then regulates future prices in order to amortize any amounts invoiced in excess or by default, should be included in the scope of any future standard. Average costs in a particular industry or whatever the basis for setting prices can be would create similar assets or liabilities in our view.

As indicated above, the formula on which basis prices are set is the critical factor in the assessment of whether assets and liabilities are generated. We agree with the Board that such a formula must be playing a substantive role, not be a form of guidance that can easily be overridden. Some activities are regulated on the basis of such formulas. However, in certain jurisdictions, price regulation is heavily influenced by political decisions, and the formula is reduced to being a sort of guideline that most often is not complied with. As a result, the regulation is not efficient. We therefore believe that indicators provided in B4 (e) and B6 (c) should be emphasized and probably reinforced, to eliminate any regulation that would not be either mature or efficient enough. Indeed there should be close to no uncertainty in our view in the way regulation prices are set, i.e. future prices should be easily predictable with a high level of accuracy, if any form of accounting is to be useful to users.

Furthermore, paragraph 4 could be interpreted as suggesting that entities within the scope do not have any freedom to grant any discount from regulated prices. We do not believe that such interpretation would be correct. Assets and liabilities represent rights and obligations substantiated by the regulation. We believe that those assets and liabilities are generated, even though the entity has full discretion in granting rebates, i.e. re-distributing part of the asset granted by the regulation or increasing its obligation towards its customer base. We would appreciate if clarification was provided in that area, if our recommendation to limit requirements to appropriate disclosures was not followed.

Question 2 - Recognition criteria

The exposure draft proposes no additional recognition criteria. Once an activity is within the scope of the proposed IFRS, regulatory assets and regulatory liabilities should be recognised in the entity's financial statements (see paragraphs BC40–BC42 of the Basis for Conclusions).

Is this approach appropriate? Why or why not?

We disagree with that approach because we do not believe that the specified scope criteria implicitly verify the two recognition criteria defined in the framework, as explained in BC 40-42. (We nevertheless commend the IASB for acknowledging in its basis for conclusions that these two criteria need to be met).

1. Probability of future cashflows

   The likelihood of future cash-in or –outflows does not lie only in the regulator's willingness to comply with the regulation. The probability of future demand also plays a critical role. Many regulatory environments are nowadays open to free competition. While we would agree that the probability criterion is likely to be met in most circumstances (the assessment being carried out on the basis of the whole customer base), we believe that the standard should not presume that it would systematically verify.

2. Reliability of measurement.

   Circumstances may arise that make future prices, despite the regulation, quite uncertain, with very wide ranges of possible estimates. In those cases we do not think that any estimate would be sound enough to meet the reliability criterion. We therefore believe that the reliability criterion has a role to play.

Question 3 - Measurement of regulatory assets and liabilities

The exposure draft proposes that an entity should measure regulatory assets and regulatory liabilities on initial recognition and subsequently at their expected present value, which is the estimated probability-weighted average of the present value of the expected cash flows (see paragraphs 12–16 of the draft IFRS and paragraphs BC44–BC46 of the Basis for Conclusions).

Is this measurement approach appropriate? Why or why not?

In some recent or less recent proposals (IAS 37, IAS 12...), the IASB has promoted the use of expected value consistently, even in contexts of single risk transactions. We disagree that such measurements are improving financial reporting.

The objective of reflecting period after period the effects of changing economic conditions may have an appeal on a theoretical basis. However no benefit can be expected in practice. Defining different possible outcomes would be very subjective, and variations thereof would trigger most probably unjustified variations from period to period. In the context of regulated activities, such a weakness would be all the greater, that the area under consideration would be the possible decisions that the regulator would make and, in some circumstances, the possible behavior of competitors. Limitations to what financial reporting may faithfully reflect must be acknowledged in standard setting and appropriate requirements be designed taking those limitations into account.

Moreover we note that the extensive use of expected value that the IASB promotes is a cause for divergence from US GAAP. This is an area where we believe that the IASB should converge with the FASB, and not the other way round.

We therefore believe that regulatory assets and liabilities should be, if accounted for, measured on the basis of management’s best estimate, with appropriate disclosures provided in the notes.

In addition to the above comments, we believe that the building block approach in paragraph 13 should be clarified. Item d) would in our view increase the amount of a liability and decrease the price of an asset. Deliberations by the Board of risk margins in the valuation of liabilities have generated more confusion than clarity so far. We believe that appropriate guidance and/ or illustration of paragraph 13, for an asset on one hand, a liability on the other, should be provided. We also believe that proper specification that non-performance risk is not to be reflected would be welcome.

Question 4 - Cost of self constructed property, plant and equipment or internally generated intangible assets

The exposure draft proposes that an entity should 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 even if those amounts would not be included in the assets’ cost in accordance with other IFRSs (see paragraph 16 of the draft IFRS and paragraphs BC49–BC52 of the Basis for Conclusions). The Board concluded that this exception to the requirements of the proposed IFRS was justified on cost-benefit grounds.

Is this exception justified? Why or why not?

We disagree with such a proposal because it contradicts any attempt at improving comparability and transparency. As explained earlier, regulated entities are most often exposed to competition. Costs of tangible and intangible assets should be reported on the same basis, whether the entity operates under a regulation agreement or not.

For clarity and transparency, regulated assets and liabilities should be, if accounted for, presented separately from other assets and liabilities.

Question 5 - Recoverability of regulatory assets and liabilities

The exposure draft proposes that at each reporting date an entity should consider the effect on its rates of its net regulatory assets and regulatory liabilities arising from the actions of each different regulator. If the entity concludes that it is not reasonable to assume that it will be able to collect sufficient revenues from its customers to recover its costs, it tests the cash-generating unit in which the regulatory assets and regulatory liabilities are included for impairment in accordance with IAS 36 Impairment of Assets. Any impairment determined in accordance with IAS 36 is recognized and allocated to the assets of the cash-generating unit in accordance with that standard (see paragraphs 17–20 of the draft IFRS and paragraphs BC53 and BC54 of the Basis for Conclusions).

Is this approach to recoverability appropriate? Why or why not?

We agree that regulatory assets, if recognized, should be tested for impairment within the cash generating unit to which they belong, whenever it is not reasonable to assume that sufficient revenue can be collected from its customers. We believe that IAS 36 requirements are appropriate for that purpose.

Question 6 - Disclosure requirements

The exposure draft proposes disclosure requirements to enable users of financial statements to understand the nature and the financial effects of rate regulation on the entity's activities and to identify and explain the amounts of regulatory assets and regulatory liabilities recognized in the financial statements (see paragraphs 24–30 of the draft IFRS and paragraphs BC59 and BC60 of the Basis for Conclusions).

Do the proposed disclosure requirements provide decision-useful information? Why or why not? Please identify any disclosure requirements that you think should be removed from, or added to, the draft IFRS.

In the context of rate regulated activities being reflected in accrual accounting, we believe that the principle set in paragraph 24 is appropriate. We believe however that disclosures required in subsequent paragraphs are excessive. Where regulations are similar, develop similarly and stem nonetheless from different regulators, we believe that aggregate disclosures should be allowed. The description of each specific approval process (26 b) is not necessary in our view. Whenever significant judgment is involved, as suggested in 26 (c), such descriptions may be helpful in explaining the conclusion reached. Furthermore, 26 (e) suggests providing forward looking information on customer base demand. We do not believe that such information should either be required or provided in the notes.

Even if the proposed disclosures were adequately reduced, accounting for individual regulatory assets and liabilities, and providing disclosures would still be quite burdensome, both in terms of preparation and financial analysis costs. We believe that users should be provided with a set of more meaningful disclosures instead.

Such disclosures would include for each group of similar regulatory agreements:

- a description of the regulations, including the frequency of regulatory decisions and approvals,
- an estimate, based on facts and circumstances, of the possible increase or decrease in future prices that the entity expects to be decided, the timing of those decisions and the periods in which they are expected to apply,
- appropriate comments and explanations, if and when those estimates change or do not materialize as expected.

Question 7 - Transition requirements

The exposure draft proposes that an entity should apply its requirements to regulatory assets and regulatory liabilities existing at the beginning of the earliest comparative period presented in the period in which it is adopted (see paragraph 32 of the draft IFRS and paragraphs BC62 and BC63 of the Basis for Conclusions). Any adjustments arising from the application of the draft IFRS are recognized in the opening balance of retained earnings.

Is this approach appropriate? Why or why not?

We agree with the transition requirements proposed.

Question 8 - Other comments

Do you have any other comments on the proposals in the exposure draft?

We would welcome clarification of how IFRIC 12 and any final standard on rate-regulated activities would inter-act in practice, both at the recognition and impairment stages of a regulatory asset. Illustrative examples would be welcome in this area.

That being said, we believe that IFRIC 12 forms a welcome piece of robust financial reporting guidance that has just started bringing significant improvements to some entities in accounting for concession agreements. Therefore, no change should be made in, or exception formed to, IFRIC 12.

Any inconsistency that the Board may identify between its proposals and IFRIC 12 should be resolved in modifying the Board's proposals, not IFRIC 12. Our recommendations would in our view be quite helpful to that purpose.