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Sir David Tweedie
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Madrid, 16 November 2009

Dear Sir David,

Re: Exposure Draft ED/2009/8 *Rate-regulated Activities*

SEOPAN thanks you for the opportunity to comment on the IASB Exposure Draft 2009/8 Rate-regulated Activities.

SEOPAN (Asociación de Empresas Constructoras de Ámbito Nacional) is a group representing the most important Spanish construction companies, and its members are worldwide leaders in the transport infrastructure concessions industry.

We value very positively the Board's efforts to address differences in practices regarding the recognition of assets and liabilities arising from rate regulation.

However, we do not agree with the proposed scope criteria for application of the final Standard, in particular with regard to the following aspects:

- From the current wording of the standard it can be interpreted that regulatory assets may only be recognised for the costs incurred that exceed the initially budgeted costs and which give rise to the right to increase future rates. Strict application of the asset recognition criteria solely to budget deviations would give rise to an accounting mismatch with other expenses / costs meeting the same conditions as the assets generated by deviations. For example, we consider that the definition proposed for a regulatory asset could equally apply to any type of costs incurred, including the finance costs during the initial period of a regulated activity, since these costs meet the basic asset recognition criteria proposed in the standard on regulated activities (control and recoverability). In other words, given that the price setting system envisages the recovery of the costs through future rates (not only through rate increases) and their recovery is probable, it makes no sense to recognise them as expenses since, intrinsically, they have the same characteristics as those required for the recognition of a regulated-activity asset resulting from a future deviation.

- In most regulated industries, such as concession arrangements, the analysis of isolated costs to determine their direct impact on the future rate does not make economic sense, since any economic and financial analysis of the concession must consider the project as a whole. In such cases, the setting of rates contemplates the necessary costs incurred for the development and the operation of the concession on a joint basis over the whole term of the contract. Therefore, we believe that the recognition of rate regulated assets and liabilities for these types of industries should be on the project term as a whole and not on a specific direct cost recovery scheme.

- Additionally, we believe that the scope should be broader in order to include price caps or incentive based forms of regulation, since these mechanisms also allow the full recovery of the expenses/costs incurred and also meet the general definitions of a regulated-activity asset included in the exposure draft.

We believe that the wording of the standard should consider all the interactions that exist with IFRIC 12 currently in force in relation to concession arrangements (which are a regulated activity and therefore should be expressly included in the standard). The joint application of the two standards gives rise to significant inconsistencies, especially with regards to the treatment of costs incurred. In the intangible asset model envisaged in IFRIC 12 the initial costs (including finance costs) are recognised as expenses in the income statement for the period in which they are incurred once the concession is in operation. However, we consider that on many occasions these costs meet the basic criteria established in the new standard for recognition as regulatory assets, as indicated in the preceding paragraphs.

These suggestions are consistent with the provisions of other countries' accounting standards that are applicable for concession arrangements, such as US GAAP (FAS 71) and Spanish GAAP, which establish mechanisms to eliminate the timing mismatches that arise in annual costs and revenue through the deferral in time of the certain costs/losses that will be recovered over the term of the concession, provided that there is sufficient evidence for such recovery. Also, this treatment had already been recommended in March 2004 by the staff of the IASB in their analysis for the preparation of IFRIC 12. The IFRIC's argument to dismiss this recommendation was the non-existence at that time, within the IFRS framework, of regulatory assets, and that the IFRIC did not have sufficient competence to consider such a matter. This restriction should be reviewed since it would not further apply upon the creation of a specific standard on regulatory assets.

In relation to the measurement criteria, due to the high complexity of calculating the expected present value of a regulatory asset, the difficulty of identifying objective criteria to do so, and given that regulatory assets are not of a financial nature but rather are more similar to intangible assets (IAS 38 does not envisage the discounting of intangible assets), we believe that the standard should consider the measurement of these assets at their nominal value.

In relation to transition, an exception should be included to the retrospective application of the standard in cases in which the application is impracticable or excessively costly. In addition, with regards to the transition to the new standard, the standard should specifically address the recognition of regulatory assets and liabilities that previously had not been recognised as a result of a business combination, but rather had been treated as part of the total amount of the goodwill arising on the acquisition.

This view, together with other additional issues, is expressed in more detail in our responses to the invitation to comment questions, which are included in Appendix A to this letter.

Kind regards,

Julián Núñez Sánchez
Vicepresident of SEOPAN

Appendix A: Invitation to Comment

SCOPE

QUESTION 1: *The exposure draft proposes two criteria that must be met for rate-regulated activities to be within the scope of the proposed IFRS. Is the scope definition appropriate? Why or why not?*

Recognition criteria – capitalisation of costs:

Based on paragraphs BC15 to BC22 of the Basis for Conclusions, it seems reasonable to consider that the costs incurred should be capitalised if they meet the basic criteria defined in the standard on rate-regulated activities, i.e. to the extent that the price setting system envisages the recovery of the costs and that such recovery is probable.

However, the wording of paragraph 8 of the standard establishes that an entity will recognise a regulatory asset as a result of the existence of a right to recover specific previously incurred costs and to earn a specified return, when it has the right to ***increase*** the rates in future periods as a consequence of the actual or expected actions of the regulator.

This wording appears to imply that only the costs incurred in excess of those initially budgeted and which give rise a right to increase future rates should be recognised as regulatory assets, which would also imply that a regulatory asset never exists at the commencement of the arrangement. There is a clear inconsistency between this situation and the points regulated by sections 13-16 of the exposure draft, on the basis of which it seems reasonable to assume that the recognition criteria should apply to the recoverable initial costs and not only to deviations. In fact, paragraph 16 of the standard even permits the capitalisation of types of costs in internally generated assets which it would not be permitted to recognise in accordance with other IFRSs in force.

Accordingly, it could also be argued that it does not appear reasonable to include the recognition of an asset for unapproved cost deviations or even costs not permitted by other IFRSs and, by contrast, not expressly regulate the recognition of an asset for the initial costs incurred, included in the initial approved plan, which have a lower level of associated uncertainty than the deviations.

The same reasoning should be used to interpret that there is no reason to limit the application of the standard on rate-regulated activities to certain costs, and, to the extent that it is expected that the costs incurred for the provision of the service will be recovered through future rates. These costs, which should necessarily include, for example, financial interest costs, and any other that would meet the criteria for recognising a regulatory asset.

The last point is especially relevant to the concession industry. Industry operators and certain regulations detailed below consider that the recognition of initial costs in the income statement, if it is expected that they can be recovered, i.e. in concessions that are profitable when considered as a whole, does not present the project fairly since, in essence, these costs meet the general definition of a regulatory asset, i.e. the price setting system envisages their recovery and this recovery is probable.

For the above reasons, we consider that an alternative wording of paragraph 8 of the standard that would resolve the aforementioned inconsistencies could be:

"An Entity shall recognise:

(a) A regulatory asset whenever it is probable that it will be able to recover previously incurred costs and to earn a specified return…

When it considers it probable that it will be able to recover its incurred costs through the rates in future periods as a result of the actual or expected actions of the regulator".

Recognition criteria – specific costs:

One of the criteria established in the scope of the standard (paragraph 3b) refers to the requirement that the price established by regulation be designed to recover the specific costs incurred by the entity providing the service and to earn a specified return *(cost-of-service-regulation)*.

The establishment of a direct link between specific costs and rate regulation must be interpreted on a broad basis in the context of some regulated activities, such as infrastructure concessions, since in arrangements of this type it is not possible to make analyses of individual costs but rather the costs required to construct, start up and operate the infrastructure must be considered as a whole over the entire life of the concession. Therefore, in such industry, if it is possible to assess that the recoverability of such cost is possible during the life of the concession; such costs/expenses also should be entitled to be treated as a regulatory asset

Recognition criteria – Price Cap:

The narrow definition of scope in the current exposure draft results in only cost of service forms of regulation being allowed to recognise regulatory assets and liabilities. Whilst the later details of the standard set out some principles which may relate far more broadly across the sector and encompass other forms of regulation, it could be interpreted that the scope is limited, ruling out, for example, price cap or incentive based forms of regulation. However, companies with these forms of regulation could have many comparable elements within their regulatory structure; certain specific costs may be recoverable in future periods, under the regulatory regime, for example via explicit guidance from the regulator. No matter when the costs are recoverable in future periods, differences between cost of service and price-cap regulations are not significant and in both schemes the cost recoverability criteria can be met. As a result, broadening the scope to include such incentive based mechanisms and price-cap schemes could well be argued as appropriate and should be clearly stated in the final standard.

Interactions with IFRIC 12:

The current exposure draft directly regulates the recognition of “regulatory assets”, permitting the entity to capitalise previously incurred costs to the extent that they will be recovered through future rate increases established by the regulator. Although the draft appears to be aimed primarily at the energy market, it is evident that the criteria established in the definition of the scope can be applied to a significant number of diverse arrangements, i.e. infrastructure concession arrangements. The concessions business is essentially a regulated industry and therefore it should be expressly included in the standard.

Accordingly, on the basis of its current wording, certain concession arrangements could be required to be accounted for by applying both IFRIC 12 and the standard on rate-regulated activities. This premise is reflected in paragraph BC39 of the Basis for Conclusions where it states: *“In another service concession arrangement, the grantor may give the operator the right to recover the operator’s costs and earn a specified return as well as the right to charge customers to use the public service. If it does, the entity would apply both IFRIC 12 and the proposed IFRS on rate-regulated activities”*, as well as in Appendix C7 of the standard: *“An entity that operates a public-to-private service concession arrangement that is within the scope of this Interpretation should also consider whether its operating activities provided using the infrastructure in accordance with the concession arrangement are within the scope of IFRS Rate-regulated activities”.*

We consider that, in practice, a large number of concessions meet the criteria established in paragraph 3 of the standard on rate-regulated activities, to be considered within the scope of the standard. The criteria are as follows:

1. *An authorised body is empowered to establish rates that bind customers.*

2. *The price established by regulation (the rate) is designed to recover the specific costs the entity incurs in providing the regulated goods or services and to earn a specific return (cost-of-service regulation).*

This could be the case, for example, of certain concession arrangements included in the IFRIC 12 intangible asset model in which the rates are set by the regulator and, although there is no unconditional right to receive a financial asset, in such cases, the public rates are calculated to recover the costs incurred by the entity and there is sufficient evidence that these rates will enable the entity to recover the aforementioned costs. In our opinion these conditions can be interpreted in many cases as the establishment of a direct cause-and-effect relationship between the costs incurred for the provision of the service and the revenue to be received. It should therefore be concluded that in these cases the rate setting system is aimed at recovering the entity’s costs (through rate increases or, as the case may be, increases in the term of the concession).

On the basis of all the foregoing, the existence of significant interactions between IFRIC 12 and the current exposure draft on rate-regulated activities is established, although this interaction and its implications are not made sufficiently clear in the current draft. Therefore, as indicated earlier, the fact that an entity applies the intangible asset model for a concession arrangement in accordance with IFRIC 12 does not prevent the application of the standard on rate-regulated activities to that arrangement (BC39, Appendix C C7); however, the joint application of the two standards gives rise to significant inconsistencies.

One of the key inconsistencies arising from the interaction of the two standards is the treatment of the costs incurred at the commencement of the life of the concessions. As regulated by the current IFRIC 12, these costs (including most notably finance costs) are recognised as expenses in the income statement for the period in which they are incurred. However, these costs, in a certain number of concession arrangements, meet the basic requirements established in the standard to be recognised as regulatory assets:

- The objective of the regulated rates is that the concession operator recovers the costs incurred or those which are expected to be incurred. As specifically established in paragraph B5 of Appendix B of the standard on rate-regulated activities, the recoverable costs should necessarily include finance costs.

- The costs incurred once, for example, the concession operators have classified their assets as intangible assets, meet perfectly the concepts and basic reasoning established in paragraphs BC15 to BC22 of the Basis for Conclusions, to be considered to be assets. This is so since:

    a. They constitute a resource controlled by the entity (understanding a resource to be a promise or even a commitment by the regulator that the costs the entity incurs will result in future cash flows).

    b. They are the result of past events (the concession arrangement).

    c. And future economic benefits are expected to flow to the entity from them.

The regulator’s commitment in relation to the recovery of the costs incurred should be viewed from a broad standpoint, i.e. not only when the mechanism is established through rate increases, but also -as is logical in the case of infrastructure concessions- when it is adjusted through an extension of the term of the concession. The existence of these guarantees and the compliance with the criteria for recognition of a regulatory asset should not be invalidated as a result of the existence of demand risk at a concession (the risk arising from the level of use of the service by the user), as established in paragraphs BC18 to BC22 of the Basis for Conclusions, where it is determined that the existence of demand risk affects the measurement of the right but not the existence of a regulatory asset that must be recognised.

Treatment in other accounting standards and IFRIC recommendations from 2004:

The adequate deferral of costs in order to correct for the timing mismatch between annual revenue and expenses, which is habitual in concession arrangements, is considered in certain legislations, such as Spanish and US GAAP (through FAS 71 “Accounting for the Effects of Certain Types of Regulation”), which already included, with a significant degree of similarity, mechanisms to eliminate the aforementioned timing mismatches which arise in relation to revenue and expenses of a concession arrangement over the life thereof, through the deferral of the initial costs/losses that will be recovered over the term of the concession. The two sets of standards consider the recognition of a regulatory asset for the right to recover *all of the costs incurred (including finance costs)* when:

- It is reasonable to assume that the rates will be set at such levels that enable the costs capitalised by the entity to be recovered.

- It is probable that the prices will be set at the aforementioned levels, i.e. it is probable that the future revenue will be generated in an amount sufficient to at least equal the total capitalised costs, through the inclusion of such costs as part of the costs “permitted” in the setting of rates.

- There is sufficient evidence that the future revenue will enable the recovery of the previously incurred costs.

Accordingly, both Spanish and US GAAP establish that it is reasonable to consider the deferral of the initial costs if it is probable that they will be recovered, since they conclude that these costs relate to the *future activities*, because they are necessary for the overall execution of the project (financing, construction and commercial operation) and, therefore, they should be considered, taken as a whole, to be costs “used” over the entire term of the project. If there is sufficient evidence that the future revenue will enable the initial costs to be recovered, there are sufficient arguments to capitalise such costs.

Also, it should be recalled that in 2004, when IFRIC 12 on Service Concession Agreements was being prepared, the IFRIC analysed the circumstances in which the concession operator could recognise an asset for the right of recovery of finance or other costs incurred (see Agenda Papers of March 2004 and the IFRIC Update of March 2004), with a particular analysis from the standpoint of the aforementioned FAS 71 and Spanish GAAP. The staff of the IASB concluded that an accounting treatment similar to the one established in the two jurisdictions for finance and other costs incurred could also be appropriate under IFRSs. The provisional recommendations of the IASB staff established that a regulatory asset for the right of recovery of the costs incurred should be recognised when it is reasonable and probable to consider that the costs incurred will be recovered through future rates, if the following conditions are also met:

a. The rates for services provided or products delivered are (i) set by, or subject to approval by, an independent regulator and/or (ii) established by a contractual mechanism. The staff of the IASB pointed out that US GAAP would not permit the capitalisation of costs in situation (ii). However, it was considered that the objective of achieving comparability between jurisdictions and ensuring that arrangements of like commercial substance are accounted for in a similar manner should permit case (ii), which also reflects the standpoint taken by the staff of the IASB, i.e. that the basis for the recognition of a regulatory asset is inherent in the arrangement; and,

b. (i) the rates are designed to recover the specific costs incurred by the company in providing its services, or (ii) if there is sufficient evidence that the rates will enable the company to recover the costs incurred. The staff of the IASB also pointed out that section (ii) is not permitted under

US GAAP, although it is consistent with the standpoint indicated above, i.e. that the basis for the recognition of an asset of this type is inherent in the arrangement.

The staff of the IASB also concluded that this criterion was consistent with both the Framework of the standards and with the IFRSs already issued. However, these recommendations were dismissed by the IFRIC, which rejected the creation of an asset of this type by arguing that any asset that did not meet the recognition criteria established in the Framework and in certain relevant IASs (IAS 11-Construction Contracts, IAS 16–Property, Plant and Equipment, IAS 18-Revenue or IAS 38-Intangible Assets) could not be recognised in an entity's financial statements. *In this regard,* ***the fundamental reason for dismissing the recommended creation of a regulatory asset was primarily that the IFRIC is a body that merely interprets IFRSs and that the creation of the aforementioned asset was outside the scope of its competences.*** **This restriction therefore no longer applies, to the extent that the IASB is developing a specific standard on regulatory assets** concluding on the existence of sufficient reasons to determine the need to recognise, in this context, the regulatory assets that meet the recognition criteria of the Framework.

RECOGNITION AND MEASUREMENT

QUESTION 2: *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. Is this approach appropriate? Why or why not?*

We consider that the proposed approach is appropriate and that a once company or transaction is within the scope of the standard, no additional recognition requirements are necessary.

QUESTION 3: *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. Is this measurement approach appropriate? Why or why not?*

Firstly it should be noted that measuring regulatory assets at their expected present value, understood to be the estimated weighted average of the present value of the expected cash flows, taking into consideration the various probability scenarios, could be considerably complicated and costly for the entities.

Basically, the complexity of the calculation arises from the capacity to identify objective values that provide reliable information on the following variables or parameters:

a) The calculation of the discount rate
b) The estimate of the range of probabilities

c) The estimate of the cash flows over long periods

Measurement at expected present value can give rise to certain inconsistencies; for example it would be necessary to recognise discounted regulatory assets but if the tax base of the assets differed from their carrying amount, a deferred tax asset or liability should be recognised which, however, is measured at the nominal value of the temporary difference.

Also, applying discounted values makes sense in the context of financial assets, financial liabilities and provisions. However, regulatory assets belong to none of these classes; their non-financial nature is clearly established in paragraph 43 of the Basis for Conclusions of the Exposure Draft. Rather, these assets have the nature of intangible assets, which under the general criteria contained in IAS 38 are not normally discounted.

Consequently, bearing in mind the uncertainties that can affect the measurement of regulatory assets, it could be more appropriate to measure them at nominal value (which conceptually should be equal to the costs incurred).

QUESTION 4: *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?

In a regulated activity, it appears appropriate to capitalise certain costs included by the regulator, even though such costs do not form part of the general cost of the assets permitted by other IFRSs, insofar as these costs will be recovered through the setting of future rates, in the same way that the recognition of the other costs which do meet the general recognition criteria established in the IFRS Framework is envisaged. Therefore, we consider the establishment of the exception included in paragraphs BC49-BC52 and paragraph 6 of the Exposure Draft to be reasonable.

Nevertheless, once again, in line with our answer to Question 1, we would point out the inconsistency arising from the fact that the capitalisation of the costs included in paragraph 16 of the standard is envisaged but not, however, the capitalisation of all the costs including the finance costs incurred during the first few years of a arrangement, since, conceptually, the two types of cost should be treated in a similar way from an accounting-standard viewpoint, because the costs are recoverable and there is a direct relationship between the need to incur the costs and the price setting mechanism aimed at their recovery.

QUESTION 5: *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 recognised 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?*

The criteria adopted in the exposure draft are consistent with those established in IAS 36 to determine the impairment of assets in relation to the cash-generating unit to which they belong. With assets of this type it is especially important to consider, in the entity's estimates, the effects that changes in expected rates can have on the evolution of demand.

DISCLOSURES

QUESTION 6: *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 recognised 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.*

Nothing significant to be commented.

TRANSITION

QUESTION 7: *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 recognised in the opening balance of retained earnings. Is this approach appropriate? Why or why not?*

The current wording of the draft indicates that the effects of the standard must be applied retrospectively, with an impact on the reserves of the earliest comparative period presented.

Bearing in mind the complexity associated with certain regulatory assets an exception should be included to the retrospective application of the standard in those cases in which it would be impracticable or excessively costly.

In addition, with regard to the transition to the new standard, the standard should specifically address the recognition of regulatory assets and liabilities that previously had not been recognised as a result of a business combination, but rather had been treated as part of the total amount of the goodwill arising on the acquisition.

OTHER COMMENTS

QUESTION 8:

There are no additional significant comments.