Norsk RegnskapsStiftelse

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UK

Cc: EFRAG

Oslo, November 20th, 2009

Dear Sir/Madam

Exposure Draft, ED/2009/8 Rate-regulated Activities

Norsk RegnskapsStiftelse (the Norwegian Accounting Standards Board) welcomes the opportunity to submit comments on the exposure draft Rate-regulated Activities. Please find enclosed the remarks to the proposed IFRS.

We are pleased with the efforts to address differences in practice regarding the recognition of assets and liabilities arising from rate regulation. Furthermore, we hope the discussion of this draft provides an opportunity to achieve an accounting for regulatory assets and liabilities, consistent with how the economic reality of such assets and liabilities are perceived by many. However, the scope of the exposure draft is defined too narrowly to achieve this target. We mainly agree with the analysis presented in BC15-BC25. However, we disagree with the strict interpretation that an asset or liability will arise only where the set price/rate is based on the specific costs of the entity. We see no basis in the Framework for restricting the scope only to regulatory activities with a close causal relationship between specific costs of the entity and future revenue cash flows. In our view, any regulatory activity where the first scope criteria (paragraph 3a) are met, and where price/rate is based on pre-fixed parameters, will create future economic benefits from past events. We therefore strongly disagree with what we perceive as an arbitrary defined scope, leaving an impression that the scope is developed to achieve a desired outcome. Rather, we believe a broader scope, comprising rate-regulated activities with similar economic characteristics as scoped under the exposure draft, could be justified within the boundaries of the asset and liability definitions of the Framework, increasing comparability across different rate regulated activities with broadly equivalent economic characteristics. We therefore urge the Board to reconsider the scope, and re-expose the exposure draft with a broader scope.

Apart from our comments about the scope we generally agree with the proposed presentation, disclosure and transition requirements, and we are for the most part supportive of the recognition and measurement criteria. However, we disagree with the requirement to capitalize, as part of the cost of self-constructed property plant and equipment or internally generated intangible assets, regulatory assets where IAS 16, IAS 23 or IAS 38 would not permit the entity to do so. We also encourage the Board to clarify the requirement to individually assess recognised regulatory assets for impairment.

Lastly, we would also like to stress our general opposition toward narrowly defined standards, confined to only certain geographical areas and certain industries or activities. As mentioned, we are pleased with the effort to address accounting for regulatory assets and liabilities as such. However, we believe the same objective could be achieved through an interpretation, or by adding further guidance to existing standards. We therefore disagree with the proposal to prepare a standalone standard for rate regulated activities.

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Our comments to your detailed questions are laid out in the appendix to this letter. The questions are answered under the premise that the Board decide to proceed with a standalone standard for rate regulated activities.

Please do not hesitate to contact us if you would like to discuss any specific issues addressed in our response, or related issues, further.

Yours faithfully,

Erlend Kvaal
Chairman of the Technical Committee on IFRS of Norsk RegnskapsStiftelse

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 (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?

We disagree with the proposed scope definition.

We believe the scope definition is too narrow, establishing different accounting treatments for economic activities that are essentially alike.

<u>First criteria (3a):</u>

For the most part we agree with the first criteria. However, we have a couple of concerns we would like to raise.

- It is not uncommon that it is the total revenue rather than rates that is regulated. For example, the regulator of the Norwegian energy distribution activities defines the total allowable revenue and not the rates (per unit). As we read the exposure draft, such regulated activities will fall outside scope of the proposed standard due to the regulation of revenue and not rates (IE 9b), although the economic reality is identical. Surely, setting the rate in order to give a return on specific costs, the expected demand must be factored in (BC 12 and IE22-IE23). We question why this is distinguishable from setting revenue and the estimated demand to get the rate. Excluding rate-regulated activities where total revenue and not rates are set (however based on the same principles as stated in paragraph 3b), while scoping in the same rate regulated activities, with the only difference being the rates and not revenue is set by the regulator, results in different accounting treatments for similar economic activities, reducing comparability between entities in different jurisdictions, but with otherwise similar economic characteristics.

- Furthermore, it is not uncommon that the regulator sets a maximum rate, however providing the rate regulated activity with some freedom to lower the prices (a price cap). For example, Norwegian regulated energy distribution companies are (as mentioned) allowed maximum total revenue. The regulator will force the regulated entities not to collect more than the maximum revenue, but it does not object to the regulated entity collecting less than the total revenue. In practice, these regulated entities always collect the maximum revenue (monopoly activity), however they are potentially allowed to collect less. Based on BC 31-32 it seems to us that this fact alone will scope them out of the proposed standard. We are concerned that this will establish different accounting treatments for similar economic activities, with reduced comparability between otherwise similar entities as a consequence.

<u>Second criteria (3b):</u>

We disagree with the second criteria.

Many regulated entities in Europe are subject to various mixed methodologies, such as an incentive-based-regulation or a price cap regulation. For example, Norwegian power distribution entities are subject to regulation where the maximum revenue is determined roughly on a formula based on 40% of entity specific costs and 60% of standard cost/industry average (incentive based part). Many European entities, such as Norwegian power distribution companies, will therefore disqualify for the proposed stringent scope definition. This worries us, as many regulated entities outside the scope of the exposure draft share many of the same economic characteristics as the regulated entities which the exposure draft are intended to apply to.

Although regulatory methodologies may be different, they pursue the same objectives; to guarantee the distribution companies an adequate return, and to provide the distribution network users with a reliable service at a reasonable fee. We believe that in all regulatory systems, irrespective of rate calculation method that satisfy the first criteria in paragraph 3 (paragraph 3a), and where the allowed price/rate is determined based on pre-fixed parameters, the regulated entities should recognise regulatory assets and liabilities.

We mainly agree with the analysis presented in BC15-BC25. However, we disagree with the strict interpretation that an asset or liability will arise only where the set price/rate is based on the specific costs of the entity. We see no basis in the Framework for restricting the scope only to regulatory activities with a close causal relationship between specific costs of the entity and future revenue cash flows. As mentioned, we believe that any regulatory activity where the first scope criteria (paragraph 3a) are met, and where price/rate is based on pre-fixed parameters, will create future economic benefits from past events (BC 17 and BC 34). We therefore strongly disagree with what we perceive as an arbitrary defined scope, leaving an impression that the scope is developed to achieve a desired outcome. Rather, we believe a broader scope, comprising rate-regulated activities with similar economic characteristics as scoped under the exposure draft, could be justified within the boundaries of the asset and liability definitions of the framework, increasing comparability across different rate-regulated activities with broadly equivalent economic characteristics. We therefore urge the Board to reconsider the scope, and re-expose the exposure draft with a broader scope.

If the Board should decide to proceed with the scope as defined in the exposure draft, the Board should at least consider to scope in certain regulation based on industry averages. Where industry average costs are the basis, and these are lower than the entity specific costs, it seems hard to justify why these cannot be viewed as restricted entity specific costs.

Lastly, we encourage the Board to explicitly state whether the proposed standard could be applied analogously or not.

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 (see paragraphs BC40–BC42 of the Basis for Conclusions).

Is this approach appropriate? Why or why not?

We agree with the analysis in BC 40-42, concluding that if rate-regulated activities satisfy the scope criteria in the proposed IFRS, the actions of the regulator provide reasonable assurance that the economic benefits will flow to or from the entity, and that measurement is possible as regulatory assets and liabilities related to specifically identifiable amounts expended or collected.

However, concerning the recognition of regulatory assets, the proposal seems internally inconsistent. According to paragraph 16, when the entity for rate-setting purposes is required to capitalize costs (where IAS 16, IAS 23 or IAS 38 would otherwise not allow for capitalizing the costs), it can only include those regulatory costs if their inclusion in the cost for rate-making purpose (the regulator allows the costs to be included) is highly probable. However, if the probability criterion is not satisfied, we understand the exposure draft to require regulatory costs to be accounted for separately as regulatory assets. This seems inconsistent. It is difficult to see the basis for requiring different recognition thresholds for similar types of regulatory costs, which in both cases are recognised as assets under the exposure draft.

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 (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?

We agree with the proposal in the exposure draft. Our conclusion is mainly based on the same arguments as those presented in BC 44-45.

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?

We disagree with this proposal.

We see no basis for overriding the principles that other IFRSs would require in similar circumstances. Furthermore, due to the constrained scope of the proposed standard, we believe this exemption will result in loss of financial reporting comparability between entities facing similar regulatory environments, and assets and liabilities bearing similar regulatory risks.

Provided that the Board decided to proceed with the proposal, we urge the Board to bring more clarity to why including the regulatory asset as part of self-constructed asset (besides the effect of discounting, BC 52) is just a presentation issue.

We are also concerned that the inclusion of imputed cost of equity capital (BC 49 and AV7) might produce some distorting effects. With the capitalization of equity costs, the cost of self-constructed or internally generated assets would include amounts that would otherwise not have been reflected in the income statement.

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?

We are confused about the proposal on the issue of impairment of regulatory assets and liability which is recognised individually (paragraph 17). As the regulatory asset is a current value measure, the need to assess the asset for impairment according to IAS 36 seems unclear to us. The current value measure includes the price, the expected volume and the effect of discounting the regulatory asset. We therefore believe that a decline in the current value of regulatory assets would be recognised through the recognition and measurement provisions of the proposed standard. However, a decline in the current value of the regulatory asset might indicate that the other assets within the CGU are impaired because of the interrelationship between the other assets and the regulatory asset. If so, any resulting impairment of the CGU would be allocated to the assets of the CGU, but not to the regulatory asset which is already at current value. We encourage the Board to clarify the wording of the proposed standard on this issue.

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.

We agree with the disclosure requirements proposed in the exposure draft. However we also find these disclosure requirements appropriate for a number of rate regulated activities outside the proposed scope of the exposure draft.

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?

We agree with the proposal not to require full retrospective application. Our conclusion is based on the same reasons as those described in BC 62-63.

Other comments

Question 8

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

None.