MAZARS

ED Rate-Regulated Activities Comment Letters
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

20 November 2009

Dear Sir/Madam,

Exposure Draft: ***Rate-Regulated Activities***

Mazars welcomes the opportunity to comment on the Exposure Draft (ED) *Rate-Regulated Activities*. Our general comments are given below. Answers to the specific questions included in the ED are given in the Appendix.

Rate-regulated activities are widespread and take various forms. We appreciate the work made by the IASB to address issues in connection with rate-regulated activities and support the need for an IFRS.

Nevertheless, we do not support the ED as drafted because we have major concerns about the proposed scope that is too narrow for an IFRS and we strongly disagree with the approach taken by the IASB to create a new category of assets and liabilities with specific recognition and measurement rules:

1. In the ED, cost-of-service regulation is the only type of regulation that meets the scope criteria. With such a narrow scope, regulations with similar economic effects (eg regulations that also have a "catch-up" provision such as regulations based on standard or assumed costs hybrid or cost-of-service regulations that are partly incentive-driven) would be scoped out. We note that the proposed scope is very similar to that of SFAS 71 and we have the same concerns on that standard that addresses only certain types of US regulations. Contrary to the IFRIC, we think that in situations considered by SFAS 71, it would be possible to recognise assets and liabilities in compliance with the definitions in the *Framework*. In order to avoid appearing as rule-based, we recommend that, in the core of the draft IFRS, the IASB should explicitly refer to both the definitions of assets and liabilities and the recognition criteria set out in the *Framework* and then provide guidance on whether these definitions and criteria would be met. In doing so, the draft IFRS would in our view capture various rate-regulations with similar economic effects and therefore ensure comparability, instead of trying to focus on one particular regulation.

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Praxity
MEMBER

2. We believe that the IASB failed to characterise the nature of regulatory assets and liabilities in the light of existing IFRSs and, as a result, proposed to create a new category of assets and liabilities with specific measurement requirements (the expected present value). We disagree with this outcome and we do not see the benefits of creating a new category of assets and liabilities for such a narrow scope. In our view, regulatory assets should be initially measured at fair value, and regulatory liabilities should fall in the scope of IAS 37 and be measured at the best estimate of amounts to be returned to customers. For these reasons, we do not support the expected present value approach with remeasurement at each reporting date as proposed in the ED. We consider that introducing the expected present value approach in an IFRS with such a narrow scope is preempting the results of the discussions the IASB is having on the revision of IAS 37.

We acknowledge that the issue is complex as it involves understanding the various types of regulations that exist around the world in the light of the *Framework* and the existing IFRSs. However, since the issue was added to the agenda of the IASB in December 2008, the ED was developed in a very short period of time (ie in less than six months) and we think that this period was too short to thoroughly address all issues in connection with rate-regulated activities.

Indeed, in our view, this project deserves more work to be spent on. As it stands, the ED takes more the form of an Interpretation designed for specific regulations than a principle-based IFRS. We urge the Board to reconsider its proposals in the ED in order to take into account all issues in connection with rate-regulated activities, thus permitting the content of the IFRS to be in line with its title.

We would be pleased to discuss our comments with you and remain at your disposal should you require further clarification or additional information.

Yours sincerely

Michel Barbet-Massin
Head of Financial Reporting Technical Support

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

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?

No, we disagree. We have serious concerns with the proposed scope: it is too narrow and appears to be rule-based, as is the scope of SFAS 71. As it stands, the ED takes more the form of an Interpretation designed for specific regulations rather than a principle-based IFRS. We believe that the issue of rate-regulated activities is an important issue that deserves more work to be spent on.

In the ED, cost-of-service regulation is the only type of regulation that meets the scope criteria. With such a narrow scope, regulations with similar economic effects (eg regulations that also have a "catch-up" provision such as regulations based on standard or assumed costs or hybrid cost-of-service regulations that are partly incentive-driven) would be scoped out. We note that the proposed scope is very similar to that of SFAS 71 and we have the same concerns on that standard that addresses only certain types of regulations. Contrary to the IFRIC, we think that in situations considered by SFAS 71, it would be possible to recognise assets and liabilities in compliance with the definitions in the *Framework*. In order to avoid appearing as rule-based, we recommend that, in the core of the IFRS, the IASB should explicitly refer to both the definitions of assets and liabilities and the recognition criteria set out in the *Framework* and then provide guidance on whether these definitions and criteria would be met. In doing so, the IFRS would in our view capture various rate-regulations with similar economic effects and therefore ensure comparability, instead of trying to focus on one particular regulation.

We acknowledge that the issue is complex as it involves understanding the various types of regulations that exist around the world in the light of the *Framework* and the existing IFRSs. However, since the issue was added to the agenda of the IASB in December 2008, the ED was developed in a very short period of time (ie in less than six months) and we think that this period was too short to thoroughly address all issues in connection with rate-regulated activities.

Indeed, in our view, scope issues deserve more work to be spent on.

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?

No, we disagree with the approach.

We note that paragraph BC 42 of the ED states that 'The Board decided that the scope criteria are both necessary and sufficient for the recognition of regulatory assets and regulatory liabilities. Consequently, once the scope criteria have been satisfied, assets and liabilities exist that meet the criteria for recognition. As a result, the Board decided not to propose a separate recognition criterion in the draft IFRS.'

As said earlier, we think that the IASB should address the issue of rate-regulated activities with a wider scope, explicitly refer to both the definitions of assets and liabilities and the recognition criteria set out in the *Framework*, and then provide guidance on whether these definitions and criteria would be met.

We believe that the IASB failed to characterise the nature of regulatory assets and liabilities in the light of existing IFRS and, as a result, proposed to create a new category of assets and liabilities with specific measurement requirements (the expected present value). We disagree with this outcome and we do not see the benefits of creating a new category of assets and liabilities for such a narrow scope.

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?

No, we strongly disagree. In our view, regulatory assets should be initially measured at fair value, and regulatory liabilities should fall in the scope of IAS 37 and be measured at the best estimate of amounts to be returned to customers. For these reasons, we do not support the expected present value approach with remeasurement at each reporting date as proposed in the ED. We consider that introducing the expected present value approach in an IFRS with such a narrow scope is preempting the results of the discussions the IASB is having on the revision of IAS 37.

Question 4

The exposure draft proposes that an entity should include in the cost of selfconstructed 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?

No, we disagree. We see no reason why there should be an exception to the requirements of existing IFRSs.

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?

Yes, we agree that IAS 36 should apply to the cash-generating unit that includes regulatory assets and liabilities. However, with the limited scope of the ED, we do not think that impairment is an issue. If it is, then it indicates that the activity should be scoped out.

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.

In our view, the proposed disclosure requirements would result in too detailed disclosures. At least, an entity should disclose which activities are in the scope and why (with a description of the regulation). As we do not support creating a new category of assets and liabilities, assets and liabilities recognised in connection with rate-regulations would be presented in accordance with existing IFRSs. In this case, there may be a need to disclose in the notes the effects of the regulation on the statement of financial position and the statement of comprehensive income.

Once the scope, recognition and measurement issues will be resolved, the IASB should reconsider the disclosure requirements.

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?

Yes, we agree with the proposal in the ED.

First-time adoption

The exposure draft includes proposed amendments to IFRS 1 First-time Adoption of International Financial Reporting Standards (see paragraph C1 of the draft IFRS). These amendments are the result of the Board's exposure draft Additional Exemptions for First-time Adopters published in September 2008. These amendments reflect the comments received on that exposure draft and the Board's redeliberations.

Other comments

Question 8

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

No, we do not.