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Discussion Paper DP/2014/2
Reporting the Financial Effects of Rate Regulation

The Edison Electric Institute (EEI), American Gas Association (AGA), and National Association of Water Companies (NAWC) appreciate the opportunity to comment on the International Accounting Standards Board's (the Board's) Discussion Paper DP/2014/2, *Reporting the Financial Effects of Rate Regulation* (the Discussion Paper).

EEI is the association that represents all U.S. investor-owned electric companies. Our members provide electricity for 220 million Americans, operate in all 50 states, and directly employ more than a half-million workers. With more than $85 billion in annual capital expenditures, the electric power industry is responsible for millions of additional jobs. EEI has 70 international electric companies as Affiliate Members, and 250 industry suppliers and related organizations as Associate Members. Organized in 1933, EEI provides public policy leadership, strategic business intelligence, and essential conferences and forums.

The AGA is an American trade organization representing natural gas supply companies and others with an interest in the production of natural gas. AGA represents more than 200 local energy companies that deliver clean natural gas throughout the U.S. There are more than 71 million residential, commercial and industrial natural gas customers in the U.S., of which 92 percent — more than 65 million customers — receive their gas from AGA members. Today, natural gas meets almost one-fourth of the United States' energy needs. Founded in 1918, AGA advocates the interests of its members and their customers, and provides information and services promoting efficient demand and supply growth, and operational excellence, in the safe, reliable and efficient delivery of natural gas.

The NAWC is the voice of the private water industry, representing quality service providers, innovation drivers and responsible partners. Each day, private water service companies help provide essential water and wastewater services to nearly 73 million people in the United States, more than a quarter of the population.

Together, EEI, AGA, and the NAWC are commenting on the Discussion Paper on behalf of their U.S. members who are predominantly financial statement preparers. We have also communicated with other key industry stakeholders, including financial statement users, industry analysts, and regulators of our member companies in the course of preparing our comments.

As background, EEI, AGA, the NAWC, and their members have been actively involved in the Board's ongoing rate-regulated activities (RRA) project, including responding to the Board's March 2013 Request for Information Regarding Rate Regulation and serving on the Consultative Group for the project. We support the Board's initiative to consider the characteristics of rate-regulated activities and assess how to best report those characteristics in a relevant and representationally faithful way financial statements prepared in accordance with IFRS.

Overall, we believe that the economic consequences of regulatory decisions, rather than the mere existence of regulation, is the key determinant in whether to recognize the effects of rate regulation in the financial statements. Certain types of rate regulation create economic consequences in the form of legally enforceable rights or obligations that impact the future cash flows and rates of return earned by the rate-regulated entity as the result of past events. In many parts of the world, including the U.S., the rights and obligations created by rate regulation are predictable, enforceable, and binding through clear, long-standing legislation and regulatory policies. As one analyst has observed, this type of rate regulation creates "a new economic reality" for the regulated entity. Therefore, we believe that the economic effects of these rights and obligations should be reflected in a rate-regulated entity's financial statements in order for them to be relevant and representationally faithful.

To the extent the effects of regulation are not included in the financial statements, the resulting earnings and financial position would not reflect the underlying economics of the rate-regulated entity's business, which would require investors or other financial statement users to make adjustments to the financial statements in order to understand and assess the underlying profitability and future cash flows of the entity. This would result in an increased use of measures and adjustments to financial statements prepared under IFRS, which would reduce the consistency and comparability of those financial statements. Furthermore, not recognizing the effects of rate regulation or adopting a disclosure-only approach would significantly increase the amount of time and effort required of investors and other users of financial statements to model the economic effects of rate regulation, which when combined with the lack of consistency and comparability of the financial statements, would increase the cost of capital for rate-regulated entities.

With the above as background, we have provided responses to the specific questions from the Discussion Paper below.

Question 1

(a) What information about the entity's rate-regulated activities and the rate-regulatory environment do you think preparers of financial statements need to include in their financial statements or accompanying documents such as management commentary?

Please specify what information should be provided in:

(i) the statement of financial position;

(ii) the statement(s) of profit or loss and other comprehensive income;

(iii) the statement of cash flows;

(iv) the note disclosures; or

(v) the management commentary.

A rate-regulated entity's financial statements and disclosures should reflect the economic effects of rate regulation and describe the regulatory environment in which it operates to allow financial statement users to understand the entity's future cash flows, earned rates of return, and rates of return expected to be earned in the future. Specifically, the financial statements should reflect the following:

(i) The statement of financial position should reflect the economic resources from (assets) or claims against (liabilities) a rate-regulated entity's future cash flows resulting from the actions of its regulator. More specifically, the statement of financial position should reflect the amount, timing, and certainty of those future cash flows. We believe that, if the rate regulation meets the criteria described in paragraphs 4.73 – 4.79 of the Discussion Paper, the future cash flows associated with the rights or obligations created by the rate regulation would be considerably certain, consistent with the "probable" threshold for recognition.

(ii) The statement of profit or loss and other comprehensive income should reflect the economic profitability of the rate-regulated entity, including the returns earned by the rate-regulated entity, which reflect the returns allowed by the rate regulator in exchange for the entity fulfilling its obligations under the regulatory compact in the applicable jurisdiction. This includes changes in the assets and liabilities that result from rate regulation in the period in which those changes occur.

(iii) The statement of cash flows should show collection or settlement of the amounts presented in the statement of financial position and the statement of profit or loss and other comprehensive income that reflect the effects of rate regulation.

(iv) The note disclosures should supplement the basic financial statements and provide financial statement users with information that gives them an understanding of:
- the nature and extent of the activities subject to rate regulation,
- any risks or uncertainty in the future recovery or reversal of the recognized deferral balances,
- the remaining periods over which the deferral account balances will be collected or refunded,
- any balances, including deferral accounts or other assets and liabilities, accruing a return and the rate of return earned or owed on those balances, and
- any material changes in deferral account balances.

(v) The management commentary should explain changes in regulatory deferral account balances that are not otherwise apparent from the financial statements and note disclosures.

(b) How do you think that information would be used by investors and lenders in making investment and lending decisions?

Investors, lenders and other financial statement users would use the financial statement and disclosure information described above to assess the rate-regulated entity's future cash flows and sustainable earned returns to make lending and investment decisions. Investors, lenders and other users of the financial statements of rate-regulated entities have a significant interest in the actions of rate regulators and the current and future effects of such actions on future cash flows and earnings. The actions of rate regulators, together with the assessment of the regulatory environment, have a direct effect on the timing and amount of future cash flows and profitability of the entity, which are important considerations for investors, lenders and credit rating agencies.

We believe that if financial statements of rate-regulated entities did not recognize the effects of rate regulation, investors, lenders and credit rating agencies would make adjustments to the primary financial statements to reflect the economic effects of the regulator's actions. We understand that this is currently the case when such information is not included in the primary financial statements. As a result of the effects of regulation, rate-regulated entities have significantly different levels of volatility in their cash flows than entities not subject to such regulation. To the extent that the financial statements do not reflect the actions of rate regulators, the reported earnings would appear to be more volatile than the entity's underlying economics. This could occur both due to timing and magnitude of differences between recognition of costs and revenues versus the approved regulatory recovery (or refund) of such costs (or billings). As a result, investors would be likely to continue to make adjustments to such financial statements to create financial measures that more faithfully reflect the underlying economics of the rate-regulated entity's business.

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Question 2

Are you familiar with using financial statements that recognize regulatory deferral account balances as regulatory assets or regulatory liabilities, for example, in accordance with US GAAP or other local GAAP or in accordance with IFRS 14? If so, what problems, if any, does the recognition of such balances cause users of financial statements when evaluating investment or lending decisions in rate-regulated entities that recognize such balances compared to:

(a) non-rate-regulated entities; and

(b) rate-regulated entities that do not recognize such balances?

The AGA, EEI, and NAWC member companies are familiar with the preparation and use of financial statements that recognize regulatory deferral account balances as regulatory assets or regulatory liabilities in accordance with U.S. GAAP. The recognition of regulatory deferral accounts reflects a rate-regulated entity's expected future cash flows and current profitability, thereby making the financial statements relevant and representationally faithful, which, in turn, provide a more accurate comparison to non-rate-regulated entities and other rate-regulated entities that recognize the effects of rate regulation.

If the effects of rate regulation were not recognized, a rate-regulated entity's financial statements may appear to be similar to those of a non-rate-regulated entity even though the underlying economics of the two businesses are very different. Rate-regulated entities have the right to charge rates designed to recover their regulator-approved revenue requirement, while non-rate-regulated entities have no such right or assurance of recovery. Therefore, the financial statements of rate-regulated entities reflect differences in profit and loss and future cash flows as compared to those of non-rate-regulated entities consistent with differences in their underlying economics. Furthermore, financial analysts in the U.S. have stated their belief that the rights and obligations created by defined rate regulation are more reliable and require less judgment than some other assets and liabilities recognized in the financial statements under other provisions of U.S. GAAP applicable to all entities because they are supported by legal and regulatory precedent that has been consistently applied for many years. We described this precedent, characterized as "the regulatory compact," in our response to the Request for Information in an earlier phase of this project.

For rate-regulated entities that currently do not recognize the effects of rate regulation, investors and other financial statement users are likely to make adjustments to the financial statements (as noted in the response to Question 1) in order to reflect the underlying economics of the entities and to more accurately compare them to the financial statements of both non-rate-regulated entities as well as rate-regulated entities that do recognize the effects of rate regulation. Providing for the recognition of the effects of rate regulation under IFRS for all similarly situated entities would eliminate the need for investors and other financial statement users to make such adjustments and would improve comparability. Requiring all rate-regulated entities that meet specified scope requirements to recognize the effects of rate regulation in their financial statements also would avoid ambiguity and promote consistency. In the U.S., preparers and users have found that the accounting guidance in place for rate-regulated entities promotes consistency and provides the comparability sought by users of financial statements in making investing and lending decisions.

Some believe that there is a problem associated with implementing a RRA standard on the grounds that such a standard would represent a rules-based approach that is specific to an industry. However, we believe a RRA standard would, in fact, provide a principles-based approach on how to account for the economic effects of rate regulation, which could be relevant and applicable to multiple industries. We do not believe that defined rate regulation, as presented in the Discussion Paper, is a rules-based approach. Rather, we believe it articulates common characteristics that would help financial statement preparers and users to identify when an entity is impacted by the economic effects of rate regulation, regardless of that entity's industry.

Question 3

Do you agree that, to progress this project, the IASB should focus on a defined type of rate regulation (see Section 4) in order to provide a common starting point for a more focused discussion about whether rate regulation creates a combination of rights and obligations for which specific accounting guidance or requirements might need to be developed (see paragraphs 3.6–3.7)? If not, how do you suggest that the IASB should address the diversity in the types of rate regulation summarised in Section 3?

We agree that the IASB's RRA project should focus on cost-of-service schemes along with hybrid rate regulation (a combination of cost-of-service and incentive-based regulation), which the IASB has termed "defined rate regulation," given that this type of rate regulation results in economic consequences, in the form of legally enforceable rights and obligations, that drive the decisions of the rate-regulated entity and influence investment or borrowing decisions by financial statement users. Unlike market or other types of regulation, "defined rate regulation" creates economic resources for or claims against a rate-regulated entity's future cash flows as the result of past events (e.g., costs incurred for cost-of-service schemes or performance targets met for incentive-based mechanisms, both of which will impact the entity's cash flows in the future when they are included in the determination of customer rates). Therefore, we believe that this type of rate regulation is the appropriate scope for consideration of future IFRS accounting guidance.

Question 4

Paragraph 2.11 notes that the IASB has not received requests for it to develop special accounting requirements for the form of limited or 'market' rate regulation that is used to supplement the inefficient competitive forces in the market (see paragraphs 3.30–3.33).

(a) Do you agree that this type of rate regulation does not create a significantly different economic environment and, therefore, does not require any specific accounting requirements to be developed? If not, why not?

(b) If you agree that this type of rate regulation does not require any specific accounting requirements, do you think that the IASB should, alternatively, consider developing specific disclosure requirements? If so, what would you propose and why?

We agree that "market" rate regulation, which often takes the form of price caps that apply to all suppliers in a competitive market, does not necessitate development of any specific accounting requirements because it does not create legally enforceable rights and obligations or provide claims for or against an entity's future cash flows; rather, it establishes parameters in which entities in a competitive market must operate. Under "market" rate regulation, suppliers do not have a legally enforceable right or any assurance that they will recover their costs or earn a return, nor is there a legally enforceable obligation that the supplier must serve the customers in its market or return certain cash inflows to those customers in the future.

Suppliers subject to price caps operate in much the same way as other entities in competitive markets that do not impose such constraints. While price caps limit the price that they may charge a particular customer, the suppliers still manage their costs to maximize their profit; compete with other entities for customers based on price, products, service, and other factors; and can reduce their prices below cost in an attempt to gain market share and increase the volume of sales. However, they still have no assurance that they will recover their costs or be profitable. Given the similarities between "market" rate regulation and purely competitive markets, we do not believe that any specific accounting or disclosure requirements are necessary or appropriate.

Question 5

Paragraphs 4.4–4.6 summarise the key features of defined rate regulation. These features have been the focus of the IASB's exploration of whether defined rate regulation creates a combination of rights and obligations for which specific accounting guidance or requirements might be developed in order to provide relevant information to users of general purpose financial statements.

(a) Do you think that the description of defined rate regulation captures an appropriate population of rate-regulatory schemes within its scope? If so, why? If not, why not?

(b) Do you think that any of the features described should be modified in order to include or exclude particular types of rate-regulatory schemes or rate-regulated activities included within the scope of defined rate regulation? Please specify and

give reasons to support any modifications to the features that you suggest, with particular reference to why the features may or may not give rise to circumstances that result in particular information needs for users of the financial statements.

(c) Are there any additional features that you think should be included to establish the scope of defined rate regulation or would you omit any of the features described? Please specify and give reasons to support any features that you would add or omit.

In general, the Discussion Paper reasonably portrays the following key distinguishing features of rate regulation, which would capture the appropriate population of rate-regulatory schemes:

- The essential nature of the goods or services being provided
- The monopoly or near-monopoly status of the supplier established through an explicit license, in legislation, or a combination of the two
- A rate regulator whose role and authority is established by legislation or other formal regulations
- Rate regulation needs to be sufficiently predictable, enforceable, and binding through clear legislation and regulatory policies

While the features above are accurately portrayed and included in the description of "defined rate regulation," we offer the following comments and suggestions on the other features of rate regulation described in the Discussion Paper:

Enforceability and Reliability of Defined Rate Regulation

We agree that defined rate regulation should be sufficiently predictable, enforceable, and binding. In this regard, the Board may want to further emphasize that those conditions should be supported by a sufficient history of judicial enforcement and regulatory recoverability that is consistent with the laws and regulations in place.

In the U.S., the regulatory compact has been established over several decades of governance under Federal and state statutes, Supreme Court rulings and other case law. At the Federal level, the regulatory compact is reflected in the Federal Power Act of 1935 and the Natural Gas Act of 1938, as well as in the policies of the Federal Energy Regulatory Commission (FERC) implementing these statutes and the Supreme Court's consistent rulings upholding those laws and policies. At the state level, the regulatory compact is reflected in statutory and case law that predates these federal statutes and in the policies of state utility commissions.

There is also a consistently high degree of reliability of recovery (or refund) of regulatory deferral accounts recognized as regulatory assets (or liabilities) by companies in the U.S. Fluctuations in regulatory asset and liability accounts reflect a pattern of increases and decreases over time consistent with regulatory objectives of cost-causation and attribution, and they do not indicate a pattern of consistently increasing or decreasing for other reasons.

The table below presents the regulatory asset and liability balances of U.S. electric and gas utilities since 2004, reflecting increases and decreases over time in both individual items as well as the net deferred asset.

($ million)	**2013**	**2012**	**2011**	**2010**	**2009**	**2008**	**2007**	**2006**	**2005**	**2004**
Deferred Debits										
Unamortized Debt Expense	2,019	1,954	1,905	1,947	1,921	1,854	1,850	1,806	1,807	1,879
Extraordinary Property Losses	322	388	371	416	447	369	272	505	775	68
Unrecovered Plant & Regulatory Study Costs	1,167	393	153	138	144	138	177	241	262	306
Other Regulatory Assets	99,327	119,366	118,241	102,692	100,159	109,851	77,338	85,207	75,062	79,245
Total Regulatory Assets	102,834	122,102	120,670	105,194	102,671	112,211	79,638	87,759	77,906	81,498
Deferred Credits										
Customer Advances for Construction	1,938	1,924	1,894	1,917	2,145	2,199	2,187	1,994	1,879	1,636
Accumulated Deferred Investment Tax Credits	3,642	3,768	3,483	3,543	3,498	3,325	3,437	3,706	4,099	4,520
Deferred Gains From Disposal of Utility Plant	69	55	62	69	71	77	82	81	86	96
Other Deferred Credits	19,085	20,500	19,191	19,103	20,943	21,374	19,543	23,055	21,535	22,390
Other Regulatory Liabilities	36,247	32,605	30,741	30,129	26,964	22,845	31,154	26,927	27,238	22,980
Total Regulatory Liabilities	60,980	58,852	55,370	54,761	53,621	49,820	56,404	55,763	54,838	51,622
Net	41,854	63,249	65,300	50,433	49,050	62,391	23,234	31,996	23,069	29,877
Year-to-Year Change	-21,396	-2,051	14,867	1,383	-13,341	39,157	-8,762	8,927	-6,808	

We understand that some who are unfamiliar with rate regulation and the utility industry may question the enforceability of the rights and obligations created by defined rate regulation and the reliability of the recovery of deferral accounts. As discussed above, in the U.S. and other parts of the world, there is long-standing legal and regulatory precedent for defined rate regulation being enforceable and highly reliable. However, if enforceability or reliability is a concern, the Board may want to consider the effects of uncertainty of cash flows in the recognition criteria of any potential future RRA standard. This would address situations in other parts of the world where the legal and/or regulatory environment may not be as mature or predictable and where reversal of legislation or regulatory policies may be more frequent. In the U.S., financial statement preparers, users, and auditors have generally found that a standard for recovery of at least “probable” is workable and appropriate for reflecting the economic impact of rate regulation in financial statements.

Rights and Obligations

In describing the rights and obligations created by rate regulation, the Discussion Paper states that the rate-regulated entity has the “right to recover the requirement” and obligation to provide non-discriminatory service to customers. It should be noted that a rate-regulated entity may not necessarily recover the exact amount of its revenue requirement depending on demand during the period – the actual amount recovered may be slightly more or less, and for cost-benefit reasons, regulators generally would not require a specific accounting for such minor differences. Therefore, we believe a more accurate description of the right created by rate regulation would be to say “the rate-regulated entity’s right to charge rates designed to recover the revenue requirement.”

Additionally, we recommend that the scope of "defined rate regulation" describe the cause-and-effect relationship between the rate-regulated entity's activities (i.e., incurring costs or achieving performance targets) and the rates approved by the regulator and charged to customers. Under "defined rate regulation," the regulator establishes one or more objective criteria, such as the incurrence of a cost or achievement of a performance metric, which the rate-regulated entity must satisfy in order to adjust its rates to customers. This cause-and-effect relationship creates an economic resource or obligation given that it provides the rate-regulated entity the legal right to collect from, or obligation to refund additional amounts to, its customers. Furthermore, this cause-and-effect relationship supports the reliability of rate regulation given that rate adjustments are generally based on objectively verifiable information (e.g., cost incurred or performance metrics achieved).

Description of the Rate-Setting Mechanism

We believe that the description of the rate-setting mechanism as set forth in paragraphs 4.12 – 4.20 is appropriate if it reflects not only dollar-for-dollar adjustment mechanisms, but also other mechanisms designed to recover the revenue requirement that do not reflect a dollar-for-dollar "true-up" adjustment feature. Under rate setting mechanisms without a dollar-for-dollar true-up (often referred to as "base rates"), the rate-regulated entity may earn more or less than the revenue requirement depending on the quantity of goods or service delivered, among other factors. However, those differences are generally within an acceptable range, and as noted above, the nature of the regulatory scheme does not require specific accountability for such differences for cost-benefit reasons. If differences between the revenue requirement and revenues earned exceed a reasonable tolerance, either the rate-regulated entity or other parties, including the regulator or other intervenors (e.g., consumer advocates), can generally seek to reset rates under the provisions of the regulatory compact.

The base rate mechanism described above is the predominant form of rate regulation in the U.S. While base rates do not provide dollar-for-dollar cost recovery or a formal true-up adjustment, they still create economic resources in the form of the right to collect future cash flows from customers. Under the regulatory compact, if a rate-regulated utility subject to base rates incurs a significant cost above and beyond the "normal," representative level of costs reflected in its revenue requirement, it likely would have the right to collect that cost from customers in future rates if the cost was "reasonably" incurred. While the determination of "normal" representative costs and "reasonably" incurred is facts-and-circumstances specific, it is sufficiently objective and supported by regulation, precedent or other means so as to allow the entity to reliably make the determination for accounting purposes. Thus, a rate-regulated entity subject to base rates and an entity with a dollar-for-dollar recovery mechanism have the same legal rights to collect future cash flows, which we believe should be accounted for consistently.

We believe that the base rate mechanisms described above are consistent with the Discussion Paper's description of incentive-based mechanisms in paragraphs 3.27 – 3.28 given that they:

- Use "benchmark" costs (typically prior period actual costs), revenue and return rates as a starting point for setting the initial rate
- Adjust the target input measures for inflation
- Do not adjust the approved rate to recover or reverse past variances between actual and estimated amounts.

However, we do not agree with the statement in paragraph 3.29 of the Discussion Paper that "such schemes typically apply when there is some competition to supply the rate-regulated goods or services but some limited rate regulation is needed to supplement the competitive forces in the market." Consistent with the description of defined rate regulation in paragraphs 4.35 – 4.37, base rates generally are used when there is little to no competition from other suppliers. Even when rates reflect an incentive component, that incentive is generally included because there is little or no competition that would otherwise drive a rate-regulated enterprise to take measures that entities in a competitive market would initiate on their own. Therefore, the regulator, through rate incentives, uses the regulatory compact to motivate the regulated entity to achieve the regulator's specific goals, such as cost control, sources of supply, operational efficiency, etc.

No Effective Competition to Supply

In paragraph 4.36 of the Discussion Paper, it is suggested that any specific accounting for rate-regulated activities should be limited to those entities that have *no* competition for the supply of the rate-regulated goods or services. While we agree that a key feature of defined rate regulation is that there should be effectively no competition for supply, we do not believe that feature should be interpreted in its strictest sense to mean that only those entities with *no* competition should be in scope. For example, certain services, such as heating for homes and businesses, can be supplied either with natural gas or electricity. However, it would be fairly cost-prohibitive for a customer to switch from natural gas heat to electric heat or vice versa, particularly on a frequent basis. Therefore, we do not believe that a gas provider, with no gas competitors in its service territory, should be excluded from the scope of any future RRA standard based on the fact that certain of its services could be supplied through electricity. The cost or other factors that would prohibit switching should be a key consideration to the extent a rate-regulated entity's services can be supplied through alternative means.

Captive Group of Customers

One key feature that we suggest expanding on in the description of "defined rate regulation" is that the rate-regulated entity must have a captive group of customers. This is not to suggest that there should be a requirement for a retroactive correction of differences (i.e., under/over-recoveries) with customers or that differences need to be settled on customer-by-customer basis, but rather that there must be a sufficient, stable customer base to enable the entity to charge and collect rates designed to recover the revenue requirement. The essential nature of the good or service, along with the monopoly or near monopoly status of the entity, generally establishes and supports a captive customer base. A captive customer base is critical to ensuring the reliability of rate regulation and that deferral accounts are ultimately recovered.

Question 6

Paragraphs 4.62–4.72 contain an analysis of the rights and obligations that arise from the features of defined rate regulation.

(a) Are there any additional rights or obligations that you think the IASB should consider? Please specify and give reasons.

As discussed above, we believe the Discussion Paper accurately portrays the legally enforceable rights and obligations created by defined rate regulation, and there are no others that we have identified.

(b) Do you think that the IASB should develop specific accounting guidance or requirements to account for the combination of rights and obligations described? Why or why not?

We agree with paragraph 4.68 of the Discussion Paper that suggests that the combination of features described in Section 4 of the Discussion Paper, rather than any one specific feature by itself, supports the existence and enforceability of the rights and obligations created by rate regulation. Given that these rights and obligations have real economic consequences that impact the future earnings and cash flows of rate-regulated entities, we believe that they should be reflected in the financial statements and that specific guidance addressing the accounting for the effects of rate regulation is the most appropriate means of accomplishing this objective.

Question 7

Section 5 outlines a number of possible approaches that the IASB could consider developing further, depending on the feedback received from this Discussion Paper. It highlights some advantages and disadvantages of each approach.

(a) Which approach, if any, do you think would best portray the financial effects of defined rate regulation in IFRS financial statements and is most likely to provide the information that investors and lenders consider is most relevant to help them make their investing and lending decisions? Please give reasons for your answer.

We believe the IASB should develop specific IFRS requirements to defer, or accelerate, the recognition of a combination of costs and revenues using a principles-based standard. We believe the alternative approaches to accounting for the effects of rate regulation outlined in the Discussion Paper would not provide information that is useful to investors and lenders and in some cases would create significant application issues.

In the first approach, the Discussion Paper describes recognizing a package of rights and obligations created by regulation as a single intangible asset. We believe this approach would be difficult and costly to apply and would not be as transparent as accounting for the effects of regulation separately in deferral accounts. The economic effect of regulatory decisions, not the mere existence of regulation, should be the pervasive factor in determining the application of generally accepted accounting principles to rate-regulated entities. Recognizing an intangible asset implies that the mere existence of regulation, rather than its specific impacts on future cash inflows and outflows, creates an asset. It also does not provide for the fact that rate regulation is symmetrical and often results in the creation of individual regulatory liabilities as well the potential for a net regulatory liability for the entity. In addition to the conceptual inconsistency inherent in this approach, it would also create significant difficulties in practice because users would have to revalue the intangible asset as a result of changes in the effects of the regulation. The Discussion Paper acknowledges in section 5.44 that identifying the effects of changes in the value of a regulatory license from other changes in an entities business would be difficult and likely lead to inconsistent accounting treatment.

In the second approach, the Discussion Paper describes reporting the effects of regulation by using the regulatory accounting requirements of the regulated entity. We believe this approach would result in inconsistent accounting for economically similar transactions and therefore would not provide useful information to investors. Regulatory accounting requirements are designed to inform the *regulator* of the effects of the regulation; not to inform *resource providers*. Depending on the regulatory regime, which may vary significantly from jurisdiction to jurisdiction, different regulators require economically similar transactions to be treated differently. As such, we do not believe this view is aligned with one of the primary objectives of the RRA project, which is to determine “what information about the economic effects of rate regulation is most relevant to users of the financial statements *in making investment and lending decisions*.”

In the third approach, the Discussion Paper describes developing specific IFRS requirements to defer/accelerate a combination of costs and/or revenues. We believe this approach is conceptually sound and will accomplish the objective of providing relevant information to investors. The economic effects of rate regulation are a defining characteristic of impacted entities and therefore should be reflected in the financial statements. By separately developing IFRS requirements for rate-regulated activities, the IASB will be able to develop the new standard specifically to address the economic effects of rate regulation and retain existing IFRS requirements for the non-regulated aspects of an entity’s operations. Further, by separately accounting for the effects of rate regulation within deferral accounts, users of the financial statements can clearly distinguish the effect of the regulation on the entity. Lastly, although not determinative, the methodology of deferring/accelerating costs/revenues to account for rate regulation has been applied in other GAAPs, including U.S. GAAP and

Canadian GAAP, for many years and is therefore widely understood and recognized by financial statement users, preparers, and auditors. We believe this approach would be a significant step toward convergence between U.S. GAAP and IFRS to the benefit of both financial statement users and preparers.

If the Board decides to pursue the third approach, we believe the IASB should develop a principles-based approach to establishing regulatory deferral accounts that includes the deferral or acceleration of both revenues and costs. We understand and appreciate the wide variety of regulatory regimes and industries that could be subject to a "defined regulation." Given this diversity, we believe a standard that considers both cost and revenue deferrals based on an underlying principle would provide the IASB with the ability to develop a standard that would achieve consistent accounting for economically similar transactions and provide the most meaningful information to users of the financial statements.

For example, in the U.S, cost deferral is the predominant mechanism for regulatory recovery and one we believe most appropriately reflects the economics of rate regulation that is designed to "reimburse" the regulated entity for an incurred cost. For deferral accounts that are designed to "pass-through" costs, a cost deferral approach is consistent with the intent and design of the regulation and therefore most faithfully represents the economics of the transaction. Conversely, we believe incentive regulatory constructs may best be reflected using a revenue deferral approach. Incentive regulations are not associated with an incurred cost, but rather with an entity achieving a desired outcome specified by the regulator that permits them to increase charges to customers and therefore may best be reflected as revenue.

While the means of establishing these accounts will be important if the Board determines to develop specific IFRS related to them, disagreement or debate on such means should in no way preclude or hinder the project from moving forward. We believe that the primary objective of a RRA standard should be recognizing assets and liabilities that reflect the rights and obligations of the rate-regulated entity that arise from regulation, along with the resulting impacts on the earnings of the entity.

(b) Is there any other approach that the IASB should consider? If so, please specify and explain how such an approach could provide investors and lenders with relevant information about the financial effects of rate regulation.

We do not believe there are any other approaches that the IASB should consider.

(c) Are there any additional advantages or disadvantages that the IASB should consider before it decides whether to develop any of these approaches further? If so, please describe them.

Recognizing the effects of rate regulation in IFRS financial statements would facilitate the fair presentation of the economic results of a rate-regulated entity's business and provide decision-useful information to third-party financial statement users. Regulatory actions can create economic resources for or claims against a rate-regulated entity's future cash flows as the result of past events. Collection (or payment) of the regulatory amounts through future billings is merely a settlement or allocation mechanism, similar to a receivable, which provides for the asset (or liability) to be collected (paid) over time. Without recognizing the effects of rate regulation, a rate-regulated entity's financial statements would not accurately portray the entity's economic resources or obligations.

Recognizing the economic resources and claims created by rate regulation in IFRS financial statements would increase their usefulness to investors and other third-party financial statement users in assessing the future cash flows of a rate-regulated utility. Rate actions have both "predictive and confirmatory value" that can influence investment decisions. Investors and other users of rate-regulated utility financial statements have a significant interest in the actions of regulators and the current and future effect of such actions. Due to the impact on cash flows, rate actions, together with the assessment of the regulatory environment in which investor-owned rate-regulated utilities operate, are important considerations to credit rating agencies and investors. Without recognizing the effects of rate regulation, credit ratings agencies would likely need to make adjustments to the primary financial statements of U.S rate-regulated companies to reflect actions of regulatory authorities.

To the extent that rate actions are not reflected in the financial statements, the resulting earnings will be inappropriately volatile due to time lags between recognition of costs and revenues and their associated impacts to customer rates. The volatility in earnings would not be representative of the underlying economics of the business. Indeed, in the U.S., regulated utilities are considered one of the most stable sectors as a result of their regulated status. This stability in no small part results from the fact that the economic effects of U.S. rate regulation are recognized in the financial statements of those entities. Absent this recognition, investors are likely to make adjustments to such financial statements to exclude the income volatility in order to take into account the regulator's actions.

Furthermore, it is possible that reporting volatile earnings would impact investors' perception of the risk associated with rate-regulated entities, which in turn could adversely impact those entities' cost of capital. If the markets assigned a higher risk from volatile earnings and capital becomes more expensive, such increased costs would be borne by customers through higher rates.

If commenting on the asset/liability approach, please specify, if it is relevant, whether your comments reflect the existing definitions of an asset and a liability in the Conceptual Framework or the proposed definitions suggested in the Conceptual Framework *Discussion Paper*, published in July 2013.

In providing our comments above, we believe that regulatory assets and liabilities should, and could, exist under the existing definitions of an asset and a liability in the Conceptual Framework or the proposed definitions suggested in the Conceptual Framework Discussion Paper, published in July 2013. We elaborated on the reasons for this view in our comment letter on that paper. We understand that some believe that collection or refund of deferral accounts based upon future billings gives the appearance of being dependent on future sales. However, in "defined regulation" transactions, we believe that future billings are merely a settlement mechanism implemented as a practical, efficient, low-cost way to settle rights and obligations associated with past events. As noted several times above in our comments, the regulator generally seeks to implement regulation by taking into account cost-benefit considerations. While the nature of defined rate regulation would support tracking and sending bills for specific amounts to both current and prior customers, such a procedure would be unduly expensive and practically impossible. Therefore, the use of adjustments to future rates charged to a relatively stable, captive customer base is an efficient method for accomplishing the objectives of the regulator both as to the enforcement of the regulatory compact and cost-minimization.

Question 8

Does your organisation carry out activities that are subject to defined rate regulation? If so, what operational issues should the IASB consider if it decides to develop any specific accounting guidance or requirements?

EEI, AGA, and the NAWC represent a significant portion of investor-owned utilities in the United States, all of which are subject to rate regulation. As with any standard setting activity, the costs of tracking, developing and reporting financial information must be weighed against the benefits the users of the financial statements might derive from such information. In our experience, the benefits of presenting regulatory assets and liabilities for all stakeholder groups, including owners, creditors, analysts, regulators, and management, far outweigh the costs of tracking and presenting them.

One additional consideration that the Board may want to address if it moves forward with this project is how an entity would present its financial statements when a change in the regulatory environment or its business activities resulted in the entity no longer meeting the scope of defined rate regulation. While we do not expect this event would occur frequently, it should be addressed in any future IFRS requirements related to regulatory accounting.

Question 9

If, after considering the feedback from this Discussion Paper and the Conceptual Framework project, the IASB decides to prohibit the recognition of regulatory deferral account balances in IFRS financial statements, do you think that the IASB should consider developing specific disclosure-only requirements? If not, why not? If so, please specify what type of information you think would be relevant to investors and lenders in making their investing or lending decisions and why.

We do not believe that a "disclosure only" approach to the economic effects of rate regulation on a regulated entity would provide investors and users of the financial statements with the information they need to make investing decisions. We believe that disclosures should supplement the base financial statements, not serve as a replacement for conveying the economic effects of rate regulation. U.S. financial analysts who follow rate-regulated companies have confirmed that adopting a disclosure-only approach would significantly increase the amount of time and effort to model the economic effects of rate regulation; when combined with the resulting lack of consistency and comparability, a disclosure-only approach would increase the cost of capital for those entities. Furthermore, such an approach would result in an increased use of non-GAAP adjustments to the financial statements. The need for investors or other users of the financial statements to make adjustments in order to reflect rate actions seems counter-intuitive to the purpose of financial statements, which is to provide financial information that is relevant and faithfully represents the economic activities of the enterprise.

Question 10

Sections 2 and 6 discuss some of the information needs of users of general purpose financial statements. The IASB will seek to balance the needs of users of financial statements for information about the financial effects of rate regulation on an entity's operations with concerns about obscuring the understandability of financial statements and the high preparation costs that can result from lengthy disclosures (see paragraph 2.27).

(a) If the IASB decides to develop specific accounting requirements for all entities that are subject to defined rate regulation, to what extent do you think the requirements of IFRS 14 meet the information needs of investors and lenders? Is there any additional information that you think should be required? If so, please specify and explain how investors or lenders are likely to use that information.

(b) Do you think that any of the disclosure requirements of IFRS 14 could be omitted or modified in order to reduce the cost of compliance with the requirements, without omitting information that helps users of financial statements to make informed investing or lending decisions? If so, please specify and explain the reasons for your answer.

Generally, we agree that the requirements of IFRS 14 meet the information needs of investors and lenders for entities that are subject to defined rate regulation. Our response to Question 1 describes the information we believe rate-regulated entities should present in their base financial statements and disclosures and explains how investors and lenders are likely to use that information.

Regarding IFRS 14 disclosure requirements, we believe the net movement presentations as required by paragraphs 22 and 23 of IFRS 14 do not adequately present the economic effects of rate regulation in the financial statements. Paragraphs 22 and 23 of IFRS 14 require the presentation, in the statement(s) of profit or loss and other comprehensive income, of the net movement in all regulatory deferral account balances distinguished from the income and expenses that are presented in accordance with other Standards. Such presentation does not show whether the movement is related to the deferral of cost, acceleration of revenue, or amortization of deferred cost or benefit, and therefore would require additional disclosure.

We believe rate-regulated entities should reflect the changes in regulatory assets and regulatory liabilities within the specific line items of income and expenses to which they relate, allowing users of the financial statements to understand the timing and economic effects of rate regulation on those affected line items and compare them to the financial statements of non-rate-regulated entities. The information required to be presented in the notes to financial statements by IFRS 14, as described in paragraph 6.23(a) of the Discussion Paper, would allow users of the financial statements to understand the effects of rate-regulation on the individual line items within the statement(s) of profit or loss and other comprehensive income.

Question 11

IFRS 14 requires any regulatory deferral account balances that have been recognized to be presented separately from the assets and liabilities recognized in the statement of financial position in accordance with other Standards. Similarly, the net movements in regulatory deferral account balances are required to be presented separately from the items of income and expense recognized in the statement(s) of profit or loss and other comprehensive income.

If the IASB develops specific accounting requirements that would apply to both existing IFRS preparers and first-time adopters of IFRS, and those requirements resulted in the recognition of regulatory balances in the statement of financial position, what advantages or disadvantages do you envisage if the separate presentation required by IFRS 14 was to be applied?

We agree with the presentation of regulatory deferral account balances as separate sections of assets and liabilities within the statement of financial position. However, as stated in our response to Question 10 above, we believe the net movement presentations as required by paragraphs 22 and 23 of IFRS14 do not properly present the economic effects of rate regulation in the financial statements. Such presentation does not show whether the movement is related to the deferral of cost, acceleration of revenue, or amortization of deferred cost or benefit, and therefore would require additional disclosure. We believe rate-regulated entities should reflect the changes in regulatory assets and regulatory liabilities within the specific line items of income and expenses to which they relate, allowing users of the financial statements to understand the timing and economic effects of rate regulation on those affected line items and compare them to the financial statements of non-rate-regulated entities.

Requiring all rate-regulated entities to account for the economic effects of rate regulation would promote consistency and provide comparability of financial statement reporting among those entities. Such financial statements would be relevant and representationally faithful, and would, in turn, provide for a more accurate comparison to non-rate-regulated entities.

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Conclusion

We support the Board's initiative to consider the characteristics of rate-regulated activities and assess how best to report those characteristics in a relevant and representationally faithful way in IFRS financial statements. We would be pleased to further discuss the impact on our industry with you or provide any additional information you may find helpful in addressing the questions in the Discussion Paper.

Very truly yours,

/s/ Richard F. McMahon, Jr.

Richard F. McMahon, Jr.
Vice President, Edison Electric Institute

/s/ William R. Ford

William R. Ford
Vice President & Chief Accounting Officer, Washington Gas Light Company
Chairman, American Gas Association Accounting Advisory Council

/s/ David P. Smeltzer

David P. Smeltzer
Executive Vice President, CFO, Aqua America
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