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Exposure Draft ED/2015/3
Conceptual Framework for Financial Reporting

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) Exposure Draft ED/2015/3, *Conceptual Framework for Financial Reporting* (the Exposure Draft).

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 Exposure Draft on behalf of their U.S. members who are predominantly financial statement preparers.

As background, EEI, AGA, the NAWC, and their members have been actively involved in the Board's ongoing rate-regulated activities (RRA) project, the purpose of which is to perform a comprehensive review of the accounting implications of rate regulation. The Board has previously indicated that it plans to use examples from the RRA project to test the definitions of assets and liabilities being developed in the Conceptual Framework project. Given the interrelationship between the RRA and Conceptual Framework projects, our response primarily focuses on questions from the Exposure Draft that could have a bearing on, or factor into, issues under consideration in the RRA project.

We have provided responses to the specific questions from the Exposure Draft below.

Question 1 – Proposed changes to Chapter 1 and 2
Do you support the proposals:

- **(a) To give more prominence within the objective of financial reporting, to the importance of providing information needed to assess management's stewardship of the entity's resources;**
- **(b) To reintroduce an explicit reference to the notion of prudence (described as caution when making judgments under conditions of uncertainty) and to state that prudence is important in achieving neutrality;**
- **(c) To state explicitly that a faithful representation represents the substance of an economic phenomenon instead of merely representing its legal form;**
- **(d) To clarify that measurement uncertainty is one factor that can make financial information less relevant, and that there is a trade-off between the level of measurement uncertainty and other factors that make information relevant; and**
- **(e) To continue to identify relevance and faithful representation as the two fundamental qualitative characteristics of useful financial information?**

Why or why not?

Yes. We agree that the proposals outlined in items (a) – (d) above provide additional clarity around and prominence to these concepts. We believe these changes could reduce the potential for confusion and further enhance the Conceptual Framework. Additionally, with regard to the fundamental qualitative characteristics set forth in item (e) above, we agree that the Conceptual Framework should continue to identify relevance and faithful representation as the two fundamental qualitative characteristics of useful financial information. Overall, we do not believe that the proposed changes represent significant differences from FASB's existing Conceptual Framework and would not preclude future convergence.

In our industry, given the unique aspects of the regulatory compact between the rate-regulated entity and its regulator, the effects of regulation need to be reflected in the financial statements in order to meet the objectives of financial reporting, including the proposed changes above. Under the regulatory compact, the regulator has significant influence over the rate-regulated entity's cash flows and management's stewardship of the rate-regulated entity's resources given that the rates that the rate-regulated entity can charge its customers are subject to the approval of the regulator. To the extent the effects of regulation are not reflected in the financial statements, the resulting earnings and financial position would not reflect the underlying "substance of the economic phenomenon" or provide relevant and representationally faithful information, which would prevent financial statement users from assessing the entity's prospects for future cash flows and management's stewardship of the entity's resources.

Question 3 – Definitions of elements
Do you agree with the proposed definitions of elements (excluding issues relating to the distinction between liabilities and equity):

- **a) an asset, and the related definition of an economic resource;**
- **b) a liability;**
- **c) equity;**
- **d) income; and**
- **e) expenses?**

Why or why not? If you disagree with the proposed definitions, what alternative definitions do you suggest and why?

Generally, we support the proposed definitions. As stated in the Exposure Draft, financial information should provide information regarding an entity's prospects for future cash flows. We agree that a right or obligation that has the potential to produce an inflow or outflow of economic benefits is a useful and relevant way to define an asset or liability. However, we believe that the assets and liabilities ultimately reflected in an entity's financial statements should take into account the probability of future cash flows. The Board has stated that for financial information to be useful, it must be relevant and representationally faithful. To be relevant, financial statement information must be timely and have predictive or feedback value. To include an economic resource (or the obligation to transfer an economic resource) in the financial statements without taking into account the probability of future cash flows would not be predictive and, thus, not provide relevant information to the users of financial statements. Therefore, we suggest that the degree of certainty of the inflows or outflows of economic benefits should be addressed in the recognition criteria if not reflected in the asset and liability definitions.

We believe that the proposed definitions would generally support the recognition of rights and obligations created by rate-regulation as assets and liabilities under International Financial Reporting Standards (IFRS). As set forth below, the proposed asset and liability definitions contain the appropriate and relevant factors that we consider in supporting the recognition of regulatory assets and liabilities.

Asset

Present Economic Resource and Obligation
Paragraphs 4.6 – 4.8 of the Exposure Draft indicate that an economic resource is a *right* that has the potential to produce economic benefits and that rights are established by contract, *legislation*, or similar means. As described in our response to the Board's Discussion Paper DP/2014/2, *Reporting the Financial Effects of Rate Regulation*, dated January 15, 2015, 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. We believe that certain types of rate regulation create economic consequences in the form of legally enforceable *present* rights or obligations that impact the future cash flows and rates of return earned by the rate-regulated entity as a result of past events.

Control
The regulatory compact creates exclusive, legally enforceable present rights to collect from, and present obligations to refund economic resources to, a group of customers within a defined service territory. Rate-regulated entities control these economic resources because of their exclusive rights and obligations under the regulatory compact to provide service and to bill and collect such amounts from a customer base within a designated service area. The Exposure Draft highlights that in order to demonstrate control, the economic benefits from a resource must flow to the entity instead of another party, and that although control "usually arises from legal rights, it can also arise if an entity has the present ability to prevent all other parties from directing the use of it and obtaining the benefits from the economic resource."

In the U.S., a utility is effectively granted a monopoly via a franchise for the provision of service within a defined geographic territory, with an obligation to serve all customers within that territory. The monopoly or near-monopoly along with the obligation to serve, created by the regulatory compact, establishes the rate-regulated entity's legal right to recover its costs from (or refund over-collections to) customers and prevents others from obtaining that right. An additional specific example of a rate-regulated entity's ability to control is a securitization transaction where a regulatory asset and the "right to bill" has been considered the rate-regulated entity's property and considered collateral in securitization related financings.

Past Events
The rights and obligations created by the existence of the regulatory compact arise from the prior delivery and receipt of economic benefits and completion of activities. The Exposure Draft states that an entity has a present obligation as a result of a past event "only if it has already received the economic benefits, or conducted the activities, that establish the extent of its obligation."

The Exposure Draft also states that "The economic benefits received could include, for example, goods or services. The activities could include, for example, operating in a particular market."

A rate-regulated entity's legal right to recover its costs from, or obligation to refund amounts to , customers arises as a result of providing goods and services to a customer base within a particular market, as permitted/ required by the regulatory compact. We believe that the costs incurred or performance targets achieved (as part of the utility fulfilling its obligation to serve) constitute past event(s).

Further, to the extent that a utility customer bill is increased or decreased to reflect the recovery or refund of additional amounts beyond the current period cost of service, those amounts also represent the transfer of economic resources associated with past events. We acknowledge that collection or refund of incremental amounts in connection with future billings may give the appearance of being associated with future period sales. However, upon evaluation of the substance of this practice, such future billings are merely a settlement mechanism implemented as a practical, efficient, low-cost way to settle rights and obligations associated with past events. In the U.S., the body of customers in any one utility's franchise territory is relatively stable, and thus recovery or refund of prior amounts is largely certain, and is included in future bills for the sake of convenience.

Potential to Produce Economic Benefits
The rights and obligations created by the regulatory compact have the potential to produce economic benefits controlled by or transferred from a rate-regulated entity, including cash inflows for the right to collect from, and cash outflows for the obligation to refund to, a group of customers within a defined service territory.

There are various rate-setting mechanisms that facilitate the regulatory compact's objective of allowing the rate-regulated entity to recover its costs (as well as a reasonable rate of return) from its customers, as described in our response to the Board's Discussion Paper DP/2014/2, *Reporting the Financial Effects of Rate Regulation*, dated January 15, 2015. Both traditional rate-setting mechanisms, such as base rates, as well as mechanisms with an automatic or formal dollar-for-dollar true-up feature, such as trackers, create legally enforceable rights and obligations that we believe meet the Board's proposed asset and liability definitions. While base rates do not provide dollar-for-dollar cost recovery or a formal true-up adjustment, they create economic resources in the form of the right to collect future cash flows from customers. In addition, an incentive regulatory construct not associated with an incurred cost, but rather with an entity achieving a desired outcome specified by the regulator creates a legally enforceable right arising from a past event that we believe meets the Board's proposed asset definition, because the regulator permits the entity to increase charges to customers as a result of achieving the desired outcome. The regulatory compact itself, rather than the specific form of the rate-setting mechanism used to effectuate that compact, creates rights and obligations that produce economic benefits. The fact that the regulatory compact permits/requires utilities to recover or refund amounts to customers in the future demonstrates that the regulatory compact creates economic resources for either the utility or its customers that are otherwise unavailable to non-regulated entities and their customers.

Equity

We agree with the proposed equity definition and noted that the definition of equity in paragraph 4.43 is consistent with the definition of equity in FASB Statement of Financial Accounting Concepts No. 6 "Elements of Financial Statements."

Income and Expenses

We agree with the proposed income and expense definitions.

Because we believe that the rights and obligations created by the regulatory compact meet the definitions of assets and liabilities, we believe the changes in those assets and liabilities should be reflected as income and expense in the statement of profit or loss and other comprehensive income. The economic profitability of the rate-regulated entity, including the returns allowed by the rate regulator in exchange for the entity fulfilling its obligations under the regulatory compact in the applicable jurisdiction, should be recognized in income and expenses.

Within the definitions of income and expenses, the Board may want to consider differentiating between revenues and gains and expenses and losses. Generally, rate-regulated entities would consider the impacts of rate regulation to constitute ongoing major or central operations, and therefore would record those impacts within revenues and expenses, as opposed to gains and losses, which are generally considered as peripheral or incidental transactions of an entity.

Question 4 – Present obligation
Do you agree with the proposed description of a present obligation and the proposed guidance to support that description? Why or why not?

We agree with the proposed definition that a present obligation must have arisen from past events (i.e., the entity has received the economic benefits, or conducted the activities, that establish the extent of its obligation) and be practically unconditional (i.e., the entity has no practical ability to avoid the transfer). As described in our response to the Board's Discussion Paper DP/2013/1, *A Review of the Conceptual Framework for Financial Reporting*, dated January 14, 2014, we agree that if an entity has the ability to avoid transfers of economic resources, without resulting in liquidation of the entity or on the cessation of trading, an obligating event has not occurred. If the entity has no practical ability to avoid a transfer of economic resources, whether due to legal constraint or other operational or regulatory factors, an obligating event has occurred.

We believe that the regulatory compact, which is established by legislation or regulation, may give rise to an obligation to transfer an economic resource resulting from past events. A regulator may require a refund in the future of amounts currently collected from customers or other economic benefits currently received by the rate-regulated entity. The rate-regulated entity has no practical ability to avoid a transfer of economic resources pursuant to the regulatory compact. Given that certain rate tariffs require specific approval by a rate regulator and refunds are typically settled through reductions of future billings, one could argue that such refunds are contingent on future sales and thus, in theory could be avoided so that the rate-regulated entity would not record a liability. However, this would not convey economic substance of the transaction or provide financial statement users with relevant information.

Question 6—Recognition criteria
Do you agree with the proposed approach to recognition? Why or why not? If you do not agree, what changes do you suggest and why?

We agree with the proposed approach to recognition, and the recognition criteria as presented in the Exposure Draft. The recognition criteria in paragraph 5.9 propose that an entity would recognize assets and liabilities (and any related income, expenses or changes in equity) if such recognition provides users of financial statements with:

(a) relevant information about the asset or liability and about any income, expenses or changes in equity;
(b) a faithful representation of the asset or the liability and of any income, expenses or changes in equity; and
(c) information that results in the benefits exceeding the cost of providing that information.

We agree with the criteria in (a) through (c) above. Generally, we support the IASB's proposal to not set a strict probability threshold on when an asset or liability should be recognized, but rather leave it to financial statement preparers to assess the relevance and usefulness of financial information, including potential existence and/or measurement uncertainty and the probability of future cash flows, to determine whether recognition is appropriate. However, the lack of thresholds and allowing financial statement preparers more discretion and judgment in determining whether recognition is appropriate could inhibit the consistency and comparability of assets and liabilities across entities.

We believe the three criteria above would support recognizing the legal rights and obligations created by certain types of rate regulation (i.e., regulatory assets and liabilities) in the financial statements. Regulatory assets and liabilities provide relevant information given that they allow financial statement users to predict the rate-regulated entity's future cash inflows and outflows. Furthermore, regulatory assets and liabilities faithfully represent the economic substance (as well as the legal form) of the rate-regulated entity's transactions and dealings with its regulator. In describing faithful representation in paragraph 5.23 of the Exposure Draft, the Board states that "If related assets and liabilities are not recognized, recognition [of other assets and liabilities] may lead to an "accounting mismatch", which may not provide an understandable or faithful representation of the overall effect of the transactions or other event giving rise to the asset or liability." While recognizing the effects of rate regulation may have an appearance of smoothing earnings by simply matching revenues and expenses, it is necessary to faithfully and accurately portray the complete economic substance of a rate-regulated entity's transactions and prevent an "accounting mismatch". Lastly, as described in our response to the Board's Discussion Paper DP/2014/2, *Reporting the Financial Effects of Rate Regulation*, dated January 15, 2015, the benefits of recognizing regulatory assets and liabilities far outweigh the costs. To the extent the effects of regulation are not recognized, investors and other financial statement users would need to make adjustments to the financial statements in order to understand and assess the underlying profitability and future cash flows of the entity. U.S. financial analysts who follow rate-regulated companies have confirmed that such adjustments to financial statements would reduce consistency and comparability, which would, in turn, increase the cost of capital for rate-regulated entities.

Question 7—Derecognition
Do you agree with the proposed discussion of derecognition? Why or why not? If you do not agree, what changes do you suggest and why?

We agree with the proposed discussion of derecognition, which is generally consistent with how derecognition is defined under U.S. GAAP.

The existing IASB Conceptual Framework includes no guidance concerning derecognition and as a consequence inconsistent approaches to derecognition are being applied across the standards. The proposed guidance for derecognition provided in the ED will serve to address that situation.

We note that in paragraph BC5.34 the IASB states that it believes it would not be useful to provide more detailed guidance on how to address existence uncertainty because relevant factors are likely to depend highly on particular circumstances. We believe it would be appropriate to address the conceptual basis for existence uncertainty at the Conceptual Framework level rather than leaving it to be dealt with at the standards level.

Question 8—Measurement bases
Has the IASB:

(a) **Correctly identified the measurement bases that should be described in the Conceptual Framework? If not, which measurement bases would you include and why?**

(b) **Properly described the information provided by each of the measurement bases, and their advantages and disadvantages? If not, how would you describe the information provided by each measurement basis, and its advantages and disadvantages?**

We agree with the Board that historical cost, fair value, and value in use are the most appropriate measurement bases to be included in the Conceptual Framework. Likewise, we agree that the Exposure Draft has appropriately identified and described the information provided by each of the measurement bases.

Question 9—Factors to consider when selecting a measurement basis
Has the IASB correctly identified the factors to consider when selecting a measurement basis? If not, what factors would you consider and why?

We agree with the factors noted in the Exposure Draft that should be considered when evaluating the measurement basis for a given asset or liability.

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Conclusion

We support the Board's initiative to reassess certain aspects of its Conceptual Framework and appreciate your consideration of our comments. 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 Exposure Draft.

Very truly yours,

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