MALAYSIAN ACCOUNTING STANDARDS BOARD
LEMBAGA PIAWAIAN PERAKAUNAN MALAYSIA

20 November 2009

Sir David Tweedie
Chairman
International Accounting Standards Board (IASB)
30 Cannon Street
London ED 4M 6 XH
United Kingdom

Dear Sir David

IASB EXPOSURE DRAFT – RATE-REGULATED ACTIVITIES

The Malaysian Accounting Standards Board welcomes the opportunity to provide comments on the IASB Exposure Draft – Rate Regulated Activities.

We appreciate the IASB's efforts to develop an IFRS to establish criteria for the recognition, measurement and disclosure of assets and liabilities arising from rate regulation for the rate-regulated industries.

Having reviewed the draft IFRS, we have significant concerns with the proposal which uses a deferring cost model but at the same time allows recognition of unearned future profit. We find this mix measurement model confusing and inconsistent with the framework and we do not agree with the concept of recognising cost plus unearned future profit due to the uncertainty over the amount to be recognised. Instead, we believe the concept of deferring cost is more appropriate and consistent with other standards on recognition of assets (other than financial assets). In our view, the additional costs incurred (without any profit element) creates a right to increase rates in the future and hence an intangible asset – the regulatory asset. For this reason, we propose the same measurement model in IAS 38 *Intangible Assets* to be applied in measuring the regulatory asset (i.e., cost less amortisation and impairment).

Our detailed responses are enclosed in the Appendix of this letter.

If you need further clarification, please contact Ms Tan Bee Leng at +603 2240 9200 or by email at beeleng@masb.org.my.

Thank you.

Yours sincerely,

Mohammad Faiz Azmi
Chairman

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Scope

Question 1
The exposure draft proposes two criteria that must be met for rate-regulated activities to be within the scope of the proposed IFRS (see paragraphs 3–7 of the draft IFRS and paragraphs BC13–BC39 of the Basis for Conclusions).

Is the scope definition appropriate? Why or why not?

We believe the scope definition is appropriate i.e. the proposals apply only to rate regulated activities where (1) the regulator is empowered to determine prices that bind the entity's customers and (2) the rate set is designed to recover an entity's specific costs of providing the regulated goods or services to earn a specified return.

However, it is not sufficiently clear whether the scope is restricted to rate regulated entities that have a *legal right* to recover its specific costs or would the scope also include rate regulated entities that do not have a legal right but is permitted / entitled to *appeal* to a regulatory body for an increase in rate based on its specific costs. Some are of the view the proposed scope only covers the former whilst some believe the scope covers both situations. We propose the Board to clarify its intent in this regard.

In addition, two differing views arose in relation to rates based on its "expected/ estimated" costs. Some viewed that expected costs would relate to cost which have not been incurred; whilst others viewed that expected costs would make reference to best estimate of historical costs that has been incurred plus the entity's best estimate. Whilst we note that the expected / estimated costs are those specific to the entity and not that of industry averages, we have significant concerns with the former view, i.e. if the cost has not been incurred, there will be a mismatch and the entity will end up recognising future profit in its financial statements. We are doubtful this proposal meets the recognition criteria of the framework. We propose the Board to clarify its intent in this regard.

Recognition and measurement

Question 2
The exposure draft proposes no additional recognition criteria. Once an activity is within the scope of the proposed IFRS, regulatory assets and regulatory liabilities should be recognised in the entity's financial statements (see paragraphs BC40–BC42 of the Basis for Conclusions).

Is this approach appropriate? Why or why not?

We would like to seek clarification if it is IASB's intention that recognition criteria applied is akin to that for intangible assets. Therefore, the cost to be capitalised as regulatory asset is limited to the extent that it is recoverable. For example, in the case of development cost, such costs are capitalised only if it can be demonstrated that the asset will generate probable economic benefits. In doing so, we are effectively considering the probability of recovery at initial recognition. We believe that at most the recognition criteria should follow the development cost criteria.

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We note from paragraph 8(a) the regulatory asset comprises (1) incurred costs and (2) a specified profit element. This is further supported by paragraph 12 which requires initial and subsequent measurement of the regulatory asset using expected present value. The proposed measurement basis using the expected cash flow model may result in the entity recognising a regulatory asset of CU110 based on an actual cost incurred of CU100.

This gives the impression the draft IFRS is applying the concept of recognising cost plus unearned future profit where the rates increase in the future is a method to collect revenue already recognised. However IE21 suggests that the recognition of regulatory assets will reduce expense in profit or loss (i.e., a concept of deferring cost). In our view, the application of a mix model is confusing and inconsistent with the framework.

In addition, we do not agree with the concept of recognising cost plus unearned future profit since there is uncertainty over the amount to be recognised. Instead, we believe the concept of deferring cost is more appropriate and consistent with other standards on recognition of assets (other than financial assets). The additional cost incurred (without any profit element) creates a right to increase rates in the future and hence an intangible asset – the regulatory asset. For this reason, we propose the same measurement model in IAS 38 *Intangible Assets* to be applied in measuring the regulatory asset (i.e., cost less amortisation and impairment). .

Nevertheless should the Board decides to proceed with the proposals despite the concerns raised, we propose IE21 to be amended. In our view, instead of reducing the expense in profit or loss, it is more appropriate to recognise revenue when a regulatory asset is recognised if the concept of recognising cost plus unearned future profit is applied. Subsequent change in estimate of the regulatory asset should be regarded as an adjustment to revenue. Similarly when a regulatory liability is recognised, it should be treated as a deferment of revenue.

On paragraph 8(b), the draft IFRS stated that an entity shall recognise a regulatory liability for its obligation to refund previously collected amounts. This statement gives the notion the recognition of the regulatory liability is premised on cash basis accounting. We believe it is more appropriate to replace "obligation to refund previously collected amounts" with "obligation to reduce rate previously billed" which is premised on the accrual concept of accounting, one of the two underlying assumptions of the framework.

Question 3

The exposure draft proposes that an entity should measure regulatory assets and regulatory liabilities on initial recognition and subsequently at their expected present value, which is the estimated probability-weighted average of the present value of the expected cash flows (see paragraphs 12–16 of the draft IFRS and paragraphs BC44–BC46 of the Basis for Conclusions).

Is this measurement approach appropriate? Why or why not?

We disagree with the proposed measurement approach for the reasons mentioned in our response to Question 2.

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Question 4
The exposure draft proposes that an entity should include in the cost of self constructed property, plant and equipment or internally generated intangible assets used in regulated activities all the amounts included by the regulator even if those amounts would not be included in the assets' cost in accordance with other IFRSs (see paragraph 16 of the draft IFRS and paragraphs BC49–BC52 of the Basis for Conclusions). The Board concluded that this exception to the requirements of the proposed IFRS was justified on cost-benefit grounds.

Is this exception justified? Why or why not?

We disagree to include in the cost of self constructed property, plant and equipment or internally generated intangible assets used in regulated activities amounts that would not be included in the assets' cost in accordance with other IFRSs as this proposal will erode comparability and cause confusion among users.

In our view, it is imperative to maintain consistent application of requirements of other standards. To do otherwise may impair the quality of information reported to users and we have significant concerns in this regard.

Notwithstanding the fact the entity is required by the regulator to capitalise amounts that would not be included in the assets' cost in accordance with other IFRSs, the objectives of regulatory reporting requirements differ from the objectives of general purpose financial reporting which provides information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions. Incidentally we see no compelling reason to provide an exception in this draft IFRS in this aspect.

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?

With reference to our response to Question 2, the regulatory asset would be required to apply the requirements of IAS 36.

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Disclosures

Question 6
The exposure draft proposes disclosure requirements to enable users of financial statements to understand the nature and the financial effects of rate regulation on the entity's activities and to identify and explain the amounts of regulatory assets and regulatory liabilities recognised in the financial statements (see paragraphs 24–30 of the draft IFRS and paragraphs BC59 and BC60 of the Basis for Conclusions).

Do the proposed disclosure requirements provide decision-useful information? Why or why not? Please identify any disclosure requirements that you think should be removed from, or added to, the draft IFRS.

We believe the proposed disclosure requirement provide decision-useful information except for paragraph 27(c). Please see our response to Question 4.

Transition

Question 7
The exposure draft proposes that an entity should apply its requirements to regulatory assets and regulatory liabilities existing at the beginning of the earliest comparative period presented in the period in which it is adopted (see paragraph 32 of the draft IFRS and paragraphs BC62 and BC63 of the Basis for Conclusions). Any adjustments arising from the application of the draft IFRS are recognised in the opening balance of retained earnings.

Is this approach appropriate? Why or why not?

We believe the proposed transition is appropriate.

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.

With reference to our response to Question 2, the Board may need to reconsider the transition for first-time adopters of this draft IFRS.