MASB MALAYSIAN ACCOUNTING STANDARDS BOARD
LEMBAGA PIAWAIAN PERAKAUNAN MALAYSIA

19 January 2015

Mr Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London, EC4M 6XH
United Kingdom

Dear Mr Hoogervorst

DISCUSSION PAPER DP/2014/2 REPORTING THE FINANCIAL EFFECTS OF RATE REGULATION

The Malaysian Accounting Standards Board (MASB) welcomes the opportunity to provide comments on the IASB Discussion Paper DP/2014/2 *Reporting the Financial Effects of Rate Regulation*.

We appreciate the IASB's effort in its comprehensive project on rate-regulated activities. Having reviewed the Discussion Paper, we agree that the IASB should focus on a defined type of rate regulation 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. However, we think that the different level of maturity of the rate regulatory framework especially in developing countries needs to be taken into account when developing the accounting requirements for rate-regulation.

We also think that the outcome of the guidance or accounting requirements for rate-regulated activities should be within the context of the revised *Conceptual Framework*.

Our detailed comments 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,

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Chairman

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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.

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

(a) The information to be included in the financial statements or accompanying documents must show the economic effects of rate regulation that is most relevant to users of financial statements in making investment and lending decisions. Such information would enhance users' understanding on the effect of rate-regulated activities and the usefulness of the information provided in the financial statements. We also think that the users would appreciate the information that helps them to distinguish the variability in performance that is adjusted through the rate-setting mechanism.

In our view, the key challenge to users of financial statements is the timing of the amounts (costs and revenue) recognised in profit or loss in accordance with the IFRS and those recognised for regulatory purposes and how these timing differences (both negative and positive) are presented in the financial statements that will provide information that satisfies the objective of general purpose financial reporting under the *Conceptual Framework*. In addition, the information to be included in the financial statements should meet the definition and recognition criteria of assets and liabilities in the *Conceptual Framework*.

However, at this juncture, we are unable to comment specifically on what information that needs to be included in the financial statements or accompanying documents. We are of the view that the elements of rate regulation that require recognition in the financial statements must be identified before deciding on what type of information to be included.

(b) In making investment and lending decisions, the investors and lenders may use the information to:

- Assess the reliability and efficiency of the rate-setting mechanism.
- Estimate future cash flows.
- Assess the stability and trustworthiness of the rate regulator – including the extent of political influences on enforceability.
- Evaluate the integrity of the rate-regulated entity management.

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We wish to highlight that there might be a limitation in disclosure of information about rate-regulated activities especially under rate-regulatory frameworks in developing countries. Therefore, such limitations need to be taken into account should the IASB decide to undertake further steps on accounting for rate-regulated activities.

Question 2

Are you familiar with using financial statements that recognise regulatory deferral account balances as regulatory assets or regulatory liabilities, for example, in accordance with US generally accepted accounting principles (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 recognise such balances compared to:

(a) non-rate-regulated entities; and

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

We noted that rate-regulated activities are widespread in many jurisdictions, including Malaysia. However, in Malaysia, regulatory deferral account balances are not recognised in the financial statements. Hence we are not able to comment further on the problems arising from recognising the regulatory deferral account balances.

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 should focus on a defined type of rate regulation 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.

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?

(a) Based on its characteristics, we 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.

(b) We believe that specific disclosure requirements are not necessary as such disclosure of information might not be meaningful to users of financial statements.

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.

We are of the opinion that the description of defined rate regulation captures an appropriate population of rate-regulatory schemes within its scope. However, we believe that this description is based upon a mature rate-regulatory framework. We think that there is still a challenge in some jurisdictions, particularly in developing countries where the maturity of the rate-regulatory framework is still at an infancy stage, to meet the features of defined rate regulation as described in paragraph 4.4.

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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.

(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 are not aware of any additional rights and obligations that the IASB should consider. We believe that the IASB should develop specific accounting guidance or requirements for the combination of rights and obligations described in this DP so that relevant information are provided to users for making decisions.

In defined rate regulation, the regulatory agreement established between the rate regulator and the entity establishes the mechanism for determining the amount of 'revenue requirement' and the right to the rate-regulated entity, through the rate per unit chargeable to customers. This right, under the agreement, that binds the customers will give rise to another issue pertaining to "unit of account". The question is whether the focus should be on an individual customer or the collective customers, as IFRS 15 *Revenue from Contracts with Customers* focuses on the former.

Therefore, the IASB may need to consider the linkage with IFRS 15 with regard to a contract with a customer and identification of performance obligation(s) with the customers and not with the individual customer given the nature of the business. In this context, the DP places emphasis on the two-party agreement, that is, the rate regulator and rate-regulated entity. Given the nature of the relationship, we think the IASB should explain how the regulatory agreement binds the customer and also how to link the rights and obligations required by defined rate regulation with an individual customer and/or customer base of the entity.

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?

(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.

(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.

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.

(a) We agree with the approach to develop specific IFRS requirements to defer / accelerate the recognition of costs and / or revenue as it would best portray the financial effects of defined rate regulation in IFRS financial statements. We think that the intangible assets approach described in the DP would give rise to the question whether the items recognised would meet the definition of an asset under the existing or revised *Conceptual Framework*.

However, we believe that the financial reporting approach should be within the context of the *Conceptual Framework* and the IASB should not permit recognition of items that do not meet the definition of assets and liabilities.

(b) In the event the outcome of the proposed approaches are not within the context of the Conceptual Framework, the IASB could prescribe disclosure requirements that would provide relevant information to users of financial statements.

(c) As explained in our response to Question 1, should the IASB decide to develop further the disclosure requirements approach as suggested in (b), it ought to consider such limitations in disclosure of information and to allow the affected rate-regulated entity to depart from meeting the disclosure requirements. Otherwise the rate-regulated entity in such IFRS jurisdictions would not be able to assert full compliance with IFRS.

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?

We are of the view that the IASB should consider the operational issues faced by developing countries whereby there are constraints in disclosure of information.

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.

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We agree that the IASB should consider developing specific disclosure-only requirements if it decided to prohibit the recognition of regulatory deferral account balances. However, as highlighted in our response to Question 1(b), the IASB should consider the constraints applicable in certain jurisdictions, in disclosing information about rate-regulated activities, if it decided to develop specific disclosure-only requirements.

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.

(a) We agree that the disclosure requirements in IFRS 14 may provide a useful starting point for discussion should the IASB decide to develop specific accounting requirements for all entities that are subject to defined rate regulation.

(b) The existing disclosure requirements of IFRS 14 are comprehensive and adequate enough to serve its current purposes. However, as explained in our response to Question 7, we think that the IASB ought to consider the limitation in disclosure of information for rate-regulated entities in developing countries.

Question 11

IFRS 14 requires any regulatory deferral account balances that have been recognised to be presented separately from the assets and liabilities recognised 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 recognised 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?

If separate presentation required by IFRS 14 was to be applied, it would enhance the understandability of users with more insightful information. In contrast, separate presentation may impair users' understanding if they are unable to link the information presented separately with other transactions arising from the ordinary activities of the entity.

We believe that the specific accounting requirements should be within the context of the *Conceptual Framework*. Therefore, we think that the IASB should first address whether the regulatory deferral account balances meet either the current or proposed revised *Conceptual Framework* definitions of an asset and a liability.

Question 12

Section 4 describes the distinguishing features of defined rate regulation. This description is intended to provide a common starting point for a more focused discussion about whether this type of rate regulation creates a combination of rights and obligations for which specific accounting guidance or requirements should be developed.

Paragraph 4.73 suggests that the existence of a rate regulator whose role and authority is established in legislation or other formal regulations is an important feature of defined rate regulation. Do you think that this is a necessary condition in order to create enforceable rights or obligations, or do you think that co-operatives or similar entities, which operate under self-imposed rate regulation with the same features as defined rate regulation (see paragraphs 7.6–7.9), should also be included within defined rate regulation? If not, why not? If so, do you think that such co-operatives should be included within the scope of defined rate regulation only if they are subject to formal oversight from a government department or other authorised body?

We believe that the existence of a rate regulator whose role and authority is established by legislation or other formal regulations is an important feature of defined rate regulation. As stated in paragraph 4.74, the rights and obligations of the rate-regulated entity, the rate-regulator and the customers are usually enforced through the application of the terms and conditions set out in the rate regulations, legislations, licences, etc.

Accordingly, we do not think that co-operatives or similar entities should be included within the population of entities that are subject to defined rate regulation as there seems to be a lack of enforcement mechanism within the framework under which co-operatives and similar entities operate.

Question 13

Paragraphs 7.11–7.22 highlight some of the issues that the IASB may consider if it continues to progress this project.

Do you have any comments or suggestions on these or any other issues that may or may not have been raised in this Discussion Paper that you think the IASB should

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consider if it decides to develop proposals for any specific accounting requirements for rate-regulated activities?

As highlighted in paragraphs 7.11–7.22 of the DP, we agree that the IASB should address the interactions with other Standards if it decides to develop proposals for any specific accounting requirements for rate-regulated activities.

In addition, we wish to emphasise that the outcome of the guidance or accounting requirements for rate-regulated activities should be within the context of the revised *Conceptual Framework*.