



1906/36824

January 18, 2015

International Accounting Standards Board  
30 Cannon Street  
London EC4M 6XH  
United Kingdom

Dear Sir/Madam,

Re: **Discussion Paper – Reporting the Financial Effects of Rate Regulation**

We appreciate the opportunity to respond to the Discussion Paper "Reporting the Financial Effects of Rate Regulation" issued by the IASB. This response represents the views of the Institute of Certified Public Accountants in Israel after conducting meetings and deliberations with representatives of the relevant entities, regulators and auditors in order to form the responses hereafter.

**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 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 recognize such balances compared to:**

- (a) Non-rate-regulated entities; and**
- (b) Rate-regulated entities that do not recognize such balances?**

**Response**

Preparers, regulators and auditors in Israel are familiar, for almost two decades, with financial statements that recognize regulatory deferral account balances according to the guidelines of ASC 980 (previously "RE-6") in US GAAP. Such accounting is implemented mainly in the financial statements of entities providing utilities such as

electricity and water. These entities, although operating as business entities, are owned and controlled by the government and regulated by special governmental authorities.

We are not aware of special problems in investment or lending decisions stemming from the recognition of such deferral accounts by these entities. This may partially result from the fact that these entities are owned and controlled by the government and, therefore, lenders usually regard them as part of the government itself (even if the liabilities of such entities are not formally covered by governmental guarantees).

### **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 summarized in Section 3?**

### **Response**

To progress this project, we agree that- the IASB should focus on defined rate regulation which meets specific criteria to be set by the future standard. However, we do not necessarily agree with the criteria described currently in Section 4 of the Discussion Paper, especially regarding enforceability issues.

### **Question 7**

**Section 5 outlines a number of possible approaches that the IASB should 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 reason 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.**

**Response**

We believe that the special characteristics of the relevant rate-regulated entities (to be defined by the future standard) require special accounting. We believe that when rate regulation creates valid rights and obligations, such rights and obligations shall be reflected in the entity's financial statements in order to faithfully present its financial position and results. This information is essential to the prediction of the entity's future cash flows, in accordance with the purpose of financial statements as described in IAS 1. Moreover, there is a significant degree of resemblance between the circumstances surrounding deferred taxes and those surrounding such rights and obligations. In both areas, the external party (either the income tax authority or the rate regulator) recognizes certain revenues and expenses in different periods than the entity itself, thereby creating "temporary differences". In the area of income taxes this situation is dealt with by deferred taxes, and in the area of rate regulation such differences shall be dealt with by regulatory deferral accounts.

Among the three sub-approaches identified by the IASB to modify existing IFRSs in this context, we believe that the approach of deferring or accelerating the recognition of revenue would be the most appropriate. This is primarily because it allows users of the financial statements to see, more readily than the cost deferral approach, the impact of the rate-regulatory adjustment. Put in other words, since the regulator performs its duties through adjusting the tariff that affects revenues, this approach would better reflect the effect of the regulation. We also suggest that adjustments related to the regulatory deferral accounts would be presented within a separate line item adjacent to revenues determined by IFRS 15, in order to allow comparability with other entities in the industry, including entities which do not recognize regulatory deferral accounts.

Needless to say, deferring or accelerating the recognition of revenue shall apply to all elements of revenue. This means that when the tariff is set to cover incurred costs plus return on equity (or any similar method), the deferral or acceleration shall include the element of return on equity embodied in the tariff.

Sincerely yours




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Adir Inbar  
Chair of the Professional Council




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Arnon Ratzkovsky  
Chair of the Financial Reporting Standards  
Committee

Copy: David Goldberg, President of the Institute of Certified Public Accountants