



December 3, 2004

Peter Martin, CA  
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Canadian Institute of Chartered Accountants  
277 Wellington Street West  
Toronto, Ontario  
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Re: Draft Guideline on Disclosures by Entities Subject to Rate Regulation

Dear Peter:

The Committee on Corporate Reporting (“CCR”) of Financial Executives International (Canada) (“FEI Canada”) is pleased to have the opportunity to provide comments to the Accounting Standards Board (ASB) on the Draft Guidelines on Disclosures by Entities Subject to Rate Regulation. The following remarks are made on behalf of the Committee and do not necessarily represent the views of FEI Canada or its members.

FEI Canada is an all-industry professional association for senior financial executives, with eleven chapters across Canada and approximately 1,500 members. Membership is generally restricted to senior financial officers of medium to large corporations. CCR is a technical committee of FEI Canada, which reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations.

FEI Canada notes the following general comments about the contents of the draft Accounting Guideline.

Certain of the comments in the Highlights section suggest that rate-regulated enterprises do not prepare their financial statements in accordance with GAAP. Prior to the effective date of Section 1100, rate-regulated enterprises followed US GAAP, specifically FAS 71, when preparing financial statements. Rate-regulated enterprises, and their auditors, believe the financial statements are in accordance with GAAP. The application of GAAP by rate-regulated enterprises appears to be different from GAAP used by other enterprises as a result of the regulator’s actions. FEI Canada also believes that the “significant diversity in practice” noted in paragraph 2 of the Background section is a result of different regulatory actions rather than a fundamental difference in accounting policies.

The comments noting that “the information should be presented in the financial statements in a coherent fashion” and the reference to “disjointed disclosures” in paragraph 3 suggests that, currently, such information is not understandable. The effects of rate regulation can be diverse, different from enterprise to enterprise, and affect many line items in the financial statements. Preparers of financial statements for rate-regulate enterprises take care to ensure that these effects are described in the notes to the financial statements, typically for each line item affected by the regulator’s actions. The economic model for these enterprises is unique and FEI Canada believes that the AcSB should take care not to suggest that the financial statements somehow misrepresent the financial circumstances of such enterprises.

We find the requirements in the draft Accounting Guideline to be very prescriptive and, as a result, will result in duplicative disclosures relating to the same financial statement item. We believe this to be unusual for a Canadian standard and not in the best interests of users.

FEI Canada believes that the AcSB should consider including all of the disclosures required by FAS 71 and other U.S. standards for rate-regulated enterprises. Examples of such items include disclosure on refunds to customers, FAS 90 disclosures on abandonments, etc.

We would like to note that, on page 6, the illustrative example discusses the group or composite life method of depreciation as being affected by rate-regulation. This is not the case. The group method of depreciation is merely one of many methods used to calculate the estimated useful lives and depreciation expense for highly capital-intensive industries and it is not used solely by rate-regulated enterprises.

The last item that FEI Canada notes is that the definition of a rate-regulated enterprise in paragraph 1 is too broad. As it is currently drafted, it will scope in enterprises whose rates are regulated but are no longer using the regulated accounting model, primarily because they are now subject to competition. One example is the telephone companies, which stopped using FAS 71 accounting in the late 90s as competition increased, despite the fact that the CRTC continues to regulate rates charged for service. The Guideline should apply to only those entities meeting the definition of a rate-regulated enterprise used in the Guideline other sections of the Handbook.

With respect to the specific questions raised by the AcSB, FEI Canada provides the following responses.

1. *Do you agree with the requirement to disclose such general information in all cases?*

We agree with disclosure of the existence of rate regulation, the nature and extent of the rate-regulated operations, the identity of the regulator(s), the rate-setting methodology and how it is applied in determining customer rates when the entity meets the definition of a rate regulated enterprise in the CICA Handbook. This information will be useful to users of the financial statements. We also agree that specific items should be disclosed, subject to materiality of the affected item, to enable users to understand the impacts of regulation.

We do not agree that the differences should be described as “differences between the entity’s accounting policies and those otherwise applicable under generally accepted accounting principles”. In our opinion, these “differences” arise due to applying generally accepted accounting principles to a unique economic circumstance, under which economic assets and liabilities, as defined under Canadian generally accepted accounting principles, are created. To describe these “differences” otherwise may infer the financial statements are not prepared according to generally accepted accounting principles.

FEI Canada does not agree the disclosures should be required when the entity does not meet the definition of a rate-regulated enterprise. In these circumstances, the regulator likely only impact the level of rates charged by the entity but will not create assets or liabilities as a result of its actions. It may be desirable to disclose how the actions of the regulator can impact the financial results of the enterprise but these disclosures should be based on the exercise of professional judgement.

2 b) *Entities are required to disclose the financial statement effect of these differences, except when the information is impracticable to obtain. The AcSB regards this information as important to an understanding of how specific financial statement items have been affected by rate regulation.*

*Do you agree with these requirements? Can you identify any circumstances under which obtaining the required financial statement effect would be impracticable?*

FEI Canada agrees that it is valuable to provide financial statement users with information to assist them in understanding how an entity is affected by rate regulation. The impact of regulation is to govern the relationship between the regulated enterprise and its ratepayers by establishing a framework for the timing of the recovery of costs with the revenues that can be charged to ratepayers. Regulation also imposes responsibilities on the rate-regulated enterprise to justify its expenditures, and the returns that should be earned. Regulatory requirements have significant influence in the financial decisions of the rate-regulated enterprise and the impacts of those

decisions. This economic framework is unique compared to that of non-regulated commercial entities that should be recognized in GAAP and not viewed simply as an industry practice.

We believe that rate-regulated enterprises should continue to apply accounting policies that properly portray the economic impact of regulation. We believe this should be enabled by having Canadian GAAP recognize the unique economic framework of rate-regulated enterprises and the need to have accounting practices that properly reflect the economic impact of regulation. Accounting practices that are required to address regulatory impacts should be appropriately disclosed, including information regarding the economic impact of any regulatory order. We do not agree that it is necessary to quantify specifically the current and cumulative effect of the difference. Rather, this may cause the reader to challenge the integrity and credibility of the accounting practices used by identifying them as non-GAAP practices.

With regard to the financial statement effects, in most cases these are readily determinable. However, in some cases, the requirements are likely to place additional burden on rate-regulated enterprises as it will require the enterprise to maintain its accounting records under alternate views (reflecting the impact of rate-regulation and assuming rate-regulation is not present). This would be particularly onerous with respect to property, plant and equipment considering AFUDC, gains/losses on retirement, etc. It is also inconsistent with the position that many rate-regulated enterprises have taken with their regulators which is to use GAAP as much as possible in determining rates.

- 2 c) *An Illustrative Example has been included, to indicate how an entity might apply the related requirements. The example illustrates the extent of the disclosures required by the Guideline, and how a tabular format may be used to present the information clearly and concisely.*

Does the Illustrative Example enhance your understanding of the information needed to comply with the Guideline, and will it assist you in choosing a suitable format to present the required information?

The example is useful to provide a clear understanding of the information needed to comply with the Guideline, will help to promote a consistent level of information being reported by rate-regulated entities and is well aligned with their particular circumstances. However, with respect to the table used to disclose regulatory assets and liabilities, it may not be possible to assess the recovery or refund period as it may be subject to future regulatory action. We also believe that, on page 6, the recognition of future income tax liabilities and future tax assets should be based on “substantively” and not “current” enacted income tax rates.

FEI Canada notes that it may be useful to require a split of regulatory assets and liabilities as current and long-term. Current practice typically displays these amounts outside of current amounts as the regulator’s actions with respect to the period of recovery or refund may be indeterminable.

- 3) Do you agree that information on the effects of rate regulation should be consolidated within the notes to the financial statements to make it easier to find and understand?

We do not agree that the effects of rate regulation should be consolidated in one note to the financial statements. Rather, consistent with General Standards of Financial Statement Presentation, S.1400.02, decisions as to disclosure in specific situations should be based on the exercise of professional judgement.

We agree that an entity should present information in a manner that enables users of financial statements to understand, without undue effort, the effects of transactions and related disclosures without the need to consider whether information elsewhere in the financial statements relates to that disclosure or transaction. In fact, this is the general premise of S.1400.07. However, if a particular financial statement item is affected by a decision of the regulator, it does not follow that separating the financial effects of those rate-setting decisions from the financial statement item itself is a better form of presentation.

As an example, an entity may follow the cash basis of accounting for pension costs, consistent with the inclusion of such costs on a cash basis for the purpose of setting rates. The Draft Guideline, if implemented, would require the financial effects of the rate-setting process to be disclosed separately from the already extensive note disclosures required by S. 3461, *Employee Future Benefits*. For smaller entities, with limited employee benefits, the S.3461 disclosures may not be as extensive and therefore, the consolidated disclosure proposed by the Draft Guideline may be preferable. However, most utilities tend to have more extensive employee benefit programs and it may be useful to incorporate disclosure of any financial effects resulting from the regulator's decision(s) with the disclosures required by S. 3461. Again, this would be a matter of professional judgement, based on the utility's specific circumstances.

Disclosure of Accounting Policies, Section 1505.11 specifically recognizes the need for flexibility in matters of format and location in disclosing accounting policies in the financial statements. We recommend that rate-regulated entities should not be held to a higher level of disclosure than other entities and should be afforded the same level of flexibility as envisioned under paragraph 1505.11.

It is possible that, if all the impacts of regulation are combined as suggested in the draft Guideline, a user could reach erroneous conclusions about the financial condition of the rate-regulated enterprise. It is our experience that users of financial statements are able to discern the effects of the actions of the regulator if the impacts are described in the individual notes and that consolidating the information in one note will add little value to the disclosures.

- 4) Does the Draft Guideline adequately address questions about the extent to which netting is permitted in the financial statements of entities subject to rate regulation?

The draft Guideline does not adequately address questions about the netting of regulatory assets and liabilities. These assets and liabilities are recovered in rates in future years as an increase or decrease in rates and are typically charged to expense as one line item called "amortization of regulatory deferrals" because that best represents how they are recovered through the ratemaking process. It is not logical to prohibit netting in this circumstance because there is no cash settlement of the asset or liability in the usual sense. However, they are recovered or repaid in rates on a net basis. Indirectly, netting is permitted by the regulator. FEI Canada believes that it is appropriate to net these amounts on the balance sheet since they are recovered in rates on a net basis.

- 5) *Are the transitional provisions appropriate?*

As noted previously, we do not agree that the "differences" should be described as being differences from what is required or permitted by generally accepted accounting principles. In our opinion, it is sufficient and appropriate to describe the accounting policies of a rate-regulated enterprise such that users have a full understanding of these policies and their impact on financial

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reporting. It is inappropriate to disclose the “differences” as impracticable to obtain as this suggests that the accounting for rate-regulated operations is not in accordance with generally accepted accounting principles. A full description of the accounting policies, and the description and amount of specific items reported in the financial statements is sufficient. In this situation all information to be disclosed, both current and comparative, should be available as it relates to accounting policies or amounts already measured and reported in the financial statements.

We agree that the Guideline should be effective for annual and interim periods beginning on or after April 1, 2005.

CCR hopes its comments will be useful to the AcSB. If you require further clarification with respect to any of our comments, please do not hesitate to contact us.

Yours very truly,



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