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Reference: Discussion Paper DP/2014/2, *Reporting the Financial Effects of Rate Regulation*

The Interstate Natural Gas Association of America (INGAA) welcomes the opportunity to provide comments in response to the International Accounting Standards Board's (IASB's) September 2014 Discussion Paper, *Reporting the Financial Effects of Rate Regulation*, regarding the characteristics of rate-regulated activities and how best to report these characteristics in International Financial Reporting Standards (IFRS). INGAA appreciates IASB's efforts to understand more fully rate-regulated accounting, and the types of information that would be appropriate for rate-regulated entities to include on their financial statements so that users of those financials can evaluate the entities' economic performance.

INGAA is a not for profit trade association comprised of 24 member companies, representing the vast majority of the interstate natural gas transmission pipeline companies in the U.S. and comparable companies in Canada. INGAA's members, which operate approximately 200,000 miles of pipelines in the U.S., provide natural gas transportation and storage services to gas producers/marketers, local gas utilities, industrial customers and gas-fired electric generators.

For purposes of these comments, INGAA is speaking on behalf of its U.S. member companies only. INGAA's member pipelines follow Generally Accepted Accounting Principles (GAAP) accounting and, where appropriate, recognize regulatory assets and liabilities.

U.S. interstate natural gas pipelines are private-sector entities regulated by the Federal Energy Regulatory Commission (FERC or Commission) under the Natural Gas Act, the statute governing transportation of natural gas in interstate commerce.[1] The FERC authorizes the construction of interstate natural gas pipelines and approves the transportation and storage rates that pipelines may charge. By doing so, FERC ensures that these rates are "just and reasonable," which is required by the Natural Gas Act.

The basic methodology interstate natural gas pipelines use to establish just and reasonable rates is cost-of-service ratemaking. Pipeline rates are set through rate case proceedings in which the pipeline has the burden of proof to justify its rates. The rates must be approved by FERC. A pipeline may not unilaterally increase its rates without FERC authorization.

[1] 15 U.S.C. §§ 717 *et. seq.* (2006). By contrast, intrastate pipelines are regulated by the states.

The FERC requires interstate gas pipeline companies to maintain their books and records in accordance with the Commission's Uniform System of Accounts (USofA).[2] GAAP permits rate-regulated entities meeting certain criteria, as outlined in Accounting Standard Codification 980-10, Regulated Operations, to recognize the effects of rate regulation in their general purpose financial statements. The effect of rate regulation generally results in the recognition of regulatory assets and liabilities on the books of the regulated entity. The FERC has the authority to, and does, audit pipeline books and records to ensure compliance with the USofA and related FERC guidance.

INGAA provided extensive comments on IASB's March 2013 Request for Information – Rate Regulation, and IASB's April 2013 Exposure Draft – Regulatory Deferral Accounts. INGAA strongly believes that recording assets and liabilities that reflect the economic impacts of rate regulation best represents companies' financial positions.

INGAA provides the following responses to the questions posed in the Discussion Paper:

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?

Response:
In addition to the information required for the financial statements of a non-regulated entity, a rate-regulated entity's financial statements also should include:

- Information sufficient for the reader of the statements to gain a basic understanding of the form of rate regulation under which the entity operates;
- Information related to orders of the regulator that pertain or may pertain to the entity along with management's estimate of the impact on the entity;
- The amount and nature of material rate-regulated assets and liabilities (RRAL) included in the balance sheet;
- The changes in balances of material RRAL between reporting periods, along with the cause(s) of the changes;
- The nature of any valuation reserves related to the recognized RRA; and
- The financial results of operations for the entity on a rate-regulated basis.

[2] 18 C.F.R. Part 201 (2014).

This information likely will be used by investors and lenders to evaluate the earnings and cash flows generated by the entity, as permitted by the regulator.

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 U.S. 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:
INGAA member companies, as a matter of standard practice, prepare general purpose financial statements that recognize RRAL. INGAA is not aware of investors, lenders or rating agencies that systematically adjust the statements of member companies to eliminate or modify the impacts of such RRAL. INGAA further believes that users of such statements find the information to be useful to evaluate the effect of rate regulation on the entity's performance. If interstate pipelines' financial statements did not utilize RRAL, INGAA believes that users of such financial statements would need to adjust the statement of operations to determine the effectiveness of the entity as it performs under regulatory oversight.

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:
The IASB's defined type of rate regulation is useful as a common starting point to develop accounting requirements. As described, this form of rate regulation includes the basic elements or characteristics unique and important to the financial impacts of rate regulation. Accordingly, defined rate regulation can be used to better understand how financial statement users can benefit from the recognition of RRAL. However, as discussed more fully below in response to Question 5, INGAA supports IASB developing principle-based criteria that a rate-regulated entity could use to determine whether it is able to use IFRS rate-regulated accounting. Such principle-based criteria would be more effective than a prescriptive model of rate regulations.

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?

Response:
Market rate regulation, as described in the Discussion Paper, may not qualify for rate-regulated accounting under rules to be developed by the IFRS. Disclosures of significant matters, unique to this form of regulation, may be useful. For instance, management should disclose situations where price caps are expected to prevent the entity's ability to recover costs and earn a reasonable rate of return.

Question 5:
Paragraphs 4.4–4.6 summarize 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.

Response:
This Discussion Paper outlines key features of IASB's defined rate regulation. INGAA cautions that any single model of rate regulation risks becoming overly prescriptive. Regulators and their stakeholders constantly are finding new and innovative ways to create new services to benefit both the pipeline and its shippers. It may be difficult to develop a standard model of rate regulation that includes, and can anticipate, all these and future variations to determine whether a

new service is to be covered under the rate-regulated accounting rules. The process would be better served if IASB compared several models of rate regulation and identified common characteristics that drive economic performance. From this process, IASB could develop a general set of principle-based criteria, which would be easier for IASB to administer and more straight-forward for preparers and users of financial statements to utilize.

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?

Response:
As acknowledged in the Discussion Paper, there is variability in the form of the rights and obligations that arise from the different regulatory mechanisms. The rights and obligations IASB identified are common to most types of rate-regulated entities and distinguish such entities from others. To the extent that the rights and obligations are enforceable, they create a financial framework that should be recognized in the regulated entity's general purpose financial statements.

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.

Response:
The IASB should focus on developing specific IFRS requirements to recognize the financial impacts of rate regulation.

Use of a single asset, "regulatory license", to recognize the effect of rate regulation would be difficult to implement and, thus, likely to result in variability between similarly situated entities. Moreover, the specific financial impacts of regulation would be difficult for statement users to identify without extensive disclosures.

Use of a specific regulator's procedures for rate-regulated entities would create variability between the statements of regulated entities. Further, prohibition of the recognition of RRAL would decrease the usefulness of general purpose financial statements for rate-regulated entities. As stated above, current users of general purpose financial statements, prepared using rate-regulated accounting procedures, do not make systematic adjustments to such financials. It follows that the absence of RRAL in these financials then would necessitate users to adjust the statements in order to make them useful.

Question 8:
Does your organization 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?

Response:
INGAA's member companies carry out activities subject to defined rate regulation. There are numerous operational issues that pose challenges in the context of accounting for rate-regulated entities but perhaps none more extensive than the differences in fixed asset accounting between entities subject to rate regulation and those not subject to such regulation. These differences include, but are not limited to, the types of direct and overhead costs that are capitalized, whether equity return during construction is capitalized, and the methods and amounts of depreciation that are recognized. These differences are, in essence, regulatory deferrals which are embedded within the fixed asset account and are a determinate of future revenue requirements. For many companies, the fixed asset balances have been recorded over many decades. Identifying the cumulative differences related to such practices would require extensive effort. In addition, the regulator typically expects the entity to adhere strictly to fixed asset accounting rules, because the fixed asset balance is a primary driver of the regulated entity's return on equity. For this reason, the entity's institutional knowledge of regulated rules for fixed asset accounting is thoroughly embedded throughout the organization – including down to field engineers and analysts. For these reasons, it would be difficult to justify the cost an entity would incur to either (1) determine the cumulative balance adjustment to conform to IFRS non-rate-regulated accounting or (2) discontinue rate-regulated accounting for fixed assets in general purpose financial statements.

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.

Response:
If the recognition of RRAL were to be prohibited, users of financial statements would need to convert the statement to a rate-regulated basis in order to ensure the usefulness of the statements. As stated above, the primary users of financial statements prepared using rate-regulated procedures are investors, lenders and credit rating agencies.

If financial statements do not include the economic effect of rate regulation, it could render the statements misleading since they would not represent the underlying economics of an entity's business. Without RRAL recognition, the regulated entity would need to report income or loss on the statement of operations for amounts otherwise deferred by the regulator in the year incurred. This would distort an entity's true profitability and would not reflect the economic substance of the regulator's recovery mechanism across financial statement cycles. Further, it would require a statement user, such as a financial lender or investor, to supplement the statement to capture the impact on costs and revenues resulting from a regulator's actions. Without recognizing regulatory assets and liabilities, there would be limited comparability between different business entities' statements.

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.

Response:
IFRS 14 provides a reasonable foundation for disclosures about rate-regulated activities.

Question 11:
IFRS 14 requires any regulatory deferral account balances that have been recognized to be presented separately from the assets and liabilities recognized 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 recognized 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?

Response:
INGAA believes that material balances of RRAL should be presented separately either on the face of the balance sheet or in the footnotes. In addition, separate tracking of the changes in material RRAL balances should be presented either on the face of the statement of operations or in the footnotes.

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 authorized body?

Response:
Any legally enforceable arrangement that requires customers to pay surcharges recovering RRAL or requires the entity to refund RRAL should be considered for treatment under rate-regulated accounting procedures. The critical factor is whether, in the case of a deferred cost, a customer is obligated to pay a surcharge recovering a cost incurred in the past. If that surcharge can be invoiced and collected through the legally enforceable arrangement, it would appear that regulatory accounting would be useful. The same is true for refunding a deferred credit.

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

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

Response:
We have no further comments or suggestions.

Respectfully submitted,

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