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Dear Mr. Ong,

Responses to IASB Exposure Draft of Rate-Regulated Activities

We refer to your letter dated 31 July 2009 inviting comments on the Exposure Draft ("ED") of Rate-Regulated Activities and are pleased to provide our comments below.

General

We support that guidance be provided under IFRS on the recognition of assets and liabilities arising from rate-regulated activities. We believe that, by meeting the criteria of rate-regulated activities, the recognition of regulatory assets and liabilities is consistent with the definition under the Framework and, with appropriate disclosures of regulatory assets and liabilities, could reflect the underlying economic environment and financial effects arising from rate regulation. On the contrary, the financial performance of the rate-regulated entities may be misinterpreted by charging to comprehensive income of those expenses incurred / revenue received that are to be recovered / refunded to customers under rate regulation.

Our response and comments on specific questions in the ED are set out in the paragraphs below.

Scope

Question 1

We suggest that further clarification on the scope be provided.

By the definition for "Regulator" under Appendix A, it appears that any private contracts with the cost-plus return type contractual arrangement between a service provider and its customer(s) could fall into the scope of the proposed standard. In this case the service provider becomes the authorized body empowered by the contract to set price (with reference to its costs plus agreed return) that binds the customer(s). If the proposed standard is not intended to apply to such private contracts, a more specific scope exclusion will be required.

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Other comment

As the objective of the proposed standard is to reflect the financial effects arising from rate-regulated activities, we suggest a specific provision to be included to give effect that the rate-regulated activities of entities shall apply the proposed standard instead of any conflicting provisions of other IFRSs.

Recognition and measurement***Question 2***

We agree to the BC40 to BC42 of the Basis for Conclusions that no additional recognition criteria are required.

Question 3

We do not think that measurement at present value is appropriate because:

- 1) Regulatory assets and liabilities at their face values represent the amounts that the entities will recover / refund through future rate-setting. Recognition at present value cannot fairly reflect the rate-setting mechanism of rate regulation.
- 2) Where the entity is entitled to recover the full amount of the regulated cost incurred / obliged to refund the sum already collected, the discount (difference between the present value and amount already incurred / collected) would also meet the criteria for recognition of another regulatory asset / liability. We do not see the need to create another regulatory asset / liability which just complicates the accounting without providing useful information to users.
- 3) In addition, if the subsequent unwinding of the discount on initial recognition is booked through the comprehensive income as expense, this will blur the effect of rate-regulated activities.
- 4) Regulatory assets and liabilities are not financial assets and liabilities. They could however be viewed as prepayment / receipt in advance which are not measured at present value.

We suggest that regulatory assets and liabilities should be measured at their undiscounted expected value.

While we agree that the regulatory assets and liabilities should be measured at their expected value, the estimated probability-weighted average of the expected cash flows could be one of the methods to come up with such value and other means of estimation should not be precluded.

Question 5

We agree to the approach to recoverability as set out in the ED with basis as explained in paragraphs BC53 and BC54 of the Basis for Conclusions.



Other comment on Paragraph 10:

Paragraph 10 specifies that the proposed standard is not applicable when items related to regulated activities have been recognised as assets or liabilities in accordance with other IFRSs.

It seems that the effect of paragraph 9 and 10 is to give priority of application of other IFRSs over the proposed standard. We do not consider this to be appropriate where an item currently recognised as assets and liabilities under other IFRSs could also qualify as regulated assets and liabilities under the proposed standard. Instead, we propose that an entity should first recognise regulatory assets and liabilities in accordance with the proposed standard if the scope criteria are met. This will fully reflect the economic and financial effects of rate regulation and to ensure the effects arising from rate regulation are treated consistently within the entity.

A corresponding transitional arrangement should also be provided for the necessary reclassification on initial adoption of the proposed standard.

Other comment on Paragraph 11:

Paragraph 11 requires that when an entity recognises a regulatory asset or regulatory liability, it shall determine whether a temporary difference exists that requires the recognition of a deferred tax asset or a deferred tax liability in accordance with IAS12 Income Taxes.

We believe that when current taxation is one of the item under the cost-of-service regulation, any deferred tax credit/expense associated with the recognition of the regulatory asset/liability in accordance with paragraph 11 above could correspondingly be recognised as another regulatory liability/asset, as the tax expense/credit will fall under the cost-of-service regulation when the timing differences reverse (i.e. when the related regulatory asset/liability is recovered/refunded through future rates). We suggest that further clarification or guidance be provided in respect of the treatment of the deferred tax recognised in paragraph 11 above.

Disclosures***Question 6***

We consider that for consistency and to facilitate comparison with other non rate-regulated entities, similar disclosure should also be made for other costs that have been capitalised as part of the property, plant and equipment that would otherwise not permitted under IAS 16.

If the regulatory assets and liabilities are measured at their undiscounted expected value as suggested under Question 3, disclosure can be made on the scheduled recovery / refund of the outstanding balances of the regulatory assets and liabilities as additional information to users.

Other comments

Question 8

We would like to see further guidance in the proposed standard for the following specific issues or situations which the rate-regulated entities may encounter arising from rate-regulated activities:

Intercompany profit relating to sales to rate-regulated entity within group

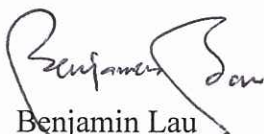
We would request the Board to consider the inclusion of similar guidance under US GAAP on the intercompany profit on sales by a group company to a regulated entity within the group. We note that under US GAAP, profit on sales to rate-regulated entity within the group shall not be eliminated if both (a) the sales price is reasonable and (b) it is probable that, through the rate-making process, future revenue of the rate-regulated entity, approximately equal to the sales price, will be derived from use of the products. We consider that the treatment under US GAAP is appropriate, having regard to the effect of rate regulation on the realisation of the portion of profit relating to intercompany sales.

Effects of the lease arrangement between entities whose activities are subject to same rate regulation

We and our associate, Castle Peak Power Company Limited (“CAPCO”), are subject to a rate regulation, i.e. the Scheme of Control Agreement, with the Government of Hong Kong. There is also an Electricity Supply Contract between us under which we are obliged to purchase all of CAPCO’s generating capacity. Pursuant to the requirements of IFRIC Interpretation 4 “Determining whether an Arrangement contains a Lease” and IAS 17 “Leases”, the electricity supply arrangement was assessed to contain leases and service elements. As the activities of both of us would be considered to meet the scope criteria under the ED, we are looking for additional guidance on (i) how the effect of rate regulation be more appropriately reflected in the financial statements; and (ii) in particular, if any difference to comprehensive income on application of lease accounting from the effect of rate regulation (e.g. the recognition of finance lease interest / income and the return under rate regulation) is to be accounted for as regulatory asset / liability.

We would welcome the opportunity to discuss our views and comments in further detail with you.

Yours sincerely,



Benjamin Lau

Director – Financial Control (Hong Kong)