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Mr Hans Hoogervorst
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4 September 2013

Dear Mr Hoogervorst

Exposure Draft ED 2013/5 - Regulatory Deferral Accounts

Deloitte Touche Tohmatsu Limited is pleased to respond to the International Accounting Standards Board's (the IASB's) Exposure Draft *Regulatory Deferral Accounts* ('the exposure draft').

The issue of accounting for rate regulation has caused significant concern in many jurisdictions and is currently the cause of delays in adoption of IFRSs – resulting in diversity between financial statements of entities in different, or even the same, jurisdiction.

We believe that the interim solution proposed in the exposure draft is an appropriate tool for jurisdictions experiencing such delays and, as such, concur with the proposal as a means of facilitating further global adoption of IFRSs and hence achieving increased global comparability in other areas of financial reporting.

However, we stress the importance of the IASB committing to pursuing the completion of its comprehensive project on rate regulation as a matter of priority and within a reasonable timeframe. It is also critical that the interim Standard does not anticipate the conclusions of that comprehensive project, which will take account of the definitions of assets and liabilities as well as other relevant matters expected to be developed in the Board's Conceptual Framework project. We note the assurance to this effect included in paragraph BC21 of the Basis for Conclusions of the exposure draft.

In this context, we agree with the proposal to limit the scope of the interim Standard to first-time adopters of IFRSs as including entities currently using IFRSs could create unnecessary diversity in practice amongst those entities.

In addition, we recommend that the interaction of any interim Standard with IFRS 3 *Business Combinations* and with paragraph D17 of IFRS *1 First-time Adoption of International Financial Reporting Standards* be made clear. In respect of IFRS 3, there are a number of permutations of acquisitions of,

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and by, entities within the scope of the exposure draft and it should be made clear whether an asset or liability in respect of regulatory deferral accounts can be recognised in the acquirer's consolidated financial statements in each case. In respect of IFRS 1 it is unclear how the interim Standard would apply to a parent transitioning to IFRSs if its subsidiary has already done so.

Our detailed responses to the questions in the invitation to comment are included in the Appendix to this letter.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0) 20 7007 0884.

Yours sincerely

Veronica Poole
Global IFRS Leader

Appendix

Question 1

The Exposure Draft proposes to restrict the scope to those first-time adopters of IFRS that recognised regulatory deferral account balances in their financial statements in accordance with their previous GAAP.

Is the scope restriction appropriate? Why or why not?

We agree with the proposal to limit the scope of the interim Standard to first-time adopters of IFRSs as including entities currently using IFRSs could create unnecessary diversity in practice amongst those entities.

As noted in our response to Question 4 below, we also agree that the option to recognise regulatory deferral account balances should be limited to entities that recognised such balances in accordance with their previous GAAP.

Question 2

The Exposure Draft proposes two criteria that must be met for regulatory deferral accounts to be within the scope of the proposed interim Standard. These criteria require that:

(a) an authorised body (the rate regulator) restricts the price that the entity can charge its customers for the goods or services that the entity provides, and that price binds the customers; and
(b) the price established by regulation (the rate) is designed to recover the entity's allowable costs of providing the regulated goods or services (see paragraphs 7–8 and BC33–BC34).

Are the scope criteria for regulatory deferral accounts appropriate? Why or why not?

We agree with the scope criterion that price must be restricted by an authorised body for the reasons set out in paragraph BC33 of the Basis for Conclusions of the exposure draft. Without an external authority to determine the price that can be charged it is unlikely that a legal or statutory basis exists for a right or obligation based on that 'permitted' price. However, it is currently unclear what is meant by the requirement that the price 'binds the customers'. For example, rate regulation will sometimes impose a maximum price that can be charged to customers, with the entity permitted to charge a lower price if it so wishes. In these circumstances the customer could be argued to be indirectly bound by the regulated price or to be bound by the price the entity chooses to charge (which is likely to be the regulated price). Another example is where customers have a choice of providers, but all are subject to the same or similar approved rates. The IASB should clarify the circumstances in which a regime is intended to be excluded from the scope of the interim Standard by this criterion or it should be removed.

In respect of the second criterion, we agree with the aim, as specified in paragraph BC34 of the Basis for Conclusions of the exposure draft, of providing reasonable assurance that the deferred amounts will be recovered through future rates. However, this could better be incorporated through a requirement to recognise an asset only when recovery is probable (as is included, for example, in U.S. GAAP[1]) as this is more consistent with the widely understood concept of recoverability of assets and would address circumstances in which it is not certain whether costs will be accepted by the rate regulator. Such a requirement could also address the circumstance in which an entity's regulatory deferral account appears

[1] Accounting Standards Codification 980-340-25-1

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to be affected by transition to, and continued application of, IFRSs (due to differing treatments of other items in the financial statements) but that change will not be reflected in the prices permitted by the rate regulator.

Question 3

The Exposure Draft proposes that if an entity is eligible to adopt the [draft] interim Standard it is permitted, but not required, to apply it. If an eligible entity chooses to apply it, the entity must apply the requirements to all of the rate-regulated activities and resulting regulatory deferral account balances within the scope. If an eligible entity chooses not to adopt the [draft] interim Standard, it would derecognise any regulatory deferral account balances that would not be permitted to be recognised in accordance with other Standards and the Conceptual Framework (see paragraphs 6, BC11 and BC49).

Do you agree that adoption of the [draft] interim Standard should be optional for entities within its scope? If not, why not?

We agree that adoption of the interim Standard should be optional for the reasons stated in paragraph BC49 of the Basis for Conclusions of the exposure draft. This would still achieve the objective of the interim Standard of facilitating adoption of IFRSs.

Question 4

The Exposure Draft proposes to permit an entity within its scope to continue to apply its previous GAAP accounting policies for the recognition, measurement and impairment of regulatory deferral account balances. An entity that has rate-regulated activities but does not, immediately prior to the application of this [draft] interim Standard, recognise regulatory deferral account balances shall not start to do so (see paragraphs 14–15 and BC47–BC48).

Do you agree that entities that currently do not recognise regulatory deferral account balances should not be permitted to start to do so? If not, why not?

As noted in our response to Question 1 above, we agree with the limitation of the scope of the interim Standard to first-time adopters of IFRSs. We also agree that it should only apply to those entities recognising regulatory deferral account balances immediately prior to the application of the Standard (i.e., at the date of transition to IFRSs) under their previous GAAP. IFRS 1 currently recognises the relevance of an entity's previous GAAP to a number of items (for example, derecognition of financial instruments and business combinations). We would be concerned by the introduction of an option to select a different national GAAP for accounting for rate-regulation. In that respect, the interaction of the requirement to continue to apply previous GAAP with IAS 8 (as referenced in paragraphs 11 to 13 of the exposure draft) should be clarified to avoid the possibility of an entity changing their accounting policy to, in effect, apply a different national GAAP.

In addition, we suggest that it be made clear how any interim Standard interacts with paragraph D17 of IFRS 1 (specifically, whether a parent shall continue to recognise regulatory deferral account balances if its regulated subsidiary has adopted IFRSs at an earlier date and has not recognised such balances). This interaction is unclear as paragraph D17 refers to the assets and liabilities of a subsidiary, whilst the exposure draft refers to regulatory deferral accounts in neutral terms (i.e., it does not refer to them as assets and liabilities and does not conclude on whether they meet the definition of those terms in the conceptual framework).

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Question 5

The Exposure Draft proposes that, in the absence of any specific exemption or exception contained within the [draft] interim Standard, other Standards shall apply to regulatory deferral account balances in the same way as they apply to assets and liabilities that are recognised in accordance with other Standards (see paragraphs 16–17, Appendix B and paragraph BC51).

Is the approach to the general application of other Standards to the regulatory deferral account balances appropriate? Why or why not?

We agree with the general approach to application of other Standards to regulatory deferral account balances as these balances need to be integrated into an IFRS reporting system. However, we believe that Appendix B to the interim Standard should be extended to explain the interaction of the Standard with IFRS 3 *Business Combinations*. There are a number of possible circumstances in which such an interaction could arise:

- an entity recognising regulatory deferral account balances after applying the interim Standard acquires an entity that is subject to a rate-regulation regime that recognises regulatory deferral account balances under either the interim Standard or under its national GAAP;
- an entity recognising regulatory deferral account balances after applying the interim Standard acquires an entity that is subject to a rate-regulation regime that does not recognise regulatory deferral account balances under either IFRSs or under its national GAAP; and
- an entity that does not recognise regulatory deferral account balances (either because it transitioned to IFRS before the interim standard, chooses not to apply the interim Standard, or its previous GAAP did not permit recognition of such balances or it is not subject to rate regulation) acquires an entity that is subject to a rate-regulation regime and recognises regulatory deferral account balances.

The interim Standard should specify in each case whether regulatory deferral account balances relating to the acquiree should be recognised in the acquirer's consolidated financial statements. As a starting point, it would appear appropriate that the acquirer's accounting policy should also be applied in its accounting for an acquired business, except if the acquirer has not yet established an accounting policy because neither the acquirer nor any entities within the group are subject to rate regulation.

Question 6

The Exposure Draft proposes that an entity should apply the requirements of all other Standards before applying the requirements of this [draft] interim Standard. In addition, the Exposure Draft proposes that the incremental amounts that are recognised as regulatory deferral account balances and movements in those balances should then be isolated by presenting them separately from the assets, liabilities, income and expenses that are recognised in accordance with other Standards (see paragraphs 6, 18–21 and BC55–BC62).

Is this separate presentation approach appropriate? Why or why not?

We agree that regulatory deferral account balances, and the effect of movements thereof on profit or loss, should be presented separately as we believe it is important that users are able to identify the effect of such balances in order to compare the financial statements of entities that do, and do not, apply the interim Standard. For the same reason, we agree with the requirement to present earnings per share figures before and after movements in regulatory account balances.

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As a point of detail, we note that the illustrative statements of profit or loss and other comprehensive income accompanying the draft interim Standard do not appear to comply with paragraph 21 of the exposure draft as they include a sub-total for profit before tax and regulatory account movements, not for profit before regulatory account movements.

Question 7

The Exposure Draft proposes disclosure requirements to enable users of financial statements to understand the nature and financial effects of rate regulation on the entity's activities and to identify and explain the amounts of the regulatory deferral account balances that are recognised in the financial statements (see paragraphs 22–33 and BC65).

Do the proposed disclosure requirements provide decision-useful information? Why or why not? Please identify any disclosure requirements that you think should be removed from, or added to, the [draft] interim Standard.

We agree with the disclosure objectives included in paragraph 22 of the exposure draft. It is important for users to be able to understand the regulatory regimes giving rise to assets and liabilities and what constitutes those assets and liabilities. The specific disclosure requirements of paragraphs 25 to 33 of the exposure draft are an appropriate means of meeting those objectives.

Question 8

The Exposure Draft explicitly refers to materiality and other factors that an entity should consider when deciding how to meet the proposed disclosure requirements (see paragraphs 22–24 and BC63–BC64).

Is this approach appropriate? Why or why not?

We agree that the concept of materiality should apply to the proposed disclosure requirements and that the considerations in paragraphs 23 and 24 of the exposure draft are relevant to the application of that concept. We do not, however, believe that any of these considerations are specific to regulatory deferral accounts and they are for the most part re-iterating the existing requirements of paragraphs 29 to 31 of IAS 1 *Presentation of Financial Statements*.

We would encourage the IASB as part of its project on a disclosure framework or its narrow-scope project on IAS 1 to address concerns raised at the Discussion Forum on Disclosure in Financial Reporting to consider the application of materiality to disclosure requirements and, if necessary, to amend the requirements of IAS 1. We believe that providing clarity on this issue to all disclosure requirements through IAS 1 is preferable to including different explanations in different standards.

Question 9

The Exposure Draft does not propose any specific transition requirements because it will initially be applied at the same time as IFRS 1, which sets out the transition requirements and relief available.

Is the transition approach appropriate? Why or why not?

We agree with the transition approach proposed in the exposure draft.

Question 10

Do you have any other comments on the proposals in the Exposure Draft?

We believe that guidance should be provided on the presentation and disclosure requirements in respect of interim financial statements for entities applying the interim Standard. In particular, we believe it should be made clear that separate line items for regulatory deferral account balances and movements therein should also be included in a condensed set of interim financial statements.