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IFRS Global office
May 2013

IFRS in Focus
IASB issues exposure draft on regulatory deferral accounts interim standard

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The Bottom Line

The ED proposes an interim standard for eligible first-time adopters of IFRS to:

- Continue apply rate-regulated accounting where that was permitted under their previous GAAP accounting policies.
- Separately present regulatory deferral account balances in the statement of financial position and movements in those balances in the statement of profit or loss and other comprehensive income to isolate these amounts.
- Provide disclosures to identify the nature of, and risk associated with, the form of rate regulation that has given rise to the recognition of regulatory deferral account balances.
- Comments on the proposals are due by 4 September 2013.

Introduction and background

In April 2013, the International Accounting Standards Board (IASB) published exposure draft ED/2013/5 *Regulatory Deferral Accounts* ('the ED') proposing an interim IFRS for entities that are first-time adopters and recognised regulatory deferral account balances under their previous GAAP. The interim standard is being proposed because the IASB is concerned that failing to provide some guidance may serve as a barrier to the adoption of IFRS for those entities that undertake rate-regulated activities and were permitted to recognise regulatory deferral account balances under their existing GAAP.

In parallel with this ED, the IASB is undertaking a comprehensive project on rate-regulated activities with a view to issuing a discussion paper later in 2013. That comprehensive project aims to address the broader issue of whether regulatory deferral account balances meet the definitions of assets and liabilities in the *Conceptual Framework*. The IASB has been considering rate-regulated activities for some time. It was initially raised as an issue to the IFRS Interpretations Committee and culminated in the IASB issuing an exposure draft in 2009. At that time the IASB was unable to proceed to the development of a standard because respondents were divided on the appropriateness of limiting the scope of the standard to a 'cost-of-service' model of regulation which only captured the regulatory regimes in some jurisdictions. Concerns were also raised about the lack of a conceptual basis to support the recognition of regulatory deferral balances as assets and liabilities.

Observation

The interim standard the IASB is proposing in the ED is similar in nature to the interim standards that have been issued in the past – IFRS 4 *Insurance Contracts* and IFRS 6 *Exploration for and Evaluation of Mineral Resources*. These interim standards effectively 'grandfather' existing requirements under previous GAAP pending the development of a comprehensive IFRS. The experience with both IFRS 4 and IFRS 6 suggests that 'interim' can mean considerable period given the complexity of the issues involved.

The proposals

Which entities are these proposals directed at?

The ED proposes that the interim standard will permit (but not require) entities that adopt IFRS to continue to use their previous GAAP, as accepted in their local jurisdiction, for the recognition, measurement and impairment of regulatory deferral account balances, subject to certain eligibility criteria. The IASB is clear that the proposed interim standard cannot be applied by entities that have adopted IFRS prior to the finalisation of the interim standard. Accordingly, the interim standard does not provide an opportunity for those entities with rate-regulated activities to start applying regulatory accounting in their financial statements. Similarly, an entity applying this interim standard upon the adoption of IFRS must have been recognising regulatory deferral account balances under the provisions of their previous GAAP to be eligible to elect to recognise such balances under IFRS.

Perhaps one of the more complex aspects of the ED is identifying what types rate regulation fall within the scope of the interim standard. The principal determinant proposed by the IASB is that the rate regulation must create a strong link between the amounts the regulator deems to be 'allowable costs' to be included in customer rates and the amounts that are eventually recognised through an entity's statement of profit or loss and other comprehensive income. The proposed interim standard is only intended to be applied to rate-regulated activities that meet the following criteria:

- 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

- The price established by the regulation (the rate) is designed to recover the entity's allowable costs of providing the regulated goods or services.

Where those conditions are satisfied, it is proposed that an entity can *elect* to apply the interim standard.

How does the accounting work?

Recognition and Measurement

The IASB proposes that entities apply the provisions of their previous GAAP to account for regulatory deferral account balances. Essentially, that means that recognition and measurement (including impairment) in respect of those balances only continues in accordance with the provisions of the entity's previous GAAP. However, specific presentation and disclosure requirements are proposed and these are discussed below. The IASB has determined that it would not be appropriate to refer to these balances as 'assets' and 'liabilities' as they do not want to prejudge the outcome of their comprehensive project which is considering that specific issue and instead requires such balances to be presented as regulatory deferral debit balances or regulatory deferral credit balances.

Observation

Although it is not readily apparent from the proposed wording of the interim standard, but 'previous GAAP' does not necessarily mean an entity's local GAAP. The IASB explains in the Basis for Conclusions that "some non-US entities with rate-regulated activities apply US GAAP" and it did not want to get into the definitional issues where entities do not apply the GAAP of their own country.

The ED proposes that all other IFRSs be applied first such that each asset and liability recognised in the statement of financial position, such as property plant and equipment, income taxes, and employee benefits, comply with the requirements of the other IFRS standards. The regulatory deferral account balances represent incremental amounts that are recognised over and above the assets and liabilities recognised under the other standards.

The ED also sets out how the interim standard will interact with other IFRSs. In particular, it is proposed that other standards continue to apply. The application guidance highlights the need to consider that any amounts in respect of deferred regulatory balances are separately identified. The table below highlights some of key considerations.

Standard	Proposed Application
IAS 10 *Events after the Reporting Period*	Consideration of the impact of events that occur between the end of the reporting period and the date the financial statements are authorised for issue on estimates and assumptions included in regulatory deferral account balances.
IAS 12 *Income Taxes*	Deferred tax to be included in the regulatory deferral account balance instead of including it in the deferred tax liability (asset) or tax expense (income).
IAS 33 *Earning per Share*	An additional measure of basic and diluted EPS is required to be presented which excludes the net movements in the regulatory deferral account balances.
IAS 36 *Impairment of Assets*	The entity's previous GAAP is applied to the measurement of impairment for its recognised regulatory deferral account balances. However, where a cash-generating unit includes regulatory deferral account balances, impairment testing under IAS 36 is required for the CGU. An entity is required to apply the guidance in IAS 36 to determine whether the regulatory balances recognised are included in the carrying amount of the CGU for impairment testing. Where an impairment loss is identified it is recognised in accordance with IAS 36.
IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*	Measurement requirements of IFRS 5 do not apply to regulatory deferral account balances. Where a discontinued operation includes a rate-regulated activity the movement in the regulatory deferral account balances are not included as part of the line items required under IFRS 5 but rather is included in the regulatory deferral account balances and movements therein.
IFRS 12 *Disclosure of Interests in Other Entities*	For each of an entity's subsidiaries with non-controlling interests, separate disclosure of regulatory deferral account balances and the net movement in those balances.

Presentation

The entity will be required to present a sub-total representing total assets (and/or liabilities) before regulatory deferral accounts and then present regulatory deferral account debit (and/or credit) balances followed by total assets (and/or liabilities). In summary, the statement of financial position will present assets in the following manner, with similar presentation requirements for liabilities.

Current assets	xxx
Long term assets	<u>xxx</u>
Total assets before regulatory deferral debit balances:	xxx
Regulatory deferral debit balances	<u>xxx</u>
Total assets	<u>xxx</u>

Similarly, the presentation standard for the statement of profit or loss also requires separate presentation of the movements in the regulatory deferral accounts. For example, the statement of profit or loss would have to present a sub-total of profit or loss before the impact of the net movement in all regulatory deferral accounts.

Revenue	xxxx
Cost of sales	<u>(xxx)</u>
Gross profit	xxxx
Expenses	<u>xxxx</u>
Profit before tax and regulatory account movements	xxxx
Income tax expense	(xxx)
Net movement on regulatory deferral accounts	<u>(xxx)</u>
Profit for the year attributable to owners of the parent	<u>xxxx</u>

Disclosure

The ED proposes specific disclosure requirements to enable users to evaluate the nature of, and the risks associated with the specific rate regulation regime and the effects of that rate regulation on its financial position, financial performance and cash flows. These disclosures include:

- specific reconciliations of the carrying amount at the beginning and end of the period for each category of regulatory deferral account that is individually material (and others in aggregate);
- the rate of return or discount rate allowed by the regulator to reflect the time value of money that is applicable to each regulatory deferral balance; and
- the remaining periods over which the entity expects to recover or amortise the carrying amount of each regulatory deferral account debit balance or reverse each regulatory deferral account credit balance.

Observation

The overarching principle that underlies the proposed presentation and disclosure requirements is that the effects of continuing to apply rate-regulated accounting on a basis consistent with previous GAAP are shown separately from all other assets, liabilities and results of operations in the financial statements. The IASB notes in its Basis for Conclusions that its intention is to minimise the accounting policy changes in accounting for rate-regulated activities – that is why the presentation is aimed at making them discrete from other recognised amounts. The discrete presentation of regulatory deferral account balances and the movements therein will enhance comparability with the financial statements of rate regulated entities that are not eligible for, or choose not to apply, the interim standard.

Transition, effective date and comment period

The ED does not propose any specific relief from full retrospective application of the proposed interim standard as there is effectively no change to an entity's accounting policy as it continues to apply the recognition and measurement requirements of its previous GAAP. IFRS 1 *First-time Adoption of International Financial Reporting Standards* already permits entities with property, plant and equipment or intangibles used in operations subject to rate-regulated activities to use the carrying amounts determined under previous GAAP as deemed cost on the date of transition to IFRS.

The IASB will determine the effective date after considering the comments received on the ED and performing necessary due process steps. It is proposed that early application will be permitted.

Comments on the ED are due by 4 September 2013.

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