European Securities and
Markets Authority

The Chair

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Francoise Flores
EFRAG
Square de Meeus 35
1000 Brussels
Belgium

The IASB's Exposure Draft Regulatory Deferral Accounts

Dear Ms Flores,

The European Securities and Markets Authority (ESMA) thanks you for this opportunity to contribute to the EFRAG's due process. We are pleased to provide you with the following comments aimed at improving the decision-usefulness of financial statements and the transparency and enforceability of IFRSs.

ESMA has considered EFRAG's draft response on the IASB's Exposure Draft (ED) *Regulatory Deferral Accounts*. ESMA understands that the IASB proposes to issue an interim standard to reduce barriers to the adoption of IFRS by entities with rate-regulated activities, until guidance is developed through a comprehensive project on Rate-regulated activities.

Like EFRAG, ESMA does not support the approach followed by the IASB to allow first time adopters to recognise deferral accounts in accordance with local *Generally Accepted Accounting Principles* (GAAP), even if this carve-in is only temporary. We believe that "deferral accounts" do not meet the definitions of assets and liabilities as set out in the IASB *Conceptual Framework*. ESMA believes that the IASB should not develop standards that increase diversity in practice even if it is on a temporary basis. Additionally, ESMA would like to point out that the interim standards "IFRS 4 – *Insurance Contracts* and IFRS 6 – *Exploration for and Evaluation of Mineral Resources*" clearly demonstrate that an interim standard is not a guarantee for a quick solution.

Therefore, as further detailed below, ESMA has serious concerns that this interim standard will jeopardise the IASB objective to provide users of financial statements with high quality financial information that is understandable, comparable, enforceable and globally accepted.

High quality information

ESMA believes that new IFRSs should not conflict with existing IFRS or the IASB's *Conceptual Framework*, as this could harm the quality of financial information in the financial statements. As stated in paragraph BC12 of the ED, many constituents (including ESMA[1]) and some members of the IASB do not think that the regulatory deferral accounts meet the definitions of assets and liabilities. In the comprehensive project of rate-regulated activities this is one of the issues to be resolved taking also into account the revision of the IASB's project on the *Conceptual Framework*. Therefore, ESMA believes that until that work is finalised, the IASB should not allow recognition of deferral accounts in IFRS financial statements even if such measure is intended to be temporary.

Furthermore, ESMA does not agree with the new terminology used. ESMA concurs with the alternative view presented in paragraph AV 6 from the ED which considers that allowing recognition of deferral accounts in the statement of financial position is equivalent to recognise them as assets and liabilities even if they are not labelled as such. ESMA points out that by using neutral terms such as "regulatory deferral account balances" instead of "regulatory assets" and "regulatory liabilities", the IASB is not solving the problems identified above and it is creating a "new category" of line items that is neither defined in the current ED nor the *Conceptual Framework*.

Comparability and globally accepted standards

ESMA also believes that the ED as noted in paragraph AV2 will severely impair comparability among preparers depending on their timing of adoption to IFRS. As the option is available to preparers in countries that until now did not adopt IFRS and first time adopters in jurisdictions that have already adopted IFRS, the comparability of financial statements will be reduced between preparers within the same and across different jurisdictions.

Furthermore, ESMA agrees with the alternative view mentioned in paragraph AV4 of the ED and believes that this interim standard lacks a sound conceptual basis. ESMA considers that the problems that the IASB puts forward to justify the development of this standard existed also in jurisdictions that have already adopted IFRS. However, despite the questions raised by preparers regarding the diversity in practice in different jurisdictions and how the effects of rate-regulated activities should be accounted for, the IASB decided at the time not to introduce an interim standard that would permit the use of local GAAP principles until a comprehensive project was finalised. Consequently, ESMA believes that providing an interim standard now continues to lack conceptual basis as the issues that were previously identified

[1] *Comment letter: EFRAG's draft comment letter on the IASB Exposure Draft Rate Regulated Activities, European Securities and Markets Authority, 8 December 2009 (CESR/09-1112)*

remain unchanged and unaddressed. ESMA also concurs with the view expressed in paragraph AV5 and fears that by issuing this interim standard the IASB will create a precedent enabling preparers to ask for similar "temporary" solutions in the future with regards to other issues or differences between local GAAP and IFRS.

Understandability and transparency

ESMA believes that this interim standard will not contribute to better understandability of financial information as it will allow entities to recognise, measure and impair deferral accounts in their financial statements according to principles, policies and basis of preparation that are defined according to local GAAP which may not be in compliance with the principles, policies, and basis of preparation that are set out in IFRS (as stated by the IASB in paragraph BC27). ESMA believes that allowing preparers to apply carve-ins will impair investors' confidence in IFRS since they will need to analyse different principles, policies and basis of preparation of different GAAP in order to understand the movements and effects of the transactions related to rate-regulated activities.

ESMA acknowledges the efforts of the IASB in trying to isolate the effects of the transactions from regulatory activities. However, we believe that the proposal set out in this ED will also impair the transparency and faithful representation of the effects of the transactions that arise from regulatory activities, as it will aggregate in one line, in the statement of financial position and comprehensive income, the effects of transactions which may not be similar in nature, frequency, function or significance. ESMA believes that the aggregation that is permitted in this ED conflicts with the principles of materiality and aggregation set out in IAS 1 – *Presentation of Financial Statements,* paragraph 29. Therefore, ESMA also agrees with the alternative views expressed in paragraph AV3 of the ED that "the proposal to isolate the impact of recognising regulatory deferral account balances by presenting separately is not sufficient to eliminate the effect of this inconsistency".

Cross-cutting issues

Finally, like EFRAG, ESMA is also concerned about the possible implications of applying the principles from this ED on other standards that are currently in place. Although the IASB tried to minimise the effects resulting from the interaction of developing this interim standard with other standards, ESMA has doubts that all cross-cutting issues are solved. ESMA believes that there may be cross-cutting issues regarding the interaction of this interim standard with the application of *IFRS 3 – Business Combinations* concerning the recognition and measurement of goodwill if the acquired company adopts this standard, or with the application of *IAS 36 – Impairment of Assets* concerning the recognition and allocation of impairment if deferral accounts are included in a cash generating unit (for instance there are doubts if an entity should recognise and allocate impairment to deferral accounts if they are not impaired under the local GAAP or if impairment is an allowable cost that is expected to be recovered through future rates).

Please do not hesitate to contact us should you wish to discuss any of the issues we have raised in this letter.

Yours sincerely,

Steven Maijoor
Chair
European Securities and Markets Authority