EFRAG

European Financial Reporting Advisory Group

Draft Comment Letter

Comments should be submitted by 21August 2013 to commentletters@efrag.org

24 May 2013

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sir/Madam,

Re: *Regulatory Deferral Accounts*, exposure draft

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the IASB's exposure draft ED/2013/5 *Regulatory Deferral Accounts,* issued by the IASB on 25 April 2013 (the 'ED').

This letter is intended to contribute to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of definitive IFRS in the European Union and European Economic Area.

EFRAG does not support the ED because:

- It results in a lack of comparability between (a) entities that take advantage of the ED and (b) entities that already apply IFRS or do not wish to apply the ED (see paragraphs 15 to 17 of the Appendix); and
- It is not limited to facilitating first-time adoption but maintains previous accounting policies for an indefinite period. Other interim standards such as IFRS 4 and IFRS 6 have shown that there was no such thing as a short-term interim standard (see paragraph 18 of the Appendix).

Although EFRAG disagrees with the pursuance of this interim project, EFRAG is supportive of the IASB's decision to make the standard an option and of its efforts to limit comparability issues to the regulatory deferral account balances. Consequently, EFRAG has carried out an analysis of the proposed standard:

- We assessed whether the IASB was successful with its intent of limiting comparability issues to the regulatory deferral account balance line items. We identified a number of issues that the IASB should resolve (see paragraphs 21 to 24 of the Appendix); and
- We considered the requirements in the ED and identified certain difficulties that application of the proposals may raise (see response to the specific questions asked in the ED).

Our detailed comments and responses to the questions in the ED are set out in the Appendix.

If you would like to discuss our comments further, please do not hesitate to contact Giorgio Acunzo or me.

Yours faithfully,

Françoise Flores
EFRAG Chairman

APPENDIX

1 As explained in our covering letter and further below, EFRAG does not support the ED.

2 Nonetheless, EFRAG supports the IASB's decision to make the standard an option and its effort to limit comparability issues to the regulatory deferral account balances. Therefore, we have carried out an analysis of the proposals in the ED to assess whether the IASB was successful with its intent of limiting issues to the regulatory deferral account balance line item. In addition, our answers to the questions aim to provide a constructive contribution to the IASB's due process and consider the difficulties the ED may give rise to for an entity that would apply it.

General Comments

Notes to constituents

Background

3 *In recent years, the IASB has received several requests for guidance on whether rate-regulated entities can or should recognise, in their IFRS financial statements, a regulatory deferral or variance account debit balance or credit balance as a result of price or rate regulation by regulatory bodies or governments.*

4 *In December 2008, the IASB added a project on rate-regulated activities to its agenda and subsequently, in July 2009, issued the Exposure Draft Rate-regulated Activities (the 2009 ED). In September 2010, the IASB decided that the technical issues related to this topic could not be resolved quickly, and suspended the project until it had considered whether to include rate-regulated activities in its future agenda. A question on this issue was included in the 2011 Agenda Consultation. The responses to this consultation, received through comment letters and other outreach activities, persuaded the IASB to prioritise addressing this issue.*

5 *In September 2012, the IASB decided to add to its agenda a research project on rate-regulated activities, with the aim of developing comprehensive guidance following requests from its constituents made in the context of its three-yearly agenda consultation.*

6 *It also decided, in December 2012, to develop an interim standard on the accounting for regulatory deferral accounts that would be applied until the completion of the comprehensive project and of the Conceptual Framework project.*

7 *The IASB recognised that discontinuing the recognition of regulatory deferral account balances in advance of the comprehensive rate-regulated Activities project, could be a significant barrier to the adoption of IFRS, particularly for those entities for which regulatory deferral account balances represent a significant proportion of net assets. This has led to an industry-specific 'carve-out' from the application of IFRS in at least one jurisdiction that has otherwise adopted IFRS, to allow rate-regulated entities to continue to use local GAAP (or, in some cases, US GAAP).*

8 *The IASB also acknowledged that in many jurisdictions, the accounting policies developed for regulatory deferral account balances are based on US GAAP or local GAAP that provides similar guidance. This is understood to allow a reasonable level of comparability of the treatment of the regulatory deferral account balances across jurisdictions. However, different approaches to accommodating existing practice for such balances has reduced comparability for*

users of financial statements in these jurisdictions, because the rest of the items in the financial statements are now accounted for using different accounting frameworks (for example, IFRS, US GAAP or local GAAP), depending on which approach has been adopted.

The ED scope

9 *The ED proposes to allow those entities that currently recognise regulatory deferral account balances in accordance with their previous GAAP, to continue to do so when making the transition to IFRS. Consequently, an entity that does not adopt an accounting policy to recognise regulatory deferral account balances in the period immediately preceding its first IFRS financial statements is not eligible to apply the ED in order to start recognising such balances.*

10 *The IASB intended to <u>allow</u>, but <u>not require</u>, those entities that currently recognise regulatory deferral account balances in accordance with their previous GAAP to continue to do so when making the transition to IFRS. Therefore, the IASB did not want to prevent entities that currently recognise regulatory deferral account balances from ceasing to recognise them because this would be consistent with the established IFRS practice. The IASB thought that this would result in an entity presenting more comparable information, which would bring the financial statements closer to the criteria in IAS 8.*

11 *The ED applies only to incremental amounts that would not otherwise be recognised as assets or liabilities in accordance with other Standards and the Conceptual Framework for Financial Reporting or other current Standards. Put differently, these regulatory deferral accounts balances would otherwise be recognised in the current or a prior period in the statement of profit or loss and other comprehensive income as an expense or income.*

12 *In addition, the IASB decided to restrict the scope of the ED to entities operating under rate regulatory schemes where there is a strong link between the amounts that the rate regulator decides are included as allowable costs when determining the customer rates and the amounts that eventually are recognised through the entity's statement of profit or loss and other comprehensive income for financial reporting purposes.*

The IASB's intentions

13 *The IASB also believed that an interim standard that permits first-time adopters of IFRS to continue to apply their existing policies for recognising and measuring regulatory deferral account balances would avoid major changes in their accounting practices until guidance is developed through the comprehensive Rate-regulated Activities project. In addition, the IASB noted that the Conceptual Framework is currently being reviewed and updated and it is clear that the outcome of the rate-regulated research project will be influenced by the outcome of the Conceptual Framework project. However, the interim standard is in no way anticipating the outcome of the comprehensive Rate-regulated Activities project.*

14 *In the IASB's view, this would improve comparability between those IFRS preparers that are subject to rate regulation but do not recognise regulatory deferral account balances and those entities that will be permitted to recognise such balances in accordance with the ED. To achieve this, the IASB proposed some changes to the presentation of these balances and to disclosures requirement to minimise the impact of introducing some inconsistency and diversity into IFRS practice for the treatment of regulatory deferral account balances, when it does not currently exist in the IFRS community.*

EFRAG's response

Comparability

15 EFRAG does not support the publication of the ED.

16 EFRAG notes the comment in paragraph AV2 of the ED that the established practice in IFRS has been that rate-regulated entities do not recognise regulatory deferral account balances in IFRS financial statements. Consequently, almost all rate-regulated entities in Europe, and also around the world, that previously recognised regulatory deferral account balances under their previous GAAP, derecognised those balances when they first adopted IFRSs. In addition, we note that at this stage it is unclear to how broad a population the ED would apply.

17 EFRAG is particularly concerned that this interim standard may introduce an uneven treatment within the IFRS community and reduce comparability. Indeed, use of the relief in the ED reduces the comparability of financial reporting between first-time adopters – which can apply the ED – and existing IFRS-reporting entities in the same jurisdiction.

18 Finally, we note that the ED would not result in comparability between entities that benefit from the relief, as they may follow different previous GAAPs for their regulatory deferral account balances. In this sense, the relief proposed in the ED is akin to IFRS 4 and IFRS 6 in that it permits a continuation of previous GAAP accounting policies, whereas most IFRS 1 reliefs are merely intended to provide a suitable starting point for accounting in accordance with IFRSs. However, we note that the ED would still require restatement of the previous GAAP regulatory deferral account balances as a result of first-time adoption of all other IFRSs (that is, a first time adopter would first restate its assets and liabilities under IFRS, and then treat regulatory deferral accounts balances as a residual (amounts otherwise not recognised under IFRS)).

19 However, EFRAG appreciates that the IASB – pending the completion of the comprehensive project on the rate-regulated activities and on the Conceptual Framework – has restricted the scope of this ED only to those entities that currently recognise regulatory deferral account balances in accordance with their previous GAAP when making the transition to IFRS. In EFRAG's view, this reduces the scope of this ED even if the number of entities potentially affected remains unclear.

20 We support the IASB's decision to permit and not require entities to adopt the ED as we believe that this would permit entities to apply full IFRSs in their financial statements. Indeed, this decision ensures that the ED can be disregarded while compliance with IFRSs is maintained.

Assessment of the effects of the ED on comparability

21 EFRAG carried out an analysis on a standard-by-standard basis to assess the effects of the ED on comparability. This assessment is presented in two parts; one part dealing with cross-cutting measurement issues and another dealing with presentation issues.

Cross-cutting measurement issues

22 EFRAG has identified the following standards for which the IASB should address the interaction with the ED:

(a) *IFRS 3 Business Combinations* – Paragraph 10 of IFRS 3 requires that all identifiable assets and liabilities acquired be recognised separately from goodwill. If paragraph 16 of the ED permits entities to recognise regulatory deferral credit and debit balances at the acquisition date (which is not entirely clear, see paragraph 64 below), then this would lead to a corresponding change in the goodwill balance recognised. In particular, the recognition of a net credit regulatory deferral account balance would result in an increase in goodwill, whereas the recognition of a net debit regulatory deferral account balance would reduce the carrying amount of recognised goodwill. However, the impact of the ED on goodwill related to regulatory deferral account balances would not be identified separately in the financial statements, thereby reducing comparability. In addition, the regulatory deferral account balances might in rare cases give rise to negative goodwill that should be recognised in profit or loss immediately.

In addition, EFRAG notes that measurement at the date of acquisition is unclear, should regulatory deferral accounting balances of the acquiree be (1) measured at fair value under IFRS 3? (2) measured in accordance with the acquirer's previous GAAP measurement requirements? or (3) measured in accordance with the acquiree's previous GAAP measurement requirements. We believe that same questions (e.g. 2 and 3) would also apply for subsequent measurement.

Finally, it is not clear how an entity which has taken advantage of the interim standard would treat an acquiree that had not (or could not) take advantage of the interim standard.

(b) *IFRS 9 Financial Instruments and IAS 39 Financial Instruments: Recognition and Measurement* – Regulatory deferral account balances do not meet the definition of financial assets or financial liabilities; however, to the extent that an entity hedges foreign net investments that recognise regulatory deferral account balances (e.g. a Canadian utility with a US subsidiary) it might result in different hedge designations, hedge effectiveness assessments and IFRS 7 disclosures.

(c) *IAS 12 Income Taxes* – IAS 12 requires temporary differences to be calculated between the carrying amount of an asset (or liability) and its tax base. Under many previous GAAPs the effects of rate-regulation are included in the carrying amount of underlying assets (or liabilities).

In order to apply IAS 12 and the requirements of paragraphs B4 to B6 of the ED, an entity would need to allocate the tax base between the part that relates to the IFRS compliant assets (or liabilities) and the part that relates to the regulatory deferral account balances. The ED provides no guidance on how this allocation should be done.

(d) *IAS 28 Investments in Associates and Joint Ventures* – To the extent that an investee – that is recognised under the equity method – accounts for regulatory deferral account balances, the amounts reported under the ED would not be comparable to those of other IFRS reporters as the effect of regulatory deferral account balances cannot be separated in the balance sheet and income statement. In addition, issues might arise to the extent that the investor hedges its investment and in the application of waterline accounting for the investee (i.e. equity accounting should not result in negative balances).

(e) *IAS 36 Impairment of Assets* – We note the concern about the double-counting in assessing cash flows for each cash-generating unit, which may arise as a result of the interactions between recoverability requirement under local GAAP and IAS 36 requirements. In addition, the recognition of regulatory deferral accounting balances may affect the way impairment losses are allocated to items included in a cash-generated unit because part of the impairment loss that would otherwise have been attributed to IFRS assets might have to be allocated to regulatory deferral account balances.

Presentation issues

23 EFRAG has identified the following standards for which the IASB should improve the presentation requirements to limit or avoid comparability issues:

(a) *IFRS 10 Consolidated Financial Statements* – If a partially-owned subsidiary recognises a regulatory deferral account balance, this would affect the carrying amount of the corresponding non-controlling interest. However, this impact is not required to be identified separately in the primary financial statements and could adversely affect comparability. Notwithstanding, EFRAG acknowledges that the ED includes additional disclosure requirements on 'interests in other entities'.

(b) *IAS 1 Presentation of Financial Statements* –

(i) *Statement of Profit or Loss and Other Comprehensive Income* – The IASB should reconsider the illustrative statement of profit or loss and other comprehensive income to make clear how an entity – that also reports other comprehensive income – should present the impact of regulatory deferral account balances (i.e. which subtotals an entity should present and whether the impact should be split between a profit or loss and another comprehensive income component) (see paragraph 81 below).

(ii) *Presentation of equity* – The equity presented by an entity applying the ED would incorporate the net regulatory deferral account balances recognised in the balance sheet, and would therefore not be entirely comparable to that of entities that do not apply the ED. In addition, no separate presentation requirements in the statement of changes in equity are included in the ED.

(iii) *Illustrative examples* – The IASB should amend the wording of the Illustrative Examples to avoid reducing comparability by including regulatory deferral account balances within 'Total assets' and 'Total liabilities' (see paragraph 80 below).

(iv) *Amounts recognised in accordance with other standards* – The IASB should clarify the presentation requirements on items recognised in accordance with other standards. For instance, it was not clear whether or not exchange differences arising on regulatory deferral balances should be presented into the single line item or in other captions of the profit or loss account.

(v) *Statement of Cash Flows* – The ED should also require separate presentation of regulatory deferral account balances in the cash flow statement (i.e. the reconciling item between net profit and net cash from operating activities).

(c) *IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors* – The ED should clarify that any changes in estimate and errors that affect or are related to regulatory deferral account balances should be presented consistently in the single line item.

24 Unless the IASB can solve the comparability issues listed above, the interim standard should not be pursued as the condition for minimum comparability would not be met.

EFRAG's responses to the IASB's specific questions

Scope

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?

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?

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 and BC11).

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

Notes to constituents

25 *The interim standard is applicable to entities that recognised under previous GAAP regulatory deferred accounts. However, entities are permitted and not required to apply the guidance set in the ED.*

26 *In addition, the ED could only be applied by entities in their first IFRS financial statements and in their financial statements for subsequent periods. Therefore, entities already presenting IFRS financial statements are not permitted to apply the interim standard.*

27 *By applying the requirements in the interim Standard, an entity recognises, as regulatory deferral account balances, amounts arising from its rate-regulated activities that would otherwise be recognised in the current or a prior period in the statement of profit or loss and other comprehensive income as an expense or income. Consequently, the interim Standard is only applicable to the incremental*

amounts that would not otherwise be recognised as assets or liabilities in accordance with other Standards and the Conceptual Framework.

28 *If an entity elects to apply the interim standard, it should recognise regulatory deferral account balances arising from its rate-regulated activities only if the following criteria are met:*

(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.*

29 *A rate regulator is defined as 'an authorised body that is empowered by statute or contract to set rates that bind an entity's customers. The rate regulator may be a third-party body or may be the entity's own governing board, if that board is required by statute or contract to set rates both in the interest of the customers and to ensure the overall financial viability of the entity'.*

30 *Furthermore, there should be an identifiable causal effect that links the regulatory deferral account balances to the rate-setting mechanism. By introducing this restriction, is intended to provide reasonable assurance that the deferred amounts will be recovered through future rates.*

31 *Finally, once an entity decides to apply the requirements in the interim standard; it should apply them consistently to all regulatory deferral account balances arising from all of the entity's rate-regulated activities.*

EFRAG's response

EFRAG is concerned that pursuing this interim standard without having a clear understanding of existing regimes might have unintended outcomes and negatively affect the reliability and relevance of the financial information.

Interaction with the comprehensive project

32 EFRAG understands that rate-regulated regimes can exist in many types of circumstances. For example, transportation (e.g. bus routes), airport luggage handling, energy distribution (managing and maintenance of grids), water and waste management, and private health care operating within the national health service, are in many cases subject to some form of price or rate regulation, and might possibly fall within the scope of the interim standard. Also, the rates that insurance companies can set in certain types of insurance markets (e.g. mandatory health or liability insurance) are often regulated.

33 EFRAG is therefore concerned that pursuing this interim standard without having a clear understanding of existing regimes might have unintended outcomes and negatively affect the reliability and relevance of the financial information.

Scope restrictions (Question 1)

34 EFRAG acknowledges that the objective of this interim standard is to allow, but not require, those entities that currently recognise regulatory deferral account balances in accordance with their previous GAAP to continue to do so when adopting IFRS.

35 Notwithstanding our general view on the ED, EFRAG supports the IASB's decision to limit the scope of the interim standard to first-time adopters that recognise

regulatory deferral account balances under their previous GAAP as – pending the completion of the comprehensive project on the rate-regulated activities and on the Conceptual Framework – this reduces the number of entities.

Scope criteria (Question 2)

36 EFRAG has a number of concerns about the scope criteria in paragraph 7 of the ED, which are explained in detail below.

Authorised body

37 The ED defines a regulator as an authorised body empowered by statute or contract to set rates that bind an entity's customers. The ED goes on to say that the regulator may be a third-party body or may be the entity's own governing board if the board is required by statute or contract to set rates. We note that this definition is consistent with the one included in the 2009 ED.

38 EFRAG is concerned that this definition may be too broad and could be interpreted to encompass the activities of an entity where, for instance, the board of directors have agreed (e.g. in the articles of association of the entity) on a strategic policy to set rates designed to recover costs, particularly under monopolistic market structures. In addition, we note that it is unclear whether this scope would include, for example, farming cooperatives or mutual insurance companies.

39 We think that such an interpretation might not always be the intention of the ED and that the reference to an entity's own 'governing body' is made in those cases where an entity is set up to carry on previously state-run monopolistic activities and would be delegated regulatory powers by the Government. Having said this, we do not think the intended meaning of an 'authorised body' is clearly articulated in the ED and recommend the IASB clarify this issue.

Binding price

40 We generally agree with the proposal that all the customers of rate-regulated activities must be bound by the price established by the regulator. However, we have concerns about the application of this approach.

41 We understand that the practice of setting different prices for different customer groups or categories of customers is common practice in rate-regulated industries. For example, wholesale customers may be charged a different price to retail customers. In other circumstances, customers within the same category (for instance retail customers) may also be charged different prices. We think that even rate-regulated entities might have some level of freedom to lower the prices in the form of discounts within categories of customers (e.g. giving preferential rates to blue-chip type customers) or across the entire customer base. In such situations we think it is the 'discounted' price set by the entity that binds its customers and not the price established by the regulator, thus the activities of such entities would in our view be outside the scope of the ED. However, we think that paragraph 7 of the ED is not clear on this point, and recommend the IASB to clarify whether differential pricing arrangements or discounting would breach the scope criteria, if so under which circumstances that would be the case.

42 In addition, we are concerned that the criterion in paragraph 7(a) of the ED places too much weight on the price set by the regulator. In some jurisdictions the regulator does not specifically set the price but sets regulation (intended for actual cost-recovery) that could be revenue-based. For example, a regulator could define the regulation based on the total allowable revenue an entity can charge not the individual rate which generates such revenue. It seems to us that entities regulated in this way are might be scoped out from the ED.

Incremental amounts

43 The ED defines the regulatory deferral account balances as the balance of any expense (income) deferral or variance account that is included in the setting of the future rate(s), by the rate regulator and that would not otherwise be recognised as an asset or a liability in accordance with other standards. Furthermore, the ED is only applicable to the *incremental amounts* that:

(a) would not otherwise be recognised as assets or liabilities in accordance with other standards and the Conceptual Framework for Financial Reporting; and

(b) would otherwise be recognised in the current or a prior period in the statement of profit or loss and other comprehensive income as an expense or income.

44 A literal reading of the wording suggests that the ED only addresses situations where rate regulation would result in additional (i.e. incremental) asset or liability balances that cannot be recognised under IFRS. However, this would leave unaddressed the question what should be done when rate regulation would result in asset or liability amounts that are lower than required by IFRSs (e.g. a decommissioning liability might be recognised for a lower amount or items of property, plant and equipment might be recognised at a lower amount as a result of the application of the deemed cost exemption in paragraph D8B of IFRS 1).

45 EFRAG believes that the IASB should clarify what is meant by ‘incremental amounts’. As drafted, it appears as if the proposals in the ED only include some of the effects of rate regulation within its scope.

Prices

46 The ED requires that prices should be designed to recover allowable costs and that there should be an identifiable causal effect that links the regulatory deferral account balances to the rate-setting process.

47 The scope of the proposed standard is limited mainly to cost-based regulation (e.g. cost-of-service and hybrid regimes) that is common in some jurisdictions, but excludes incentive-based regulation that is more common in other jurisdictions.

48 Given that the ED is intended as an interim standard, EFRAG believes that its scope should be limited to the extent possible. For this reason, we accept that the proposals only apply to cost-based regulation. However, we would like to stress that in its comprehensive project, the IASB should consider all forms of rate regulation.

Option to apply the ED (Question 3)

49 The ED allows, but does not require, those entities that currently recognise regulatory deferral account balances in accordance with their previous GAAP to continue to do so when making the transition to IFRS. The IASB wanted to avoid that entities that currently recognise regulatory deferral account balances would have to derecognise.

50 Notwithstanding our general view on the ED, EFRAG agrees with the IASB’s proposals to permit, rather than to require, application of this ED as this permits entities to comply with full IFRS and improves comparability.

Other issues

51 Paragraph B1 of the ED states that an entity recognises ‘a regulatory deferral account debit balance when the entity has the right, as a result of the actual or

expected actions of the rate regulator, to increase rates in future periods in order to recover its allowable costs' and conversely it might need to recognise a regulatory deferral account credit balance. EFRAG believes that permitting an entity to rely on 'expected actions of the rate regulator' introduces concerns around the reliability of the information. We believe that the IASB should improve the wording by emphasising the enforceable rights that an entity has under the rate regulation.

52 Paragraph B1(b) of the ED permits an entity to measure 'regulatory deferral account balances on an undiscounted basis or on a discounted basis that uses the interest/discount rate specified by the rate regulator', but in accordance with paragraph 12 of the ED such a policy cannot be introduced subsequently. EFRAG is concerned that by allowing the rate regulator to provide some of the accounting assumptions underlying discounting, the ED might result in considerable inconsistencies with other balances in the financial statements that are discounted in accordance with IFRSs. In addition, it is unclear to what extent regulation is permitted to influence accounting policy selection.

Recognition, measurement and impairment

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?

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?

Notes to constituents

53 *The ED requires that an entity shall continue to apply its previous GAAP accounting policies for the recognition, measurement and impairment of regulatory deferral account balances.*

54 *To achieve this, the ED introduces a temporary exemption for entities in developing their accounting policies for the recognition, measurement and impairment of regulatory deferral account balances from the requirements in paragraph 11 IAS 8* Accounting Policies, Changes in Accounting Estimates and Errors*. The IASB provided a similar relief when IFRS 4* Insurance Contracts *and IFRS 6* Exploration for and Evaluation of Mineral Resources *were issued.*

55 *Paragraph 11 of IAS 8 requires entities to consider the applicability of other Standards and the* Conceptual Framework *in making the judgement to develop and apply an accounting policy in the absence of an IFRS that specifically applies.*

Therefore, by introducing a temporary exception to paragraph 11 of IAS 8 within the interim standard, the IASB intended to avoid on a short term basis to address the issue related to the nature of regulatory deferral account balances (e.g. are they assets and liabilities in compliance with IFRSs?).

56 *Once an entity elects to continue to use existing accounting policies, it will recognise:*

(a) *a regulatory deferral account debit balance when it has the right, as a result of the actual or expected actions of the rate regulator, to increase rates in future periods in order to recover its allowable costs; and*

(b) *a regulatory deferral account credit balances when it is required, as a result of the actual or expected actions of the rate regulator, to decrease rates in future periods in order to reverse over-recoveries of allowable costs.*

57 *However, an entity is permitted to change its accounting policies for recognising and measuring regulatory deferral account balances, if the change makes the financial statements more relevant to the economic decision-making needs of users and no less reliable, or more reliable and no less relevant to those needs. Considering the scope requirements of this interim standard, this provision would result in permitting first-time adopters to discontinue the application of previous GAAP and therefore applying other relevant standards in recognising assets and liabilities.*

58 *Furthermore, in the absence of any specific exception, exemption or additional requirement contained within the ED, other Standards shall apply to regulatory deferral accounts in the same way as they apply to assets, liabilities, income and expenses that are recognised in accordance with other Standards. Application Guidance is provided with reference to IAS 21* The Effects of Changes in Foreign Exchange Rates*, IAS 10* Events after the Reporting Period*, IAS 12* Income Taxes*, IAS 33* Earnings per share*, IAS 36* Impairment of Assets*, and IFRS 12* Disclosure of Interests in Other Entities.

59 *For instance, the interim standard requires that when applying IFRS 5 an entity shall not apply the measurement requirements in it to the regulatory balances recognised as they are measured consistently with previous GAAP.*

60 *Furthermore, an entity shall apply guidance within IAS 36 also to regulatory balances that are included in the carrying amount of the CGU for the purpose either of performing the impairment test or to allocate any impairment loss recognised.*

61 *Paragraphs BC56 to BC58 of the ED explain that an entity is not allowed to include the regulatory deferral account balances in the cost of the asset that is recognised in accordance with other Standards as a single asset irrespective of the fact that regulatory assets are complementary to other assets and have similar useful lives. The approach in the ED is inconsistent with that applied in US GAAP (Topic 980).*

EFRAG's response

EFRAG supports the IASB's decision to measure regulatory deferral account balances as residuals, i.e. ensuring that other IFRS requirements are applied unmodified.

Grandfathering principle (Question 4)

62 EFRAG agrees with the drafting of paragraphs 9 to 13 of ED as it is based on the wording in IFRS 4 *Insurance Contracts* and IFRS 6 *Exploration for and Evaluation of Mineral Resources*, which also offered relief to first-time adopters only.

Previous GAAP without detailed guidance

63 EFRAG believes that it is unclear how the ED would apply in cases where the previous GAAP permits recognition of rate-regulated assets (liabilities) on the basis of a general matching principle, rather than a specific standard including guidance on recognition, measurement and impairment. We believe the IASB should clarify whether entities in such circumstances would be permitted to benefit from the relief proposed in the ED.

Interaction with other standards (Question 5)

64 The paragraph 16 of the ED contains guidance on the interaction with other standards. It clarifies that in the absence of any specific exception, exemption or additional requirement contained within the interim standard, other standards shall apply to regulatory deferral accounts in the same way as they apply to assets, liabilities, income and expenses that are recognised in accordance with other standards. EFRAG believes that the wording of this paragraph is ambiguous as it is unclear whether (1) it requires other standards to be applied to regulatory deferral account balances to be treated *as if* they were assets or liabilities or (2) it requires other standards to be applied without modification.

65 We understand that the IASB aims to avoid making consequential amendments – relating to the interim standard – to other standards, because the ED's application is restricted to a limited population of entities. In addition, it is intended to be applicable only as a short-term interim solution until the comprehensive Rate-regulated Activities project is completed. Therefore, we believe that the ED should not make consequential amendments to paragraph D8B of IFRS 1 as they could affect entities that do not intend to apply the ED.

Other scope issues

66 EFRAG notes that the interim standard does not refer derecognition of regulatory deferral account balances. In our view, the ED should clarify that entities should also continue the derecognition accounting policies from their previous GAAP.

Presentation

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?

Notes to constituents

67 *The ED proposes specific presentation requirements to separate the impact of recognising regulatory deferral account balances from other items presented into the statement of financial position and the profit or loss statement.*

68 *The ED proposes that separate line items shall be presented in the statement of financial position for:*

(a) *the total of all regulatory deferral account debit balances; and*

(b) *the total of all regulatory deferral account credit balances.*

These separate line items shall be separated from the assets and liabilities that are presented in accordance with other Standards by use of sub-totals, which are struck before the regulatory deferral account balances are presented.

69 *Similar requirements are applicable to the profit or loss statement where entities will have to present the net movement in all regulatory deferral account balances for the reporting period in a separate line item.*

70 *When an entity recognises a deferred tax asset or a deferred tax liability as a result of recognising a regulatory deferral account balance, the entity shall include that deferred tax amount within the related line item that is presented for regulatory deferral account balances or movements in those balances, instead of including it within the deferred tax liability (asset) or the tax expense (income).*

71 *When applying IFRS 5* Non-current Assets Held for Sale and Discontinued Operations *an entities shall present regulatory deferral account balances that arise from the rate-regulated activities of the discontinued operation or which belong to the disposal group within the related line item that is presented for regulatory deferral account balances, instead of within the line items that are required by IFRS 5.*

72 *If an entity applies the deemed cost exemption in paragraph D8B of IFRS 1* First-time Adoption of International Financial Reporting Standards *then the interim standard only requires the regulatory deferral account amounts for those items to be presented separately on a prospective basis from the date of transition to IFRS. Whereas, all other regulatory deferral accounts balances (e.g. those included in inventories or other assets) should be reclassified into the single line item.*

73 *The ED does not require regulatory deferral account balances to be classified as current or non-current and offsetting of debit and credit balances is not permitted. The IASB believes that significant judgement would be needed in preparing complex and detailed scheduling of the timing of recovery or reversal of each regulatory deferral account debit or credit balance necessary to estimate the short and the long-term component of each balances.*

EFRAG's response

EFRAG believes that the presentation required by the ED largely isolates the effects of the application of the ED both in the statement of financial position and in the statement of comprehensive income. However, as noted in paragraph 23 above, EFRAG has identified a number of standards for which the IASB should improve the presentation requirements to limit or avoid comparability issues.

74 The ED requires that the total of all regulatory deferral account debit and credit balances should be presented as separate line items in the statement of financial position. Similarly, movements between the opening and closing balances, except for acquisitions and disposals, would be presented as a single line item within the statement of profit or loss and other comprehensive income.

75 The IASB concluded that presenting the regulatory impact separately would provide more useful information about the regulatory environment and would be consistent with the enhancing qualitative characteristic of comparability in paragraphs QC20 to QC25 of the *Conceptual Framework*. In particular, it would make the financial information of rate-regulated entities (and non-rate-regulated entities) more comparable, regardless of whether regulatory deferral account balances are recognised.

76 While EFRAG disagrees with the ED (see paragraphs 1520**Error! Reference source not found.**), we believe that the presentation required by the ED largely isolates the effects of the application of the ED both in the statement of financial position and in the statement of comprehensive income. However, as noted in paragraph 23 above, EFRAG has identified a number of standards for which the IASB should improve the presentation requirements to limit or avoid comparability issues.

Current/non-current term presentation

77 The ED does not require an entity to present current and non-current regulatory deferral account balances, this to avoid that entities need to do complex and detailed scheduling of the timing of recovery or reversal of each regulatory deferral account debit or credit balance.

78 In addition, entities will be required to disclose in the notes to the financial statements the remaining periods over which the entity expects to recover or amortise the carrying amount of each regulatory deferral account debit balance or to reverse each regulatory deferral account credit balance.

79 EFRAG agrees with the IASB's proposal as we understand that similar requirements are currently in paragraph 56 of IAS 1 which sets guidance on presentation of deferred tax balances as non-current.

Illustrative Examples

80 EFRAG notes that the IASB uses the wording 'Total Assets' to identify the sum of amounts included within the debit side of the statement financial position. We believe that it should instead use more neutral language (e.g. 'Total Assets and Regulatory Deferral Account Balances') to avoid giving the impression that regulatory deferral account balances are in fact assets. The same comment applies to totals and subtotals of liabilities.

81 We believe that the IASB should reconsider the illustrative statement of profit or loss and other comprehensive income to make clear how an entity – that also reports other comprehensive income – should present the impact of regulatory deferral account balances (i.e. which subtotals an entity should present and whether the impact should be split between a profit or loss and another comprehensive income component).

IFRS 5 Non-current Assets Held for Sale and Discontinued Operations

82 EFRAG notes that the requirements of IFRS 5 would only apply to a disposal group excluding any related regulatory deferral account balances, which would remain accounted for under previous GAAP together with regulatory deferral account balances related to other activities.

83 We are concerned that presenting regulatory deferral accounts balances held for sale separately from the IFRS 5 balance would result in an IFRS 5 disclosure that is not comparable to that of an entity that has not taken advantage of the interim

standard. In addition, it might affect the measurement of gains and losses on disposals.

84 Therefore, we believe that the IASB should reconsider the cross-cutting issues between the ED and IFRS 5.

Disclosure

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.

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?

Notes to constituents

85 *The disclosure objective of the ED is that an entity is required to disclose information that enables users to evaluate (a) the nature of, and the risks associated with, the rate regulation that restricts the price that the entity can charge customers for the goods and services it provides and (b the effects of that rate regulation on its financial position, financial performance and cash flows.*

86 *In addition, entities will be required to disclose information by providing a table, containing aggregated information, and showing a reconciliation of the movement in the carrying amounts in the statement of financial position of the various categories of regulatory items.*

87 *The ED requires both qualitative and quantitative disclosures to be part of the financial statements. These disclosures shall be given either in the financial statements or incorporated by cross-reference from the financial statements to some other statement that is available to users of the financial statements on the same terms as the financial statements and at the same time.*

88 *Finally, in applying disclosures requirement in IFRS 12, entities should provide sufficient information to identify the effects of regulatory deferral accounts balances on results allocated to non-controlling interests of a subsidiary, on gains and losses recognised on losing control of a subsidiary.*

EFRAG's response

EFRAG supports the IASB's proposals on disclosures on regulatory deferral accounts.

89 EFRAG agrees with the general disclosures objectives and the disclosure requirements proposed.

Transition

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?

Notes to constituents

90 *The IASB did not intend to provide any explicit relief from full retrospective application of the interim standard because it believes that existing recognition and measurement policies are continued when the interim Standard is applied.*

91 *In addition, the ED permits first-time adopters to use the deemed cost exemption for property, plant and equipment and intangible assets that is already available in IFRS 1.*

92 *Finally, the interim standard becomes effective prospectively; that is, entities will only need to change their presentation policies for regulatory deferral account balances to isolate them on a prospective basis from the date of transition to IFRS.*

EFRAG's response

EFRAG agrees with the transitional provisions in the ED.

93 EFRAG supports retrospective application of IFRSs because it improves comparability.

94 In addition, EFRAG believes that entities would be permitted to perform an analysis of the effects (e.g. costs and benefits) of the ED before deciding whether electing to apply it and therefore it is not likely to be burdensome for preparers.

Other Comments

Question 10

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

EFRAG's response

95 As noted in paragraphs 21 to 23 above, EFRAG has identified several standards for which the IASB should address the interaction with the ED and a number of other standards for which the IASB should improve the presentation requirements to limit or avoid comparability issues.