Overview and background

As a result of feedback received during the 2011 Agenda Consultation process, the International Accounting Standards Board (the IASB or the Board) decided to restart its rate-regulated activities project. Following a research phase on the common characteristics of regulatory schemes used around the world, the Board plans to issue a discussion paper on rate-regulated activities by the end of 2013.

In the discussion paper, the IASB will identify and more clearly articulate:

- The common features of rate regulation
- Whether these common features create economic resources for, or claims against, a rate-regulated entity that should be recognised in IFRS financial statements
- The information about the consequences of rate regulation that would be most useful for users of IFRS financial statements

In addition, the Board is currently reviewing and updating the Conceptual Framework, including the definitions of assets and liabilities. Enhancements to these definitions and an analysis of the rights and obligations created by rate regulation may allow the Board to resolve some of the issues that caused the rate-regulated activities project to stall in 2010.

The comprehensive rate-regulated activities project is expected to take time to complete and the outcome is uncertain. As such, the Board has issued an exposure draft on a proposed interim standard, Regulatory Deferral Accounts (the ED or proposed interim standard) to provide some relief to first-time adopters of IFRS. The proposed interim standard is intended to eliminate a barrier to adopting IFRS for entities in jurisdictions that currently allow or require the recognition of rate-regulated assets and liabilities. If adopted, the interim standard would allow entities to continue recognising regulatory deferral accounts.

Due to the continuing debate on whether regulatory assets and liabilities meet the definitions of assets and liabilities in the current Conceptual Framework, the ED uses the term ‘regulatory deferral account balances’ as a neutral descriptor for these items.

This publication provides an overview of the key components of the proposed interim standard.

What you need to know

- The IASB has restarted the rate-regulated activities project, which has been on hold since 2010.
- The IASB is collecting information on rate-regulated schemes used throughout the world and plans to issue a discussion paper by the end of 2013.
- The IASB has issued an exposure draft on an interim standard that would allow entities with rate-regulated assets and liabilities to continue recognising these accounts upon their initial adoption of IFRS.
- The interim standard would require regulatory deferral accounts, and the related movements for a period, to be presented separately on both the statement of financial position and statement of profit or loss.
- The IASB is separately reviewing the definitions of assets and liabilities in its Conceptual Framework project. The outcome of this project may have a bearing on the rate-regulated activities discussions.
- The exposure draft is open for comment until 4 September 2013.
The ED proposes that regulatory deferral account balances would be combined and presented as separate line items.

As outlined by the IASB, the ED proposes to:

- Permit an entity that adopts IFRS to continue to use its previous accounting policies, as accepted in their local jurisdiction, for the recognition, measurement and impairment of regulatory deferral account balances
- Require the entity to present regulatory deferral account balances as separate line items in the statement of financial position and to present movements in those account balances as a separate line item in the statement of profit or loss and other comprehensive income
- Require specific disclosures to identify clearly the nature of, and risks associated with, the rate regulation that has resulted in the recognition of regulatory deferral account balances in accordance with the proposals

The ED is intended to encourage rate-regulated entities to adopt IFRS without needing to implement significant changes to their accounting policies for regulatory deferral account balances until the IASB has completed its comprehensive rate-regulated activities project.

**How we see it**

The ED is issued against a backdrop of concerns raised by jurisdictions, especially Canada, where financial reporting by rate-regulated entities is diverse and based predominantly on US generally accepted accounting principles (GAAP). The option to continue recognising regulatory deferral account balances is intended to enhance comparability by encouraging such companies to adopt IFRS. In their comment letters to the IASB, we encourage Canadian rate-regulated entities to discuss whether the proposed interim standard will be a sufficient impetus to adopt IFRS prior to the expiration of certain exemptions that allow financial reporting under US GAAP.

**Scope of the exposure draft**

An entity can only adopt the proposed interim standard in connection with the application of IFRS 1 *First-time Adoption of International Financial Reporting Standards*. The proposed interim standard cannot be adopted by entities that are currently preparing their financial statements under IFRS. Also, an entity whose current GAAP does not allow the recognition of rate-regulated assets and liabilities, or that has not adopted such policy under its current GAAP, would not be allowed to recognise them through adoption of the proposed interim standard.

The scope of the Board’s 2009 exposure draft *Rate-regulated Activities* was limited to specifically defined ‘cost-of-service’ rate-regulatory schemes. Although the new ED broadens the scope from 2009, it is restricted to the types of schemes that have an identifiable causal effect between the costs that are expected to be incurred by the rate-regulated entity and the revenue generated through the authorised rates. Specifically, the proposed interim standard would include only those rate-regulated activities for which: (i) an authorised body restricts the price that the entity can charge its customers for the goods and services that the entity provides, and that price binds the customers; and (ii) the price established by the regulation is designed to recover the entity’s allowable costs of providing the regulated goods or services

**Recognition, measurement and impairment**

The proposed interim standard would allow recognition of regulatory deferral account balances as the incremental amounts from what would otherwise be recognised as assets and liabilities under IFRS. Consequently, regulatory deferral account balances would be determined using a two-step process. An entity would first determine the assets and liabilities under IFRS, other than the proposed interim standard. These amounts would then be compared with the assets and liabilities determined under the entity’s current GAAP presentation. The differences would represent the regulatory deferral debit or credit account balances that the entity would recognise.
The ED is intended to encourage rate-regulated entities to adopt IFRS while the IASB works on the comprehensive rate-regulated project.

For example, a regulator might specify the useful lives and method used in determining depreciation expense of property, plant and equipment (PP&E) for rate-making purposes, which differs from the requirements of IAS 16 Property, Plant and Equipment. Under the proposed interim standard, a regulatory deferral debit or credit balance would be the difference between the carrying amount of PP&E, as recognised under IAS 16, and as calculated in accordance with the applicable regulatory accounting requirements. The related difference between the depreciation charges would be shown on a separate line on the statement of profit or loss.

**How we see it**

The accounting for PP&E is a common area that creates differences between regulatory reporting and IFRS. For example, the costs that are capitalised and the depreciation methods used (e.g., group depreciation) for regulatory purposes may be inconsistent with the requirements of IAS 16. The one-time exemption from retrospective application of IAS 16 provided by IFRS 1 saves rate-regulated entities the cost and efforts of analysing their historical PP&E balances. However, subsequent to the adoption of IFRS, they would need to maintain two PP&E ledgers, one for IAS 16 and another for regulatory purposes. We encourage entities to assess how the cost of developing a second PP&E ledger and maintaining two PP&E ledgers prospectively may impact their decision to adopt the proposed interim standard.

**Presentation**

The ED proposes that regulatory deferral account balances be presented as separate line items on the statement of financial position. Furthermore, the sum of all regulatory deferral debit balances would be separated from the sum of all regulatory deferral credit balances. The movements in these account balances would be required to be presented, net of the applicable deferred income taxes, as a separate line item on the statement of profit or loss.

The IASB believes that presenting the regulatory deferral accounts separately would enable users of the financial statements to compare the assets, liabilities and profit or loss to other rate-regulated entities, regardless of whether they recognise regulatory deferral account balances in their financial statements.

The illustrative statement of financial position and statement of comprehensive income provided in the table below is an example of the presentation proposed in the ED:

**Statement of financial position**

<table>
<thead>
<tr>
<th>Non-current assets</th>
<th>450</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current assets</td>
<td>215</td>
</tr>
<tr>
<td>Total assets before regulatory balances</td>
<td>665</td>
</tr>
<tr>
<td>Regulatory deferral debit balances</td>
<td>85</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td>750</td>
</tr>
<tr>
<td><strong>Total equity</strong></td>
<td>280</td>
</tr>
<tr>
<td>Non-current liabilities</td>
<td>210</td>
</tr>
<tr>
<td>Current liabilities</td>
<td>195</td>
</tr>
<tr>
<td>Total liabilities before regulatory balances</td>
<td>405</td>
</tr>
<tr>
<td>Regulatory deferral credit balances</td>
<td>65</td>
</tr>
<tr>
<td><strong>Total liabilities</strong></td>
<td>470</td>
</tr>
<tr>
<td><strong>Total equity and liabilities</strong></td>
<td>750</td>
</tr>
</tbody>
</table>

**Statement of comprehensive income**

<table>
<thead>
<tr>
<th>Revenue</th>
<th>825</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of revenue</td>
<td>(675)</td>
</tr>
<tr>
<td>Gross profit</td>
<td>150</td>
</tr>
<tr>
<td>Selling and administration expenses</td>
<td>(75)</td>
</tr>
<tr>
<td>Profit before tax and regulatory deferral account movements</td>
<td>75</td>
</tr>
<tr>
<td>Income tax expense</td>
<td>(25)</td>
</tr>
<tr>
<td>Net movement in regulatory deferral accounts</td>
<td>(10)</td>
</tr>
<tr>
<td><strong>Profit</strong></td>
<td>40</td>
</tr>
</tbody>
</table>
Disclosure
The ED requires an entity to disclose information that enables users to evaluate: (a) the nature of, and risks associated with, the rate regulatory scheme; and (b) the effects of the rate regulation on financial position, financial performance and cash flows. Generally, these disclosures would include:

- A description of the rate-regulated activities
- The basis on which regulatory deferral account balances are recognised and measured initially and subsequently
- Reconciliations of the carrying amount at the beginning and end of the period for each category of regulatory deferral account

The ED would allow an entity to omit disclosures that are not considered relevant or material. In addition, the description of the rate-regulated activities may be provided in the financial statements or incorporated by cross-reference to information that is readily available to users of the financial statements (e.g., management commentary or risk report).

Applicability of other standards
The ED includes additional presentation and disclosure requirements for regulatory deferral accounts in respect of the following:

- An entity would be required to present additional earnings per share (EPS) amounts. Although entities would continue presenting basic and diluted EPS in accordance with IAS 33 Earnings per Share, they would also present basic and diluted EPS excluding the net movement in the regulatory deferral accounts.
- Regulatory deferral accounts, and the related net movement, would be excluded from discontinued operations or disposal group amounts presented in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations.
- Disclosures under IFRS 12 Disclosure of Interests in Other Entities would include separate disclosure of the regulatory deferral accounts and the related net movement for subsidiaries.

How we see it
Many national GAAPs, such as US GAAP, contain extensive presentation and disclosure requirements for rate-regulated activities. As such, except for the possible impact of developing an additional PP&E ledger, the adoption of the proposed interim standard may be accomplished with minimal incremental effort. However, the presentation of regulatory deferral accounts would differ significantly from what users of the financial statements are accustomed to seeing, in particular, the users of US GAAP financial statements. We encourage users of rate-regulated entities' financial statements to provide feedback to the IASB on how the proposed presentation and disclosure requirements could impact their analysis and comparison of financial statements and trends.

Transition
The proposed interim standard would be applied on a full retrospective basis. The IASB will determine the effective date after considering the comments received on the ED and performing necessary due process steps. The ED proposes to permit early adoption of the interim standard.

Looking ahead
The ED is open for comment until 4 September 2013. We encourage entities to submit their feedback on the proposal. Stay tuned to the IASB’s progress on its rate-regulated activities comprehensive project and the Discussion Paper expected by the end of 2013.