XRB EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho
NZ ACCOUNTING STANDARDS BOARD

3 September 2013

Mr Hans Hoogervorst
Chairman
The International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
**United Kingdom**

Dear Hans

**IASB Exposure Draft ED/2013/5 *Regulatory Deferral Accounts***

The New Zealand Accounting Standards Board (NZASB) is pleased to submit its comments regarding the International Accounting Standards Board (IASB) Exposure Draft ED/2013/5 *Regulatory Deferral Accounts*.

**We do not support an interim standard**

Overall, we support the alternative views of Martin Edelmann, Amaro Luiz de Oliveira Gomes and Wei-Guo Zhang, who voted against the publication of the Exposure Draft. Specifically, we do not support an interim standard because:

(a) an interim standard establishes dangerous precedents;

(b) an interim standard disadvantages existing users of International Financial Reporting Standards (IFRS); and

(c) the proposals allow recognition that potentially is contrary to the *Conceptual Framework*;

***Dangerous precedents***

Establishing an interim standard sets dangerous precedents by:

(a) pre-empting the outcome of the IASB's project on rate-regulated activities under circumstances of significant uncertainty and disagreement;

(b) creating an expectation that interim solutions will be provided in the future (creating uncertainty for future adopters of IFRS); and

(c) regime widening at the expense of meeting user needs.

*Pre-empting the outcome of the IASB's project on rate-regulated activities*

The proposal in the Exposure Draft is intended to be a practical and short-term solution to address a significant barrier to the adoption of IFRS in some jurisdictions.

Interim standards have been used in the past. However, in the case of rate-regulated activities, the circumstances are very different. Interim standards were established in the case of insurance contracts and extractive activities. The existence of assets and liabilities arising from insurance contracts and extractive activities, and the need for accounting standards in these areas, was not under dispute. This is not the case with rate-regulated activities.

In the case of rate-regulated activities:

(a) There is major disagreement as to whether rate-regulated assets and liabilities exist. The proposed grandfathering of existing practice implies that there is no doubt in this case.

(b) The IASB is in the early stages of its project and has yet to determine that specific guidance is necessary.

(c) There is existing evidence that guidance is not required (see the conclusions of the International Financial Reporting Interpretations Committee (IFRIC) noted below).

(d) There is existing evidence that the criteria for the recognition of assets and liabilities arising from rate-regulation that are permitted to be recognised under accounting standards other than IFRS, are not fully consistent with the recognition criteria in IFRS (see IFRIC's conclusions noted below).

We consider it inappropriate to establish any standard (even an interim standard) under these circumstances. Establishing an interim standard now will make it difficult for the IASB not to issue a final standard, even if the IASB eventually concludes that rate-regulation does not give rise to assets and liabilities and/or that specific guidance is not necessary.

*Creating an expectation that interim solutions will be provided (creating uncertainty for future adopters of IFRS*)

We are concerned that establishing an interim standard for rate-regulated activities might create an expectation that the IASB will adopt interim solutions whenever they are 'needed' by jurisdictions that are still to adopt IFRS whenever a major standard-setting project is activated.

We note that the majority of IFRS Advisory Council members, at their meeting in October 2012, did not support the development of an interim standard that would permit the continuation of existing previous GAAP policies. Many of those members warned against setting a precedent of implementing a policy of adopting an interim solution whenever a major standard-setting project is activated. We are concerned that developing an interim solution in this situation might create uncertainty as to what the IASB's approach might be when major projects are being researched in the future.

*Regime widening at the expense of meeting user needs*

Proposing an interim standard to facilitate the adoption of IFRS creates the impression that the IASB's objective is purely to maximise the number of jurisdictions claiming use of IFRS.

Further, allowing jurisdictions to claim compliance with IFRS, when in fact IFRS differs between jurisdictions due to carve-outs or add-ins not available in all jurisdictions, undermines the IFRS brand. Such an action implies that regime widening takes precedence over requiring high quality financial reporting that meets user needs.

Comparability between jurisdications is not enhanced by more jurisdications adopting IFRS if the composition of IFRS differs between jurisidications.

***Disadvantaging existing users of IFRS***

We consider establishing an interim standard will disadvantage existing users of IFRS for the following reasons:

(a) When they adopted IFRS, existing users of IFRS were not provided with similar relief for issues that were a significant impediment to their acceptance of IFRS. This is particularly the case for those jurisdictions that have had to derecognise regulatory assets and liabilities on adoption of IFRS.

(b) An interim standard introduces inconsistent accounting treatment for similar transactions and reduces comparability.

*Similar relief was not provided to existing users of IFRS*

The proposed interim Standard is intended to be a practical and short-term solution to address a significant barrier to the adoption of IFRS in some jurisdictions. A major argument for the proposal is to avoid rate-regulated entities having to make a major change to their accounting policies when making the transition to

IFRS until guidance can be developed through the comprehensive project on rate-regulated activities. However, this argument is not new; nor is it specific to this particular subject.

The IASB does not usually introduce interim standards to be applied only by first-time adopters of IFRS. In particular, the IASB did not decide to introduce an interim standard when it worked on the 2009 exposure draft ED/2009/8 *Rate-regulated Activities*, which, at that time, would have equally avoided the issue for many entities in jurisdictions that have since adopted IFRS.

*Inconsistency with existing practice and reduced comparability*

We support the alternative views that note:

> "The established practice in IFRS has been that rate-regulated entities do not recognise regulatory deferral account balances. Consequently, almost all rate-regulated entities around the world that previously recognised regulatory deferral account balances derecognised them when they adopted IFRS. … to now permit an unknown population of rate-regulated entities to recognise these balances will introduce inconsistent accounting treatment into IFRS reporting and will reduce comparability.
>
> In addition, … the proposal to permit first-time adopters of IFRS to continue to measure the regulatory deferral account balances using their previous GAAP accounting policies may introduce further inconsistency because their existing practices that might not be comparable with other entities that have different existing practice. …the proposal to isolate the impact of recognising regulatory deferral account balances by presenting them separately is not sufficient to eliminate the effect of this inconsistency."

***Potential conflict with the* Conceptual Framework**

Our understanding is that the key 'drivers' for this project are that entities in certain jurisdictions currently are, or have been, recognising regulatory assets and liabilities and wish to continue to do so.

Specifically, the IFRIC in November 2008 recorded that, although rate regulation is widespread and significantly affects the economic environment of regulated industries, divergence does not seem to be significant in practice. In addition, in deciding not to add this project to the agenda, the IFRIC noted that the recognition criteria in SFAS 71 *Accounting for the Effects of Certain types of Regulation* were not fully consistent with the recognition criteria in IFRS and would require the recognition of assets under certain circumstances which would not meet the recognition criteria of relevant IFRS. Thus, the requirements of US generally accepted accounting principles (US GAAP) were not indicative of the requirements of IFRS.

In New Zealand there are entities that are subject to rate regulation and we do not believe that regulation gives rise to balances that meet the definitions of assets and liabilities in the IASB's *Conceptual Framework*.

This is one of the issues that the comprehensive rate-regulated activities project is looking to resolve. Consequently, the IASB has stated that the Exposure Draft does not anticipate the outcome of the comprehensive project. However, permitting these balances to be included in the statement of financial position is permitting them to be recognised as assets and liabilities before agreement is reached on whether or not these balances meet the definitions of assets and liabiltiies.

In addition, allowing regulatory deferral account balances to be recognised in the financial statements is contrary to the IASB's objectives of requiring high-quality, transparent and comparable information in financial statements by requiring like transactions and events to be accounted for and reported in a like way. The IASB has asserted that the objective of financial reporting is different from that of government regulation[1]. We note that many rate regulators do not limit their use of financial information to the information provided by IFRS. It follows that it does not appear necessary to include deferral account balances in the financial statements to satisfy the needs of regulators.

**Responses to specific questions for respondents**

Our responses to the specific questions for respondents which are in the Appendix to this letter.

If you have any queries or require clarification of any matters in this submission, please contact Clive Brodie (clive.brodie@xrb.govt.nz) or me.

Yours sincerely

Michele Embling
**Chairman – New Zealand Accounting Standards Board**
Email: michele.embling@xrb.govt.nz

[1] Paragraph AV10 of the 2009 Exposure Draft *Rate-regulated Activities* ED/2009/8

**Appendix**

***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?

As discussed in our covering letter, we do not support an interim standard and do not support the proposed scope of the proposed interim Standard.

**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 of the Exposure Draft).

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

The Exposure Draft presumes that regulatory assets and liabilities exist and that the issue simply is whether or not these assets or liabilities should be recognised. As discussed in our covering letter, we question this presumption.

However, if the IASB proceeds with the proposals, we consdier that the scope should be limited as this will minimise the impact of the proposals until such time as the IASB's rate-regulated activities project is sufficiently advanced to produce tentative proposals for all users of IFRS.

We are concerned that the proposed scope is too broad because governing bodies may be considered an 'authorised body' for the purposes of the proposed standard. This is because there are cases where governing bodies are given the authority to determine prices that bind customers. As such, certain activities of many entities may inadvertently fall within the proposed scope.

In addition, we are concerned that, through the hierarchy in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, the proposals in the Exposure Draft could by analogy be applied to a wide variety of similar situations and result in many entities deferring expenditure that should be recognised as an expense.

**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 of the Exposure Draft).

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

As discussed in our covering letter, we do not support an interim standard.

However, if the IASB proceeds with the proposed standard, we support including the option not to apply the proposals. Generally we do not support options in standards because they introduce inconsistency and reduce comparability of reported information. If entities have a choice of whether or not to adopt the proposed standard, entities will at least be able to choose to adopt an accounting treatment that is consistent with established practice in IFRS and so report information that is comparable to that of other entities using IFRS.

***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 of the Exposure Draft).

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 discussed in our covering letter, we do not support an interim standard. However, if the IASB proceeds with an interim standard we accept that entities that currently do not recognise regulatory deferral account balances should not be permitted to start to do so.

Although this disadvantages existing users of IFRS, introduces inconsistent accounting treatment and reduces comparability of information reported about like transactions, prohibiting entities from starting to recognise regulatory deferral account balances minimises the impacts of the proposals until such time as the IASB's rate-regulated activities project is sufficiently advanced to produce tentative proposals for all users of IFRS.

We are concerned about relying on the impairment requirements related to regulatory deferral account balances in previous GAAP. We do not know the relevant requirements of every jurisdiction that has not adopted IFRS, and consider that there may be previous GAAPs that permit the recognition of regulatory deferral account balances that are unrecoverable. We consider that the IASB should impose a ceiling on such balances, if they are permitted to be recognised. This would be similar, in principle, to the previous practices that were prohibited by IFRS 4 *Insurance Contracts.*

**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 of the Exposure Draft).

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

We consider that accounting for the effects of rate regulation should be consistent with the *Conceptual Framework* and other IFRS. Therefore, if the IASB proceeds with the proposed interim Standard, we agree that, as far as possible, other Standards should apply to regulatory deferral account balances in the same way as they apply to assets and liabilities that are recognised in accordance with other IFRS.

***Presentation and disclosure***

**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 of the Exposure Draft).

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

**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 of the Exposure Draft).

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.

The NZASB maintains that regulatory assets and liabilities do not exist and should not be recognised. However, the NZASB acknowledges that rate regulation may have a significant effect on an entity. We believe the most effective approach to making users aware of the effects of regulation on an entity would be to require appropriate disclosure of information regarding activities subject to rate-regulation in the notes to the financial statements rather than establishing an industry-specific accounting standard that is inconsistent with the *Conceptual Framework* and other IFRS. Such information is relevant for all entities subject to rate-regulation, not only entities subject to regulation that meets specific criteria.

If the IASB allows or requires the recognition of regulatory assets and liabilities, the NZASB believes that, in order to maintain transparency, it is absolutely vital that the impact of rate-regulation on the financial statements be clearly identified separately from other assets and liabilities to avoid completely undermining comparability between regulated and unregulated entities and between regulated entities provided with an interim standard and regulated entities not provided with an interim standard.

If the IASB proceeds to issue a standard, the NZASB is particularly concerned that useful information regarding operating expenses will be lost if expenditure that is currently disclosed separately in the statement of comprehensive income (or in the notes thereto) is combined into a single net movement in a regulatory asset or liability. Therefore, we recommend that the entities be required to disclose a breakdown of the expenditure making up any regulatory asset.

**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 of the Exposure Draft).

Is this approach appropriate? Why or why not?

Judgement must be exercised, and materiality considered, in the application of all IFRS. Therefore, we do not object to any reference to materiality (and the other factors listed) as a factor that an entity should consider when deciding how to meet the proposed disclosure requirements.

***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 *First-time Adoption of International Financial Reporting Standards*, which sets out the transition requirements and relief available.<br><br>Is the transition approach appropriate?  Why or why not? |

If an entity applied the proposed standard it would continue to apply its previous GAAP accounting policies. As such it is likely that there would be no change in recognition or measurement.  Therefore, we see no need for specific transition requirements.

***Other comments***

| **Question 10** |
| --- |
| Do you have any other comments on the proposals in the Exposure Draft? |

We are concerned that the proposals undermine comparability.  The proposals in the Exposure Draft are directed towards the form of rate-regulation in North America when there are various other forms of industry regulation that may have similar impacts on the regulated entities.

To fall within the scope of the Exposure Draft it is required that a regulator establish a price that the regulated entity must then charge to customers.  In New Zealand and Australia, however, often regulators set price caps or acceptable price ranges.  As such, regulated entities are still free to charge whatever price they consider appropriate provided the price charged does not exceed the price cap or provided the price charged falls within the acceptable price range.

Because these entities are not required to charge their customers a specific price, it appears that they will not fall within the scope of the Exposure Draft (ignoring the fact that they also have already adopted IFRS) even though they are subject to regulation which may affect their activities.

This inconsistency, as well as the inconsistency between the proposals in the Exposure Draft and other IFRS, undermines comparability by requiring that economically similar transactions be accounted for differently.

As noted in our response to questions 6 and 7 above, we believe the most effective approach to making users aware of the effects of regulation on an entity would be to require appropriate disclosure of information regarding activities subject to rate-regulation in the notes to the financial statements rather than establishing an industry-specific interim accounting standard that is inconsistent with the *Conceptual Framework* and other IFRS.  Such information is relevant for all entities subject to rate-regulation, not only entities subject to regulation that meets specific criteria.