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Mr Hans Hoogervorst, Chairman
International Accounting Standards Board (IASB)
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Mr Hoogervorst,

On behalf of the Austrian Financial Reporting and Auditing Committee (AFRAC), the privately organised standard-setting body for financial reporting and auditing standards in Austria, we appreciate the opportunity to comment on the Exposure Draft *ED/2013/5 Regulatory Deferral Accounts* (April 2013).

Principal authors of this comment letter were Max Eibensteiner, Peter Geyer, Christian Höllerschmid, Michael Komarek, Gerhard Marterbauer, Thomas Possert and Maximilian Schreyvogl. In order to provide a balanced Austrian view on the topic, the professional background of these authors is diverse (auditors as well as preparers, partly from companies in regulated industries).

General remarks

There is currently no IFRS that specifically addresses accounting issues of rate-regulated businesses. As some national GAAPs permit or require regulatory balances to be recognised in financial statements, the IASB developed this ED for an interim standard to ease the transition for rate-regulated businesses to IFRS in certain jurisdictions. We welcome the IASB's initiative to develop a Standard dealing with rate-regulated activities, as there are indeed issues to be addressed. The energy networks in the European Union (EU), for example, have been subject to regulation since the end of the 1990s. Since 2010, there is a specific statutory mechanism in Austria for adjusting the actual results of a rate-regulated entity to conform with the results required under the regulatory system. In practice, the regulatory regime of the electricity and gas distribution networks determines the tariffs for a given year on the basis of actual volumes and actual costs of previous years. If there are shortfalls in revenues in one year (for example due to deviations of actual volumes from planned volumes) this leads to increased network tariffs in the years beginning after the next year ($t + 2$). Similarly, an actual surplus results in a corresponding reduction of the network tariff two years after the surplus occurred. In Austria, there is some divergence in practice when it comes to the accounting treatment of such regulatory deferrals.

The ED does not deal with the question whether regulatory assets or liabilities arise from scenarios similar to the ones described above. We will therefore scope out this aspect in this comment letter. However, we believe that developing guidance with respect to this question would be beneficial, as the absence of a specific standard might lead to financial statements of firms under rate regulation not providing a true and fair view of the underlying economics of these businesses. We acknowledge that developing such a standard is exceptionally difficult as the rate regulation mechanisms not only differ across jurisdictions but also across industries – the energy industry is not the only industry affected. To increase the complexity, different regulatory regimes may be applicable – even within one jurisdiction and one industry. For instance, in the Austrian power industry the Distribution System Operators (DSOs) and the Transmission System Operator (TSO) operating the high voltage grid, face different regulatory regimes. While the DSOs are subject to incentive-based regulation, the TSO is subject to cost-based regulation. The regulatory regimes are also far from stable, and are subject to frequent changes.

Even though we support the IASB's effort to address accounting issues of rate-regulated businesses, we are not in favour of the short-term interim solution presented in the ED. In our opinion, it discriminates against current users of IFRS and effectively results in a "two-class society" of rate-regulated businesses applying IFRS. We would prefer to see the IASB speed up its work on the longer-term comprehensive rate-regulated activities project. We are also concerned that this ED may prejudice the outcome of the current rate-regulated activities research project.

SPECIFIC REMARKS

<u>Question 1</u>: 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?

We cannot support this uneven-handed treatment of preparers of IFRS financial statements. The ED discriminates again current IFRS users, many of which derecognised regulatory assets or liabilities on first-time adoption of IFRS. This discrimination results in distortion of ratios and reduced comparability, although the effects are mitigated by the ED's provisions that require the regulatory deferral account balances to be presented separately. The effect of the ED's application on the first-time adopter's equity, however, cannot be presented separately. As explained in the General Remarks, we believe that a comprehensive standard on rate-regulated activities would be beneficial, but we believe that such a standard should be applicable to the whole IFRS community and not just to a certain group of first-time adopters. Bearing in mind that the need for accounting guidance on this highly complex and sensitive issue has been recognised for more than a decade, we are concerned that even though the IASB only proposes an interim standard, it may be in force for a longer period than initially expected.

Another reason why we believe that restricting the application to first-time adopters is not appropriate is that it offers structuring opportunities to circumvent the restricted application. For example, a first-time adopter who is active in several jurisdictions and whose home jurisdiction allows the recognition of regulatory deferral account balances could move its company headquarters to another jurisdiction that also allowed the recognition. If the entity adopted IFRS in the following year it would be allowed to recognise regulatory deferral account balances.

<u>Question 2</u>: 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?

Paragraph 8 states that rate-setting mechanisms that determine rates based on targeted or assumed costs, for example industry averages, not linked to the actual costs of the entity, are not within the scope of this interim Standard. Application is restricted to regulatory regimes designed to recover an entity's allowable cost (i.e., the cost acknowledged by the regulator). We do not support this approach, as we believe it is too narrow. We believe that incentive-based regulatory regimes should also be within the scope of a standard dealing with rate regulation. Otherwise companies with similar business models, e.g., the TSO and the DSOs in Austria, are treated differently because they are subject to divergent regulatory regimes. In addition, we are concerned that changes in the regulatory regimes, which are for instance common in Austria, could lead to the activities of a rate-regulated business being within the scope of the rate-regulated activities standard in one year and outside the scope in the next year.

For this reason, we believe that whenever there are regulatory regimes that lead to temporary differences between allowed revenues and actual revenues and these differences are reversed in subsequent periods, they should be within the scope of a Standard dealing with rate-regulated activities. This can also be the case with ex-ante incentive regulation methodology with regulatory accounts where excess past profits lead to reduced future prices. The scope should thus include all forms of price regulation, whether there is a link to the entity's costs or not. A necessary criterion for the recognition of these temporary differences would be that the regulatory deferral accounts can be measured reliably.

<u>Question 3</u>: 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). Do you agree that adoption of the [draft] interim Standard should be optional for entities within its scope? If not, why not?

As explained above, we do not support permitting only first-time adopters to recognise regulatory deferral accounts, as this results in a lack of comparability of financial statements under IFRS. However, if the Standard is adopted, we would prefer to make its application optional as this would decrease (overall) the lack of comparability and transparency between the preparers of financial statements according to IFRS as fewer first-time adopters would apply these rules.

<u>Question 4</u>: 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?

We do not support limiting the scope to first-time adopters that have already recognised regulatory deferral account balances. We would rather change (and thereby extend) the scope from "entities that currently do not recognise regulatory deferral account balances" to "all entities operating in jurisdictions that permit the recognition of regulatory deferral account balances". Encouraging the possibility of recognising regulatory deferral accounts instead of focusing on any firm's actual accounting practice could decrease perverse incentives, e.g., when it comes to voluntary adoption of IFRS. If the limited scope proposed in the ED is retained, the first-time adoption of IFRS could deliberately be delayed by potential voluntary adopters, so as to recognise regulatory deferral accounts under IFRS: If a firm can decide on the adoption of IFRS and has not yet recognised regulatory deferral account balances in its financial statements, it could change its accounting policy under local GAAP and delay the first-time adoption of IFRS by one year to be within the scope of the ED.

<u>Question 5</u>: 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?

We support this approach and believe that it makes sense to recognise assets and liabilities in accordance with other standards first, and to recognise only the residual amounts as regulatory deferral accounts. This approach ensures that other IFRS requirements are applied unmodified and that the effects of rate regulation are shown as a separate item in financial statements.

<u>Question 6</u>: 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?

We support the presentation of the total of all regulatory deferral account debit and credit balances and movements on those balances recognised under the ED as a separate line item in the statement of financial position, because this ensures that the effect of regulatory deferral accounting can separately identified in the financial statements.

<u>Question 7</u>: 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.

The proposed disclosure requirements are too extensive and might exacerbate the problem of information overload in the notes of IFRS financial statements. Moreover, the required disclosures might be too burdensome for many adopters of IFRS. For this reason the IASB should consider limiting the disclosure requirements proposed in the ED.

If the entity is operating in different regulatory regimes, it should disclose the information required by paragraph 25 for each regulatory regime separately. If the rate-regulated businesses facing different regulatory regimes are also different operating segments in the sense of IFRS 8, the disclosure could be integrated into the entity's segment reporting.

The disclosure requirements could be limited to the following information:

- a description of 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;
- the effects that rate regulation has on the entity's financial position;
- the relation between future recovery of each regulatory deferral account balance and related risks and uncertainty;
- the basis on which regulatory deferral account balances are recognised and measured initially and subsequently, including information on the way regulatory deferral account balances are tested for recoverability and potential impairment losses are allocated;

- 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.

We believe that the requirement to disclose the regulatory deferral account debit and credit balances and the net movements in those balances for each associate is too extensive. We acknowledge that this requirement is consistent with IFRS 12 but we also believe that, taking cost-benefit considerations into account, this requirement is not practicable.

Paragraph 26 allows the disclosures required under paragraph 25 to be included by cross-referencing from the financial statement to some other statement. We do not support this approach, as, in our opinion, the required disclosures should only be presented in the financial statements. Because disclosure requirements and the level of detail for statements such as risk reports or management commentaries may vary across jurisdictions, we believe that this option reduces comparability.

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?

We have no objections to this proposed disclosure requirement. An entity should consider materiality when deciding how to meet the proposed disclosure requirements.

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?

The ED becomes effective prospectively, and in its application entities only need to isolate their regulatory deferral accounts on a prospective basis. In addition the ED permits first-time adopters to use the deemed cost exemption of IFRS 1 for PPE and intangible assets. Therefore, specific transition requirements are not necessary.

If the IASB eventually finalises the rate-regulated activities project and the final standard is also applicable to current preparers of IFRS financial statements, specific transition requirements should be provided.

Question 10: Do you have any other comments on the proposals in the Exposure Draft?

As explained above, we feel that the provisions of the ED discriminate against current users of IFRS in comparison with first-time adopters. In our opinion the same set of accounting rules for rate-regulated activities should apply for all entities affected by rate regulation. We would therefore prefer to see increased efforts to finalise the rate-regulated activities project.

We believe the IASB should further consider the interaction of the ED with several other standards and interpretations, e.g., IAS 12 and IFRIC 12.

In addition, we are critical of the requirements proposed in paragraph B1 (in connection with paragraph 12); it potentially limits the ability of a regulated business to adapt its accounting treatment of regulatory deferral account balances to changes in the regulatory regime. We recommend that the IASB clarify whether ED/2013/5 stipulates a “static” or a “dynamic” cross-reference to previous GAAP accounting policies.

Please do not hesitate to contact us if you wish to discuss any aspect of our comment letter in more detail.

Kind regards,

Romuald Bertl

Chairman