September 4, 2013

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

RE: *Regulatory Deferral Accounts* Exposure Draft (ED 2013/5)

Dear Sirs and Madams:

In April, 2013, the International Accounting Standards Board (IASB) issued an Exposure Draft on *Regulatory Deferral Accounts* (ED/2013/5) seeking comments no later than September 4, 2013. The Exposure Draft sets forth a draft interim standard that specifies the financial reporting requirements for *regulatory deferral account balances*[1] that may arise when an entity provides goods or services to customers at a price or rate that is subject to rate regulation. After setting forth the proposal of the IASB the Exposure Draft then seeks responses to a series of ten questions that specifically seek input regarding the appropriateness and usefulness of the proposal.

On behalf of its membership, the National Association of State Utility Consumer Advocates (NASUCA) hereby files its comments regarding the Exposure Draft on *Regulatory Deferral Accounts.* NASUCA is an association of 44 consumer advocates in Barbados and 40 states and the District of Columbia within the United States of America. Its members are designated by the laws of their respective jurisdictions to represent the interests of utility ratepayers before state and federal regulators, the courts, and policy-makers. NASUCA member offices operate independently from the regulatory

[1] Often referred to as regulatory assets or regulatory liabilities in other settings. *Regulatory Deferral Account Balances* are defined as "the balance of any expense (income) deferral or variance account that is included in the setting of future rate(s) by the rate regulator and that would not otherwise be recognized as an asset or liability in accordance with other Standards."

commissions in their jurisdictions and generally act as intervener or a legally designated party in regulatory proceedings that are quasi-judicial and quasi-administrative in nature. The member consumer advocate agencies routinely use the financial statements of the utilities as part of their review processes and in the formulation of recommendations to regulatory authorities about financial and ratemaking matters.

Barbados has adopted the International Financial Reporting Standards (IFRS) as its national set of accounting standards. The other members of NASUCA are part of the United States of America, which has not yet adopted IFRS as its accounting platform. With a limited number of exceptions, the rate regulated utilities with which the NASUCA members interact base their accounting and reporting on United States Generally Accepted Accounting Principles (GAAP) which has a specific accounting standard for accounting for the effects of certain types of regulation.

NASUCA generally supports the recognition of regulatory deferral account balances as separate line items on the financial statements when accompanied by comprehensive disclosures about the nature of those regulatory deferrals. For those entities that would be permitted to recognize these separate account categories on their financial statements, such as public utilities, the understandability and usefulness of the financial statements would be enhanced. Implementation of the proposed standard would also begin to bridge a large chasm between IFRS and U.S. GAAP. This one difference in accounting standards and reporting has been the subject of many discussions and comments over the past few years by both members of the utility industry and regulators. For example, the U.S. Securities and Exchange Commission's *Final Staff Report,*[2] issued after an examination of concerns related to implementing IFRS in the United States of America states at page 83:

> Several regulators highlighted that U.S. GAAP contains industry-specific standards which, if lost, would impair their regulatory regime (in addition to providing less meaningful information to investors). [Footnote omitted] For example, IFRS does not have an equivalent standard to ASC Topic 980, *Regulated Operations* (formerly known as FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation).* A method of incorporating IFRS that would not permit the retention of rate-regulated assets and liabilities as permitted under ASC Topic 980 would significantly impact utility regulators.

The introduction of an interim proposal to address the ever-growing regulatory deferral account balances is a positive step and a much needed move toward the convergence of IFRS and U.S. GAAP.

NASUCA further believes that the Exposure Draft provides for appropriate guidance relative to the disclosures that should accompany the financial reports containing regulatory deferral account balances such as the risk associated with the inclusion of the regulation creating the regulatory balances, the anticipated period for recovering or returning the regulatory balance from customers, and the reconciliation of the beginning and end of year balances.

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[2] *Final Staff Report, Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers,* Office of the Chief Accountant, U.S. Securities and Exchange Commission, dated July 13, 2012.

As noted in the Exposure Draft, without the interim proposal, the requirements of International Accounting Standard (IAS) 8,[3] paragraphs 10-12 would apply. Under this existing standard, management would use its best judgment, based on some general criteria such as relevance, completeness, neutrality, and accepted industry practices to record the transaction which was created or modified through the regulatory process. As further stated in the Exposure Draft,[4] this existing practice has resulted in financial statements by companies that are difficult to compare. The regulatory deferral proposal could offer a way to provide more consistency and usability of the data contained within regulated entities' financial statements – depending on how and to whom the IASB choses to apply the interim standard. However, as it is proposed to be implemented, with different standards applying to different entities, we are concerned that one set of inconsistent financial reports is being traded for a different set of inconsistent financial reports.

Comparability of data is a significant issue for the member offices of NASUCA. A frequently used analytical tool relative to reviewing regulatory filings is to compare data for a utility across time to see how costs have changed, and to compare data of one utility to others, in order to better understand differences in costs. While the rates are traditionally established using adjusted historical or forecast costs of the individual utility being examined, part of the prudency analysis of the costs involves comparisons and benchmarking. Without relatively consistent data, this benchmarking and comparability analysis becomes much more difficult and the results are much less meaningful.

As requested in the invitation to comment on the Exposure Draft, NASUCA is providing comments and information below in response to the specific questions posed by the IASB regarding its interim proposal. The questions contained in the Exposure Draft have been summarized for the sake of brevity.

Question 1
Is the proposal to restrict the scope to first-time adopters of IFRS that recognized regulatory deferral account balances in their financial statements in accordance with their previous GAAP appropriate?
and
Question 4:
Is it appropriate that entities that *currently* do not recognize regulatory deferral account balances <u>not</u> be permitted to start to do so as a result of this draft interim standard?

The proposal would permit entities that are first-time adopters of IFRS to continue to record regulatory deferral account balances as part of their financial statements if the accounting system being used by those entities immediately prior to the use of IFRS allowed for regulatory deferrals. The proposal would <u>not</u> allow an entity that had not previously recorded regulatory deferrals to begin to record them in their financial statements as a result of the adoption of the proposed interim standard. The

[3] IAS 8, *Accounting Policies, Changes in Accounting Estimates, and Errors*.

[4] IASB Exposure Draft ED/2014/5, *Regulatory Deferral Accounts*, at Introduction, page 4, paragraph (c).

result would be inconsistencies in the financial reporting treatment of regulatory deferrals between existing and new IFRS users.

This proposal addresses the much spoken of needs of those entities moving from non-IFRS accounting standards to IFRS. It addresses the immediate need of entities in countries such as Canada to be able to record regulatory deferral account balances as they transition to IFRS. Allowing such first-time adopters of IFRS to ease the transition by maintaining regulatory deferrals makes a lot of sense. Furthermore, the continued use of regulatory deferral account balances will allow users of the financial statements to maintain their general understanding of the entity's transactions and the impact that regulatory decisions have on those transactions. Yet, ensuring the proper identification in the financial statements of regulatory deferral account balances is not the primary focus of the IASB as it issues this Exposure Draft. If it were, it would allow regulatory deferral account balances for all users of IFRS. Instead, it appears that allowing the use of regulatory deferral account balances is simply a necessary concession that must be endured to ensure that entities transition from a myriad of non-uniform accounting standards to IFRS.[5] The bottom line is that the proposal would create inconsistencies where none currently exist in exchange for gaining some conformity in other areas of financial reporting.

In principle, calling out the regulatory deferral account balances and explaining them through disclosure requirements provides for a more informative set of financial statements than not recognizing the regulatory deferrals separate and apart from other accounts. In its proposal, the IASB moves in this direction but is not prepared to wholeheartedly embrace the principle for all entities. We hope that after its final analysis of this issue, IASB will provide consistent guidance for all entities. Meanwhile, we are not prepared to make a judgment or offer an opinion on whether it is better to allow some financial statements to be more clear and informative by adopting the interim standard, even though additional inconsistencies are created – or whether it is better to have consistent treatment of the issue by rejecting the interim proposal, even though the interim proposal clearly is movement in the right direction and makes the financial statements more informative.

Question 2
Are the criteria that must be met for regulatory deferral accounts to be recorded within the scope of the proposed interim standard appropriate?

The criteria set forth in the Exposure Draft that must be met for an entity to qualify to record regulatory deferral account balances is quite similar to the criteria that exists within current U.S. GAAP.[6] Both require that the entity's rates for regulated services be established by a third-party (or independent) regulator and that the price established is binding on customers. Both require that the prices established by the regulator be designed to recover the specific entity's costs of providing the

[5] See IASB Exposure Draft ED/2014/5, at page 32 at BC19 and BC20, "The IASB acknowledges that the proposal to permit only a limited population of entities to recognize regulatory deferral account balances will introduce some inconsistency and diversity into IFRS practice for the treatment of regulatory deferral account balances, when it does not currently exist…The IASB thinks that the following benefits of the proposed interim Standard justify introducing this diversity: … Having more entities applying IFRS would ensure that their other activities are reported in accordance with IFRS, thereby increasing comparability for those other assets and liabilities…"

[6] Financial Accounting Standards Board Accounting Standards Codification Section 980-10-15(2)

regulated goods or services, with the explanation that there is not a requirement that the costs be matched on a one-on-one basis to the entity but that there is a link directly back to the entity's specific costs. U.S. GAAP has one additional explicit requirement: based on the demand for the regulated service, it is reasonable to assume that rates set at the directed levels will recover the entity's costs and can be charged to and collected from customers. This is not explicitly set forth in the IASB's proposal, but there is an explanation in the Exposure Draft[7] that explains that the criterion that there be a direct link between the entity's prices and costs is intended "to provide reasonable assurance that the deferred amounts will be recovered through future rates." Thus, it is easy to conclude that the IASB's interim proposal and the current U.S. GAAP regarding regulatory deferral account balances are similar enough to be applicable to the same entities.

NASUCA agrees with the qualifying criteria set forth in the Exposure Draft. It is appropriate to include criteria that an independent party set the rates and that the rates are binding once established by the regulator so that there is a basis for establishing regulatory deferral account balances that have a real economic substance. We also believe that the proposal is broad enough to encompass most cost-of-service based ratemaking as well as some incentive ratemaking based on the clarification that the established rates have a link to the entity's specific costs but that there not be a one-to-one direct tie to the entity's costs.

Question 3
Is it appropriate that the adoption of the draft interim standard be optional for entities that meet the eligibility standards?

Making adoption of the proposal optional may very well create additional non-comparable financial reports from some entities that choose not to implement the proposed standard. In addition, requiring adoption of the standard does not seem unreasonable as the number of entities who would choose not to apply the standard is likely to be small, at least in North America, given the past clamoring for the IASB to allow the recognition of regulatory deferrals under IFRS. The U.S. Securities and Exchange Commission has allowed some optional implementation of IFRS for a small number of entities in the United States of America. Nonetheless, given the small number of entities likely to opt out and the overall goal and attendant advantages of comparable financial statements, NASUCA believes that adoption of the standard should not be optional.

Question 5
Is the proposal contained within the draft interim standards, that directs that other existing International Financial Reporting Standards that address regulatory deferral account balances be applied in the absence of any specific exemptions or exceptions, appropriate?

The proposal directs that if other accounting and reporting standards would normally apply to assets and liabilities that those same standards should be applied to the regulatory deferral account balances, unless there is further specific direction to apply to the regulatory deferrals. An example is

[7] At page 36, BC34 of the IASB Exposure Draft ED/2013/5/.

included in the Exposure Draft[8] that discusses how a regulatory deferral may be required at the same time another IFRS is applicable to the same transaction. The example discusses how the measurement of a regulatory deferral might need to be modified in order to take into account the impacts of foreign currency exchange rates. Thus, both the interim standard for regulatory deferrals and the existing International Accounting Standard 21, *The Effects of Changes in Foreign Exchange Rates*, would apply. We agree with this aspect of the Exposure Draft and find the proposal as to how other accounting standards would interact with the interim standard to be reasonable.

Question 6
Is it appropriate to require that the incremental amounts that are recognized as regulatory deferral account balances and movements in those balances be isolated from the other assets, liabilities, income and expenses?

The proposal directs that the entity recognizing regulatory deferral asset balances is to present the total of all regulatory deferral account debit balances separately from the total of all regulatory deferral account credit balances. It further directs that these two separate line items be distinguished from the entity's assets and liabilities, given that the IASB has not yet determined whether the regulatory deferral account balances meet the established definitions of assets and liabilities. Additionally, the proposal requires that net changes in the regulatory deferrals, other than those acquired or disposed of during the period, be presented in the profit or loss section of the financial statements.

NASUCA agrees that the regulatory deferral account balances and the changes in those balances should be separately presented in the financial statements distinguished from the other assets, liabilities, revenues, and expenses. The separate presentation of these amounts, when examined in conjunction with the required disclosures, should assist users of the financial statements to assess the impact of the regulatory deferrals, making the financial information being presented more useful and understandable.

Question 7
Do the proposed disclosure requirements provide decision-useful information that enable users of financial statements to understand the nature and financial effects of rate regulation on the entity's activities?
and
Question 8
Does the proposal appropriately include materiality and other factors to be considered relative to the disclosure requirements?

The Exposure Draft contains both general and specific guidance regarding the disclosures to accompany the recognition of the regulatory deferral account balances in the financial statements. The disclosure guidance includes, but is not limited to: (a) description of the nature of, and the risks associated with the rate regulation that restricts the price the entity is permitted to charge; (b) the effects of the rate regulation on the entity's financial position, financial performance, and cash flows; (c) the basis on which the regulatory deferrals are recognized and measured; (d) the assessment of the regulatory deferrals for recovery and any potential impairment loss; (e) a quantified reconciliation of the

[8] See IASB Exposure Draft ED/2013/5/ at page 13, paragraph 17.

beginning and end of period deferral amounts; and (f) the expected remaining recovery or amortization period associated with the deferral.

We find the disclosure guidance of the proposal to be appropriate and reasonable. The information to be provided should be useful to various types of users of the financial statements, including regulators and regulatory analysts. The type of disclosures required are also consistent and necessary to achieve one of the stated goals of the proposal: to ensure that users of the financial statements will be able to identify clearly the amounts of regulatory deferral account balances, and changes in those balances, in order to be able to compare financial statements of entities that recognize such balances to those who do not.[9] The disclosures may be particularly important if the proposal continues to apply only to first-time users of IFRS. The disclosures should assist in providing responses to questions that may arise as additional entities apply IFRS and new line items related to regulatory deferrals appear on the financial statements.

Question 9

Is it appropriate that the Exposure Draft not set forth any specific transition requirements since the draft interim standards would be applied at the same time as IFRS 1 (*First-Time Adoption of International Financial Reporting Standards)* which already sets forth transition requirements?

NASUCA agrees that no further transitional requirements are necessary, since IFRS 1 already includes transitional instructions for entities moving from non-IFRS to IFRS accounting and reporting. Further transitional guidance may be needed if the IASB were to decide to require consistent application of the regulatory deferrals proposal to more than only entities in the process of transitioning from non-IFRS to IFRS accounting and reporting.

Question 10

Do you have any other comments on the proposals?

We have no additional specifics to offer. The proposal contained in the Exposure Draft was clearly and thoroughly explained. Additionally, the proposal was described adequately – particularly the disclosure requirements – such that implementation should not be difficult or burdensome.

[9] See IASB Exposure Draft ED/2013/5/ at page 5.

On behalf of its members, NASUCA appreciates IASB's efforts to continue the dialogue on the issue of regulatory deferrals. We also look forward to the continuing discussion of how to address regulatory deferrals in an entity's financial statements as the IASB seeks a permanent resolution of this matter.

Respectfully submitted on the 4th of September, 2013.

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