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4 September 2013

Dear Sir

ED/2013/05 Regulatory Deferral Accounts

We are pleased to comment on the above Exposure Draft (the ED). Following consultation with the BDO network[1], this letter summarises views of member firms that provided comments on the ED.

We acknowledge and understand that, in certain circumstances, it may be considered necessary to provide reliefs to first-time adopters of IFRS. In some cases, this may encourage certain entities to adopt IFRS, which overall will result in an improvement in the quality of financial reporting. Such reliefs have been provided in the past, with perhaps the most significant of these being related to IFRS 4 *Insurance Contracts* and IFRS 6 *Exploration for an Evaluation of Mineral Resources* which were available to first-time adopters in 2005.

However, we do not believe that the proposals set out in the ED are appropriate. We are concerned at the introduction at this point of potentially significant differences in amounts presented in an entity's primary financial statements, dependent purely on the point at which it adopted IFRS, with the IASB proposing to take action now when a significant number of entities in multiple jurisdictions have faced the same issue and have derecognised assets and liabilities relating to rate regulated activities.

Although special provisions for first-time adopters have previously been made available, some of the most significant of these applied to first-time adopters in 2005, before which point a considerably smaller number of jurisdictions permitted, and fewer still required, entities to report in accordance with IFRS. Arguably, the position now is different due to the wide range of jurisdictions and entities that have adopted IFRS, meaning that the introduction of an interim standard as proposed would result in the introduction of significant additional diversity in financial reporting.

We are also concerned that, despite the IASB's assurances to the contrary, if an interim standard were to be issued as proposed there would be significant pressure from some constituents to treat this as a first step towards regarding rate regulated activities as giving

[1] Service provision within the international BDO network of independent member firms ('the BDO network') in connection with IFRS (comprising International Financial Reporting Standards, International Accounting Standards, and Interpretations developed by the IFRS Interpretations Committee and the former Standing Interpretations Committee), and other documents, as issued by the International Accounting Standards Board is provided by BDO IFR Advisory Limited, a UK registered company limited by guarantee. Service provision within the BDO network is coordinated by Brussels Worldwide Services BVBA, a limited liability company incorporated in Belgium with its statutory seat in Brussels. Each of BDO International Limited (the governing entity of the BDO network), Brussels Worldwide Services BVBA, BDO IFR Advisory Limited and the member firms is a separate legal entity and has no liability for another such entity's acts or omissions. Nothing in the arrangements or rules of the BDO network shall constitute or imply an agency relationship or a partnership between BDO International Limited, Brussels Worldwide Services BVBA, BDO IFR Advisory Limited and/or the member firms of the BDO network.
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rise to balances that do qualify to be recognised as assets and liabilities. That said, we acknowledge that the IASB's project to review and update its Conceptual Framework may result in changes being made to the definitions of assets and liabilities.

However, for the purposes of IFRSs that are currently effective, we believe that if relief is to be granted to entities that have rate regulated activities then this relief should be granted to all entities that have adopted IFRS. In addition, we believe that no amounts should be permitted to be recognised in an entity's primary financial statements, with the amount of any regulatory deferral accounts being disclosed in the notes. In order that clear information is provided to users of financial statements, these disclosures should be required to show the effects of regulatory deferral accounts on all of the primary financial statements, including any disclosures that are made within those primary financial statements such as earnings per share amounts. We believe that this would reduce the risk of an interim standard being viewed as in any way prejudging the outcome of the IASB's wider project on rate regulated activities.

The proposals would result in entities within the scope of the interim standard recognising regulatory deferral accounts based on the requirements of their local GAAP or regulator at the point at which they adopt IFRS. We believe that this should be reconsidered, with the local GAAP or regulatory requirements used for the purpose of the IFRS disclosures being updated as they change in order to avoid the need to keep multiple accounting records.

In determining which arrangements might fall within the scope of an interim standard, we believe that the two criteria which have been proposed need to be tightened. This should also link to the information gathered by the IASB about rate regulated activities; a wide range of different types of those activities exist and it is important that an informed view of them is obtained in order that the scope can be set appropriately.

We hope that you will find our comments and observations helpful. If you would like to discuss any of them, please contact me at +44 (0)20 7893 3300.

Yours faithfully,

Andrew Buchanan

Andrew Buchanan

Global Head of IFRS

Appendix

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?

No.

In order to maintain as much comparability as possible among entities that report in accordance with IFRS, we believe that in principle any new requirements or reliefs that are incorporated into IFRS should be available regardless of when an entity has adopted IFRS. To do otherwise creates the potential for two groups of entities that report similar transactions and events in different ways. These groups could comprise not only entities from different jurisdictions, but also entities within the same jurisdiction. We do not believe that it is appropriate deliberately to add potentially significant inconsistency to financial reporting.

As noted in the ED, the question of whether regulatory deferral accounts qualify for recognition in accordance with IFRS is not a new issue. However, almost all entities that have adopted IFRS in previous years have ceased to recognise these balances, and it is not entirely clear why the IASB considers that it is appropriate for relief to be granted prospectively to first-time adopters now when there are many entities in multiple jurisdictions which were similarly affected in previous periods.

We acknowledge that IFRS 4 *Insurance Contracts* and IFRS 6 *Exploration for and Evaluation of Mineral Resources* each provided relief specifically for first-time adopters of IFRS. However, these IFRSs were made available to entities that adopted IFRS in 2005, before which point a considerably smaller number of jurisdictions permitted, and fewer still required, entities to report in accordance with IFRS. The position in 2013 is significantly different, and it is arguable whether it is appropriate to grant relief to first-time adopters in the same way as before. While entities in jurisdictions that have not yet adopted IFRS may feel that they should be given similar types of reliefs to those who adopted some time ago, some may consider that there is a difference between providing reliefs to first-time adopters when the use of the related accounting standards is in its relatively early stages, and providing reliefs to entities that are adopting them almost a decade after entities in many other significant jurisdictions. This is because, once a larger number of jurisdictions and entities have already adopted those accounting standards, a relief that is then granted only to first-time adopters will bring a greater degree of diversity in practice.

We also note that it is not clear whether 'previous GAAP' refers to those accounting standards that an entity has adopted for the purposes of its consolidated or its separate financial statements. In addition, given that in some jurisdictions entities adopt IFRS at different times for the purposes of their consolidated and separate financial statements, significant complexity and inconsistency in reporting could arise within an entity's own financial statements if it presents them on both a consolidated and separate entity basis.

We believe that if any relief is to be given for rate regulated activities, this should be provided by way of disclosures only and be available to all entities that report in accordance with IFRS, regardless of the point at which they have adopted IFRS. In order that users of financial statements are able to make adjustments to show the effect of regulatory deferral accounts, these disclosures should be required to show the effect on all of the primary financial statements, including any disclosures that are made within those primary financial statements such as earnings per share amounts.

Linked to this point, although the IASB has indicated in the ED that the interim standard would in no way prejudge the outcome of the more comprehensive project on rate regulated activities, we are concerned that permitting the recognition of regulatory deferral account balances in the primary financial statements could be viewed by some as representing a first step towards permitting recognition in accordance with IFRS. However, we acknowledge that the timing of the comprehensive project is likely to be linked to the timing of the IASB's project to review and update its Conceptual Framework, and that this latter project may result in changes to the definitions of assets and liabilities.

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?

No.

Although we agree that the criteria that have been proposed are necessary, these need to be supplemented by additional criteria. In addition, given that the IASB is currently in the process of gathering information about the types of arrangements that should be within the scope of its wider project on rate regulated activities, care will be needed in any interim standard to ensure as far as possible that its scope includes all of, and only, those arrangements that are intended to be captured.

In many jurisdictions, many activities are subject to rate regulation in a form which might be viewed as meeting the two proposed criteria. For example, a regulated taxi service will have fares set at restricted amounts that are designed to cover the cost of running the taxi and permit an acceptable profit margin to be earned. It is doubtful that the IASB intends those arrangements to be within the scope of the interim standard.

Consequently, we encourage the IASB to progress its information gathering work as quickly as possible, to enable as informed a view as possible to be taken when establishing the scope of any interim standard.

Although it might be viewed as being implicit in the proposed guidance, it is not clear whether an entity that records a regulatory deferral amount within assets needs to have a reasonable expectation that the debit balance will be recovered. We suggest that an explicit requirement is included, and note that under US GAAP in order for a regulatory asset to be recognised it is necessary for it to be probable that future revenue arising from that asset will at least cover the amount recognised.

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).

Do you agree that adoption of the [draft] interim Standard should be optional for entities within its scope?

If not, why not?

We agree.

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?

As noted above, we do not agree that entities should be permitted to recognise regulatory deferral accounts in their statements of financial position, with any amounts instead being disclosed in the notes.

However, if the IASB decides to permit such recognition, we do not agree that the approach followed in determining the amount of regulatory deferral account balances at the point of first-time adoption of IFRS should be retained for all future periods. This is because this does not take account of the potential for local GAAP or regulatory requirements to change in the future. Consequently, an entity which recognises regulatory deferral balances in accordance with an interim standard might find, in future periods, that it needs to calculate amounts in accordance with IFRS, its local GAAP or regulatory requirements that applied when it adopted IFRS, and its local GAAP or regulatory requirements that are currently in force. We believe that this would be overly burdensome and inappropriate. This would be particularly the case for an entity that adopted IFRS at different times for the purposes of its consolidated and separate financial statements.

Consequently, if an interim standard is issued, it should require regulatory deferral account balances to be recognised and measured in accordance with current local GAAP or local regulatory requirements that are in force at each reporting date, with any changes in such requirements being dealt with in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors.*

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?

If not, why not?

Yes, the proposed approach is appropriate.

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?

As noted above, we do not agree that entities should be permitted to recognise regulatory deferral accounts in their statements of financial position, with any amounts instead being disclosed in the notes.

However, if the IASB decides to permit such recognition we agree with the proposals.

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.

As noted above, we do not agree that entities should be permitted to recognise regulatory deferral accounts in their statements of financial position, with any amounts instead being disclosed in the notes.

However, except for any changes which would arise from our suggested approach of showing the effect of regulatory deferral accounts only in the notes, we agree with the proposed disclosure requirements.

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?

Please identify any disclosure requirements that you think should be removed from, or added to, the [draft] interim Standard.

Yes. In principle, we believe that entities should be encouraged to present only that information which is relevant to them and is material.

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?

As noted above, we do not agree that the scope of the interim standard should be restricted to first-time adopters of IFRS.

However, if the IASB decides to continue with its proposed scope, we agree with the proposals.

Question 10

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

We have no other comments on the proposals.