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Mr Hans Hoogervorst
International Accounting Standards Board
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Our ref MV/288
Contact Mark Vaessen

4 September 2013

Dear Mr Hoogervorst

Comment Letter on ED/2013/5 *Regulatory Deferral Accounts*

We appreciate the opportunity to comment on the International Accounting Standards Board's (IASB) Exposure Draft ED/2013/5 *Regulatory Deferral Accounts* (the ED). We have consulted with, and this letter represents the views of, the KPMG network.

We support the Board's proposal for an interim standard that would apply while its comprehensive project on accounting for the effects of rate regulation is underway. We agree that the proposals will reduce barriers to the adoption of IFRS by entities with rate-regulated activities until guidance can be developed through the comprehensive project. We also agree that separate identification of regulatory deferral account balances will make it easier to compare the financial statements of entities that do and do not apply the proposed interim standard. However, recognising that some jurisdictions that recently transitioned to IFRS would have welcomed the proposed interim relief, we would be open to exploring the possibility of limited expansion of the scope of the ED.

We support the overall approach of the ED regarding the general application of other IFRSs to regulatory deferral accounts. However, we have identified additional clarifications that we believe would improve the consistency with which the proposed interim standard would be applied in practice. The Appendix to this letter contains our responses to the specific questions raised in the ED, including suggestions aimed at improving the clarity of the proposed interim standard and its interaction with other IFRSs.

As these proposals are intended to serve as temporary guidance, we encourage the IASB to move forward with the comprehensive project as quickly as possible, with a goal of limiting the time period for which the interim standard would be applicable. Our support for the proposed interim standard does not anticipate the outcome of the comprehensive project, nor is it indicative of what our response may be to proposals for a comprehensive standard.

If you have any questions about our comments or wish to discuss any of these matters further, please contact Mark Vaessen or Phil Dowad at +44 (0)20 7694 8871.

Yours sincerely

KPMG IFRG Limited

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Appendix: KPMG's responses to specific questions posed by the Board

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?

In our comment letter on ED/2009/8 *Rate-regulated Activities*, we suggested that if the Board concluded that it would be unable to address the conceptual and application issues raised by constituents in time for use of the proposed standard by 'wave 2' first-time adopters of IFRS, then the Board should adopt an interim step. We continue to support the introduction of an interim standard. We agree that the proposals will reduce barriers to the adoption of IFRS by entities with rate-regulated activities until guidance can be developed through the comprehensive project. However, given that some jurisdictions have recently completed their transition to IFRS, the relief proposed by the ED would not be available to them. Accordingly, while we support the current proposals, we would also be open to exploring the possibility of expanding the scope of the ED to rate-regulated entities that recently transitioned to IFRS.

We agree with restricting the scope to entities that recognised regulatory deferral account balances in accordance with their previous GAAP, that is, in their general purpose financial statements published prior to transition to IFRS.

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?

While it will be important that the Board considers scope more broadly as part of the comprehensive project, we believe, from a practical standpoint, the proposed scope criteria are sufficiently clear to achieve consistent application in jurisdictions likely to move to IFRS during the limited period during which the proposed interim standard will apply.

However, we recommend clarification is provided of the Board's intention, as expressed in BC34, for the second scope criterion to provide 'reasonable assurance' that the deferred amounts will be recovered through future rates, as it seems to add an additional layer of complexity to the proposed interim standard. We suggest the Board makes clear whether it intends to imply some form of a recovery threshold and what factors would be relevant. For example, the ED does not discuss whether estimated changes in the level of demand or competition during the recovery period are to be considered.

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 that adoption of the interim Standard should be optional for entities within its scope. This will allow entities to adopt the interim standard and so maintain greater comparability with their previous GAAP reporting, or not to adopt the interim standard and so increase comparability with entities that have already transitioned to IFRS. We believe it is appropriate to permit entities to make this decision based on their own facts and circumstances given the practical, temporary nature of the interim standard.

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?

We agree that, if the scope of the interim standard is limited to first-time adopters of IFRS, then entities that currently do not recognise regulatory deferral account balances should not be permitted to start to do so. If there were a limited expansion of the scope of the interim standard to include entities that have recently transitioned to IFRS, then we would support making the standard available to entities that recognised regulatory deferral balances in their financial statements immediately prior to transition.

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?

We agree with the approach to the general application of other Standards to the regulatory deferral account balances. However, we have identified additional clarifications that we believe would enhance the consistency with which the proposed interim standard would be applied in practice, as follows.

- IFRS 10 *Consolidated Financial Statements*: An entity's previous GAAP may not have required accounting policies of subsidiaries to be harmonised upon consolidation. Accordingly, we believe the proposals should address the tension that could arise between the principles of IFRS 10 and the scope requirements in paragraph 4 of the ED. For example, a parent entity that applies the interim standard may have rate-regulated subsidiaries which did not recognise regulatory deferral account balances under previous GAAP, as well as rate-regulated subsidiaries which did recognise regulatory deferral account balances under previous GAAP.

  We believe that the interim standard should specify which takes priority in such circumstances: the IFRS 10 principle of consistent accounting policies, or the ED's option for continuation of previous GAAP.

- IFRS 3 *Business Combinations*: The ED is silent on whether an acquiree's regulatory deferral account balance would be an identifiable asset in a business combination. For example, if an entity that applies the interim standard acquires an entity that conducts rate-regulated activities that would fall within the scope of the ED, then would the acquirer be prevented from recognising regulatory deferral account balances in the acquisition accounting? If not, would the recognition of regulatory deferral account balances depend on whether the acquiree recognised such balances? And, to the extent that regulatory deferral account balances were recognised by the acquiree, how would they be measured under IFRS 3?

  We suggest the proposals be clarified to indicate that if the acquirer applies the interim standard, then there should be a recognition and measurement exception from IFRS 3, and that regulatory deferral account balances should be recognised based on the acquirer's accounting policies regardless of the acquiree's previous accounting. This is a separate point to the issue above regarding whether to prioritise the principle of consistent accounting policies or the option to continue previous GAAP on adoption of the interim standard; we believe that, in a subsequent transaction, an acquirer should not continue an acquiree's accounting.

- IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*: The ED does not explicitly address the impact of a regulatory deferral account balance on the measurement of a disposal group or recognition of an impairment loss or reversal, including whether to allocate the loss to the regulatory deferral account balance.

  We suggest the proposals specify that, consistent with the treatment of items that fall within the measurement exception in IFRS 5.5 and the guidance in IFRS 5.23, an impairment loss (or subsequent gain) recognised for a disposal group would not reduce (or increase) the carrying amount of regulatory deferral account balances that are part of the disposal group.

- IAS 21 *The Effects of Changes in Foreign Exchange Rates*: The reference to translation of regulatory deferral account balances in the final sentence of paragraph 17 of the ED can be read to imply that regulatory deferral account balances are monetary items. We believe that the intention of paragraph 17 is to explain that IAS 21 will apply to the translation of a foreign operation that contains rate-regulated activities, not to comment on whether regulatory deferral account balances are monetary or non-monetary items. We recommend that the paragraph be redrafted accordingly.

- IAS 3*6 Impairment of Assets*: The proposals specify that IAS 36 does not apply to impairment testing of individual regulatory account balances, but that IAS 36 would apply to a cash generating unit (CGU) containing a regulatory deferral account balance. However, it is not clear how the entity would allocate an impairment loss to the assets within a CGU that contains a regulatory deferral account balance, including whether any portion of the impairment loss should be allocated to the regulatory deferral account balance.

  We suggest that the proposed interim standard be clarified to state that when allocating an impairment loss in accordance with IAS 36.104 to a CGU that contains a regulatory deferral account balance, an entity shall not reduce the carrying amount of the regulatory deferral account balance below the amount determined in accordance with the proposals. In effect, an impairment loss would only be allocated on a pro-rata basis to the other assets in the unit.

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?

We agree with the separate presentation approach as it will be helpful for users in comparing entities by transparently reporting the impact of recognising regulatory deferral account balances in the statement of financial position. However, we believe the following require additional clarification.

- *Other comprehensive income (OCI)*: The ED proposes that the movement in regulatory deferral balances should be shown separately in profit or loss. It is not clear whether this is intended to apply to the movement in a regulatory deferral balance that arises from an allowable expense that is recognised in OCI in accordance with another standard, such as IAS 19 *Employee Benefits*, to recognise certain items in OCI. We believe application of the separate presentation approach to amounts flowing through OCI relating to regulatory deferral accounts would be appropriate.

- *Current tax*: While paragraphs B4-B6 address the application of IAS 12 *Income Taxes*, they only contemplate deferred taxes. We believe these paragraphs should apply to all income taxes and therefore suggest the use of wording that would capture both current and deferred tax amounts.

- *Interests in other entities*: While paragraphs B14-B17 address the application of IFRS 12 *Disclosure of Interests in Other Entities*, it is not clear whether, in accordance with paragraphs 20 and 21, equity accounting should include regulatory deferral account balances and movements relating to associates and joint ventures. In addition, if the regulatory deferral account balances are included in the equity accounting, it is not clear whether the impact of the regulatory deferral account balances should be presented as a separate line item or disclosed as part of the analysis of the regulatory line items as described by paragraphs 28-29 of the proposed interim standard. We suggest the proposed interim standard specifically states that paragraphs 20 and 21 should be applied to interests in other entities, thereby requiring regulatory deferral account balances recognised through equity accounting to be presented or disclosed separately.

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.

In general, we believe the proposed disclosure requirements will provide decision-useful information as they will assist users in gaining an understanding of the entity's rate-regulated activities, including how risks and uncertainties affect the future recovery of balances recognised. In addition, given the proposed interim standard allows grandfathering of existing accounting policies, the disclosures explaining the recognised amounts of regulatory deferral account balances will help improve comparability and be particularly useful to users of the financial statements who may not be familiar with the entity's previous GAAP. Also, the aggregation of this information in a tabular format will assist with accessibility and understandability of the disclosures.

We do not, however, support the disclosures required by paragraph 25 being incorporated by cross-reference from some other statement such as a management commentary or risk report. If the disclosures are considered relevant and material to the financial statements, we believe they should be included within the financial statements themselves. Information becomes less useful to a user if an alternate document has to be obtained and referred to. In addition, audit challenges would arise if the external auditor is not associated with the document incorporated by reference

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?

Overall, we support the IASB's initiative to reinforce the general principle of materiality in the context of disclosures. However, we do not support the proposals in the ED in advance of progress on the IASB's overall work on disclosures.

In particular, it is not clear whether the proposals are merely intended to be an interim measure pending the finalisation of the work on disclosures, or whether the additions are intended to be long-term. We note that any plan to add wording similar to paragraphs 23 and 24, adjacent to the disclosure requirements of each and every standard and interpretation, might create unnecessary duplication and therefore may not be the best way to achieve the desired result. In the meantime, we are concerned that the existence of this paragraph in only one of the IASB's standards may add to confusion as to the interpretation of disclosure requirements of other standards.

In terms of drafting, we note that the following few areas raise questions about the intention of the proposal:

- Although the section on 'disclosures' begins with the heading 'objective', paragraph 23 frames paragraph 22 as a 'requirement'; in addition, paragraphs 25, 27 and 28 use the phrase "the entity shall disclose…" and paragraph 26 refers to "the disclosures required by paragraph 25". These wordings are not necessarily consistent with a principles-based disclosure requirement and may still give an impression that the extensive list of disclosures is to be seen as minimum requirement.

- Paragraph 23 of the ED states that "if any of the disclosures… are not considered <u>relevant</u> to meet the requirements in paragraph 22, they may be omitted from the financial statements" (emphasis added). The reference to 'relevant' information is different from the references to 'material' information in paragraphs 24, 25 and 28 of the ED and that in paragraph 31 of IAS 1, which could be confusing and may raise interpretative questions. In addition, consideration should be given to the overall principle with respect to materiality of disclosures in IFRS financial statements before considering its application to a particular topic such as regulatory deferral account balances. We recommend that Board reconsider the appropriate criteria in a more comprehensive manner and then clarify its choice if the chosen term differs from that used in IAS 1.

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 proposed transition approach is appropriate given that existing recognition and measurement policies would be continued when the interim Standard is adopted. With regard to the interaction of the ED with other Standards, given the proposed scope restriction to first-time adopters of IFRS, transition requirements in IFRS 1 are sufficient.

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

In additional to our answers to the specific questions raised in the ED, we identified the following comments:

- There is an inconsistency between reference to an identifiable causal effect that links the regulatory deferral account balances to the rate-setting mechanism in paragraph 8 and BC34 and the requirement of a 'strong link' in BC27. The latter terminology could be interpreted as a recognition threshold which is not reflected in the proposed interim standard.

- Paragraph 22(a) and 25 should make reference to 'goods or services' rather than 'goods and services'.

- The lead-in to paragraph B1(a) that "paragraph 12 prohibits the introduction of the practices described" is inconsistent with the drafting that follows, which contemplates practices that are permitted. We suggest this sentence is moved to the end of the section, to follow B1(c) so that paragraphs (a) to (c) are a discussion of practices the entity is permitted to continue to apply in accordance with its previous GAAP accounting policies, followed by a caveat that the introduction of such practices is prohibited.

- The statement in B1(a) that the "entity has the right, as a result of expected actions of the rate regulator to increase rates in future periods" should be amended to eliminate use of the term 'right' in the context of an expected action. For example, it could be rephrased to "recognising a regulatory deferral account debit balance for an increase in rates in future periods in order to recover its allowable costs, as a result of the actual or expected actions of the rate regulator".