

STAFF PAPER

March 2017

IASB Meeting

Project	Conceptual Framework
Paper topic	Applying the amendment to paragraph 11 of IAS 8 <i>Accounting Policies, Changes in Accounting Estimates and Errors</i> to rate-regulated activities
CONTACT(S)	Yulia Feygina yfeygina@ifrs.org +44 (0)20 7332 2743

This paper has been prepared for discussion at a public meeting of the International Accounting Standards Board (the Board) and does not represent the views of the Board or any individual member of the Board. Comments on the application of IFRS® Standards do not purport to set out acceptable or unacceptable application of IFRS Standards. Technical decisions are made in public and reported in IASB® *Update*.

Purpose of the paper

1. Paragraph 11 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* requires that entities refer to the *Framework for the Preparation of the Financial Statements* (the *Framework*) when developing accounting policies in the absence of an IFRS Standard that specifically applies to a transaction, event or condition.
2. In January 2017, the Board tentatively decided to:
 - (a) replace the reference to the *Framework* in paragraph 11 of IAS 8 with a reference to the *Conceptual Framework*; and
 - (b) consider whether rate-regulated activities should be excluded from the scope of that amendment.
3. This paper discusses whether and how the amendment to paragraph 11 of IAS 8 should apply to accounting policies for rate-regulated activities.

Structure of the paper

4. This paper is structured as follows:
 - (a) Staff recommendations (paragraph 6);
 - (b) Background (paragraphs 7–13);

- (c) Staff analysis:
 - (i) Scope of the potential exclusion from applying the amendment (paragraphs 14–24).
 - (ii) Exemption or exception from applying the amendment (paragraphs 25–30).
5. Appendix A illustrates how the scope exclusion from applying the amendment could be drafted. The staff do not plan to discuss drafting at the meeting.

Staff recommendations

6. The staff recommend that:
- (a) the amendment to paragraph 11 of IAS 8 will not apply to accounting policies for regulatory account balances. Instead, entities that develop accounting policies for regulatory account balances by reference to the *Framework* will be required to continue doing so until they apply the future Standard on rate-regulated activities;
 - (b) the prohibition from applying the amendment to paragraph 11 of IAS 8 to accounting policies for regulatory account balances will apply both to existing and new accounting policies; and
 - (c) a regulatory account balance will be defined as the balance of any expense (or income) account that is not recognised as an asset or a liability in accordance with IFRS Standards and is included, or is expected to be included, by the rate regulator in establishing the rate(s) that can be charged to customers. (The term ‘rate regulator’ is defined in IFRS 14 *Regulatory Deferral Accounts*.)

Background

7. The Exposure Draft *Updating References to the Conceptual Framework* (the Updating References Exposure Draft) proposed replacing references to the *Framework* in IAS 8 and other affected Standards with references to the *Conceptual Framework*. Replacing the references to the *Framework* was

proposed to achieve transition to the revised *Conceptual Framework for Financial Reporting* (the *Conceptual Framework*) for entities that develop their accounting policies by reference to the *Framework*.

8. However, as reported to the Board in January 2017, the work performed on assessing the effects of the revised *Conceptual Framework* on preparers and the feedback received on the Updating References Exposure Draft suggested that replacing the reference in paragraph 11 of IAS 8 could create unintended consequences for some entities that conduct rate-regulated activities.
9. At present, entities that conduct rate-regulated activities develop accounting policies for regulatory account balances on the basis of:
 - (a) IFRS 14 if:
 - (i) the entity was a first-time adopter of IFRS Standards after IFRS 14 became effective; and
 - (ii) the entity elected to apply IFRS 14;¹ or
 - (b) the hierarchy for developing accounting policies in the absence of an applicable IFRS Standard set out in paragraphs 10–12 of IAS 8. The staff understand that, in practice, most of these entities develop those accounting policies by reference to the *Framework* in accordance with paragraph 11 of IAS 8 and do not recognise regulatory account balances as assets or liabilities² in their financial statements.
10. If the reference in paragraph 11 of IAS 8 is replaced, entities that develop accounting policies for regulatory account balances by reference to the *Framework* would be required to reassess those accounting policies in the light of the revised definitions and concepts included in the *Conceptual Framework*. The revised *Conceptual Framework* will provide guidance that will help the Board and preparers decide whether assets and liabilities exist, whether they should be recognised and how they should be measured and presented. However, as discussed in the October 2016 Agenda Paper 10C *Testing the proposed asset and*

¹ IFRS 14 permits, but does not require, first-time adopters of IFRS Standards that conduct rate-regulated activities to *continue* to recognise and measure regulatory deferral account balances in accordance with their previous generally accepted accounting principles.

² Paragraph BC7 of the Basis for Conclusions on IFRS 14

liability definitions—illustrative examples and the December 2016 Agenda Paper 9A *Overview of the core features of the model*, the revised definitions and concepts in the *Conceptual Framework* will not answer definitively:

- (a) whether regulatory account balances meet the definitions of assets and liabilities;
 - (b) whether those balances should be recognised; and
 - (c) how those balances should be measured and presented.
11. Consequently, the revision of accounting policies for those balances as a result of replacing the reference to the *Framework* in paragraph 11 of IAS 8 could lead to diversity in practice. In addition, the revision of those policies could lead to two rounds of accounting changes in a short period of time:
- (a) on application of the revised accounting policies resulting from replacing the reference to the *Framework* in paragraph 11 of IAS 8; and
 - (b) on application of the future IFRS Standard on rate-regulated activities.
12. Two rounds of accounting changes in a short period of time would be disruptive for both preparers and users of financial statements.
13. At the January 2017 meeting, the Board acknowledged those concerns and decided to consider whether rate-regulated activities should be excluded from the amendment to paragraph 11 of IAS 8 that will replace the reference to the *Framework* with the reference to the *Conceptual Framework*.

Scope of the potential exclusion from applying the amendment

14. The staff have identified the following questions related to the scope of any potential exclusion from applying the amendment to paragraph 11 of IAS 8:
- (a) which aspects of the accounting policies of entities that conduct rate-regulated activities should be subject to any such exclusion (paragraphs 15–19); and
 - (b) whether any such exclusion should only apply to existing accounting policies or also to new accounting policies developed by:

- (i) preparers that already apply IFRS Standards and begin to conduct rate-regulated activities (or acquire entities that already conduct such activities); and
- (ii) first-time adopters of IFRS Standards that are not eligible to apply IFRS 14, or choose not to apply it (paragraphs 20–24).

Aspects of accounting policies subject to the exclusion

15. As discussed in paragraphs 9–10 above, any potential exclusion from applying the amendment to paragraph 11 of IAS 8 would be applicable only for entities that develop their accounting policies for rate-regulated activities on the basis of the IAS 8 hierarchy rather than on the basis of IFRS 14 (ie those entities that are not eligible to apply IFRS 14, or chose not to apply it). However, the staff think that in setting the scope of any potential exclusion from applying the amendment, the Board should consider the scope of IFRS 14.
16. IFRS 14 applies to ‘regulatory deferral account balances’ only. A regulatory deferral account balance is defined in IFRS 14 as ‘the balance of any expense (or income) account that would not be recognised as an asset or a liability in accordance with other Standards, but that qualifies for deferral because it is included, or is expected to be included, by the rate regulator in establishing the rate(s) that can be charged to customers’. The Standard does not apply to other aspects of the accounting for rate-regulated activities that are addressed by other IFRS Standards.
17. The staff think that the same considerations apply to any potential exclusion from applying the amendment to paragraph 11 of IAS 8. That is, the exclusion should only apply to regulatory account balances that:
 - (a) are included, or are expected to be included, by the rate regulator in establishing the rate(s) that can be charged to customers; and
 - (b) are not recognised as an asset or a liability in accordance with other IFRS Standards.
18. The term ‘regulatory account balances’ and its definition proposed in paragraph 17 above are based on the term and the definition in IFRS 14 except they do not

refer to deferring those balances. This is because IFRS 14 applies to regulatory account balances of first-time adopters of IFRS Standards that qualify for deferral because those entities recognised those balances as assets and liabilities under their previous GAAP. In contrast, as discussed in paragraph 9(b) above, entities that will be applying the potential exclusion from the amendment to paragraph 11 of IAS 8, typically do not recognise assets and liabilities for those balances.

19. The term ‘rate regulator’ referred to in the proposed definition of regulatory account balances in paragraph 17 above is already defined in IFRS 14 as ‘an authorised body that is empowered by statute or regulation to establish the rate or a range of rates that bind an entity. The rate regulator may be a third-party body or a related party of the entity, including the entity’s own governing board, if that body is required by statute or regulation to set rates both in the interest of the customers and to ensure the overall financial viability of the entity’. That definition could be used for the purposes of applying any potential exclusion from the amendment to paragraph 11 of IAS 8.

Question 1 for the Board

Does the Board agree that any potential exclusion from the scope of the amendment to paragraph 11 of IAS 8 will apply to accounting policies for regulatory account balances as defined in paragraph 17 above?

Existing only or existing and new accounting policies

20. Excluding accounting policies for regulatory account balances from the amendment to paragraph 11 of IAS 8 would delay the application of the revised definitions and concepts in the *Conceptual Framework*. However, as discussed in paragraph 10 above, those definitions would not provide definitive answers for how best to account for regulatory account balances. Therefore, as discussed in paragraphs 11–12 above, excluding *existing* accounting policies for regulatory account balances from the amendment to paragraph 11 of IAS 8 would facilitate comparability of the financial statements both:
- (a) between entities that conduct rate-regulated activities; and

- (b) over time for a single entity until the new Standard on rate-regulated activities is applied.
21. Avoiding diversity in practice and disruption to trend information would result in more useful information for users of financial statements.
22. In addition, as also discussed in paragraphs 11–12 above, excluding existing accounting policies for regulatory account balances from the amendment to paragraph 11 of IAS 8 would avoid creating operational burden resulting from two rounds of accounting changes in a short period of time.
23. Excluding *new* accounting policies for regulatory account balances from the amendment to paragraph 11 of IAS 8 would not affect the comparability of the financial statements over time of entities that newly develop those policies. In addition, entities that newly develop accounting policies for regulatory account balances would not face the disruption caused by two rounds of accounting changes over a short period of time, unlike entities with existing accounting policies for those balances. However, excluding new accounting policies for regulatory account balances from the amendment to paragraph 11 of IAS 8 would make it easier for such entities to make their accounting comparable with other entities that conduct rate-regulated activities.
24. On balance, the staff think that it is important to make it easy for entities to make their accounting for regulatory account balances comparable with accounting adopted by other entities for those balances pending completion of the Rate-regulated Activities project. Doing so would be consistent with the argument for excluding accounting policies for regulatory account balances from the amendment to paragraph 11 of IAS 8. Accordingly, the staff think that any such potential exclusion should cover both existing and new accounting policies for regulatory account balances.

Question 2 for the Board

Does the Board agree that any potential exclusion from the scope of the amendment to paragraph 11 of IAS 8 will apply to both existing and new accounting policies for regulatory account balances?

Exemption or exception from applying the amendment

25. The staff think that revising existing accounting policies for regulatory account balances as a result of replacing the reference to the *Framework* in paragraph 11 of IAS 8 is undesirable. As discussed in paragraphs 11–12 above, making such revisions could lead to diversity in practice and could result in two rounds of accounting changes for rate-regulated activities in a short period of time that would be disruptive for both users and preparers of financial statements. In the past, such considerations have led the Board to provide temporary exemptions from applying paragraphs 10–12 of IAS 8 in IFRS 4 *Insurance Contracts*, paragraphs 11 and 12 of IAS 8 in IFRS 6 *Exploration for and Evaluation of Mineral Resources* and paragraph 11 of IAS 8 in IFRS 14.
26. The staff have considered two approaches to excluding accounting policies for regulatory account balances from the amendment to paragraph 11 of IAS 8:
- (a) exempting entities from applying the amendment to those accounting policies, ie permitting, but not requiring, entities to apply it (paragraph 27); or
 - (b) prohibiting entities from applying that amendment to those accounting policies (paragraph 28).
27. Exempting entities from applying the amendment to paragraph 11 of IAS 8 to regulatory account balances would assist those entities that do not wish to revise those accounting policies pending completion of Rate-regulated Activities project. It would help to avoid operational disruption for both users and preparers of financial statements caused by two rounds of accounting changes in a short period of time. However, an exemption would not stop entities from revising their accounting policies following the replacement of the reference in paragraph 11 of IAS 8 if the entities choose to revise those accounting policies. That could still lead to diversity in practice and create disruption for both users and preparers of financial statements and could therefore undermine the argument for excluding those policies from the scope of the amendment in the first place.
28. In contrast, prohibiting entities from applying the amendment to paragraph 11 of IAS 8 to regulatory account balances would improve comparability pending the completion of the Rate-regulated Activities project and avoid disruption to both

users and preparers of financial statements. That would be consistent with the argument for excluding accounting policies for regulatory account balances from the amendment to paragraph 11 of IAS 8.

29. Accordingly, the staff recommend that entities should be prohibited from applying the amendment to paragraph 11 of IAS 8 to accounting policies for regulatory account balances. Appendix A illustrates how the amendment to IAS 8 could be drafted to achieve such a prohibition. Once the Rate-regulated Activities project is completed, that prohibition would be removed by a consequential amendment to IAS 8 accompanying the new Standard on rate-regulated activities.
30. Finally, the staff note that even if some entities choose to revise their accounting policies for regulatory account balances by reference to paragraph 14(b) of IAS 8 (ie voluntary change in an accounting policy if an entity can demonstrate that a new accounting policy provides reliable and more relevant information) they would still be required to apply the *Framework* rather than the *Conceptual Framework* in developing such revised policies. This is because they would be required to follow the IAS 8 hierarchy for developing accounting policies in the absence of applicable IFRS Standards and paragraph 11 of IAS 8 would require them to apply the *Framework*.

Question 3 for the Board

Does the Board agree that entities will be prohibited from applying the amendment to paragraph 11 of IAS 8 to accounting policies for regulatory account balances?

Appendix A—illustrative drafting for excluding regulatory account balances from the scope of the amendment to paragraph 11 of IAS 8

A1. This appendix illustrates how the scope exclusion from applying the amendment to paragraph 11 of IAS 8 could be drafted. The staff do not plan to discuss drafting at the meeting.

Proposed amendments to paragraph 11 of IAS 8 (new text is underlined, paragraphs 10 and 12 of IAS 8 are included to provide context)

10 In the absence of an IFRS that specifically applies to a transaction, other event or condition, management shall use its judgement in developing and applying an accounting policy that results in information that is:

- (a) relevant to the economic decision-making needs of users; and
- (b) reliable, in that the financial statements:
 - (i) represent faithfully the financial position, financial performance and cash flows of the entity;
 - (ii) reflect the economic substance of transactions, other events and conditions, and not merely the legal form;
 - (iii) are neutral, ie free from bias;
 - (iv) are prudent; and
 - (v) are complete in all material respects.

11 In making the judgement described in paragraph 10, management shall refer to, and consider the applicability of, the following sources in descending order:

- (a) the requirements in IFRSs dealing with similar and related issues; and
- (b) the definitions, recognition criteria measurement concepts for assets, liabilities, income and expenses:
 - (i) in the *Conceptual Framework*, unless (ii) applies; but
 - (ii) in the *Framework*, if the accounting policy relates to regulatory account balances. A regulatory account balance is the balance of any expense (or income) account that is not recognised as an asset or a liability in accordance with IFRS Standards and is included, or is expected to be included, by the rate regulator as defined in IFRS 14 *Regulatory Deferral Accounts* in establishing the rate(s) that can be charged to customers.

12 In making the judgement described in paragraph 10, management may also consider the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards, other accounting literature and accepted industry practices, to the extent that these do not conflict with the sources in paragraph 11.