January 2014

Project Summary and Feedback Statement

IFRS 14 *Regulatory Deferral Accounts*

At a glance

This is a brief introduction to IFRS 14 *Regulatory Deferral Accounts*. The Standard was issued in January 2014 and is effective from 1 January 2016, with earlier application permitted.

Rate regulation

Many governments regulate the supply and pricing of particular types of activity by private entities, including utilities such as gas, electricity and water. These regulations are often designed to allow the suppliers to recover specified costs and other amounts through the prices they charge to customers. However, rate regulation is also designed to protect the interests of customers. Consequently, the rate regulation may defer the recovery of these amounts in order to reduce price volatility. The suppliers usually keep track of these deferred amounts in separate regulatory deferral accounts until they are recovered through future sales of the regulated goods or services.

In some jurisdictions, national accounting standard-setting bodies permit or require entities that are subject to particular types of rate regulation to recognise these deferred amounts as part of assets (such as the related property, plant and equipment) or as separate receivables or payables. This changes the timing of when these amounts are recognised in profit or loss.

IFRS does not have requirements specific to rate regulation. The IFRS Interpretations Committee has previously concluded that simply applying the specific requirements of another jurisdiction, such as US generally accepted accounting principles (US GAAP), might lead to the recognition of some items in the statement of financial position that would potentially conflict with the requirements of other Standards. The established practice of most entities that currently apply IFRS is not to recognise these regulatory deferral account balances but to allow them, instead, to flow through profit or loss as they arise.

The IASB's project on rate regulation

The IASB has a comprehensive project to consider the broad issues of rate regulation and plans to publish a Discussion Paper on this subject in 2014.

The outcome of the project could be a Standard for rate-regulated activities, or a decision by the IASB not to develop specific requirements.

Because of the uncertainty about the outcome of this comprehensive project, the IASB has received requests from jurisdictions that are yet to adopt IFRS to allow rate-regulated entities to continue to use their current accounting for regulatory deferral accounts until this uncertainty is resolved.

These jurisdictions also argue that allowing their current accounting for rate regulation to be continued would facilitate the timely adoption of IFRS.

IFRS 14

In response to these requests, the IASB decided to develop an interim Standard, pending the outcome of its comprehensive Rate-regulated Activities project. The result is IFRS 14, which permits first-time adopters of IFRS to continue to recognise amounts related to rate regulation in accordance with their previous GAAP requirements when they adopt IFRS. However, to enhance comparability with entities that already apply IFRS and that do not recognise the deferred amounts, IFRS 14 requires that the effect of recognising the deferred account balances that arise from rate regulation must be presented separately from other items.

Requirements of IFRS 14

An entity that already presents financial statements in accordance with IFRS is not eligible to apply IFRS 14. The Standard permits an entity that is a first-time adopter of IFRS to continue to use its previous GAAP accounting policies for its rate-regulated activities. Application of the Standard is not mandatory, but if a first-time adopter of IFRS is eligible to apply the Standard, it must elect to do so in its first IFRS financial statements. If it does not, the entity will not be eligible to apply the Standard in subsequent periods.

In order to isolate the effect of recognising the regulatory deferral account balances that arise from rate-regulated activities, the Standard requires the entity to present these account balances as separate line items in the statement of financial position and to present movements in these account balances as separate line items in the statement of profit or loss and other comprehensive income (OCI).

The Standard also requires specific disclosures to identify clearly the nature of, and risks associated with, the rate regulation.

How will IFRS 14 affect IFRS financial statements?

No impact on existing IFRS preparers of financial statements

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No impact on cash flows

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Isolated impact of recognising regulatory deferral account balances in IFRS financial statements

Two line items in the statement of financial position:	Two line items in the statement of profit or loss and OCI:
• regulatory deferral account debit balances—after total assets; and • regulatory deferral account credit balances—after total liabilities.	• movement in regulatory deferral account balances related to profit or loss; and • movement in regulatory deferral account balances related to OCI.

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Additional disclosure required when regulatory deferral account balances are recognised

Why is IFRS 14 restricted to first-time adopters of IFRS?

The IASB has issued this Standard with the aim of enhancing the comparability of financial reporting by reducing barriers to the adoption of IFRS by entities with rate-regulated activities.

The IASB does not want to anticipate the outcome of the comprehensive Rate-regulated Activities project. Consequently, it wishes to limit the effect of the Standard until the more fundamental issues about accounting for rate-regulated activities are resolved through the comprehensive project.

One of the fundamental issues that the comprehensive project needs to address is whether regulatory deferral account balances meet the definitions of 'assets' and 'liabilities' in the *Conceptual Framework for Financial Reporting*. Consequently, the term 'regulatory deferral account balances' has been chosen as a neutral descriptor for these items in IFRS 14 instead of describing them as 'regulatory assets' or 'regulatory liabilities'.

Feedback Statement

We published the Exposure Draft *Regulatory Deferral Accounts* in April 2013 with a four-month comment period. We received 114 comment letters in response.

There was general support for the IASB's comprehensive Rate-regulated Activities project. There was a mixed response to the proposal to issue an interim Standard for first-time adopters of IFRS:

- a clear majority of respondents supported the proposed interim Standard. Most of these respondents also supported limiting its application to first-time adopters. However, some of those who support an interim Standard think it should not be limited to first-time adopters.
- a significant minority of responses (a little over one quarter of all responses) disagreed with the issue of an interim Standard.

Some of the respondents noted that their support for the interim Standard was partially conditional on the IASB prioritising the work on the comprehensive Rate-regulated Activities project to ensure that it is completed in a timely manner. Some stressed that the 'uneven playing field' created by an interim solution that is aimed only at prospective first-time adopters is not sustainable as a long-term solution.

In the pages that follow, we outline the more significant matters raised and how we responded:

- Restricting the scope to first-time adopters
- Defining the type of rate-regulation within the scope
- Other changes from the Exposure Draft.

Restricting the scope to first-time adopters

The Exposure Draft proposed to restrict the scope to first-time adopters of IFRS that currently recognise regulatory deferral account balances in their financial statements in accordance with their previous GAAP (ie the basis of accounting that a first-time adopter used immediately before adopting IFRS).

Respondents' comments

Although a majority of respondents supported this proposal, a significant minority suggested that the scope should be applicable to a wider range of entities, although views were mixed as to what this wider population should be.

The respondents that supported an interim solution only for first-time adopters agreed with the IASB's reasons for publishing the proposals, in particular because:

- it will not increase diversity among existing IFRS preparers;
- it will reduce a significant barrier to the adoption of IFRS by entities with rate-regulated activities, which will improve comparability by reducing the number of different accounting frameworks being used; and
- the separate presentation and disclosure requirements will help comparability across IFRS preparers.

Our response

At this time, the IASB is not able to establish the most appropriate model for reporting the effects of rate regulation. Before we can identify an appropriate model, we need answers to the fundamental issues that are currently being addressed in the research phase of the comprehensive Rate-regulated Activities project. Consequently, we decided that identifying a model to allow existing IFRS preparers that currently do not recognise regulatory deferral account balances would be beyond the scope of the interim project and would delay introducing the benefits of issuing an interim solution, as outlined previously.

Defining the type of rate regulation within the scope

The Exposure Draft proposed two criteria that must be met for regulatory deferral account balances to be captured within the scope of the interim solution. The criteria proposed that:

(a) an authorised body (the rate regulator) restricts the price that an entity can charge its customers for the goods or services that it 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.

Respondents' comments

The majority of respondents agreed that the two criteria are appropriate. However, some respondents asked for clarifications of the IASB's intention and others rejected the criteria.

In particular, respondents asked the IASB to:

(a) be more explicit about whether an entity must be subject to external rate regulation or whether self-regulation could be permitted;

(b) clarify whether an entity that has flexibility in setting prices is within the scope; and

(c) delete the criterion linking the price to the recovery of the entity's allowable costs.

Our response

We changed the definitions of 'rate regulation' and 'rate regulator'. These changes clarify that the entity can have some flexibility in pricing. However, that flexibility must be restricted by a pricing framework that is supported by statute or regulation that balances the interests of the customers and ensures the financial viability of the entity.

We agreed with the respondents who suggested that the criterion linking the price to the allowable costs could be interpreted as being too narrowly focused on a particular type of rate regulation (commonly called 'cost-of-service' rate regulation) that is common in a limited number of jurisdictions. Retaining this criterion could also be perceived as prejudging the outcome of the comprehensive Rate-regulated Activities project. In addition, it could limit the number of entities (and jurisdictions) that would be able to benefit from the proposed relief. This is contrary to the IASB's objective of issuing an interim solution to reduce the barrier to adoption of IFRS without prejudging the outcome of the comprehensive project.

Consequently, we deleted the criterion that linked the price to the allowable costs.

Summary of other main changes from the Exposure Draft

Exposure Draft proposal	Respondents' comments	IFRS 14 requirement
Group accounting issues Other Standards apply to regulatory deferral account balances in the same way that they apply to assets and liabilities recognised in accordance with other Standards.	We were asked to clarify whether an acquiree's regulatory deferral account balances would be treated as an identifiable asset or liability to be recognised in a business combination.	We introduced a limited exception to IFRS 3 *Business Combinations* and added application guidance to clarify that the reporting entity's accounting policies for regulatory deferral account balances are applied for all its subsidiaries, both at acquisition and subsequently.
Recognising new regulatory deferral account balances Changing an accounting policy to start to recognise regulatory deferral account balances is prohibited.	Some respondents were concerned that the transition to IFRS could create new regulatory deferral account balances that would not be recognised. This would result in incomplete information in financial statements.	We added application guidance to clarify that the recognition of such new regulatory deferral account balances would be permitted when those balances are created because of new timing differences arising between when items are recognised as income or expense for regulatory purposes and when they are normally recognised for financial reporting purposes.
Single line item in profit or loss The net movement in regulatory deferral account balances is presented as a single line item in profit or loss.	Several respondents suggested that this would create a mismatch when some regulatory deferral account balances relate to items that are recognised in OCI.	We added a requirement to present separately the net movements in regulatory deferral account balances that relate directly to items that are recognised in OCI.

Effects analysis

We have analysed the likely effect of introducing IFRS 14, including a qualitative assessment of the costs and benefits associated with the requirements.

The scope of the Standard is limited to first-time adopters of IFRS that already recognise regulatory deferral account balances in their financial statements in accordance with their previous GAAP. Consequently, the financial statements of rate-regulated entities that already apply IFRS, or that do not otherwise recognise such balances, will not be affected by this Standard.

Rate-regulated entities within the scope will continue to apply their existing recognition, measurement, impairment and derecognition policies for regulatory deferral account balances. Consequently, the application of the Standard should have little or no impact on the net assets or the net profit reported in the financial statements.

There will be some costs involved for preparers and users in changing the presentation of some of the regulatory deferral account balances. However, the IASB thinks that the requirement to isolate the impact of recognising regulatory deferral account balances and present them separately will result in increased transparency and improved comparability.

This isolation of regulatory deferral account balances and the related disclosure requirements will help users of financial statements to understand more clearly the impact of rate regulation on the entity.

A more complete effects analysis is provided as part of the Basis for Conclusions that accompanies the Standard.

The IASB's comprehensive project

Where are we with Rate-regulated Activities?

We are currently researching a wide range of rate regulation schemes and assessing their characteristics. We aim to use this research to help us understand the effects of rate regulation, whether these effects should be reflected in IFRS financial statements and, if so, how.

We aim to publish a Discussion Paper that explores these issues and seeks input from interested parties. This will help us to identify what accounting model would be appropriate to reflect the impact of rate regulation and what changes, if any, are needed to the established IFRS practice.

At this time, it is unclear what the outcome of the comprehensive Rate-regulated Activities project will be. In the meantime, IFRS 14 is a short-term, interim step that is targeted at first-time adopters of IFRS that recognise regulatory deferral account balances in accordance with their previous GAAP.

The comprehensive Rate-regulated Activities project

Rate-regulated Activities

Short-term interim solution for first-time adopters of IFRS: IFRS 14 *Regulatory Deferral Accounts* (issued in January 2014)

Longer-term comprehensive project for all rate-regulated entities: research phase is ongoing—Discussion Paper is expected to be issued in Q2 2014

Important information

This Project Summary and Feedback Statement has been compiled by the staff of the IFRS Foundation as guidance for interested parties. The views within this document are those of the staff who prepared this document and are not the views or the opinions of the IASB and should not be considered authoritative in any way. The content of this Project Summary and Feedback Statement does not constitute any form of advice or opinion.

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Notes

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