AGENDAPAPER

IFRS Advisory Council Meeting

LONDON	25–26 February 2013	**Agenda ref 9**
TOPIC	Summary of the Rate-regulated Activities discussions at the October 2012 Council meeting	
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Overview

1. At the October 2012 meeting of the IFRS Advisory Council it discussed the agenda proposal on Rate-regulated Activities.

2. The Council had been presented with an agenda paper (Agenda Paper 3) on the issue, which covered the following:
   (a) background on the issue;
      (i) financial reporting issues to be addressed
      (ii) the previous Rate-regulated Activities project; and
      (iii) why we are restarting the project with a Discussion Paper.
   (b) request for an interim IFRS;
      (i) reasons for the request;
      (ii) alternatives for an interim IFRS.
   (c) questions for the Advisory Council; and
   (d) next steps.

3. At the meeting in October 2012 Jane Pike and Michael Stewart gave a presentation on the issue. The presentation covered the following:
   (a) background;
   (b) requests for an interim IFRS—overview;
   (c) IFRS 6—background; and
   (d) requests for an interim IFRS—closer look

4. After the presentation the Council was divided into four groups to discuss five questions from the agenda paper that the staff had prepared.

Questions prepared by staff

5. The questions prepared by staff were the following:

   What comments or advice do you have on the alternatives for developing an interim IFRS to permit the recognition of regulatory assets and regulatory liabilities until such time as the IASB completes its main project on Rate-regulated Activities? For example:

   (a) What do you see as the consequences (positive or negative) of not issuing an interim IFRS?

   (b) Some of the alternatives identified for an interim IFRS may introduce diversity in practice with IFRS reporting. What mitigating factors should the IASB consider against the potential diversity in practice?

   (c) Issuing an interim IFRS that mandates a specific basis for accounting for rate-regulated activities may reduce the risk of diversity in practice but will take longer to develop and introduces the risk that some entities will face two changes in accounting policies (both the adoption of the interim IFRS and potentially again when the comprehensive project is completed). How should the IASB set the priority between consistency of application and timeliness of issuing comprehensive guidance?

   (d) If you think that the IASB should issue an interim IFRS, which features of the alternatives presented in paragraph 27 of Agenda Paper 3 do you think the IASB should prioritise?

   (e) Are there any other issues that the IASB should consider in making their decision as to whether to develop an interim IFRS and, if so, what type of IFRS?

Reports

6. The Council members were split into four groups:

   (a) Group 1 (Users and securities regulators) led by Vincent Papa

   (b) Group 2 (Preparers) led by Christoph Hütten

(c) Group 3 (Standard-setters and others) led by Bruce Mackenzie

(d) Group 4 (Auditors and prudential regulators) led by Thomas Blöink.

7. The main result of the discussions was that the views of the break-out groups were mixed. One group advised against an interim solution; one group supported an IFRS 6 approach; while another supported a "disclosure only" approach. Another group preferred that there should not be an interim solution, but if this posed a problem, particularly in deterring first-time adopters of IFRSs, the group would support a "disclosure only" interim solution.

8. Members supported the importance of completing the main standard-setting project quickly and worried that an interim solution might delay starting the main project and lessen the incentive to complete it expeditiously (noting that IFRS 4 and IFRS 6 have been in place for many years).

9. Members warned against a policy of adopting an interim solution whenever a major standard-setting project is activated. In particular, grandfathering existing practices could be like opening a "Pandora's Box".

10. In the closing session, Paul Cherry, the Chairman, summarised the discussion as indicating that a majority of members did not support an interim solution.

11. The following are the reports of the individual break-out groups.

Group 1

12. Vincent Papa reported back for the group. The key conclusion of the group was that the focus in the interim stage should be on disclosure requirements only. This view was driven by the significant uncertainty that is in place. The group thinks that there are two major uncertainty elements: first, uncertainty about what the outcome would be, and second, time uncertainty over when the project will be concluded, especially if you take into consideration the cycle from Discussion Paper to a final Standard.

13. Because of the uncertainty and the limited information the group had about different parameters, there was a leaning towards a disclosure-only-focused interim solution.

14. In the discussions there was also an acknowledgement of some of the constraints that need to be considered and that have been identified in the various papers that have been

circulated. There are also considerations about the needs of first-time adopters versus existing adopters of IFRS.

15. The group thinks that there is a need to know more about the aggregate picture. The group recognised the need to minimise disruption for whoever adopts IFRS and then potentially has to adjust subsequently, if an interim solution were to be chosen, which could be disruptive. The group felt it did not know enough at this stage to assess the extent to which these considerations could then feed into the different grandfathering options presented. The group recognises particular factors as being important but again more information would be needed before there is a clear sense of what would be optimal.

16. The group also felt the need for the identification and articulation of user needs. In this regard an acknowledgement was made that what has been articulated so far in different jurisdictions could be shaped by a home bias or a familiarity bias and the input needs to be taken further in terms of identifying what is optimal.

17. It is important in preparing the Discussion Paper to keep it aligned with the Conceptual Framework. The group largely supported these two projects being closely aligned. However, the time frame is important and it is encouraging to hear that the Conceptual Framework is on a three-year time frame target and that should also be reflected in this project.

18. It is also important that there is continuity from the previous project. There was an Exposure Draft in 2009 and there needs to be a seamless handover of the findings from the views received from various stakeholders. There should not be a total reset in terms of articulating the needs of different stakeholders.

19. On this basis the group came to the conclusion that it is important to ensure that users have transparent information. Focusing on the disclosures would meet that particular need in the interim before you come up with a final Standard.

20. Paul Cherry asked why the group felt it did not know enough to make a decision: whether that related to the full standard-setting project or specifically to the question on the interim solution.

21. Vincent responded that it was in terms of, for example the prominence that would be given towards first-time adopters. If you take a wide view of the requirements across IFRS constituencies, how important a fact is this? The group also worried that undue prominence might be given to the needs of particular first-time adopters, relative to the big picture. It is hard to make a meaningful judgement at this juncture and the group felt that a Discussion Paper could potentially inform everyone on these issues.

Group 2

22. Christoph Hütten reported for the group. The views within the group were mixed. Some members supported an interim Standard while others did not.
23. Those in favour of an interim Standard said that there could be a risk that the performance of regulated entities could not be properly assessed and therefore the insight into their performance would be impaired if there was no information about the impact of regulation. Hence, the usefulness of the financial statements might be impaired.
24. Other points that were raised were that countries may hesitate to adopt IFRS, and that those in the process of adopting, and companies subject to only voluntary application of IFRS, may not adopt.
25. The group members who opposed an interim Standard were not persuaded by the arguments above and emphasised that an interim Standard would unavoidably be a mess, and that there is a risk of opening a "Pandora's box": grandfathering here could be the start of grandfathering in other cases.
26. They also pointed out that there is a lack of clarity regarding how to measure regulation, which may prevent a clear-cut scope for the interim Standard. There is also a risk for the standing of the IASB, that while fighting hard against "carve-outs" in other countries and regions the IASB would create a "carve-out" itself. They also pointed to Europe, and recently Brazil, who adopted IFRS despite a requirement to eliminate rate-regulated assets and liabilities from the balance sheet.
27. The group looked more broadly into grandfathering and the question was asked whether there was support for a general notion that whenever a country is adopting IFRS, it would get grandfathering for all topics on which the IASB is working at the time of adoption.

There was however no support for this notion and those in favour of an interim Standard pointed out that they think this is a very specific case, because of the specifics of the economics of regulated entities, which would make it necessary to go for a interim Standard here, although they would not support it in other instances.

28. Finally, the group looked at the alternatives to an interim Standard. The group agreed that the only alternative was disclosure, which is very different to the other options because it is not really changing IFRS but was instead adding something to it. Recognition and measurement would stay the same, and there would only be a disclosure element. There was however some doubt whether it would make sense to focus on disclosure, because some expect companies to make these disclosures on a voluntary basis. Even those supporting an interim Standard on disclosure said that it should be done with some isolation of the effect of regulation, so while there was an agreement that there may not be one line on the balance sheet and profit or loss, at lease people can see both the performance with and without the impact of the regulated entities.

Group 3

29. Bruce Mackenzie reported on behalf of the group. The group started by looking at the conceptual view. What do we think about the whole idea of an interim Standard? One of the first concerns raised was about the very concept of an interim Standard. A lot of comments were raised around insurance, which was originally intended to be only an interim solution, but that has become pretty final over the last couple of years. Another concern was the message given to the market. Is something going to be interim, which therefore means that we are looking at another five years before a final Standard is issued, or is it to be effective for only three years? There is a need to manage this perception.

30. On the other hand, the group felt that there was a need to something about this. This is an area were we could end up with people not adopting or with divergence from IFRS. One of the cases in point given was the experience in Canada, where rate-regulated industries are currently not required to apply IFRS and have been given the option to use US GAAP as an alternative. This means that in a country that is driving towards IFRS there is already a “carve-out” or an exemption for an industry where it is needed. While the group

accepted that this was not affecting a large number of companies, those companies generally had a high profile, which is where the impact is felt. The group therefore felt that something had to be done.

31. As a starting-point the group looked at the spectrum of options, and looked closely at only two: to go purely for an interim Standard or go for a final Standard. The group did not feel that there was much "grey" area in between and the reason for that is because once you get into the recognition and measurement principles, you are dealing with the full Standard. Consequently, you must either provide an interim solution or go for the full Standard.

32. This issue is however too important a topic to wait for the final Standard. The group therefore favoured an interim Standard and then continuing to go on and work on the full Standard. As for the choices on an interim Standard, the group did not support a disclosure-only option. This was for a number of reasons: for example the group did not think that merely augmenting disclosures would help, especially when there is much more interest in reducing disclosure in IFRSs.

33. As a minimum, the IASB would have to go to some level of grandfathering whereby preparers would be allowed to apply what they are currently doing, but probably more in the 2(c) area (grandfathering of national GAAP with isolation of impact), by which the group felt that a degree of grandfathering would get us to where we needed to be. The group acknowledged that using the grandfathering option would not lead to full comparability but thought that was a better short-term solution than having nothing on rate-regulated industries in the IFRS body of literature.

34. As for timing, the feeling was that this very urgent, so the IASB should look to try and get something out soon. Comments were made that maybe the IASB could get it out before Christmas this year, but this is unlikely. The interim Standard should be out within a year.

35. The group did not, however, want to compromise the timetable on the final Standard. For that reason, if there is a final Standard, the group did not want all resources to be

withdrawn on that project only to get the interim Standard out. There really is a need for the project on the final Standard to continue.

36. The IASB also needs to make sure that it is addressing the needs of people in that industry and make use of the work that has been done. The views received in response to the previous papers need to be considered in this work. It was also brought to the group's attention that India has developed material on this issue that could be useful input.

37. To sum up, the group does believe that an interim Standard is very much needed at the moment, but that it should not be too detailed (ie, it should not get into the major recognition and measurement issues) and should instead only deal with a degree of grandfathering.

Group 4

38. Thomas Blöink reported on behalf of the group. The group thought that the basic question was whether to have an interim solution or not. The group did not discuss in detail what kind of interim solution should be chosen. The group also voted on whether an interim solution should be developed or not.

39. The arguments against an interim solution have already been mentioned by other groups. Most of the group members said that they want clear IFRS application in all jurisdictions using IFRS and there should not be "carve-outs" or additional sets.

40. The group also discussed why this was different from the IFRS 6 situation and the group thought that we have moved forward from 10 years ago and we are now living in a different IFRS world.

41. By developing an interim solution we would be allowing inconsistencies without knowing when the "sunset" for such inconsistencies would be. In addition, an interim solution might pre-empt the final solution of the IASB, which might want to move in a different direction.

42. The arguments in favour of an interim solution were to get a Standard at the end and not change the level playing field, because of the lack of a level playing field at the moment (there is so much divergence). We do also want to bring as many jurisdictions into the IFRS world as possible, even if we have some kind of transformation guidance that opens

it up for other jurisdictions. The final argument was that this is more of a political question of finding as many jurisdictions as possible to join the IFRS world.

43. The result of the group vote was that seven members voted against an interim solution while three voted for such a solution.

44. The group also discussed what kind of interim measure identified in the agenda paper should be used. Two of those that supported the interim solution said that they would opt for a fully-fledged Standard, but only for the cost/service model as in the Exposure Draft in 2009. The one remaining supporter of an interim solution thought that the IFRS 6 grandfathering solution might be used.

45. Finally the group discussed whether there are any alternative solutions for the problem, for example whether the issue should be brought to the IFRS Interpretations Committee again. There was however a general understanding that the issue would be too big for the Interpretations Committee and would take away resources that are needed for the Discussion Paper on the issue.

46. After the reports Paul Cherry opened the discussions.

47. Hans Hoogervorst asked what the Advisory Council's advice was. He thought it was tilting towards not providing an interim solution.

48. Paul said that one group supported an interim solution; one group was divided, one group supported a disclosure-only solution; and one group was clearly against an interim solution. This result was in his opinion not surprising, given the topic.

49. Hans commented that to a certain extent this **was** surprising, because an interim solution would have been an easy way out. But there seem to be a lot of people who do not think it is a good idea.

50. Paul commented that there was one point all of the groups alluded to, which was the timing. That there does not seem to be an appetite for doing something short-term if it runs the risk of delaying or complicating the completion of the full project. Against that is the notion that we have the Conceptual Framework project, which is to be completed in three years. There is however a worry that with the two projects tangled together, and if the timeline on the larger project lengthens, then the case for the interim solution becomes

stronger. That is therefore a judgement call that the IASB faces, if there is to be an interim solution. Even on disclosure there were mixed views on whether it would complicate matters.

51. Hans commented that what also complicates the issue is that we do not know what the outcome of this exercise will be. We do not know whether it will result in a Standard and the IASB will really struggle with this.

52. Paul noted that the obvious consequence of that is that if a question mark hangs over us for a prolonged period it could be a significant consideration in the migration path of countries considering adoption.

53. Hans said that what he has heard is that it all depends on whether the Discussion Paper comes up with an answer. If the Discussion Paper comes up with a very clear “no” to a Standard, then we know where we are going. This would also be the case if the Discussion Paper comes up with a “yes” to a Standard. Another suggestion that he has heard is that if it is clear that this issue is under time pressure, we should try to do it as quickly as we can. For a country like Canada, it might be worthwhile to extend the temporary exemption that Canada has for companies in this industry. But he finds the outcome of the discussions remarkable for the preponderant lack of support for an interim solution.

54. Judith Downes said that one thing that has not been mentioned and was quite persuasive in the group she was in was the experience of Brazil, which is a very recent experience of adoption as apposed to Europe and Australia. There they faced similar issues to people that are adopting now and in the last couple of years and dealt with it within an IFRS framework with a comment from their regulator. The group were told that the rate-regulated issue in Brazil was not debated at the IASB. It seems unfortunate if one particular country does not have its issues debated at the IASB, and yet when another country faces a similar issue in a very similar time frame it gets a different sort of outcome. She thinks that this is something for the IASB to think about very carefully.

55. Paul finally noted that there is a range of views, with the majority expressing misgivings about an interim solution, which is somewhat surprising. He said that approaching this

issue from a disclosure-only point of view may be a lot more difficult than you would think at first glance, because you might think that it is something that is relatively easy to do. He thinks that an easy approach to disclosure-only would fall very unevenly and would impose additional disclosures on some who have information, and on a great many others for which it could almost be as onerous to generate this information as it would be to follow particular guidance. It would also be difficult, if not impossible, to do without describing a starting-point. The marketplace and investors probably get this information, or a reasonable proxy for it, anyway. There might therefore be very little payback from what might divert energy from the major project. If the project did not play out as quickly as the IASB had expected, the IASB might take the opportunity to rethink this interim solution.

56. Hans commented that this could also mean losing time working on something that would make no one happy.

57. Jane Pike thanked the Council for its input and said that the staff had been struggling with a recommendation to the IASB in terms of how to take this project forward. A lot of the staff's thoughts have been reflected in the discussions, but some additional ideas have come out of those discussions, which the staff will consider in preparing the next proposal to the IASB.