STAFF PAPER

January 2013

IASB Meeting

Project	**Rate-regulated Activities**		
Paper topic	Interim Standard: Presentation		
CONTACT(S)	Jane Pike	jpike@ifrs.org	+44 (0)20 7426 6925
	Michael Stewart	mstewart@ifrs.org	+44 (0)20 7426 6922

Introduction

1. This paper considers the presentation requirements of the interim Standard. It presents the following staff recommendations:

   (a) all regulatory deferral account debit balances and all regulatory deferral account credit balances should be presented as separate line items immediately below a subtotal for "Total assets (or liabilities) before regulatory amounts[1]";

   (b) the impact of rate regulation should be isolated in such a way that all other items in the financial statements, including property, plant and equipment and intangible assets, are presented in accordance with IFRS in the same way as for a non-rate-regulated entity;

   (c) any regulatory deferral account debit balances and credit balances should be offset if they arise with the same regulator and are taken into account by the regulator in setting the rate for the same rate-regulated activities;

   (d) the current and non-current amounts of any net regulatory deferral account debit balance and net regulatory deferral account credit balance are presented separately only in the notes; and

[1] In this context, 'regulatory amounts' comprise the net regulatory deferral account balances recognised at the reporting date.

(e) the net movement between the opening and closing balance of all regulatory deferral accounts should be presented in profit or loss as a separate line item immediately below a subtotal for “Profit (or loss) before taxation and regulatory amounts ”.

Presentation

Background

2. The 2009 Exposure Draft (2009 ED) contained little guidance on general presentation. It made no reference to the presentation of items in the statement of profit or loss and other comprehensive income. In the statement of financial position, it proposed that regulatory deferral account balances should be disaggregated into current and non-current amounts. Offsetting debit and credit balances that are subject to the same rate regulator was permitted.

3. No specific question was asked about general presentation and so very few respondents commented on this point. Those that did comment requested greater clarity as to the presentation or treatment of movements between the opening and closing balances of regulatory deferral accounts within the statement of profit or loss and other comprehensive income.

Property, plant and equipment and intangible assets

4. It is common for a rate regulator to require an entity to capitalise certain costs as part of the ‘rate-base’ cost of such items, which is then used in the rate-setting determination. These amounts would not be capitalised as part of the cost of these items in the financial statements of non-rate-regulated entities. These regulatory amounts include adjustments to depreciation, intercompany profit and indirect overheads that would otherwise not be permitted to be capitalised in accordance with the applicable IFRS, such as IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*.

5. In addition, the regulator may require a “deemed interest” cost (sometimes referred to as an “allowance for funds used during construction” (AFUDC)) to be capitalised that is not capitalised or measured in accordance with IAS 23 *Borrowing Costs*. This deemed interest may consist of a computed interest rate or

cost based on a variety of formulas set by regulators (such as an industry-average 'weighted average cost of capital' ratio). This deemed interest also commonly includes a designated cost of equity funds. In contrast, some regulators exclude borrowing costs from the rate-base cost of similar assets.

2009 ED proposals

6. The 2009 ED proposed that these costs should be presented as part of the cost of the relevant item of property, plant and equipment or intangible asset for financial reporting purposes. The aim of this proposal was to more closely align the carrying value of these items in the financial statements with their carrying value for regulatory purposes.

7. Responses to this presentation proposal were mixed. In general, respondents in jurisdictions that recognise regulatory deferral account balances in accordance with Topic 980 *Regulated Operations*[2] in the *FASB Accounting Standards Codification*® or with similar local GAAP requirements, agreed with the proposal because it was broadly consistent with Topic 980. Some of these respondents also requested that the departure from IAS 16, IAS 23 and IAS 38 should be expanded (consistently with Topic 980) for additional items that rate regulators commonly require or permit to be included in the rate-base cost of the relevant tangible or intangible asset for regulatory purposes. Examples of such adjustments include the inclusion of intercompany profit, deferred gains or losses on the disposal or retirement of assets, and adjustments to the useful life or depreciation rate to correspond to those set by the rate regulator.

8. Many other respondents objected to the presentation proposal. They argued that the only reason that those transactions or activities are recognised in the statement of financial position (and not directly in the statement of profit or loss and other comprehensive income), is because of the effects of the rate-setting mechanism. Consequently, those respondents claimed that proper recognition of these transactions within the statement of financial position should be within the regulatory line item for regulatory deferral account balances, which would be consistent with the impact of rate regulations on all other transactions or activities.

---

[2] Topic 980 brings together the requirements formerly contained in SFAS 71 *Accounting for the Effects of Certain Types of Regulation* and subsequent related guidance and amendments.

Staff recommendations

9. We agree with those respondents who objected to the 2009 ED presentation proposals. Consequently, we recommend that the [draft] interim Standard should set specific presentation proposals that would require the net regulatory deferral account amounts to be presented as separate line items within the financial statements.

10. We think that presenting the regulatory impact separately would provide more useful information about the regulatory environment and would be consistent with the enhancing qualitative characteristic of comparability[3] in the *Conceptual Framework*. In particular, it would enable users to more directly compare the property, plant and equipment or internally generated intangible assets of comparable rate-regulated entities (in addition to those of non-rate-regulated entities). This would also result in consistent application of IFRS for all other transactions or activities, irrespective of whether an entity has rate-regulated activities and irrespective of what type of rate regulatory environment the entity is subject to.

11. The following paragraphs deal with the presentation of these separate line items within the statement of financial position (including items of property, plant and equipment and intangible assets), and the statement of profit or loss and other comprehensive income.

Statement of financial position

12. We recommend that the [draft] interim Standard should propose that all regulatory deferral account debit balances and all regulatory deferral account credit balances should be presented as separate line items immediately below a subtotal for "Total assets (or liabilities) before regulatory amounts".

13. There is currently a great deal of uncertainty as to whether regulatory deferral account balances, often described as 'regulatory assets and regulatory liabilities', meet the definitions of assets and liabilities within the IFRS *Conceptual Framework*. It is widely acknowledged that many of the items currently included in such regulatory deferral accounts would not otherwise be

[3] IFRS *Conceptual Framework* paragraphs QC20-QC25.

capitalised as assets (or liabilities) in the absence of regulatory approval to defer such costs and to include them in future rate-setting procedures. Examples of such costs include, but are not restricted to, indirect overheads; deemed interest capitalised as part of the cost of property, plant and equipment (see paragraph 4 above); gains and losses on disposal or retirement of property, plant and equipment; IFRS transition costs; storm damage costs; deferred income taxes; and settlement costs for legal cases.

14. Consequently, we do not think that it is appropriate to integrate these amounts within amounts presented for other items, the accounting for which is already dealt with in other relevant Standards. This is particularly so when those other Standards specifically prohibit such amounts from being capitalised.

Property, plant and equipment and intangible assets

15. We agree, for the reasons noted in paragraphs 10 and 13-14, with those respondents to the 2009 ED who disagreed with the proposed departure from the requirements of IAS 16, IAS 23 and IAS 38 (see paragraphs 4-6). We therefore recommend that the [draft] interim Standard should propose that the impact of rate regulation is isolated in such a way that all other items in the financial statements, including property, plant and equipment and intangible assets, should be presented in accordance with IFRS in the same way as for a non-rate-regulated entity.

Summary

16. Applying the [draft] interim Standard will introduce some inconsistency of accounting treatment in IFRS financial statements between rate-regulated entities and non- rate-regulated entities, and between those rate-regulated entities that currently do not recognise regulatory deferral account balances and those that will be allowed to do by grandfathering existing local GAAP policies. To minimise the impact of this inconsistency, we think that the statement of financial position should be presented in such a way that users should be able to identify ‘at a glance’ the comparable amounts of all individual line-item assets and liabilities and for total assets and total liabilities, excluding any regulatory deferral account balances.

17. This would provide greater transparency of reporting for the regulatory effects of whatever rate-setting mechanism the entity is subject to. It would also improve consistency and comparability with those rate-regulated entities that would not be permitted to start recognising regulatory deferral account balances, because they did not previously do so in accordance with IFRS or other local GAAP[4].

Questions for the IASB

Question 1: presentation of property, plant and equipment and intangible assets
Do you agree with the staff's recommendation that the impact of rate regulation should be isolated in such a way that all other items in the financial statements, including property, plant and equipment and intangible assets, should be presented in accordance with IFRS in the same way as for a non-rate-regulated entity? If not, what alternative do you suggest?

Question 2: presentation in the statement of financial position
Do you agree with the staff's recommendation that all regulatory deferral account debit balances and all regulatory deferral account credit balances should be presented as separate line items immediately below a subtotal for "Total assets (or liabilities) before regulatory amounts"? If not, what alternative do you suggest?

Offsetting

18. We also recommend that any regulatory deferral account debit balances and credit balances shall be offset if they arise with the same regulator and are taken into account by the regulator in setting the rate for the same rate-regulated activities.

19. Any regulatory deferral account balances that will be separately recognised in accordance with the [draft] interim Standard will not meet the definition of

[4] This assumes that the IASB agrees to such a restriction (see Agenda Paper 5B).

financial instruments[5]. Consequently, they cannot meet the criteria in IAS 32 *Financial Instruments: Presentation* to be presented net. IAS 12 *Income Taxes* permits (non-financial) current and deferred tax assets and liabilities to be offset if certain conditions are satisfied. One of those conditions for both current tax and deferred tax amounts is that the entity must have a legal right to set off the recognised amounts.

20. Regulatory deferral account balances arise from specific individual costs that the regulator requires or permits to be deferred and taken into account in future rate determinations. When regulatory deferral account debit balances and credit balances are subject to the same regulator and will be included in the determination of a single rate, we think that this is comparable to the conditions for offset in IAS 12. Consequently, we think that it is appropriate to offset them in such circumstances.

Questions for the IASB

Question 3: offsetting
Do you agree with the staff's recommendation that any regulatory deferral account debit balances and credit balances shall be offset if they arise with the same regulator and are taken into account by the regulator in setting the rate for the same rate-regulated activities? If not, what alternative do you suggest?

Current and non-current classification

21. We further recommend that the current and non-current amount of any net regulatory deferral account debit balance and net regulatory deferral account credit balance is presented separately only in the notes to the financial statements.

22. IAS 1 *Presentation of Financial Statements* requires separate presentation of current and non-current assets and liabilities. As noted in paragraph 13 above, there is some uncertainty as to whether regulatory deferral account balances are

[5] It is assumed that items that satisfy the requirements for recognition in accordance with IFRS will be accounted for in accordance with the relevant Standard. Consequently, regulatory deferral and variance account balances represent those items that would not otherwise be capitalised for financial reporting purposes in the absence of regulatory approval to defer them and include them in future rate-setting procedures.

assets and liabilities for this purpose. Consistently with our recommendation in paragraph 12, we recommend that a single line item should be presented for all net regulatory deferral account debit balances and credit balances immediately below a subtotal for "Total assets (or liabilities) before regulatory amounts".

23. If the IASB decides instead to require or permit separate presentation of current and non-current amounts in the statement of financial position, we recommend that each amount is presented immediately below an appropriate subtotal, eg "Total current assets, before regulatory amounts".

Questions for the IASB

Question 4: location of current and non-current classification presentation
(a) Do you agree with the staff's recommendation that the current and non-current amount of any net regulatory deferral account debit balance and net regulatory deferral account credit balance is presented separately only in the notes rather than in the statement of financial position? (b) If not, do you agree with the staff's recommendation that each amount is presented immediately below an appropriate sub-total, eg "Total current assets, before regulatory amounts"?

Statement of profit or loss and other comprehensive income

24. We recommend that the [draft] interim Standard should propose that the net movement between the opening and closing balance of all regulatory deferral accounts should be presented in profit or loss as a separate line item immediately below a subtotal for "Profit (or loss) before taxation and regulatory amounts".

25. As discussed in paragraph 13 above, many of the items currently included in regulatory deferral accounts would not otherwise be capitalised as assets (or liabilities) in the absence of regulatory rate-setting mechanisms. It is clear that most of these items would be recognised in profit or loss but in a different period than the one in which they are recognised through the use of regulatory deferral

accounts. However, there is some uncertainty as to whether the movements on these deferral accounts should be reflected in income (either revenue or other income) or in expense.

26. Consequently, we think that the statement of profit or loss and other comprehensive income should be presented in such a way that users should be able to identify ‘at a glance’ the comparable amounts for all line items excluding any regulatory deferral account movements. Requiring separate presentation would improve comparability between those rate-regulated entities that currently do not recognise regulatory deferral account balances in financial statements and those that will be allowed to do so in accordance with the [draft] interim Standard. In addition, it would improve transparency and comparability between those entities that do recognise regulatory deferral accounts but that may recognise the movements within different line items.

Questions for the IASB

Question 5: presentation in the statement of profit or loss and other comprehensive income
Do you agree with the staff’s recommendation that the net movement between the opening and closing balance of all regulatory deferral accounts should be presented in profit or loss as a separate line item immediately below a subtotal for “Profit (or loss) before taxation and regulatory amounts”? If not, what alternative do you suggest?