STAFF PAPER

November 2013

IASB Meeting

Project	**Rate-regulated Activities: Interim IFRS**		
Paper topic	Effective date and due process steps		
CONTACT(S)	Jane Pike	jpike@ifrs.org	+44 (0)20 7246 6925

Purpose of the paper

1. The purpose of this paper is to:

    (a) decide whether the proposals for an interim IFRS *Regulatory Deferral Accounts* need to be re-exposed;

    (b) decide the effective date for the interim IFRS;

    (c) summarise the steps in the due process taken by the IASB until now (see Appendix B) and seek confirmation that the IASB is satisfied that it has complied with the due process requirements so far; and

    (d) decide if the staff can prepare the interim IFRS for balloting and identify whether any IASB members intend to dissent.

Introduction and background

2. In April 2013, the IASB published the Exposure Draft *Regulatory Deferral Accounts* (the interim ED). The proposals in the interim ED are aimed at entities that adopt IFRS, and that currently recognise regulatory deferral accounts in accordance with their previous GAAP (as defined in IFRS 1 *First-time Adoption of International Financial Reporting Standards*, ie the basis of accounting that a first-time adopter used immediately before adopting IFRS). The closing date for comments on the interim ED was 4 September 2013.

3. The IASB considered an initial analysis of the high-level messages received on the interim ED proposals in the September 2013. A summary of the high-level messages (see Appendix A) was discussed further in October 2013, together with a more detailed analysis of comment letter responses to the detailed questions contained in the Invitation to Comment.

4. In response to some of the comments received, the IASB considered whether to widen the scope of the proposals instead of restricting the scope only to first-time adopters of IFRS. The IASB decided to retain this scope restriction because the proposals provide relief to potential first-time adopters of IFRS and are expected to provide the following benefits:[1]

   (a) it is likely to remove a major barrier to the adoption of IFRS for many entities for which regulatory deferral account balances represent a significant proportion of net assets;

   (b) it should reduce the risk of entities adopting locally developed ‘carve-ins’ or ‘carve-outs’ that would otherwise create greater diversity of accounting treatment and greater confusion for users of financial statements. Having more entities applying IFRS would ensure that their other activities are reported in accordance with IFRS, thereby increasing comparability for those other assets and liabilities; and

   (c) it is likely to improve transparency and consistency in the way that regulatory deferral account balances and movements in those balances are presented, thereby highlighting the impact of recognising such items and improving comparability between entities that will recognise such balances in accordance with the proposed interim Standard.

5. One of the main purposes of the IASB proposing an interim solution was to help first-time adopters within the proposed scope to avoid making a major change to their accounting policies for regulatory deferral account balances until guidance is developed through the comprehensive Rate-regulated Activities project.[2]

[1] See paragraph BC21 of the Basis for Conclusions on the Exposure Draft *Regulatory Deferral Accounts* (the interim ED).

[2] See paragraph BC18 of the interim ED. Research is being undertaken in the comprehensive project and a Discussion Paper is being developed.

Allowing other entities to develop new accounting policies or to revert to previous policies that may again need to be changed when the comprehensive project is completed would be contrary to the IASB's objective and introduce greater volatility and inconsistency. Restricting the scope to first-time adopters avoids making changes to existing practice for IFRS preparers while there is still uncertainty about the outcome of the comprehensive project.

6. In addition, the IASB noted that there was general support from respondents for the ongoing research work being undertaken in the comprehensive project and the need to prioritise the work on that project to ensure that it is completed in a timely manner. Widening the scope of the interim IFRS would risk diverting resources away from the comprehensive project and delaying its completion.

Changes to the interim ED proposals

7. Following redeliberation of the proposals in the interim ED, the IASB tentatively decided to retain the proposals in the interim ED, with the following amendments:
   (a) clarify that the scope criterion in paragraph 7(a) of the interim ED excludes self-regulated entities but permits some flexibility in the prices to be charged, within a range of prices established by the rate regulator;
   (b) delete the scope criterion in paragraph 7(b) of the interim ED, which requires that the price established by regulation (the rate) is designed to recover the entity's allowable costs of providing the regulated goods or services;
   (c) add application guidance to clarify some group accounting issues;
   (d) introduce a limited exception to IFRS 3 *Business Combinations* to permit the continuation of the previous GAAP accounting policy for the recognition and measurement of regulatory account balances acquired in a business combination;
   (e) specify that an entity should continue to apply its previous GAAP policies for the derecognition of regulatory account balances;

(f) clarify that an entity is not prohibited from recognising new regulatory balances that are created as a consequence of a change in an accounting policy for other items required by IFRS;

(g) require the net movement in regulatory balances presented in the statement of profit or loss and other comprehensive income (OCI) to be split between amounts related to items reported in profit or loss and those reported in OCI; and

(h) delete the specific reference to materiality as a factor to consider in deciding the level of detail to disclose.

Staff analysis and recommendations

Re-exposure

8. We have summarised the proposed amendments from the original proposals in paragraph 7 above. We do not think that the amendments introduce fundamental changes on which respondents have not had the opportunity to comment. We think that they represent clarifications and refinements that are consistent with the IASB's intentions discussed in the Basis for Conclusions accompanying the Exposure Draft.

9. Consequently, we do not consider that there is a need for re-exposure.

Effective date

10. The proposed scope of the interim IFRS is limited to entities that are first-time adopters of IFRS and that recognised regulatory deferral account balances in accordance with their previous GAAP. For this reason, an entity will apply IFRS 1 *First-time Adoption of International Financial Reporting Standards*, at the same time as it initially applies the interim IFRS. Consequently, the terms

"first-time adopter" and "previous GAAP" have the same definition and meaning as in IFRS 1.[3]

11. Entities within the scope of the proposals will be able to continue to apply their existing accounting policies for the recognition and measurement of regulatory deferral accounts balances, with enhanced presentation and disclosure requirements. In addition, entities that are eligible to use the interim IFRS are permitted, but not obliged, to apply it. Consequently, no specific transition requirements are proposed because we consider that the adoption requirements of IFRS are sufficient.

Previous GAAP

12. At the October 2013 meeting, one IASB member asked whether the interim IFRS should try to change the meaning of "previous GAAP" or to fix the definition of the 'baseline' GAAP to mean the basis of accounting that a first-time adopter is currently using or is using at the date that the interim IFRS is published. This question arose because of a concern that the use of "previous GAAP" may permit some structuring opportunity for entities that currently do not recognise regulatory balances in financial statements presented in accordance with local GAAP or in accordance with IFRS. Two scenarios were suggested:

    (a) Currently, an entity does not recognise regulatory deferral account balances in accordance with local GAAP. The entity could delay the adoption of IFRS in order to start to recognise such balances in their local GAAP financial statements. The revised local GAAP financial statements could then become the "previous GAAP" when the entity later adopts IFRS and becomes eligible to use the interim IFRS.

    (b) An entity currently applies IFRS and does not recognise regulatory deferral account balances in its IFRS financial statements. The entity might stop using IFRS and instead prepare financial statements on the

[3] IFRS 1 and the Exposure Draft of the interim IFRS contain the following definitions:

A **first-time adopter** is an "entity that presents its **first IFRS financial statements**".

First IFRS financial statements are the "first financial statements in which an entity adopts International Financial Reporting Standards (IFRS), by an explicit and unreserved statement of compliance with IFRS".

Previous GAAP is the "basis of accounting that a **first-time adopter** used immediately before adopting IFRS".

basis of another GAAP that permits the recognition of regulatory deferral account balances. The entity could later revert to presenting financial statements in accordance with IFRS, which would require them to apply IFRS 1 for a second time and enable them to apply the interim IFRS.

13. We accept that these and other scenarios that could be designed to enable entities to become eligible to use the interim IFRS may be possible. However, we think that there are a lot of obstacles for entities to overcome in order for the scenarios to work in practice. Such obstacles could be legislative, regulatory, financial or investor-driven. For example, company law or securities regulation may require the use of IFRS and so an entity could not choose to delay adoption or stop using IFRS; lenders may have imposed loan covenants on the entity that could be breached if the current accounting policies for regulatory deferral account balances are changed significantly; and investors/analysts may react adversely to the disruption in trend information that would result.

14. We think that these obstacles will act as a deterrent to such structuring activities. In addition, we think that if the IASB's comprehensive Rate-regulated Activities project continues to progress without significant delay, then the incentive to make major changes to existing financial reporting policies in order to become eligible to use the interim IFRS will be reduced. This is because the outcome of the comprehensive project may differ from the effects of applying the interim IFRS and so entities may be faced with yet another accounting policy change for its regulatory balances.

15. Consequently, we do not recommend that the interim IFRS should try to change the meaning of "previous GAAP" or to fix the definition of the 'baseline' GAAP to mean the basis of accounting that a first-time adopter is currently using or is using at the date that the interim IFRS is published.

Suggested effective date and early application

16. We think that the ability of entities that are within the scope of the proposals to continue to apply their existing accounting policies will minimise the disruption to accounting systems and will facilitate a short application period. Although some changes may be needed to apply the enhanced presentation and disclosure

requirements, we do not think that this will require an extended period in order for entities to adapt their reporting systems.

17. The interim IFRS will be available only to first-time adopters of IFRS and so will need to be applied at the date of transition to IFRS.[4] An effective date of accounting periods beginning on or after 1 January 2016 will therefore take effect for a date of transition to IFRS of 1 January 2015 (assuming that comparatives are required for one year). We think that this will provide sufficient time for translation and for eligible entities to prepare adequately for application of the interim IFRS.

18. The proposals provide relief to potential first-time adopters of IFRS and are expected to provide the benefits outlined in paragraph 4. Consequently, entities may wish to apply the interim IFRS at an earlier date. For entities applying the interim IFRS for the first time in financial statements beginning on or after 1 January 2015, the date of transition to IFRS will be 1 January 2014. The interim IFRS may not be published by this date, because it is currently expected to be published during January 2014. However, because the interim IFRS is proposing to allow entities to retain their existing recognition and measurement policies, we do not think that this will create significant concerns.

19. Consequently, we recommend that the effective date is set at 1 January 2016 and that early application should be permitted to make the benefits outlined in paragraph 4 available at the earliest opportunity.

Due process steps

20. The due process steps followed so far and the actions taken are documented in Appendix B. The due process steps applicable so far have been completed.

[4] IFRS 1 defines the date of transition to IFRS as: "The beginning of the earliest period for which an entity presents full comparative information under IFRSs in its first IFRS financial statements".

Questions for the IASB

Questions for the IASB
1. Does the IASB agree that re-exposure is not required? 2. Does the IASB agree to set the effective date as reporting periods beginning on or after 1 January 2016, with early application permitted? 3. Is the IASB satisfied that all due process steps applicable so far have been complied with? 4. Does the IASB agree that the staff can prepare the interim Standard for balloting? 5. Do any IASB members intend to dissent and present their dissenting opinions in the material accompanying the interim IFRS?

Appendix A: Summary of high level messages received in responses to the Exposure Draft *Regulatory Deferral Accounts*, published in April 2013

A1. 114 responses were received from 26 countries, representing seven geographical regions. Appendix A shows a breakdown of the geographical distribution of respondents. The largest number of respondents (49 per cent) are preparers of financial statements and preparer representative bodies. Other respondents are primarily standard-setters (19 per cent), and accounting firms or bodies (13 per cent). Of the six responses[5] (five per cent of responses) described as "User/representative body", one is an association of valuers and three represent consumer groups.

Summary of responses—geographical analysis

	Europe	**North America**	**Asia**	**Latin America**	**Oceania**	**Global**	**Africa**	**Total**
Accountancy body	2	0	2	0	0	1	3	**8**
Accounting firm (Big 4 and others)	0	0	0	0	0	7	0	**7**
Government body	0	1	0	0	0	0	0	**1**
Individual	2	0	0	1	0	0	0	**3**
Preparer	6	28	2	4	0	0	0	**40**
Preparer/ representative body	4	8	1	3	0	0	0	**16**
Rate regulator/ representative body	1	3	0	0	0	0	0	**4**
Securities regulator/ representative body	2	4	1	0	0	0	0	**7**
Standard-setting body [including endorsement advice bodies]	10	1	4	3	3	0	1	**22**
User/ representative body	0	5	0	0	0	1	0	**6**
Total	**27**	**50**	**10**	**11**	**3**	**9**	**4**	**114**

[5] International Association of Consultants, Valuators and Analysts (IACVA); National Association of State Utility Consumer Advocates; NASUCA Tax & Accounting Committee; Wyoming Public Service Commission. Other user responses came from Standard & Poors and from the User Advisory Council [the User Group of the Canadian standard-setter].

A2. The overall support or disagreement with the general proposal to issue an interim Standard available to first-time adopters of IFRS is mixed:

(a) a slight majority of responses support the issue of an interim IFRS applicable to first-time adopters only;

(b) a significant minority of responses (a little over one quarter of all respondents) disagree with the issue of an interim IFRS; and

(c) a slightly smaller number of responses (approximately one-fifth of all responses) disagree with providing an interim IFRS only for first-time adopters. The majority of these would support an interim IFRS that was applicable to a wider range of entities.

A3. Many of the respondents that disagreed with the overall proposal still provided responses to the individual questions within the interim ED, which were provided to assist the IASB if it decides to go ahead with publishing an interim IFRS.

A4. There was general support for the IASB's comprehensive Rate-regulated Activities project. Some of the respondents noted that their support for the interim IFRS was partially conditional on the IASB prioritising the work on that project to ensure that it is completed in a timely manner. Some stressed that the 'uneven playing field' created by an interim solution aimed only at prospective first-time adopters is not sustainable as a long-term solution.

General reasons for supporting or disagreeing with the proposals

A5. A high level summary of the main arguments for and against the general proposal for an interim IFRS was presented to the IASB in September 2013[6] and will not be reproduced in full here.

A6. In short, those that support an interim solution only for first-time adopters agree with the IASB's reasons for issuing the interim ED, in particular:

(a) it will not increase diversity among existing IFRS preparers;

[6] Agenda Paper 9C interim ED: *Early feedback from comment letters*.

(b) it will lower 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

(c) the separate presentation and disclosure requirements will help comparability across IFRS preparers.

A7. Those that disagree with issuing an interim solution gave a wider variety of reasons in addition to those provided by the alternative views of IASB members.[7] Those other reasons include:

(a) the proposals are contrary to the IASB's policy of publishing a single set of Standards that are available to all on equal terms, ie creating a 'level playing field'. This will weaken the reputation of the IFRS 'brand' and is unfair to entities that previously eliminated regulatory balances on adoption of IFRS;

(b) experience with other 'interim' Standards, ie IFRS 4 *Insurance Contracts* and IFRS 6 *Exploration for and Evaluation of Mineral Resources*, suggest that an interim Standard will not be a 'short-term' solution; and

(c) although the IASB has stated that the interim proposals will not prejudice the outcome of the comprehensive project, the recognition of regulatory balances through an interim IFRS will naturally increase the pressure to continue this treatment for all.

A8. Several respondents suggested that the IASB should redirect resources to the comprehensive project instead of completing the interim IFRS. Many of them noted the importance of addressing whether rate regulation should result in the recognition of assets and liabilities for all IFRS preparers, not merely the limited population of entities targeted by the interim proposals.

[7] See paragraphs AV1–AV7 of the interim ED.

Restricting the scope to first-time adopters only

A9. The interim ED proposes to restrict the scope to the first-time adopters of IFRS that recognised regulatory deferral account balances in their financial statements in accordance with their previous GAAP (as defined in IFRS 1 *First–time Adoption of International Financial Reporting Standards*).

A10. There was widespread acknowledgement that the question as to whether rate regulation should result in the recognition of 'regulatory assets' and 'regulatory liabilities' was a complex and difficult one. Consequently, many of the supporters of this scope restriction agreed that allowing first-time adopters of IFRS to continue to recognise regulatory balances that they currently recognise in accordance with their previous GAAP was a practical and pragmatic short-term solution to a significant barrier to the adoption of IFRS. In addition, some supporters of this scope restriction noted that it would be inappropriate for other entities to begin recognising regulatory balances in IFRS financial statements until the IASB completes its comprehensive project to answer whether, and if so, how, such balances should be recognised.

A11. Some respondents suggested that the scope should be open to all rate-regulated entities that satisfy the other scope criteria. Those respondents argued that restricting the scope to the first-time adopters that recognised regulatory balances in accordance with their previous GAAP would reduce comparability between entities, depending on when they first applied IFRS.

A12. Some respondents also suggested that restricting the scope to only the first-time adopters that recognised regulatory balances in accordance with their previous GAAP might also discriminate against existing IFRS preparers. This may give an unfair advantage to those entities within the scope. For example, one respondent wrote:

> ... companies bidding for tenders would be subject to distortions of competition, depending on whether they are allowed by their local GAAP to recognise regulatory deferral accounts or not, and on whether they are first time adopters or not.

A13. A few responses suggested that the scope should be widened to also capture entities that eliminated regulatory balances when adopting IFRS. They suggested that limiting the scope to future first-time adopters was unfair to those that had already reluctantly accepted the predominant IFRS practice and had eliminated the regulatory balances when they adopted it. It could be argued that this is especially relevant to those entities in jurisdictions that have recently adopted IFRS, such as Brazil and Korea and to the few entities in Canada that have made the transition to IFRS.

Staff analysis

A14. We do not agree that the proposals will reduce comparability. As explained in IASB Agenda Paper 22 *Interim IFRS: Comment letter analysis*, October 2013, we think that comparability will be enhanced because reducing the barrier to IFRS adoption will result in the requirements of IFRS being applied to the other reported balances and transactions in the financial statements instead of a variety of other accounting frameworks.

A15. We do agree that the treatment of regulatory balances will not be consistent across all entities, as the IASB acknowledged in paragraph BC19 of the interim ED. The interim ED proposes to permit first-time adopters to continue to apply existing accounting policies for the recognition, measurement and impairment of regulatory balances. This 'grandfathering' policy may result in different accounting policies being adopted for regulatory balances. However, the IASB has previously observed that, in many jurisdictions, the accounting policies developed for regulatory balances are based on US GAAP or other local GAAP that provides similar guidance. Consequently, a reasonable level of comparability of the treatment of the regulatory balances is expected within the limited population of eligible entities.

A16. The respondents who disagreed with the scope restriction, and suggested that the scope should include existing IFRS preparers that are subject to rate regulation, gave no clear direction as to what accounting policies should be adopted by entities that currently do not recognise regulatory balances. Some suggested that entities should return to the policies that they used before making the transition to IFRS; others suggested allowing entities to develop their own policies; and others suggested that the IASB should provide more detailed guidance on what recognition, measurement and impairment policies should be applied.

A17. The staff are not convinced by these arguments. Allowing entities to return to previous accounting policies or to determine their own policies will introduce a wider variety of accounting policies and, therefore, introduce more inconsistency than the proposals in the interim ED. As noted in paragraph BC39 of the interim ED, the IASB is not able to establish the most appropriate recognition, measurement and impairment requirements for reporting the effects of rate regulation until there are answers to the fundamental issues that are currently being addressed in the comprehensive research project.

A18. In addition, we do not think that it is appropriate for entities that have recently eliminated regulatory account balances when making the transition to IFRS to reinstate them when the outcome of the IASB's comprehensive Rate-regulated Activities project is still uncertain. One of the main purposes of the IASB proposing an interim solution was to help first-time adopters within the proposed scope to avoid making a major change to their accounting policies for regulatory account balances until guidance is developed through the comprehensive project. Allowing entities to revert to a previous policy that may again need to be changed when the comprehensive project is completed would be contrary to the IASB's objective and introduce greater volatility and inconsistency.

Existing IFRS preparers

A19. During the development of the interim ED, the IASB focused on first-time adopters of IFRS because the predominant practice among existing IFRS preparers is not to recognise regulatory balances. Although it was acknowledged that there may be a few rare examples of regulatory balances being recognised within the existing IFRS population, the IASB tentatively decided that the interim ED did not need to address those cases.

A20. While carrying out research for the comprehensive project, the staff have not seen evidence to contradict the IASB's earlier observation that exceptions to the predominant practice are rare. Consequently, we do not think that the scope needs to be widened to capture existing IFRS preparers that currently recognise regulatory balances in IFRS financial statements.

Staff recommendation

A21. We recommend that the IASB should retain the proposal to restrict the scope to first-time adopters of IFRS that recognised regulatory deferral account balances in their financial statements in accordance with their previous GAAP.

Appendix B: Due process steps – finalisation of a Standard

Step	*Required/ Optional*	*Metrics or evidence*	*Evidence provided to DPOC*	*Actions*
Consideration of information gathered during consultation				
The IASB posts all of the comment letters that are received in relation to the ED on the project pages.	Required if request issued	Letters posted on the project pages.	The IASB has reported on progress as part of its quarterly report at Trustee meetings, including summary statistics of respondents.	Comment letters have been posted on the project pages in a timely manner. The IASB has reported progress on the project to the Trustees at their quarterly meetings, most recently in October 2013.
Round-tables between external participants and members of the IASB.	Optional	Extent of meetings held.	The DPOC has received a report of outreach activities.	Not required, because this is a narrow-scope project.
IASB meetings are held in public, with papers being available for observers. All decisions are made in public sessions.	Required	Meetings held. Project website contains a full description with up-to-date information. Meeting papers posted in a timely fashion. Extent of meetings with consultative group held and confirmation that critical issues have been reviewed with them.	The IASB and the DPOC have discussed progress on major projects, in relation to the due process being conducted. The IASB and the DPOC have reviewed the due process over the project life cycle, and how any issues about the due process have been/are being addressed. The DPOC has met with the Advisory Council to understand stakeholders' perspectives. The DPOC has reviewed and responded to comments on due process as appropriate.	The IASB considered a preliminary analysis of high level messages received in comment letters in the September 2013 meeting. The IASB considered a more detailed analysis and redeliberated the proposals in the October 2013 meeting. The Consultative Group has been established primarily for the comprehensive project and detailed consultation with them on the Exposure Draft is not considered necessary. The Group will be updated on the project at the meeting on 15 November 2013.

Step	*Required/ Optional*	*Metrics or evidence*	*Evidence provided to DPOC*	*Actions*
Analysis of likely effects of the forthcoming Standard or major amendment, for example, costs or on-going associated costs.	Required	Publication of the Effects Analysis.	The IASB and the DPOC have reviewed the results of the Effects Analysis and how it has considered such findings in the proposed Standard. The IASB has provided a copy of the Effects Analysis to the DPOC at the point of the Standard's publication.	The Effects Analysis was previously considered by the IASB and was published with the Exposure Draft. The proposed changes to the Exposure Draft proposals are not expected to change the outcome of the Effects Analysis.
Email alerts are issued to registered recipients.	Optional	Evidence that alerts have occurred.	The DPOC has received a report of outreach activities.	Not required, because this is a narrow-scope project.
Outreach meetings to promote debate and hear views on proposals that are published for public comment.	Optional	Extent of meetings held, including efforts aimed at investors.	The DPOC has received a report of outreach activities.	Not required, because this is a narrow-scope project.
Regional discussion forums are organised with national standard-setters and the IASB.	Optional	Extent of meetings held.	The DPOC has received a report of outreach activities.	Not required, because this is a narrow-scope project.
Finalisation				
Due process steps are reviewed by the IASB.	Required	Summary of all due process steps have been discussed by the IASB before a Standard is issued.	The DPOC has received a summary report of the due process steps that have been followed before the Standard is issued.	To be discussed at the October 2013 IASB meeting; see the body of this paper for details.
Need for re-exposure of a Standard is considered.	Required	An analysis of the need to re-expose is considered at a public IASB meeting, using the agreed criteria.	The IASB has discussed its thinking on the issue of re-exposure with the DPOC.	To be discussed at the October 2013 IASB meeting; see the body of this paper for details.

Step	*Required/ Optional*	*Metrics or evidence*	*Evidence provided to DPOC*	*Actions*
The IASB sets an effective date for the Standard, considering the need for effective implementation, generally providing at least a year.	Required	Effective date set, with full consideration of the implementation challenges.	The IASB has discussed any proposed shortening of the period for effective application with the DPOC.	To be discussed at the October 2013 IASB meeting; see the body of this paper for details.

The Due Process steps related to drafting and publication of the interim IFRS will be completed in due course and will be included in a later report.