STAFF PAPER

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IASB Meeting

Project	**Rate-regulated Activities: Interim IFRS**
Paper topic	Interaction with other IFRSs

CONTACT(S) Jane Pike jpike@ifrs.org +44 (0)20 7246 6925

Purpose and structure of the paper

1. Agenda Paper 22B analyses the responses to Question 5 in the Invitation to Comment of the Exposure Draft *Regulatory Deferral Accounts*, published in April 2013 (the 'interim ED'). In addition, this paper summarises the staff's recommendations for finalising the proposals.

Summary of staff recommendations

2. We recommend that the recognition, measurement and impairment and interaction with other IFRS requirements proposed in paragraphs 14–17 and Appendix B of the interim ED are retained with the following amendments:

   (a) introduce a limited exception to IFRS 3 *Business Combinations* to permit the continued previous GAAP accounting policy for the recognition and measurement of regulatory account balances to be applied for a business combination (see paragraphs 5–11);

   (b) specify that an entity should continue to apply its previous GAAP policies for the derecognition of regulatory account balances (see paragraphs 22–23); and

(c) clarify that an entity may recognise new regulatory balances that are created due to a change in accounting policy for other items required by IFRS (see paragraphs 24–29).

Question 5: is the approach to the application of other IFRSs to regulatory balances appropriate?

3. The interim ED proposes that, in the absence of any specific exemption or exception contained within the [draft] interim IFRS, other Standards shall apply to regulatory deferral account balances in the same way as they apply to assets and liabilities that are recognised in accordance with other Standards. Application requirements are proposed in Appendix B of the interim ED to support this proposal.

4. The vast majority of respondents agreed with this proposal. A few responses asked for clarifications or changes relating to the interaction of some Standards with the regulatory balances. In particular:

   (a) IFRS 3 *Business Combinations*;

   (b) IAS 34 *Interim Financial Statements*;

   (c) IAS 36 *Impairment of Assets*

   (d) IFRIC 12 *Service Concession Arrangements*;

   (e) derecognition of regulatory balances; and

   (f) the creation of 'new' regulatory balances resulting from changes in accounting policies due to the adoption of IFRS.

IFRS 3 Business Combinations

5. Some respondents asked the IASB to clarify whether an acquiree's regulatory account balances would be an identifiable asset or liability in a business combination. Those respondents also asked how the acquirer should measure the regulatory balances recognised in a newly acquired subsidiary at the date of acquisition. They asked whether the measurement should be:

   (a) at fair value in accordance with IFRS 3;

(b) in accordance with the acquirer's previous GAAP requirements; or

(c) in accordance with the acquiree's previous GAAP requirements.

6. One respondent suggested that a specific exception be developed to the recognition and measurement requirements of IFRS 3.

Staff analysis

7. We agree that additional application guidance is needed for the interaction between the interim proposals and the requirements of IFRS 3.

8. Paragraph 19 of IFRS 10 requires that a "parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances". Consequently, we think that if an acquirer does not recognise regulatory balances (and so is not eligible to use the [draft] interim IFRS) but subsequently acquires a subsidiary that does recognise such balances, the acquirer would not be eligible to start to recognise the acquiree's regulatory balances separately within the consolidated financial statements..

9. If, alternatively, an acquirer currently recognises regulatory balances and is permitted to continue to recognise them in accordance with the proposals in the interim ED, then (consistently with the approach in paragraph 8 above) the acquirer should recognise any regulatory balances in the acquiree at the date of acquisition. This should apply irrespective of whether the acquiree recognises those balances in its own financial statements.

10. In addition, when an acquirer recognises an acquiree's regulatory balances in accordance with the acquirer's previous GAAP policies, we do not think that the acquirer should need to value those recognised balances at fair value at the date of acquisition. Instead, we think that the acquirer should apply its existing business combination measurement policies (ie the policies established in its previous GAAP). This would be consistent with the general requirement that was proposed in the interim ED.

11. Consequently, we agree with the respondent who suggested that a specific exception to the recognition and measurement requirements of IFRS 3 should be added to the interim ED.

IAS 34 Interim Financial Statements

12. A few respondents asked for additional application guidance that is related to the application of IAS 34 to be provided. In particular, they requested that it should be made clear that separate line items for regulatory deferral account balances and movements therein should also be included in a condensed set of interim financial statements.

Staff analysis

13. We are not persuaded that additional guidance is necessary. Paragraph 10 of IAS 34 requires that condensed interim financial statements “shall include, at a minimum, each of the headings and subtotals that were included in its most recent annual financial statements and the selected explanatory notes as required by this Standard. ...”. In addition, paragraphs 15–15A of IAS 34 require that an entity shall include an explanation of events and transactions that are significant to an understanding of the changes in the financial position and performance of the entity.

14. We think that the existing requirements, together with the detailed year-end information proposed in the interim ED (see Agenda Paper 22C), are sufficient to provide users with the relevant information to understand the regulatory account balances that are recognised.

IAS 36 Impairment of Assets

15. Paragraph B9 of the interim ED proposes to require an entity to continue its previous GAAP impairment policy for any regulatory balances recognised. Paragraph B10 then proposes that, if the entity needs to carry out an impairment test on the cash–generating unit (CGU) that contains regulatory balances, the entity should apply the general requirements of IAS 36 to that CGU.

16. A few respondents suggested that the IASB should reconsider the existing guidance proposed in paragraphs B9–B10 of the interim ED. However, there was no consensus as to how the guidance should be clarified.

Staff analysis

17. We are not persuaded that the IASB needs to revise its previous decision to require that the general requirements of IAS 36 should apply to a CGU that contains regulatory balances.

18. There are already a number of items that do not fall within the scope of IAS 36's impairment requirements for individual assets and, therefore, regulatory balances are not unique in this respect.[1] There is no special exception for those specified items from IAS 36's general requirements for impairment testing of a CGU or the allocation of an impairment loss to the assets within an impaired CGU.

IFRIC 12 Service Concession Arrangements

19. A few respondents noted that the interim ED does not contain guidance on the interaction of the proposals with the requirements of IFRIC 12. However, none suggested how this interaction should be dealt with.

Staff analysis

20. The requirements of IFRIC 12 and the potential interaction with any accounting guidance that may be produced as a result of the comprehensive Rate–regulated Activities project will be investigated during that project. At this stage, it is too early to provide detailed guidance.

21. However, the staff are not convinced that the lack of guidance will create significant diversity in practice because we do not think that there will be a large population of entities for which this issue will apply.[2]

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[1] These items are listed in paragraph 2 of IAS 36 and include items such as inventories, financial instruments, assets arising from construction contracts, and non–current assets classified as held for sale, for which specific impairment requirements are already contained in other Standards.

[2] The US Financial Accounting Standards Board Emerging Issues task Force has recently reached the same tentative conclusion. See paragraph BC6 of the Proposed Accounting Standards Update—*Service Concession Arrangements* (Topic 853) (a consensus of the FASB Emerging Issues Task Force).

Derecognition of regulatory balances

22. A few respondents suggested that the [draft] interim IFRS should refer explicitly to the continuance of an entity's existing accounting policy for the derecognition of regulatory balances in accordance with their previous GAAP.

Staff analysis

23. We agree that, for completeness, it would be worth specifying that an entity should continue to apply its previous GAAP policies for the derecognition of regulatory account balances.

Creation of 'new' regulatory balances resulting from changes in accounting policies due to the adoption of IFRS

24. During informal outreach, it was drawn to our attention that some of the accounting policy changes that are required on the transition to IFRS may create additional differences between the accounting policies used in general purpose financial statements and those used for regulatory purposes. Those differences may be reflected in the entity's regulatory account balances for regulatory purposes but would not have been reflected in the previous GAAP financial statements, because they were not relevant when the previous GAAP applied.

25. For example, the rate regulator might allow pensions costs to be reflected in rates as incurred. The previous GAAP accounting policy for pension costs may have been consistent with this 'as incurred' policy and so no regulatory account balance would have existed for those costs. However, IAS 19 *Employee Benefits* requires pension costs to be attributed to periods of service in accordance with the plan's benefit formula, or in some cases on a straight–line basis. For defined benefit pension costs, this would create a timing difference for which a regulatory balance would be created.

26. The question was raised as to whether this newly created regulatory balance could be recognised when it was not recognised in accordance with previous GAAP.

Staff analysis

27. Paragraph BC48 of the interim ED notes that:

> the IASB thinks that changing an accounting policy to start to recognise such [regulatory account] balances, or to recognise a wider range of such balances by modifying a previous GAAP policy, when that changed policy might need to change again following the completion of the Rate-regulated Activities project, would not make the financial statements more reliable. This [draft] interim Standard, therefore, proposes that entities that currently do not recognise regulatory deferral account balances would not be permitted to start doing so on application of this [draft] interim Standard.

28. We appreciate that some readers may interpret this to mean that new regulatory account balances that are created because of changes in the accounting policies for other items may be prohibited from being recognised. We understand that this may cause some concern. However, we do not think that this was the intention of the IASB when developing the interim ED, nor do we think that the recognition of such new regulatory account balances would be contradictory to the general prohibition from widening the range of balances recognised. In most cases, the recognition of regulatory account balances includes those balances that are created because of timing differences between when items are recognised as income or expense for regulatory purposes and when they are normally recognised in profit or loss (or other comprehensive income) in general purpose financial statements.

29. Consequently, we agree that it would be useful to clarify that when new regulatory balances are created due to a change in accounting policies for other items required by IFRS, the recognition of those regulatory account balances is permitted.

Staff recommendations

30. We recommend that the IASB clarifies in the body of the [draft] interim IFRS or in additional application requirements that:

    (a) a limited exception to IFRS 3 is introduced to permit the continued previous GAAP accounting policy for the recognition and measurement of regulatory account balances to be applied for a business combination (see paragraphs 5–11 above);

(b) an entity should continue to apply its previous GAAP policies for the derecognition of regulatory account balances (see paragraphs 22–23 above); and

(c) an entity may recognise new regulatory balances that are created due to a change in accounting policies for other items required by IFRS (see paragraphs 24–29 above).

31. We do not recommend adding any additional guidance or requirements for impairment, interim financial statements or the interaction with IFRIC 12 (see paragraphs 12–21 above).

Additional interactions

32. A number of other relevant issues were also raised but we think that they can be dealt with via drafting and so do not propose to deal with each of them individually here.

Question for the IASB

Questions: Additional application guidance
1. Do you agree with the staff's recommendations to add further guidance for: (a) recognition and measurement of regulatory account balances in a business combination? (b) derecognition of regulatory account balances? (c) new regulatory account balances created by changes in the accounting policy when making the transition to IFRS? 2. Do you agree with the staff's recommendation not to add guidance for: (a) impairment? (b) interim financial statements? (c) the interaction with IFRIC12?