STAFF PAPER

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IASB Meeting

Project	**Rate-regulated Activities: Interim IFRS**
Paper topic	Presentation and disclosure

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Purpose and structure of the paper

1. This Agenda Paper 22C analyses the responses to the presentation and disclosure questions presented within 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.

2. The paper deals with the following questions from the interim ED:

   (a) Question 6: should regulatory balances be presented separately?

   (b) Question 7: are the disclosure requirements appropriate? and

   (c) Question 8: should materiality be specifically considered?

Summary of staff recommendations

3. We recommend that the presentation and disclosure requirements proposed in paragraphs 18–33 of the interim ED are retained with the following amendments:

   (a) the net movement in regulatory balances presented in the statement of profit or loss and other comprehensive income (OCI) should be split between amounts related to items reported in profit or loss and those reported in OCI (see paragraphs 4–18 below); and

(b) the specific reference to materiality as a factor to consider in deciding the level of detail to disclose should be deleted (see paragraphs 30–37 below).

Question 6: should regulatory balances be presented separately?

4. The interim ED proposes that the incremental amounts that are recognised as regulatory deferral account balances and movements in those balances should then be isolated by presenting them separately from the assets, liabilities, income and expenses that are recognised in accordance with other Standards.

5. The majority of respondents who answered this question agreed with the proposal to isolate the regulatory balances recognised and present them separately. A few of these respondents noted that this separation of the balances was critical to their support of the proposals. Without separation, they claimed, the level of inconsistency and reduction of comparability would be unacceptable.

6. However, several respondents suggested that the separate line item presented below the profit before tax item in the statement of profit or loss and other comprehensive income (OCI) should be split into two components; the amount related to profit or loss and the amount related to OCI.

7. The respondents noted that, for example, the rate regulator might allow pensions costs to be reflected in rates as incurred, whereas IAS 19 *Employee Benefits* requires them to be attributed to periods of service in accordance with the plan's benefit formula, or in some cases on a straight-line basis. This would create a timing difference for which a regulatory balance could be created. When movements in the net pension asset or liability are recorded in OCI, in accordance with IAS 19, presenting the movement in the related regulatory account balance within the single line item in profit or loss could be misleading.

8. Although this issue was raised mainly within the context of IAS 19, it may also apply to other items reflected in OCI in accordance with other Standards, such as IFRS 9 *Financial Instruments*.

9. In contrast, a few respondents suggested that the separate presentation was too restrictive and asked that more flexibility should be permitted. For example:

(a) the net movement in regulatory balances should be allowed to be included within operating profit;

(b) the net movement in regulatory balances should be allowed to be disaggregated and incorporated within other line items, with the total highlighted in a disclosure note;

(c) a split of regulatory balances between current and non-current amounts and should be permitted in the statement of financial position; and

(d) the net regulatory balances should be allowed to be disaggregated and incorporated within other line items.

10. A few respondents suggested that further separation should be required in the statement of changes in equity and in the statement of cash flows.

Staff analysis

11. We are persuaded by those respondents who argue that separating out the net movement on regulatory balances that relates to amounts presented in OCI from amounts included in profit or loss would provide more relevant information in the primary statement. In particular, this split would be most useful in cases in which the entity chooses to present the statement of profit or loss separately from the statement of other comprehensive income, as permitted by IAS 1 *Presentation of Financial Statements*.[1]

12. We are not persuaded by arguments for other changes. We think that if an entity wants to disaggregate the regulatory line items further, for example in order to show the impact of movements in regulatory balances against individual profit or loss items, then this would be more appropriately included in the note disclosure (see paragraphs 21 and 28 below).

13. In addition, the proposed disclosure requirements already include information about the remaining periods over which the entity expects to recover/amortise or reverse the carrying amount of each regulatory balance[2]. We consider that this is sufficient to enable users to identify the current and non-current amounts. An

[1] Paragraph 10A of IAS 1.

[2] Paragraph 28(c) of the interim ED.

entity could also disclose subtotals for current and non-current accounts within the note if considered useful.

14. As noted previously, the majority of respondents agreed with the proposals to isolate the presentation of regulatory balances within the primary financial statements, with a more detailed breakdown to be disclosed in the notes. Indeed, some respondents noted that this element of the proposals was critical to the IASB's intention to improve comparability between entities, irrespective of whether they could recognise regulatory account balances in accordance with the [draft] interim IFRS or not.[3]

15. It is worth noting that many respondents from Canada and the USA accepted this proposal on this basis. For example, the following statement from Hydro-Québec is typical of several responses:

> "We believe the separate presentation approach is appropriate. It will enhance comparability with other entities and increase the transparency of regulatory deferral account balances. It will also help users to clearly identify the amounts involved. In addition, this separate presentation approach would result in a consistent application of IFRS for all other transactions or activities, regardless of whether an entity has rate-regulated activities."

16. The US Federal Energy Regulatory Commission (FERC) further noted:

> "Additionally, we support the IASB's proposal that the [draft] interim Standard require separate presentation of regulatory deferral account balances from assets, liabilities, income, and expenses that are recognized in accordance with other IFRS Standards. This approach will assist users of IFRS financial statements to fully understand the nature and financial effects of rate regulation and at the same time preserve the presentation of all other assets, liabilities, income, and expenses that are recognized in accordance with other IFRS Standards

[3] Paragraph BC20 of the interim ED.

intact and, thus, comparable to those of non-rate-regulated entities. We believe that this approach, if adopted, will result in reporting of financial information that is relevant, comparable, and readily available to users of such financial information from both rate-regulated entities and non-rate-regulated entities."

Staff recommendation

17. We recommend that the IASB should add a requirement to present separately, in the statement of profit or loss and other comprehensive income, the net amount of any movements in regulatory balances that relate directly to movements in items that are recognised in other comprehensive income.

18. Except for this change, we recommend that the presentation requirements proposed in paragraphs 18-21 of the interim ED are retained.

Question for the IASB

Question 1: Separation of regulatory line items	
Do you agree with the staff recommendation to	
(a)	separate the net movement in regulatory balances between amounts related to profit or loss and amounts related to items included in other comprehensive income? and
(b)	retain the presentation requirements proposed in paragraphs 18-21 of the interim ED?

Question 7: are the disclosure requirements appropriate?

19. The interim ED proposes disclosure requirements to enable users of financial statements to understand the nature and financial effects of rate regulation on the entity's activities and to identify and explain the amounts of the regulatory deferral account balances that are recognised in the financial statements.

20. The majority of respondents that answered this question agreed that the disclosure proposals set out in the interim ED are appropriate and would provide relevant

information to help users understand the impact of the rate-regulatory environment on the financial statements.

21. A few respondents suggested that additional disclosure should be provided to analyse each material change to the regulatory balances that is reflected in the movement reported in the statement of profit or loss and other comprehensive income. This would involve allocating the net movement reflected in the statement of profit or loss and other comprehensive income to each relevant line item of income or expense presented in that statement.

22. In addition, three respondents[4] expressed concern with the proposed option to incorporate the explanation of activities subject to rate regulation, which was proposed in paragraph 25 of the interim ED, by cross–reference from the financial statements to some other statement such as the accompanying management commentary. For example one respondent[5] is "unsure as to how cross-referencing external documents such as a management risk report would be accepted by our local securities regulators and auditors". Another[6] suggested that "Information becomes less useful to a user if an alternate document has to be obtained and referred to".

23. A few respondents commented that the proposed disclosures were too detailed or too prescriptive and that entities should be given more discretion and flexibility to decide what disclosures are considered necessary to provide users with sufficient information. However, the vast majority agreed that the proposed disclosures were appropriate and that the approach taken in paragraphs 22-24 of the interim ED provides sufficient flexibility (see the section related to Question 8 below).

Staff analysis

24. Paragraph 24 of the interim ED provides a list of issues that an entity should when deciding how much detail is required to satisfy the overall disclosure requirement set out in paragraph 22 of the interim ED. We think that this provides sufficient

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[4] Enbridge Inc., KPMG; and Zambia Institute of Chartered Accountants (ZICA).

[5] Enbridge Inc.

[6] KPMG

flexibility and, consequently, we disagree with those respondents that suggested that the proposed disclosures are too prescriptive.

25. Several other respondents noted that they already provide much of the information in accordance with their existing local GAAP. One respondent[7] went further by noting that:

> "We think the proposed disclosure requirements provide decision-useful information and note their similarity to the requirements of Accounting Guideline AcG-19 "Disclosures by Entities Subject to Rate Regulation" in pre–changeover Canadian GAAP. Our experience with the Canadian requirements has been that preparers do not consider them burdensome and financial statement users find them beneficial. We consider the table required by paragraph 28 of the Exposure Draft to be an improvement over pre–changeover Canadian GAAP disclosure requirements for the reasons stated in paragraph BC65."[8]

26. We also disagree with those respondents that object to permitting the qualitative information referred to in paragraph 22 above to be incorporated by cross-reference from the financial statements to an accompanying report. The cross–reference means that the disclosures are an integral part of the financial statements, as confirmed in paragraph 26 of the interim ED, which states: "If the information is not [. . .] incorporated by cross–reference, the financial statements are incomplete."

27. In addition, incorporating the information by cross-reference is an option, not a requirement. Many entities that currently recognise regulatory balances in accordance with their local GAAP already provide much of the qualitative information about rate regulation in their management commentary report. We do not think that it is necessary to require them to replicate, or relocate, this information. As explained in paragraph BC66 of the interim ED, this approach is consistent with that used in IFRS 7 *Financial Instruments: Disclosures*.

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[7] Canadian Accounting Standards Board (AcSB).

[8] Paragraph BC65 of the interim ED.

28. We agree with the respondents who suggested that presenting disaggregated information about each material change to the regulatory balances that is reflected in the movement reported in the statement of profit or loss and other comprehensive income might provide useful information in some circumstances. However, this may not be relevant to all types of rate–regulatory environment. We do not, therefore, think that it is necessary to mandate such an analysis but instead would prefer to allow management to decide whether it would be useful to provide it. Consequently, we do not propose to add this to the existing proposals.

Staff recommendation

29. We recommend that the IASB should confirm the disclosure requirements as drafted in the interim ED (except for deletion of the specific reference to materiality as a factor to consider in deciding the level of disclosure to be provided, see the section related to Question 8 below).

Question for the IASB

Question 2: Detailed disclosure requirements
Does the IASB agree with the staff recommendation to retain the disclosure requirements as drafted in paragraphs 22–33 of the interim ED, subject to the decision related to the specific reference to materiality discussed below?

Question 8: should materiality be specifically considered?

30. The interim ED explicitly refers to materiality and other factors that an entity should consider when deciding how to meet the proposed disclosure requirements.

31. Almost all of the respondents were content with the proposal that entities should consider the general factors listed in paragraph 24 of the interim ED in order to decide how to comply with the general disclosure requirement set out in paragraph 22 of the interim ED. However, many of respondents that answered this question disagreed with the explicit reference to materiality in paragraph 24(a) of the interim ED.

32. Those respondents that disagreed with the explicit reference to materiality generally noted that materiality is already dealt with by the

Conceptual Framework for Financial Reporting (the *Conceptual Framework*) and by IAS 1 *Presentation of Financial Statements*. Consequently they argued that:

(a) referring to materiality is superfluous because it is already dealt with in the *Conceptual Framework* and in IAS 1, which apply to all items in IFRS financial statements;

(b) referring to materiality in specific Standards could cause confusion because readers of this [draft] interim IFRS may question whether materiality applies to other Standards that do not mention it (despite the general comments above about the *Conceptual Framework* and IAS 1);

(c) the concept of materiality should not be introduced into a specific Standard without it being specifically defined within the Standard; and

(d) guidance on materiality will be better dealt with through the IASB's Disclosure Initiative project[9].

33. However, many other respondents supported the explicit reference to materiality, noting that it provided a useful reminder of the need to consider materiality in order not only to include material items and disclosure but also to help reduce 'clutter' and unnecessary levels of detail.

Staff analysis

34. We agree with those respondents who think that more emphasis should be placed generally on the assessment of materiality when an entity considers what disclosures are necessary in financial statements.

35. However, we are not convinced that including materiality in the list of factors in this specific project is the best way to achieve this greater awareness. Instead, we are persuaded by the respondents that argue that the explicit reference to materiality is superfluous and could create confusion if it is not referred to in each individual Standard or Interpretation.

36. The staff have provided a detailed summary of the comments related to materiality to the project staff working on the Disclosure Initiative.

[9] Further details can be found on the project page at http://www.ifrs.org/Current-Projects/IASB-Projects/Disclosure-Initiative/Pages/Disclosure-Initiative.aspx

Staff recommendation

37. We recommend that the IASB should delete the materiality factor in paragraph 24(a) of the interim ED but retain the remaining factors.

Question for the IASB

Question 3: Factors to consider for disclosure, including materiality
Does the IASB agree that the specific reference to materiality as a factor to consider in deciding the level of detail to provide to satisfy the disclosure requirements should be deleted?