IFRS

STAFF PAPER

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IASB® meeting

Project	**Rate-regulated Activities**
Paper topic	Feedback summary—Effective date and transition

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Objective

1. This paper analyses the feedback from comment letters and outreach events on:

    (a) the proposed transition requirements set out in Appendix C to the Exposure Draft *Regulatory Assets and Regulatory Liabilities* (Question 10 of the Invitation to Comment); and

    (b) the proposed amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards* set out in Appendix D to the Exposure Draft (Question 11(b) of the Invitation to Comment).[1]

Key messages

2. Most respondents did not support the proposed requirement to apply the Standard retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Respondents were particularly concerned about the cost and complexity of full retrospective application for some regulatory assets and regulatory liabilities. Some respondents suggested the Board permit a modified retrospective application that does not involve restatement of comparative information.

[1] At its October 2021 meeting, the Board discussed the feedback on the proposed amendments to IFRS Standards other than IAS 1 *Presentation of Financial Statements* and IFRS 1.

3. Many respondents who commented agreed with the proposals relating to the simpler approach for past business combinations. A few respondents suggested recognising the net amount of adjustments in equity, instead of adjusting goodwill.

4. Most respondents who commented asked for a longer transition period, such as a transition period of at least 24–36 months after the date of publication, with earlier application permitted.

Structure of the paper

5. The feedback summary is structured as follows:

   (a) Question 10(a)—Transition (paragraphs 7–23);

   (b) Question 10(b)—Effective date (paragraphs 24–27); and

   (c) Question 11(b)—Proposed amendments to IFRS 1 (paragraphs 28–35).

6. This paper uses the following terms as defined in paragraph C2 of the Exposure Draft and paragraph BC218(b) of the Basis for Conclusions on the Exposure Draft:

   (a) the *date of initial application* is the beginning of the annual reporting period in which an entity first applies the Standard;

   (b) the *date of transition* is the beginning of the earliest annual reporting period presented in the financial statements for the annual reporting period that includes the date of initial application;

   (c) a *past business combination* is a business combination for which the acquisition date is before the date of transition; and

   (d) *regulatory balances* refer to the effects of rate regulation that an entity recognises as assets or liabilities.

Question 10(a)—Transition

Proposed requirements

7. Paragraph C3 of the Exposure Draft proposes that an entity should apply the Standard retrospectively in accordance with IAS 8 (full retrospective application), except as permitted in paragraph C4.

8. Paragraph C4 of the Exposure Draft proposes that an entity may elect not to apply the Standard retrospectively to a past business combination, and if it makes this election, it should at the date of transition:

   (a) apply the election to all of its past business combinations.

   (b) apply the requirements in subparagraphs (c)–(g) separately to each past business combination.

   (c) recognise and measure, applying the Standard, all regulatory assets acquired, and all regulatory liabilities assumed, in a past business combination, which still exist at the date of transition.

   (d) derecognise all items (such as some regulatory balances) that were recognised as assets or liabilities in that past business combination but would not have been recognised if the Standard had always been applied.

   (e) recognise any deferred tax effects of the adjustments described in subparagraphs (c)–(d).

   (f) adjust the carrying amount of non-controlling interests from that past business combination remaining at the date of transition for their proportionate share of the net amount of the adjustments described in subparagraphs (c)–(e), if the entity measured those non-controlling interests at their proportionate share in the recognised amounts of the acquiree's identifiable net assets, rather than at fair value.

   (g) adjust the carrying amount of goodwill still remaining from that past business combination for the net amount of the adjustments described in subparagraphs (c)–(f). If that adjustment reduces the carrying amount of goodwill to nil, the entity shall recognise any remaining amount of adjustment in retained earnings or, if appropriate, another category of equity.

9. Paragraphs BC204–BC213 of the Basis for Conclusions on the Exposure Draft describe the reasoning behind the Board's proposals.

Comment letter and outreach feedback

10. The Board asked stakeholders whether they agree with the proposals.

11. The feedback summary is structured as follows:

    (a) full retrospective application (paragraphs 12–19); and

    (b) past business combinations (paragraphs 20–23).

Full retrospective application

12. Some respondents who commented, including preparers across jurisdictions, agreed with the Board's proposal for the reasons explained in the Basis for Conclusions. Almost all users of financial statements who participated in outreach meetings and who commented agreed with the Board's proposal.

13. In support of the Board's proposal:

    (a) a few respondents, mainly preparers, said that the effects of a prospective application would be difficult to explain. Because some regulatory assets and regulatory liabilities have a long life, the financial effects of not accounting for regulatory assets and regulatory liabilities that exist at the date of transition and accounting for those that arise subsequently may affect financial statements over a long period. Any savings in the cost of transition may be outweighed by the cost of tracking and explaining those financial effects over a long period and the cost for users of financial statements to understand those effects.

    (b) an accounting firm said that the Board's considerations in other recent Standards, such as IFRS 15 *Revenue from Contracts with Customers*, in permitting entities not to restate comparative information may not apply to entities affected by the Exposure Draft. Before applying IFRS 15, entities applied IAS 18 *Revenue*, and therefore, the revenue information was comparable across entities. However, in the case of entities affected by the Exposure Draft, the financial information is currently not comparable across entities because not all entities recognise regulatory balances in the financial statements.

14. However, most respondents across all stakeholder types who commented did not support the full retrospective application. These respondents disagreed with paragraph BC204 of the Basis for Conclusions, which states the Board observed that retrospective application would be unlikely to burden preparers because to a large extent, the proposed model would use inputs that the Board expects preparers already need to gather and process in determining regulated rates. These respondents said that:

    (a) the effort required to collect information at various points in time to make the judgements and estimates without using hindsight would increase the cost and complexity of full retrospective application and, in some cases, would be impracticable.

    (b) an entity may need more granular information than that currently used in setting regulated rates. Regulators use the regulatory capital base as an input in setting the rates. Entities' regulatory capital base is typically not componentised at the level required in IAS 16 *Property, Plant and Equipment*, cannot be readily disaggregated into its component parts, and cannot be reconciled with the carrying amount of property, plant and equipment. Moreover, the recovery period of the regulatory capital base and the useful lives of property, plant and equipment can be very long. Therefore, significant effort is required:

        (i) to recalculate the carrying amount of property, plant and equipment if the carrying amount before transition includes accumulated regulatory returns on assets not yet available for use. This would be the case, for example, of preparers that apply IFRS 14 *Regulatory Deferral Accounts* and have accounted for regulatory balances using US GAAP or a GAAP based on US GAAP.

   (ii) to calculate the carrying amount of a regulatory asset associated with overheads added to the regulatory capital base but not included in the carrying amount of property, plant and equipment.

   (iii) to calculate the carrying amount of a regulatory asset or regulatory liability arising because of the regulatory recovery period being longer or shorter than the useful life of an asset.

(c) an entity typically does not track information about items of income or expense included in profit or loss. Therefore, significant effort is required:

   (i) to calculate the carrying amount of a regulatory liability associated with regulatory returns on assets not yet available for use if the returns charged to customers were included in revenue; and

   (ii) to calculate the carrying amount of a regulatory liability associated with items of property, plant and equipment pre-funded directly or indirectly by customers, especially if an entity included all of the pre-funding in revenue.

15. A few respondents suggested the Board further engage with preparers and users of financial statements to fully understand the costs and benefits of full retrospective application.

16. Some respondents, mainly accounting firms, national standard-setters from Asia-Oceania and Europe, and European preparers, suggested the Board permit an entity to apply the Standard retrospectively from the date of initial application without restating comparative information as was allowed in other recently issued IFRS Standards such as IFRS 15 and IFRS 16 *Leases*.

17. To reduce the cost and complexity of retrospective transition, some respondents across jurisdictions and across stakeholder types (accounting firms, national standard-setters and preparers) suggested the Board allow an entity, for example:

(a) to use hindsight in making the judgements and estimates required by the proposals.

(b) to measure regulatory assets and regulatory liabilities using the regulatory interest rate at a specified date.

(c) to carry over property, plant and equipment at the amount determined applying IFRS 14 and apply the proposals prospectively. This would be aligned to the proposal to retain an existing relief in IFRS 1 (see paragraph 30).

(d) to recognise regulatory liabilities associated with regulatory returns charged to customers on assets not yet available for use only for assets that became available for use on or after a specified date.

(e) to recognise prospectively from a specified date any regulatory liabilities associated with items of property, plant and equipment pre-funded directly or indirectly by customers.

18. Some respondents, mainly national standard-setters from Asia-Oceania, and preparers from Asia-Oceania, Europe and North America, suggested the Board require prospective application of the Standard from the beginning of the price control period (block of years for which rates are set) that includes the date of initial application.

19. A few respondents, mainly preparers from Asia-Oceania and Europe, suggested the Board require prospective application of the Standard from a specified date.

Past business combinations

20. Not many respondents commented on the proposed simpler approach for past business combinations. Many respondents who commented agreed with the proposal. A European standard-setter also said that the proposal to apply the simpler approach to all of an entity's past business combinations would improve comparability of information about regulatory assets and regulatory liabilities that have arisen from the entity's past business combinations.

21. Nevertheless, a few respondents—including accounting firms, and European standard-setters and a regulator—suggested the Board require an entity to recognise the net amount of the adjustments in retained earnings (or another category of equity, if appropriate), instead of adjusting the carrying amount of goodwill. An accounting firm said that adjusting retained earnings would be consistent with the requirements in other IFRS Standards and would avoid unintended consequences. Another accounting firm said there is no evidence that the adjustment arises from facts and circumstances that existed at the acquisition date.

22. A few respondents raised questions and concerns about certain aspects of the proposal:

(a) a European national standard-setter questioned whether the simpler approach is needed. Paragraph 50 of IFRS 3 *Business Combinations* specifies that, after the measurement period ends, an acquirer revises the accounting for a business combination only to correct an error in accordance with IAS 8. However, the proposal implies that IFRS 3 is intended to require that an entity revises the accounting for past business combinations retrospectively in accordance with IAS 8 on initial application of any new requirements in IFRS Standards. The respondent was concerned about the widespread implications for the existing practice. The respondent, along with another European standard-setter, asked the Board to clarify how the proposal would interact with paragraph 50 of IFRS 3.

(b) a preparer representative body and a standard-setter from Europe suggested the Board clarify the description 'all regulatory assets acquired, and all regulatory liabilities assumed, in a past business combination, which still exist at the date of transition'. It is unclear whether the description refers to regulatory assets acquired and regulatory liabilities assumed that have not been derecognised at the date of transition, or to the enforceable rights and obligations in the regulatory agreement that enable the recognition of regulatory assets and regulatory liabilities at a point in time.

(c) a preparer in Asia-Oceania said that past business combinations may form part of an operation subject to a regulatory agreement. The entity would apply the proposed simpler approach to past business combinations, and the full retrospective transition to the remaining part of the operation. Such an accounting would result in misleading information about the effects of the regulatory agreement on the operation as a whole.

23. An accounting firm suggested simplifying the measurement of regulatory assets acquired, and all regulatory liabilities assumed, in a past business combination based on the remaining cash flows at the date of transition. The respondent further suggested requiring the adjusted goodwill to be tested for impairment at the date of transition, regardless of whether there is any indication that the goodwill may be impaired.

Question 10(b)—Effective date

Proposed requirements

24. Paragraph C1 of the Exposure Draft proposes that an entity applies the Standard for annual reporting periods beginning on or after a date 18–24 months from the date of its publication. Earlier application is permitted. Paragraph BC203 of the Basis for Conclusions on the Exposure Draft explain the reasoning behind the Board's proposal.

Comment letter and outreach feedback

25. The Board asked stakeholders whether they:
    (a) agree with the proposal; and
    (b) have any comments that they wish the Board to consider when it sets the effective date.

26. Some respondents commented on the proposed effective date. A few respondents including a few preparers from Europe and North America agreed with the proposed effective date.

27. Most respondents who commented asked for a longer transition period. For example:
    (a) most of those respondents suggested a transition period of at least 24–36 months after the date of publication, with earlier application permitted. Most preparers from North America said that they expect to apply IFRS 1 and the Standard at the same time, which will involve additional complexity and effort. Moreover, entities may need to have discussions with the regulator to realign requirements in the regulatory agreements to the requirements in IFRS 1 and the Standard. A few preparer-representative bodies in North America added that entities may be overwhelmed if the transition period coincides with the rate application period or the performance period, and suggested the Board provide a longer transition period even if an entity is currently recognising regulatory balances.

(b) a few respondents, mainly an accounting firm and preparers, suggested an even longer transition period of 36–60 months to allow the flexibility of applying the Standard together with a regulatory performance period.

Question 11(b)—Proposed amendments to IFRS 1

Proposed requirements

28. Some regulatory agreements treat goodwill as an allowable cost to be added in determining the future regulated rates. In some such cases, first-time adopters applying their previous GAAP treated that goodwill as a regulatory balance (goodwill-related regulatory balance). Because such a goodwill-related regulatory balance does not arise from the supply of goods or services, that balance does not give rise to a regulatory asset when a business combination occurs.

29. IFRS 1 provides a first-time adopter an optional exemption from applying IFRS 3 retrospectively to business combinations that occurred before the date of transition to IFRS Standards. The Board proposes amending IFRS 1 to require a first-time adopter to derecognise goodwill-related regulatory balances in the same way as intangible assets not qualifying for recognition: by increasing the carrying amount of goodwill, rather than by decreasing equity. Because IFRS Standards prohibit amortisation of goodwill, the carrying amount of goodwill would have been higher by that amount if those regulatory balances had not been recognised as assets separately from goodwill as part of the acquisition-date accounting.

30. The Board also proposes amending an optional exemption in IFRS 1 relating to deemed cost for some assets used in operations subject to rate regulation. IFRS 1 permits a first-time adopter to use carrying amounts determined under a previous GAAP as deemed cost of certain assets used in operations subject to rate regulation. The proposed amendment retains the transition relief but aligns terminology with that in the Exposure Draft.

31. Paragraphs BC252–BC259 of the Basis for Conclusions on the Exposure Draft describe the reasoning behind the Board's proposals.

Comment letter and outreach feedback

32. The Board asked stakeholders to comment on the proposed amendments.

33. Only a few respondents commented on the proposed amendments to IFRS 1.

34. An accounting firm suggested the Board provide guidance on the interaction with IFRS 1 that may arise from entities' transition to the Standard. According to the respondent, it is unclear:

    (a) how entities that did not previously recognise regulatory balances applying IFRS 1 should identify differences in timing that arose before the date of transition to IFRS Standards; and

    (b) whether and how the proposed transition requirements would interact with the optional exemptions in IFRS 1 that entities have previously elected to apply on transition to IFRS Standards.

35. Another accounting firm suggested the Board consider whether additional amendments to IFRS 1 may be necessary for entities that become a first-time adopter at the same time that they initially apply the Standard.

Question for the Board
Does the Board have any questions or comments on the feedback discussed in this paper? Specifically: a. Is there any feedback that is unclear? b. Are there any points you think the Board did not consider in developing the Exposure Draft but should consider in the re-deliberations? c. Are there any points you would like staff to research further for the re-deliberations?