

## Regulatory Deferral Accounts

Exposure Draft ED/2013/5, issued by the International Accounting Standards Board (IASB)

Comments from ACCA  
4 September 2013

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ACCA welcomes the opportunity to comment on the above Exposure Draft (ED). Our Global Forum for Corporate Reporting has considered the proposals, and its views are reflected in the following general and specific comments.

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## GENERAL COMMENTS

ACCA concurs to a greater extent with the Alternative View (AV) than the proposals contained in the ED. We share the concerns expressed in the AV about the inconsistency which will result between new and existing adopters of IFRS (this is a concern which also arises from Question 3 below). The AV also draws attention to the divergent practices which would result from the differences between national GAAPs.

We support globally-applicable Standards which are principles-based. Accordingly, we concur with the point made in the AV about a lack of legitimacy for recognising regulatory deferral account balances within existing IFRS and the Conceptual Framework, caused by the various national GAAPs which would be imported, with little change, into an International Standard.

The AV also expressed concerns about the idea of issuing Standards on an interim basis. ACCA has noted that interim Standards, once issued, can remain in existence for much longer than intended (as has happened with IFRS 4 and IFRS 6).

Consequently, ACCA's concerns about this ED are as much about the standard-setting process, as they are about the technical content.

As it is difficult to conclude that the proposals in the ED represent sufficient progress, even on an interim basis, the IASB might consider the following alternative approaches:

- a) A disclosure-only Standard, or
- b) No changes, pending the production by the IASB of an ED of a final Standard. The IASB's work plan currently indicates that before the end of 2013, it will both consider responses to this ED, and also issue a Discussion Paper on rate-regulated activities. It therefore appears that a timescale is being envisaged for

a final Standard which should be acceptable to many preparers and users of financial statements.

Our consideration of the ED, and the consultation questions in it, has led us to consider whether the IASB should instead prioritise the exposure and subsequent issue of a comprehensive final international Standard. This approach could be justified on the following grounds:

- a) The IASB would be able to follow due process in setting accounting practice.
- b) The question would be avoided of whether national GAAP should be permitted, as proposed in the ED, and if so to what extent (for example, only if the recognition criteria of national GAAP accord with those in the IASB's Conceptual Framework).
- c) The process of issuing a final standard should not be lengthy, as rate-regulated activities do not represent a complex accounting area, and have an impact on far fewer entities than other accounting areas.
- d) There would also be an opportunity to provide clarity as to what is encompassed by the definition of rate-regulated activities (Question 2 below), and greater coverage of the accounting for a rate-regulated activity, as well as of its presentation (Question 7 below).
- e) The potential for confusion would be avoided between first-time adopters under the current proposals, and entities which already recognise, under IFRS, regulatory deferral account balances in their financial statements. Whilst the IASB regards recognition under IFRS as being extremely rare (Introduction – "Reasons for publishing the Exposure Draft", Para. (b)), the adoption of this proposed interim Standard may well cause problems for this minority of preparers, and the users of their financial statements.

Having expressed the above overall views, we do also wish to comment on each consultation question in the ED, in order to provide the feedback sought by the IASB.

## SPECIFIC COMMENTS

We now give our comments on the specific questions raised in the ED, as follows:

### Question 1

**The Exposure Draft proposes to restrict the scope to those first-time adopters of IFRS that recognised regulatory deferral account balances in their financial statements in accordance with their previous GAAP.**

**Is the scope restriction appropriate? Why or why not?**

### ACCA response

ACCA acknowledges that, as set out in Para BC15 of the ED, the IASB is attempting to assist the adoption of IFRS in certain jurisdictions. We also note that the IASB does not want entities, which already adopt IFRS, to make changes as a result of this proposed Standard, as they may then have to make further changes once the project on rate-regulated activities is complete (ED, Para BC48).

We considered whether existing adopters of IFRS might nonetheless feel disadvantaged compared to first-time adopters, by being excluded from the scope of the Standard. This would be especially the case where national GAAP, or the nature of the activities undertaken, generally result in the recognition of high levels of assets or liabilities. We also considered the concern that this proposal might create, not reduce, divergence in practice, as set out in the Alternative View (ED, Para AV2).

However, we have also expressed a number of fundamental concerns about the ED, as set out in our General Comments above. As a result, ACCA would not support extending the application of the proposed Standard to existing adopters. Therefore, we agree with the proposed scope restriction, although not for positive reasons.

### Question 2

The Exposure Draft proposes two criteria that must be met for regulatory deferral accounts to be within the scope of the proposed interim Standard. These criteria require that:

- (a) an authorised body (the rate regulator) restricts the price that the entity can charge its customers for the goods or services that the entity provides, and that price binds the customers; and
- (b) the price established by regulation (the rate) is designed to recover the entity's allowable costs of providing the regulated goods or services (see paragraphs 7–8 and BC33–BC34).

**Are the scope criteria for regulatory deferral accounts appropriate? Why or why not?**

#### ACCA response

The IASB regards the above scope as being broader than the 'cost-of-service' model covered by the 2009 ED, whilst maintaining a link between the price charged and the costs incurred by the entity (as opposed to a measure not specific to the entity, such as an industry average – Para 8 of the current ED). The current scope is therefore limited to rates which are based on the costs incurred by the charging entity.

ACCA believes that further guidance is needed on the activities which would constitute rate-regulated activities for the purposes of an International Standard on this subject. The above criteria leave room for uncertainty, as explained below.

#### **A narrow interpretation of the criteria:**

Condition (a) does not appear to include industries in which participants are free to set prices (such as by reference to the international market rate), whilst being subject to specific regulatory scrutiny (and if necessary, control) because few participants are permitted to operate in the industry, or are able to because of high entry costs. An example of this would be the domestic gas and electricity suppliers in certain countries.

Condition (b) appears to exclude prices which are partly set with a wider purpose in mind, such as environmental and to regulate periodic demand. An example of the former is a levy on energy costs, passed on to government in order to fund home insulation schemes. An example of the latter is the peak and off-peak structure agreed for public transport, where peak fares tend to subsidise off-peak fares and further government subsidy is required for private operators to cover costs (the subsidy being variable according to the success of revenue raised, including through the peak / off-peak mix of passengers).

**A broader interpretation (which ACCA would support):**

The above examples are, in effect, scenarios which are mere variations on the criteria set out in Para 7 of the ED. The similarity with those criteria is sufficient for the activities to come within the definition of 'rate-regulated'. It might therefore be more appropriate to term the criteria 'factors', around which there is some latitude. Furthermore, it would then be helpful for the IASB to provide some additional discussion material, to assist preparers in deciding whether their activities are within the scope of the proposed Standard.

**Question 3**

The Exposure Draft proposes that if an entity is eligible to adopt the [draft] interim Standard it is permitted, but not required, to apply it. If an eligible entity chooses to apply it, the entity must apply the requirements to all of the rate-regulated activities and resulting regulatory deferral account balances within the scope. If an eligible entity chooses not to adopt the [draft] interim Standard, it would derecognise any regulatory deferral account balances that would not be permitted to be recognised in accordance with other Standards and the *Conceptual Framework* (see paragraphs 6, BC11 and BC49).

Do you agree that adoption of the [draft] interim Standard should be optional for entities within its scope? If not, why not?

**ACCA response**

ACCA agrees that where an entity chooses to apply the proposed Standard, then it should apply it to all of its rate-regulated activities and regulatory deferral account balances.

We also note the IASB's argument that full compliance with IFRS will increase if entities are allowed to cease to recognise these balances on their transition to IFRS (ED, Para 49). However, the proposal to permit, but not require, adoption of the interim Standard is likely to lead to diversity between entities in practice. We have referred to this point (which is also expressed in the Alternative View) in the General Comments section above.

We also note that there appears to be a lack of symmetry between the proposals described in Questions 3 and 4. On the one hand, an entity already recognising regulatory deferral account balances under national GAAP does not have to continue to do so, on transition to IFRS (Question 3). Conversely, an entity which has not previously recognised the balances cannot choose to do so, on transition to IFRS (Question 4). Whilst the proposals in both Questions encourage full compliance with IFRS, their lack of symmetry is unsatisfactory, and adds to our overall concerns about the issuing of this proposed interim Standard.

#### **Question 4**

**The Exposure Draft proposes to permit an entity within its scope to continue to apply its previous GAAP accounting policies for the recognition, measurement and impairment of regulatory deferral account balances. An entity that has rate-regulated activities but does not, immediately prior to the application of this [draft] interim Standard, recognise regulatory deferral account balances shall not start to do so (see paragraphs 14–15 and BC47–BC48).**

**Do you agree that entities that currently do not recognise regulatory deferral account balances should not be permitted to start to do so? If not, why not?**

#### **ACCA response**

This section of the proposals appears to affect entities in one of four situations, and it is unclear whether this proposal is considered to be equally valid to all:

- A. As described in Para BC17 of the ED, entities may not previously have undertaken rate-regulated activities, but then start to do so during the first year in which they adopt IFRS.

- B. Similarly, a new entity may undertake rate-regulated activities during its first year when it also adopts IFRS, rather than national GAAP.
- C. An entity which continues to undertake rate-regulated activities would not, under its own national GAAP, recognise regulatory deferral account balances in two situations:
- i) Its national GAAP does not permit such recognition. In this case, there would appear to be just one course of action in any case. The entity would have to continue not to recognise the balances on transition to IFRS, as the alternative would be to adopt GAAP from another jurisdiction, which would be an inappropriate step; or
  - ii) Its national GAAP permits, but does not require, such recognition. In this case, an entity would not be able to change, and adopt a policy of recognition on transition to IFRS.

However, ACCA has also expressed a number of fundamental concerns about the ED, as set out in our General Comments above. Consequently, we support the IASB's proposal, as it effectively gives pre-eminence to the current treatment under IFRS. In this way, some of the greater complexity and concerns arising from this ED generally can be avoided.

#### **Question 5**

**The Exposure Draft proposes that, in the absence of any specific exemption or exception contained within the [draft] interim Standard, 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 (see paragraphs 16–17, Appendix B and paragraph BC51).**

**Is the approach to the general application of other Standards to the regulatory deferral account balances appropriate? Why or why not?**

#### **ACCA response**

Paras 16 – 17 of the ED follow the proposals that a first-time adopter of IFRS will continue to adopt its previous GAAP accounting policies for the recognition,



measurement and impairment of regulatory deferral account balances (Paras 14-15). In view of this, we agree with the approach set out in this question, and believe that few entities would question it, for the following reasons:

- For first-time adopters of IFRS, the extent to which they can continue to use national GAAP should be clear.
- For entities which commit to IFRS, IFRS will be adopted over national GAAP to the fullest extent possible.
- The proposal is not intended to be a long-term solution.

#### **Question 6**

**The Exposure Draft proposes that an entity should apply the requirements of all other Standards before applying the requirements of this [draft] interim Standard. In addition, the Exposure Draft 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 (see paragraphs 6, 18–21 and BC55–BC62).**

**Is this separate presentation approach appropriate? Why or why not?**

#### **ACCA response**

With respect to the application of all other IFRS before this proposed Standard, please see our response to Question 5 above, which agrees with this principle.

We also agree that the separate presentation approach is appropriate under the proposed interim Standard. Entities involved in rate-regulated activities, and which adopt the provisions of the proposed Standard, will recognise incremental assets and / or liabilities compared to other entities. Furthermore, the way in which rate-regulated activities will be accounted for will vary according to the national GAAP adopted (notwithstanding that US GAAP is likely to be the most widely

applied). For these reasons, the effect of rate-regulated activities on the financial statements needs to be made clear to users.

Looking ahead, ACCA does not regard this proposal as a long-term solution. We refer to the General Comments section above, in which we give our views about the advantages of having in place a final international Standard, as soon as is practicable.

### **Question 7**

**The Exposure Draft 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 (see paragraphs 22–33 and BC65).**

**Do the proposed disclosure requirements provide decision-useful information? Why or why not? Please identify any disclosure requirements that you think should be removed from, or added to, the [draft] interim Standard.**

### **ACCA response**

ACCA supports the ED's aim of disclosures which make the effect of rate-regulated activities clearly distinguishable from the rest of the financial statements.

Para 26 of the ED permits the explanations required by Para 25 (Explanation of activities subject to rate regulation) to be included either in the financial statements or certain other information provided with the financial statements. As the disclosure requirements concern items included within the statements of financial position and profit or loss and which are subject to the application of judgement by preparers, ACCA prefers that they are included within the notes to the financial statements. This would also be consistent with the disclosure requirements in the following section (Explanation of recognised amounts).

Taken as a whole, the proposed disclosure requirements appear to go beyond the accounting requirements which form the basis of the ED. We appreciate that an interim Standard is being proposed, but as set out in the General Comments

section above, we would hope that a final international Standard would evidence a greater match between the accounting and presentation requirements.

Please also see our comments in response to Question 8 below, particularly with regard to the references made to materiality in the ED.

#### **Question 8**

**The Exposure Draft explicitly refers to materiality and other factors that an entity should consider when deciding how to meet the proposed disclosure requirements (see paragraphs 22–24 and BC63–BC64).**

**Is this approach appropriate? Why or why not?**

#### **ACCA response**

ACCA welcomes the inclusion of a statement of factors to be considered in determining the disclosures to be made in the financial statements. We agree that there is a role for the use of judgement by preparers, particularly where the IFRS financial statements will include elements of another framework (national GAAP). The statement of factors also assists in reducing possible diversity between preparers in practice.

Para BC64 of the ED explains why materiality considerations are specifically included in Paras 24(a), 25 and 28. However, we believe that the provisions on materiality already in IFRS, and of which an understanding will be crucial for first-time adopters of IFRS, are sufficient for the purposes of this proposed Standard. In particular, IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a definition of materiality in Para 5, and Para 8 of IAS 8 gives some guidance on how to apply materiality. The additional inclusion of a concept of materiality in this ED may raise questions as to whether the concept differs from that applied in IFRS generally.

**Question 9**

The Exposure Draft does not propose any specific transition requirements because it will initially be applied at the same time as IFRS 1, which sets out the transition requirements and relief available.

**Is the transition approach appropriate? Why or why not?**

**ACCA response**

We agree that as a matter of principle, an entity which applies IFRS for the first time should look to IFRS 1 for the transition requirements. Furthermore, we see the detailed requirements of IFRS 1 (such as the presentation of comparatives) as being suitable for an entity which would adopt this proposed Standard.

The proposal in Question 9 is also in accordance with the principle (discussed in Question 6) that an entity should look first to the requirements of other Standards when applying this proposed Standard.

In view of the scope of the proposed Standard, there are no transition provisions for existing adopters of IFRS. We will look to comment on transition provisions for existing adopters when the IASB covers these in future.

**Question 10**

**Do you have any other comments on the proposals in the Exposure Draft?**

**ACCA response**

Please see the 'General Comments' section above.