

International Accounting Standards Board  
30 Cannon Street  
London  
EC4M 6XH

4 September 2013

*Submitted electronically through the IASB website ([www.ifrs.org](http://www.ifrs.org))*

Dear IASB members

**Invitation to comment - Exposure Draft ED/2013/5 - *Regulatory Deferral Accounts***

Ernst & Young Global Limited, the central coordinating entity of the global EY organisation, welcomes the opportunity to offer its views on the *Regulatory Deferral Accounts* Exposure Draft (ED or interim standard).

**Comprehensive rate-regulated activities project**

We continue to support the Board's initiatives to consider the accounting for rate-regulated activities under IFRS. The Board's comprehensive project on rate-regulated activities, along with possible enhancements to the definitions of assets and liabilities under the *Conceptual Framework for Financial Reporting (Conceptual Framework)*, may culminate in a final accounting standard for rate-regulated activities. We are looking forward to the Board's issuance of a Discussion Paper which is expected to address the features of rate regulation that may create rights and obligations and whether these features satisfy the definitions of assets and liabilities under the *Conceptual Framework*.

**Needed clarifications of the IASB's proposal**

We understand the Board's objective for interim relief in the period preceding the completion of the comprehensive project on rate regulated activities but would caution the Board not to have this delay the completion of the comprehensive project. We believe there are certain areas where the proposed interim standard will require interpretation and may result in diversity in its application. In the Appendix to this letter, we have responded to the specific questions raised by the Board and provided suggestions for clarifications and enhancements to be considered as the interim standard is finalised.

Should you wish to discuss the contents of this letter with us, please contact Leo van der Tas at +31 88 407 5035 or Dennis Deutmeyer at +44 207 951 2947.

Yours faithfully

*Ernst & Young Global Limited*

## Appendix A - Responses to the specific questions in the invitation to comment

### Scope

**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?

We believe the scope restriction is appropriate and consistent with the ED's objectives:

- ▶ The scope restriction is required in order for the interim standard to be consistent with one of its objectives: "that rate-regulated entities avoid major changes in accounting for regulatory deferral balances on transition to IFRS until comprehensive guidance is developed"; and
- ▶ In the *Introduction* section of the ED, the Board acknowledged that it has not seen any evidence of significant diversity in practice within jurisdictions that are applying IFRS and that almost no entities recognise regulatory deferral account balances in IFRS financial statements. As such, allowing ongoing preparers of IFRS financial statements to adopt the interim standard would be inconsistent with the ED's objectives and would introduce diversity in current practice.

**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?

We believe the Board should review the proposed interim standard's scope criteria to ensure it: (a) accomplishes the goal of allowing rate-regulated entities that follow US GAAP to continue recognising regulatory deferral accounts upon their adoption of IFRS and (b) adequately reflects the rate-setting mechanisms of today's regulatory schemes such that it will be treated by the applicable entities in a consistent manner.

Paragraph BC16 of the ED indicates that during its outreach, the IASB was told that in many jurisdictions the accounting policies developed for regulatory deferral accounts are based on US GAAP or local GAAP that provides similar guidance. Although the scope criteria included in the ED are similar to the scope criteria included in US GAAP Accounting Standards Codification (ASC) 980-10-15-2, they are not exactly the same. Differences in the scope criteria may result in an unintended consequence of an entity that currently recognises regulatory deferral accounts not meeting the scope criteria of the ED and thus not being allowed to continue recognising these accounts upon adoption of IFRS. We suggest the Board modify the scope criteria to more closely match the scope criteria in US GAAP ASC 980 or include a statement in the standard or basis of conclusion which indicates the scope of the interim standard is intended to be consistent with the scope of US GAAP ASC 980.

Regarding the specific scope criteria for regulatory deferral accounts included in the ED:

- ▶ We agree with the first criterion that an authorised body restricts the price that the entity can charge its customers and that price binds the customers.
- ▶ With respect to the second scope criterion, we do agree that the interim standard should be limited to regulation that is designed to recover the entity's allowable costs of providing the regulated goods or services. However, we have concerns that the diverse nature of regulatory mechanisms in different jurisdictions and the significant amount of judgement involved in determining whether a regulatory regime is considered to be designed to recover allowable costs may lead to diversity in practice. Particularly, hybrid and incentive based regulation (such as price-cap regulation) share many similar characteristics with basic cost-of-service regulation and can often have the same economic effect. As such, in addition to the suggested enhancement to the scope criterion related to US GAAP ASC 980 described above, we believe the final standard's application guidance on the second scope criteria needs to be enhanced to ensure the intended regulatory regimes are included in the scope and that it is applied consistently across jurisdictions.

**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?

We agree with the Board's proposal that adoption of the interim standard should be optional for entities within its scope.

**Recognition, measurement and impairment****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?

We agree that entities that currently do not recognise regulatory deferral account balances should not be permitted to start to do so. However, while we understand that allowing entities that currently do not recognise regulatory deferral account balances to start to do so would be inconsistent with the primary objective of the ED, we believe that it is important for the IASB to be aware that this view may not be shared in jurisdictions where companies derecognised such balances when they adopted IFRS.

**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?

We agree with the Board's proposed approach to the general application of other standards to the regulatory deferral account balances. However, we suggest the Board provide additional application guidance to clarify the treatment of the following matters as they relate to regulatory deferral account balances:

- ▶ IAS 12 *Income Taxes* - It is not clear in the ED how an entity should determine deferred income taxes related to a regulatory deferral account. For example, additional guidance is needed in connection with the calculation or allocation of deferred income taxes for a regulatory deferral account related to accumulated depreciation.
- ▶ IFRS 3 *Business Combinations* - The final standard should clarify how regulatory deferral accounts are to be treated and how the related goodwill should be determined when IFRS 3 is applied to a transaction involving an entity that has adopted the interim standard. Most importantly, the Board should clarify whether regulatory deferral accounts are intended to meet the requirements of paragraph 10 of IFRS 3: "To qualify for recognition as part of applying the acquisition method, the identifiable assets acquired and liabilities assumed must meet the definitions of assets and liabilities in the *Conceptual Framework for Financial Reporting* at the acquisition date." This clarification will be necessary for any business combination that includes an entity that has adopted the interim standard.
- ▶ IAS 36 *Impairment of Assets* - Paragraphs B9 and B10 of the ED provide some guidance on the application of IAS 36 to regulatory deferral accounts. However, it is not clear how these paragraphs are to be applied and therefore the final standard should provide further application guidance on the recognition and measurement of an impairment loss. Specifically, clarification is needed on the determination of the recoverable amount of a regulatory deferral account in connection with the requirements of paragraphs 105 and 106 of IAS 36 which limit the recognition of an impairment loss to the individual assets' recoverable amount. In addition, the final standard should address the accounting for an impairment loss determined in accordance with IAS 36 when the rate regulator does not allow the recognition of that loss on the regulatory books. The Board should consider including examples in the final standard which clarify the accounting for impairment losses by entities that adopt the interim standard.

- ▶ *IFRIC 12 Service Concession Arrangements* - Many governments have utilised contractual service concession arrangements for the development, maintenance and operation of various infrastructure initiatives. When adopting IFRS, an entity would apply the requirements of IFRIC 12 prior to application of the proposed interim standard. However, given the similarities that exist between some service concession arrangements and rate-regulated schemes (e.g. the use of variance accounts) and the potential overlap in the scope of IFRIC 12 and the scope of the ED, implementation issues are likely to arise when a service concession arrangement exists. The Board should consider providing application guidance on the interaction between IFRIC 12 and the proposed interim standard.
- ▶ In some situations (e.g. pensions and other post-employment benefits), regulatory deferral accounts are recognised in connection with activity that is recorded in other comprehensive income. As paragraph 21 of the ED requires the net movement in all regulatory deferral accounts to be presented in profit or loss, certain costs may be recognised in profit or loss in a period that is inconsistent with the recovery of the cost under the entity's regulatory regime. The Board should clarify whether this accounting is consistent with its intentions for entities that apply the proposed interim standard. Alternatively, the Board should consider modifying paragraph 21 or adding application guidance to require the matching of the movement in the regulatory deferral accounts with the related activity recorded in profit or loss or other comprehensive income in accordance with other IFRS.

## Presentation

### 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?

The Board's proposal to present the regulatory deferral account balances and movements in those balances separately from the assets, liabilities, income and expense that are recognised in accordance with other standards is an important component of accomplishing the ED's objectives. As such, we agree with the Board's separate presentation approach. However, as described in our response to Question 5 above, applying these requirements to certain situations will require judgement and may result in diversity in the application of the interim standard.

To be consistent with the presentation of regulatory deferral accounts on the statements of financial position and profit or loss, we suggest the Board consider separate presentation of the cumulative effect of recognising regulatory deferral accounts upon adoption of IFRS, along with an annual roll-forward of the net movement in the regulatory deferral accounts, in the statement of changes in equity. This would enhance comparability of an entity's shareholders' equity with other entities that have adopted IFRS.

## Disclosure

### 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.

We believe the proposed disclosures provide decision-useful information as they will give users the information necessary to understand the nature of the entity's regulatory scheme and its impact to the financial statements while giving preparers the flexibility to include only relevant and material disclosures.

### 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?

We support the Board's approach to allowing an entity to consider materiality and other factors when deciding how to meet the proposed disclosure requirements. Although it would not be inappropriate to include a reference to materiality, we believe it is unnecessary given the consideration of materiality as it relates to disclosures that already exists in paragraph 31 of IAS 1 *Presentation of Financial Statements*.

## Transition

### 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?

We agree that an entity that adopts the interim standard should apply the transition requirements described in IFRS 1. This will create consistency with other entities that have previously adopted IFRS.

### Other Comments

### Question 10

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

We have the following additional comments on the proposals in the ED:

- ▶ The Board should clarify the inconsistency between the presentation requirements described in paragraph 21 and the statement of profit or loss and other comprehensive income shown in Example 3 on page 57 of the ED.

Specifically, paragraph 21 indicates “...This separate line item shall be distinguished from the income and expenses that are presented in accordance with other Standards by the use of a sub-total for the amount of profit or loss before the net movement in regulatory deferral account balances.” To be consistent with these requirements, the statement of profit and loss included in Example 3 should include a sub-total between the “Income tax expense” and “Net movement in regulatory deferral accounts” line items.

- ▶ The illustrative examples included in the ED are helpful in applying the related guidance. However, the examples are rather straightforward and address only the basic concepts of the proposed interim standard. We suggest the Board expand the examples in the final standard to address some of the more complex issues that will arise in practice. For instance, we suggest the Board include an example of an entity’s initial adoption of the interim standard, including the treatment of items that will become regulatory deferral accounts and items that reflect differences between an entity’s previous GAAP and IFRS but are not addressed in the rate-regulated books and thus will be included in a cumulative adjustment to shareholders’ equity. Illustrative examples could also be considered for the issues included in our response to Question 5 above.



- ▶ The Board should clarify the potential inconsistencies which may arise through interpretations of paragraphs 6, 18 and 14 of the proposed interim standard. Paragraphs 6 and 18 of the ED propose an incremental approach to the presentation of regulatory deferral account balances based on the difference between the assets and liabilities recognised in accordance with other IFRS standards and regulatory assets and liabilities. Paragraph 14 of the ED requires continuation of existing accounting policies for recognition, measurement and impairment of regulatory deferral account balances. The inconsistency of the proposed guidance may arise because the regulatory deferral account balances recognised under existing accounting policies may have been determined under a method which is different from the incremental approach proposed in paragraphs 6 and 18.