April 2013

Exposure Draft

Snapshot: Regulatory Deferral Accounts

This snapshot introduces the Exposure Draft *Regulatory Deferral Accounts*, which has been published for public comment by the International Accounting Standards Board (IASB). It provides an overview of the main proposals that were developed by the IASB.

Project objectives:	The long-term objective of the Rate-regulated Activities project is to develop a Discussion Paper to consider whether rate regulation creates assets or liabilities in addition to those already recognised in accordance with IFRS for non-rate-regulated activities. If so, the project will also consider how such assets and liabilities should be accounted for and whether (and how) IFRS should be amended. The objective of the proposals in the Exposure Draft *Regulatory Deferral Accounts* is to enhance the comparability of financial reporting by reducing barriers to the adoption of IFRS by entities with rate-regulated activities until guidance is developed through the comprehensive Rate-regulated Activities project. If the proposals are accepted, the IASB will issue an interim Standard.
Project stage:	The IASB published, in March 2013, the Request for Information *Rate Regulation*. The responses to that consultation will be used as part of the research for the development of the Discussion Paper. This research phase is being carried out alongside the development of the proposed interim Standard.
Comment deadline:	The Exposure Draft is open for public comment until **4 September 2013**.
Next steps:	The IASB aims to issue the Discussion Paper in the fourth quarter of 2013. Comment letters received during the consultation process for each phase of the project will be published on the IASB's website. The IASB will discuss the feedback received and will redeliberate on the proposals for the interim Standard in public IASB meetings in the fourth quarter of 2013.

IFRS

Why is the IASB undertaking the project?

Rate regulation is a restriction on the setting of prices that can be charged to customers for services or products. In many jurisdictions, the charges that particular entities can demand from their customers are set by regulatory bodies or governments. Typically, such an entity (a 'rate-regulated entity') has a monopoly or a dominant market position that gives it excessive market power.

In 2009, the IASB published for public comment an Exposure Draft *Rate-regulated Activities*, which focused on a particular type of rate-regulatory scheme (a 'cost-of-service' scheme). After reviewing the responses to that Exposure Draft, the IASB decided that it could not resolve, in a timely manner, the complex, fundamental issues involved and suspended the project.

As a result of the views received from its three-yearly agenda consultation, the IASB, in September 2012, started a revised, comprehensive Rate-regulated Activities project. The aim of this comprehensive project is to develop a Discussion Paper that will identify and more clearly articulate:

(a) the common features of rate regulation;

(b) whether these common features create economic resources for, or claims against, a rate-regulated entity that should be recognised in IFRS financial statements; and

(c) the information about the consequences of rate regulation that would be most useful for users of IFRS financial statements.

Why is the IASB proposing an interim Standard?

The requirements of some national accounting standard-setting bodies permit or require entities that are subject to certain types of rate regulation to capitalise and defer expenditures (or income) that would otherwise be recognised as expenses (or income) in the statement of profit or loss and other comprehensive income by non-rate-regulated entities. These amounts are often referred to as 'regulatory deferral' (or 'variance') accounts.

There is currently no Standard in IFRS that specifically addresses the accounting for rate-regulated activities. The increased use of IFRS has increased the pressure on the IASB to address whether regulatory deferral account balances should be recognised in IFRS financial statements. The pressure has come mainly (but not exclusively) from jurisdictions that have not yet adopted IFRS and that currently recognise such regulatory items in accordance with their current GAAP.
The complex issues that are being addressed in the comprehensive Rate-regulated Activities project will take time to resolve.

In addition, the *Conceptual Framework* is currently being reviewed and updated, which will influence the outcome of the Rate-regulated Activities project.

The IASB recognises that discontinuing the recognition of regulatory deferral account balances before the completion of the comprehensive Rate-regulated Activities project could be a significant barrier to the adoption of IFRS for those entities for which regulatory deferral account balances represent a significant proportion of net assets. The IASB is, therefore, proposing to allow those entities that currently recognise regulatory deferral account balances in accordance with their current GAAP to continue to do so when making the transition to IFRS.

Why are the proposals restricted to first-time adopters of IFRS?

By publishing this Exposure Draft, the IASB is in no way anticipating the outcome of the comprehensive Rate-regulated Activities project. Although the IASB has developed these proposals with the aim of enhancing the comparability of financial reporting by reducing barriers to the adoption of IFRS by entities with rate-regulated activities, the IASB wishes to limit the impact of the proposals until the more fundamental issues about accounting for rate-regulated activities is completed through the comprehensive project.

One of the fundamental issues to address is whether regulatory deferral account balances meet the definitions of assets and liabilities in the *Conceptual Framework*. Consequently, the term ‘regulatory deferral account balances’ has been chosen as a neutral descriptor for these items instead of describing them as ‘regulatory assets’ or ‘regulatory liabilities’.

What types of rate-regulation are in the scope of the proposed interim Standard?

A number of rate-regulatory methodologies exist and their application can vary by rate regulator, the entity being regulated and the particular circumstances. The previous Exposure Draft focused on a specifically defined rate-regulatory scheme (a 'cost-of-service' scheme). The current proposals do not have such a narrow focus. They do, however, still intend to restrict the types of schemes captured by the proposals to those that have an identifiable causal effect between the costs (and income) that are expected to be recognised in the financial statements of the rate-regulated entity and the basis of the rate calculation.

Consequently, the proposals address only those rate-regulated activities that meet the following two criteria:

(a) an authorised body is empowered to establish rates that bind customers; and

(b) the price established by the regulation (the 'regulated rate') is designed to recover the costs that are specific to the entity and for which the regulated rate is intended to provide recovery.

What is the IASB proposing?

The Exposure Draft proposes to:

(a) permit an entity that adopts IFRS to continue to use its previous GAAP accounting policies, as accepted in their local jurisdiction, for the recognition, measurement and impairment of regulatory deferral account balances;

(b) require the entity to present regulatory deferral account balances as separate line items in the statement of financial position and to present movements in those account balances as a separate line item in the statement of profit or loss and other comprehensive income; and

(c) require specific disclosures to identify clearly the nature of, and risks associated with, the rate regulation that has resulted in the recognition of regulatory deferral account balances in accordance with the proposals.

Some IASB members think that the separate presentation is essential until the consideration of the more fundamental issues about accounting for rate-regulated activities is completed through the comprehensive project.

Transition

The IASB does not propose any explicit relief from full retrospective application of the proposed interim Standard because existing recognition and measurement policies will continue. First-time adopters of IFRS can use the deemed cost exemption for property, plant and equipment and intangible assets that is already available in IFRS 1 *First-time Adoption of International Financial Reporting Standards* that allows adopters to use their previous GAAP carrying amounts at the date of transition to IFRS.

Consequently, first-time adopters will only need to change their presentation policies for property, plant and equipment and intangible assets to isolate the regulatory deferral account amounts on a prospective basis from the date of transition to IFRS. This will result in these items being presented on the same basis as those of entities that are not eligible for, or choose not to apply, this proposed interim relief.

How can I comment on the Exposure Draft?

The Exposure Draft includes questions related to the IASB's proposals. Please send us your comments on any or all of those questions on or before 4 September 2013.

To view the Exposure Draft and to submit your comments, visit the 'Open for Comment' section on www.ifrs.org

Important information

This Snapshot has been compiled by the staff of the IFRS Foundation for the convenience of interested parties. The views expressed within this document are those of the staff who prepared the document. They do not purport to represent the views of the IASB and should not be considered as authoritative. Comments made in relation to the application of IFRS do not purport to be acceptable or unacceptable application of IFRS.

International Accounting Standards Board (IASB)

30 Cannon Street | London EC4M 6XH | United Kingdom
Telephone: +44 (0)20 7246 6410 | Fax: +44 (0)20 7246 6411
Email: info@ifrs.org | Web: www.ifrs.org

For further information about the IFRS Foundation, IASB, copies of International Financial Reporting Standards, International Accounting Standards, exposure drafts and other publications, including details of IASB subscription services, please contact our Publications Department on telephone: +44 (0)20 7332 2730 or email: publications@ifrs.org

Printed on 100 per cent recycled paper