Australian Government
Australian Accounting Standards Board

Memorandum

To:	**AASB Members**	**Date:**	26 May 2014
From:	**Kala Kandiah**	**Agenda Item:**	5.2 (M138)
Subject:	**Sweep issues arising on AASB 14 *Regulatory Deferral Accounts* ballot draft**	**File:**	

Action

Consider sweep issues raised by AASB members on AASB 14 *Regulatory Deferral Accounts* (ballot draft) with a view to finalising the Standard for issuance in Australia.

Background and main requirements of AASB 14

1 The International Accounting Standards Board (IASB) issued ED/2013/5 *Regulatory Deferral Accounts* in June 2013, proposing to permit first-time adopters of International Financial Reporting Standards (IFRSs) to continue to account for regulatory deferral account balances in their financial statements in accordance with their previous GAAP. However, to enhance comparability with entities that already apply IFRSs and do not recognise such amounts, ED/2013/5 proposed that the effect of rate regulation must be presented separately from other items.

2 The AASB discussed the ED in July 2013 and decided to raise the following key concerns in its comment letter to the IASB[1]:

(a) the proposals could result in the IASB inappropriately setting a precedent of introducing additional interim standards for first-time adopters of IFRS to encourage transition to IFRS; and

(b) the proposals would reduce comparability between first-time adopters of IFRS that choose to apply the proposals and those that already apply IFRS or first-time adopters of IFRS that do not elect to apply the proposals.

3 In January 2014, the IASB issued IFRS 14 *Regulatory Deferral Accounts* (incorporating the proposals in ED/2013/5 without substantive changes), for annual reporting periods beginning on or after 1 January 2016, with early application permitted.

4 A ballot draft of AASB 14 *Regulatory Deferral Accounts* (incorporating IFRS 14) was sent to AASB members in May 2014 for voting in light of AASB's policy of incorporating IFRSs into Australian Accounting Standards. Some AASB members have raised sweep

[1] http://www.aasb.gov.au/admin/file/content106/c2/AASB_submission_IASB_ED-2013-5_Regulatory_Deferral_Accounts_FINAL.pdf

issues in relation to the ballot draft. These issues and staff views on each issue are outlined below.

Issues raised by AASB members on AASB 14

Issue 1: What is the impact of AASB 14 on a newly listed entity from a foreign jurisdiction or a newly acquired foreign subsidiary?

5 AASB 14 (ballot draft) would permit an entity to apply the requirements of the Standard in its first Australian-Accounting-Standards financial statements if and only if it:

(a) conducts rate-regulated activities; and

(b) recognised amounts that qualify as regulatory deferral account balances in its financial statements in accordance with its 'previous GAAP' .

6 AASB 14 (ballot draft) defines 'previous GAAP' as "the basis of accounting that a **first-time adopter** used immediately before adopting Australian Accounting Standards."

7 'First-time adopter' is defined in AASB 14 (ballot draft) as "an entity that presents its first Australian-Accounting-Standards financial statements".

8 The above definitions are also in AASB 1 *First-time Adoption of Australian Accounting Standards.*

9 Staff note that examples of 'previous GAAP' could be (i) foreign GAAP; and (ii) the basis of accounting adopted in domestic special purpose financial statements that do not apply the recognition and measurement requirements of Australian Accounting Standards (SPFSs without R&M).

AASB Staff views on Issue 1

10 A newly listed entity from a foreign jurisdiction that conducts rate-regulated activities and applied foreign GAAP in its most recent previous reporting period prior to adopting Australian Accounting Standards would be, in staff's view (consistent with paragraph 9 above), a first-time adopter that is able to apply AASB 14.

11 Staff acknowledge that the above is a consequence of adopting IFRSs that are set by the IASB without considering borders and jurisdictions[2]. However this is not an Australian specific issue as it would also apply to other jurisdictions in a cross-border listing. Staff also note that accounting options involving the 'grandfathering' of previous GAAP accounting (such as in the case of extractive industries, which is more prevalent in Australia) are currently available in Australian Accounting Standards via AASB 1 (refer to paragraph 23 below).

12 Furthermore, staff note that, also consistent with paragraph 9 above, an Australian entity that currently prepares SPFSs without R&M would also be able to apply AASB 14 when it adopts Australian Accounting Standards for the first time.

[2] We note that some might be concerned that Australian citizens should not be expected to be aware of foreign GAAP and therefore we note the view that foreign GAAP should not be regarded as 'previous GAAP' in an Australian context.

13 In addition, irrespective of the above, staff expect that the practical impact of a newly listed rate regulated entity from a foreign jurisdiction continuing to recognise regulatory deferral account balances under Australian Accounting Standards would be practically nil.

14 A newly acquired foreign subsidiary that conducts rate regulated activities and has regulatory deferral account balances may be able to continue to recognise regulatory deferral account balances in its individual financial statements, prepared under Tier 1 Australian Accounting Standards or Tier 2 Australian Accounting Standards – Reduced Disclosure Requirements as a first-time adopter. However, as the group would not be a first-time adopter, the regulatory deferral account balances would be required to be derecognised when the foreign subsidiary is consolidated into its Australian parent entity's consolidated financial statements, prepared under Tier 1 Australian Accounting Standards or Tier 2 Australian Accounting Standards – Reduced Disclosure Requirements.

<u>Issue 2: What is the impact of AASB 14 on a foreign entity that 'back door' lists in Australia?</u>

15 A 'back door' listing occurs, for example, when a foreign operating entity wants to become an Australian listed entity but does not want to register its equity shares. To achieve a back door listing, the foreign entity enters into an arrangement whereby a Australian entity acquires its equity interests in exchange for the equity interests of the Australian entity. These transactions are accounted for as reverse acquisitions for accounting purposes, where the legal subsidiary (i.e. the foreign entity) is the accounting acquirer/parent and the legal parent (i.e. the Australian entity) is the accounting acquiree/subsidiary.

16 Consolidated financial statements prepared following a reverse acquisition are issued under the name of the legal parent (accounting acquiree i.e. the Australian entity) but described in the notes as a continuation of the financial statements of the legal subsidiary (accounting acquirer i.e. the foreign entity).

AASB Staff views on Issue 2

17 A foreign entity that conducts rate regulated activities and recognises regulatory deferral account balances that obtains a back door listing in Australia, would prepare consolidated financial statements under Australian Accounting Standards. Consistent with staff views in paragraph 10 above, staff consider that such an entity could continue to recognise regulatory deferral account balances as a first-time adopter that chooses to apply AASB 14. However, staff understand that listings of such entities in Australia are not common.

<u>Issue 3: To include in the material accompanying AASB 14 some wording about its expected impact in practice</u>

18 One Board member has suggested that the material accompanying AASB 14 (Preface or Basis for Conclusions) should state that AASB 14 is not expected to have any, or only an insignificant impact in Australia.

AASB Staff views on Issue 3

19 Staff believe that, in similar circumstances, the practice has been not to include any statement regarding the practical implications of a Standard in the Preface to the Standard. Instead, the expected practical implications of AASB 14 could be included as part of the AASB's communication strategy, for example, in the media release accompanying AASB 14, if issued in Australia.

20 However, staff note that there is precedent, as in the case of the Investment Entities amendments to IFRS 10 *Consolidated Financial Statements*, for the AASB preparing a Basis for Conclusions on an IFRS where a Dissenting Opinion of a minority of AASB members accompanies a Standard.

21 As such, if AASB 14 is accompanied by a Dissenting Opinion, the Board could decide to publish a Basis for Conclusions (along the lines of that in the Appendix to this memo) and address the matter raised in paragraph 18 above (drawing on the analysis included in this paper).

<u>Issue 4: Other concerns raised by AASB members</u>

22 The other concerns raised by AASB members are consistent with the concerns raised by the AASB in its comment letter to the IASB on ED/2013/5 outlined in paragraph 2 above. Indeed one Board member is contemplating expressing a dissenting opinion and the draft wording of the dissenting opinion (which is currently being reviewed by the Board member and subject to change) is outlined below:

> "AASB 14 *Regulatory Deferral Accounts* is consistent with the AASB's policy of incorporating IFRSs into Australian Accounting Standards. While I generally support that policy, from a 'first principles' basis I do not agree with the key approach in AASB 14 that allows the continuation of accounting policies that are inconsistent with existing recognition and measurement requirements in other Australian Accounting Standards for late first-time adopters of Australian Accounting Standards.
>
> Despite AASB 14 being described as an interim standard, it risks perpetuating differences in the recognition and measurement of assets and liabilities, and detracts from the comparability of financial statements, across similar entities. On this basis, I do not support adoption of AASB 14".

Overall staff views and recommendation

23 Staff note that, currently under AASB 1, if a first-time adopter recognises property, plant and equipment or intangible assets used in rate regulated activities and the carrying amounts of such items include amounts determined under previous GAAP that do not qualify for capitalisation in accordance with Australian Accounting Standards, the first-time adopter may elect to use the previous GAAP carrying amount of such items at the date of transition to Australian Accounting Standards as deemed cost (paragraph D8B of AASB 1). Staff also note that a first-time adopter with oil and gas properties may elect to account for its exploration and evaluation assets at the amount determined under the entity's previous GAAP on transition to Australian Accounting Standards (paragraph D8A of AASB 1).

24 Therefore, staff note that, arguably, the exemption in AASB 14 (ballot draft) that would permit first-time adopters to continue to recognise amounts related to rate regulation in accordance with their previous GAAP when they first-time adopt Australian Accounting Standards seems somewhat similar to the exemption in AASB 1.

25 Staff also note that the IASB has issued IFRS 14 as an interim measure to facilitate the adoption of IFRS pending the outcome of its comprehensive *Rate-regulated Activities* project. A discussion paper on *Rate-regulated Activities* is expected to be issued by the IASB in Q3 2014.

26 Staff consider that the practical impact of adopting AASB 14 in Australia is minimal.

27 Therefore, staff recommend not making any amendments to the AASB 14 ballot draft (including the Preface) as a consequence of the sweep issues raised by AASB members outlined above. Depending on whether there are any dissenting opinions, staff recommend issuing AASB 14 as drafted.

28 If any Board member wants to issue a dissenting opinion, then in accordance with paragraph 71 of the AASB Policies and Processes document[3], all Board members should be provided the wording of the dissenting opinion before they vote on the issuance the Standard. Furthermore, if there is to be a Dissenting Opinion, staff would also suggest that the AASB publish a Basis for Conclusions.

29 Staff note that a delay in issuing AASB 14 would not be expected to be a major concern as it would only be applicable for annual reporting periods beginning on or after 1 January 2016. However, the consequence of a delay would result in resending the Omnibus Amending Standard to Board members for voting as the consequential amendments arising due to the issuance of AASB 14 are currently included in the Omnibus Amending Standard and would need to be removed.

Question 1 to Board members:

Do you agree with the staff recommendation in paragraph 27 and 28 above?

Question 2 to Board members:

After considering the analysis above, do any Board members (still) intend to vote against (and express a dissenting opinion), or abstain from voting on, AASB 14?

[3] http://www.aasb.gov.au/admin/file/content102/c3/Policy_Statement_03-11.pdf

Appendix

BC1 This Basis for Conclusions summarises the Australian Accounting Standards Board's (AASB) considerations in issuing AASB 14 *Regulatory Deferral Accounts*. Individual Board members gave greater weight to some factors than to others.

Background

BC2 AASB 14 is the result of the AASB's due process, which began when the AASB issued Exposure Draft ED 240 *Regulatory Deferral Accounts* (AASB ED 240) in May 2013 (incorporating International Accounting Standards Board [IASB] ED/2013/5 *Regulatory Deferral Accounts*). That Exposure Draft proposed an interim Standard to permit first-time adopters of Australian Accounting Standards (AASs) [International Financial Reporting Standards (IFRSs)] to continue to account for regulatory deferral account balances in their financial statements in accordance with their previous GAAP. The proposed interim standard was not intended, in any way, to anticipate the outcome of the IASB's longer term Rate-regulated Activities project.

BC3 In the Preface to ED 240, the AASB expressed the view that it did not expect the proposed interim standard, if it were to be incorporated into Australian Accounting Standards, would have a significant impact on entities in Australia as the Standard could conceivably only affect entities that adopt Australian Accounting Standards for the first time and have recognised regulatory deferral account balances under their previous GAAP.

BC4 The AASB received two comment letters on ED 240 that expressed broad support for issuing the interim Standard, acknowledging that it was an interim measure while the IASB developed a Discussion Paper under its comprehensive Rate Regulated Activities project. One respondent expressed the view that they were not aware of any entities in Australia whose financial statements would be directly impacted by the proposals in ED 240.

BC5 The AASB in its comment letter to the IASB on ED/2013/5 raised the following key concerns:

(a) the proposals could result in the IASB inappropriately setting a precedent of introducing additional interim standards for first-time adopters of IFRS to encourage transition to IFRS; and

(b) the proposals would reduce comparability between first-time adopters of IFRS that choose to apply the proposals and those that already apply IFRS or first-time adopters of IFRS that do not elect to apply the proposals.

BC6 In January 2014, the IASB issued IFRS 14 *Regulatory Deferral Accounts* (incorporating the proposals in ED/2013/5 without substantive changes), for annual reporting periods beginning on or after 1 January 2016, with early application permitted.

BC7 The AASB noted that its concerns with the ED/2013/5 proposals, expressed in its submission to the IASB, were not addressed in IFRS 14. However, after considering the types of entities that might be affected by the requirements (including a newly listed rate-regulated entity from a foreign jurisdiction and a foreign rate-regulated entity that 'back door' lists in Australia), the AASB expects that the practical impact of adopting AASB 14 in Australia would be minimal and, given the interim nature of the Standard, the AASB decided to issue AASB 14, consistent with the AASB's policy of adopting IFRSs in Australia.

BC8 The AASB also noted that, currently under AASB 1 *First-time Adoption of Australian Accounting Standards*, if a first-time adopter recognises property, plant and equipment or intangible assets used in rate-regulated activities and the carrying amounts of such items include amounts determined under previous GAAP that do not qualify for capitalisation in accordance with Australian Accounting Standards, the first-time adopter may elect to use the previous GAAP carrying amount of such items at the date of transition to Australian Accounting Standards as deemed cost (paragraph D8B of AASB 1). A similar exemption is also available to a first-time adopter with oil and gas properties, whereby the entity may elect to account for its exploration and evaluation assets at the amount determined under the entity's previous GAAP on transition to Australian Accounting Standards (paragraph D8A of AASB 1). The AASB considered that the exemption in AASB 14 that would permit first-time adopters to continue to recognise amounts related to rate regulation in accordance with their previous GAAP when they first-time adopt Australian Accounting Standards is somewhat similar to these exemptions in AASB 1. Therefore, AASB 14 would be broadly consistent with the approach taken by the AASB to allowing first-time adopters to 'grandfather' previous GAAP when transitioning to Australian Accounting Standards.