International Financial Reporting Standard IFRS 14

Regulatory Deferral Accounts

January 2014

BASIS FOR CONCLUSIONS

CONTENTS

Basis for Conclusions on IFRS 14 *Regulatory Deferral Accounts*

This Basis for Conclusions accompanies, but is not part of, the Standard.

Introduction

BC1 This Basis for Conclusions summarises the considerations of the International Accounting Standards Board (IASB) in reaching the conclusions in IFRS 14 *Regulatory Deferral Accounts*. Individual IASB members gave greater weight to some factors than to others.

BC2 The IASB and the IFRS Interpretations Committee (the 'Interpretations Committee') received several requests for guidance on whether rate-regulated entities can or should recognise, in their IFRS financial statements, a regulatory deferral or variance account debit or credit balance as a result of price or rate regulation by regulatory bodies or governments. Some national accounting standard-setting bodies permit or require such balances to be recognised as assets and liabilities under some circumstances, depending on the type of rate regulation in force. In such cases, these regulatory deferral account balances are often referred to as 'regulatory assets' and 'regulatory liabilities'. However, as explained in this Basis for Conclusions (see paragraphs BC11–BC12 and BC21), the term 'regulatory deferral account balances' has been chosen as a neutral descriptor for these items for the purpose of this Standard.

BC3 US generally accepted accounting principles (US GAAP) have recognised the economic effect of certain types of rate regulation since at least 1962. In 1982, the US national standard-setter, the Financial Accounting Standards Board (FASB) issued SFAS 71 *Accounting for the Effects of Certain Types of Regulation*.[1] SFAS 71 formalised many of those principles. In the absence of specific national guidance, practice in many other jurisdictions followed SFAS 71. In the financial statements of rate-regulated entities that apply such guidance, regulatory deferral account balances are often incorporated into the carrying amount of items such as property, plant and equipment and intangible assets, or are recognised as separate items in the financial statements.

BC4 In June 2005, the Interpretations Committee received a request about SFAS 71. The request asked whether an entity could apply SFAS 71 in accordance with the hierarchy in paragraphs 10–12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* when selecting an accounting policy in the absence of specific guidance in IFRS.

BC5 The Interpretations Committee previously discussed the possible recognition of regulatory deferral account debit balances as part of its project on service concessions. As a result of its consideration at that time, the Interpretations Committee concluded that "entities applying IFRS should recognise only assets that qualified for recognition in accordance with the IASB's *Framework for the*

1 The guidance in SFAS 71, together with subsequent amendments and related guidance, has now been incorporated into Topic 980 *Regulated Operations* in the FASB *Accounting Standards Codification®*.

Preparation and Presentation of Financial Statements[2] ... and relevant accounting standards, such as IAS 11 *Construction Contracts*, IAS 18 *Revenue*, IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*." In other words, the Interpretations Committee thought that an entity should recognise 'regulatory assets' only to the extent that they meet the criteria to be recognised as assets in accordance with existing IFRS.

BC6 The Interpretations Committee concluded that the recognition criteria in SFAS 71 were not fully consistent with the recognition criteria in IFRS. Applying the guidance in SFAS 71 would result in the recognition of regulatory deferral account balances under certain circumstances that would not meet the recognition criteria of relevant Standards. Consequently, the requirements of SFAS 71 were not indicative of the requirements of IFRS. The Interpretations Committee decided not to add a project on regulatory assets to its agenda.

BC7 In January 2008, the Interpretations Committee received a second request to consider whether rate-regulated entities could or should recognise a regulatory liability (or a regulatory asset) as a result of rate regulation by regulatory bodies or governments. The Interpretations Committee again decided not to add the issue to its agenda for several reasons. Importantly, it concluded that divergence did not seem to be significant in practice for entities that were applying IFRS. The established practice of almost all entities is to eliminate regulatory deferral account balances when IFRS is adopted and not to recognise such balances in IFRS financial statements. However, the Interpretations Committee also noted that rate regulation is widespread and significantly affects the economic environment of many entities.

BC8 The IASB noted the ongoing requests for guidance on this issue. It also considered the comments that had been received on the Interpretations Committee's tentative agenda decisions. Those comments pointed out that although divergence in IFRS practice did not exist, several jurisdictions whose local accounting principles permitted or required the recognition of regulatory deferral account balances would be adopting IFRS in the near future. This would increase pressure for definitive guidance on the recognition of regulatory deferral account balances as assets or liabilities.

BC9 Consequently, in December 2008, the IASB added a project on rate-regulated activities to its agenda and subsequently, in July 2009, published an Exposure Draft Rate-regulated Activities (the '2009 ED'). The responses to the 2009 ED raised complex and fundamental issues at a conceptual level. In September 2010, the IASB decided that the complex technical issues could not be resolved quickly, and suspended the project until it had considered whether to include rate-regulated activities in its future agenda. The 2011 Agenda Consultation asked stakeholders to provide their views as to which projects the IASB should give priority.[3] The responses to this consultation, received through comment

2 In September 2010, the IASB replaced the *Framework for the Preparation and Presentation of Financial Statements* with the *Conceptual Framework for Financial Reporting*. The definitions of assets and liabilities and the criteria for recognising them in the statement of financial position were unchanged.

3 In July 2011, the IASB published a formal Request for Views document to provide a channel for formal public input on the broad aspects of our agenda-setting process.

letters and other outreach activities, persuaded the IASB to prioritise addressing the unresolved issues related to rate-regulated activities.

BC10 As a result of its agenda-setting process, in September 2012 the IASB decided to add to its agenda a comprehensive project on rate-regulated activities to investigate these complex issues. In addition, the *Conceptual Framework for Financial Reporting* (the *'Conceptual Framework'*) is currently being reviewed and updated. The outcome of the Rate-regulated Activities project will be influenced by the outcome of the *Conceptual Framework* project. The initial objective is to develop a Discussion Paper for each of these projects, which the IASB hopes will provide a basis for developing guidance in the long term.[4] It also decided, in December 2012, to develop an interim Standard on the accounting for regulatory deferral accounts that would apply until the completion of the comprehensive project. This Standard is the result of that decision.

Reasons for issuing this Standard

BC11 Many rate-regulated entities think that recognising regulatory deferral account balances as assets and liabilities would provide more relevant information and would provide a more faithful representation of their rate-regulated activities than the established practice in IFRS currently. They suggest that rate regulation creates special conditions that support the recognition of regulatory deferral account balances, even when those balances consist of deferred costs that other Standards require to be recognised as an expense in the period in which they are incurred. The 2009 ED, which proposed that regulatory deferral account balances should be recognised when arising from activities that are subject to a specific type of rate regulation (referred to in the 2009 ED as "cost-of-service rate regulation"), raised expectations that the IASB had agreed that there was merit to the arguments used to support recognition of such balances as assets and liabilities.

BC12 Consequently, some respondents have noted that, although the case has not been made conclusively for amending IFRS to permit or require the recognition of regulatory deferral account balances as assets and liabilities, neither has it been made conclusively for an approach that eliminates such balances and changes existing accounting policies. These policies are being widely applied in accordance with some national GAAPs, and are familiar to many users of financial statements in jurisdictions that currently permit or require the recognition of rate-regulated items.

BC13 The IASB recognises that discontinuing the recognition of regulatory deferral account balances in advance of the conclusion of the comprehensive Rate-regulated Activities project could be a significant barrier to the adoption of IFRS for entities for which regulatory deferral account balances represent a significant proportion of net assets. This has led to an industry-specific 'carve-out' from the application of IFRS in at least one jurisdiction that has otherwise adopted IFRS, to allow rate-regulated entities to continue to use local GAAP (or, in some cases, US GAAP). In addition, there are examples of 'carve-ins'

4 The IASB published, in July 2013, the Discussion Paper *A Review of the Conceptual Framework for Financial Reporting*. The deadline for comments was 14 January 2014.

being created that introduce specific guidance for rate-regulated activities that overlies IFRS requirements as issued by the IASB. However, the interaction of such guidance when it is in conflict with the requirements of IFRS can create diversity of application in practice.

BC14 During outreach, some respondents told the IASB that, in many jurisdictions, the accounting policies developed for regulatory deferral account balances are based on US GAAP or local GAAP that provides similar guidance. This is understood to provide a reasonable level of comparability for regulatory deferral account balances across jurisdictions. However, different approaches to accommodating existing practice for such balances have reduced comparability for users of financial statements in these jurisdictions, because the rest of the items in the financial statements are now accounted for using different accounting frameworks (for example, IFRS, US GAAP or local GAAP), depending on which approach has been adopted. In some cases, the development of these carve-in or carve-out options has been in direct response to the publication of the 2009 ED.

BC15 The IASB acknowledges the difficult practice problems related to this issue. The IASB has, therefore, decided to issue this Standard, which allows entities that currently recognise regulatory deferral account balances in accordance with their previous GAAP to continue to do so when making the transition to IFRS. In accordance with paragraph 5, an entity is only eligible to apply this Standard if it:

(a) is subject to oversight and/or approval from an authorised body (the rate regulator);

(b) recognised regulatory deferral account balances in its financial statements in accordance with its previous GAAP; and

(c) elected to apply the requirements of this Standard in its first IFRS financial statements.

BC16 Consequently, an entity that does not recognise regulatory deferral account balances in accordance with its previous GAAP in the period immediately preceding its first IFRS financial statements is not eligible to apply this Standard in order to start recognising such balances. An entity would not, therefore, be eligible if, for example:

(a) the entity did not have any relevant rate-regulated activities in the period before it made the transition to IFRS but then acquires or commences rate-regulated activities after the date that it adopts IFRS; or

(b) the entity is a newly formed business and adopts IFRS in its first IFRS financial statements.

BC17 The IASB thinks that this restriction balances the needs of preparers and users in jurisdictions that currently recognise regulatory deferral account balances in accordance with previous GAAP, and those that already prepare IFRS financial statements and do not recognise such balances.

BC18 A Standard that permits first-time adopters of IFRS to continue to apply their existing policies for the recognition, measurement, impairment and

derecognition of regulatory deferral account balances will help those entities avoid having to make a major change to their accounting policies for regulatory deferral account balances until the comprehensive Rate-regulated Activities project is completed. The related presentation and disclosure requirements should help to reduce the disruption to information available for trend analyses for these entities on transition to IFRS, until the IASB can consider these issues in its comprehensive project. This would enable rate-regulated entities to overcome the barrier noted in paragraph BC13 and, consequently, to make the transition to IFRS.

BC19 Although comparability will be improved overall by having more entities applying IFRS, the IASB acknowledges that permitting only a limited population of entities to recognise regulatory deferral account balances will introduce some inconsistency and diversity into IFRS practice for the treatment of regulatory deferral account balances, when it does not currently exist. In order to improve comparability between IFRS preparers that are subject to rate regulation but that do not recognise regulatory deferral account balances and entities that are permitted to recognise such balances in accordance with this Standard, the IASB decided to require segregated presentation of these balances. The IASB thinks that the resulting presentation and disclosure requirements in this Standard will help to minimise the impact of introducing this inconsistency, and that the benefits to users and preparers of financial statements outweigh the costs.

BC20 The IASB thinks that the following benefits of this Standard justify introducing this diversity:

(a) it is likely to remove a major barrier to the adoption of IFRS for entities for which regulatory deferral account balances represent a significant proportion of net assets;

(b) it should reduce the risk of entities adopting locally developed carve-ins or carve-outs that would otherwise create greater diversity of accounting treatment and greater confusion for users of financial statements. Having more entities applying IFRS would ensure that their other activities are reported in accordance with IFRS, thereby increasing comparability for those other assets and liabilities; and

(c) it is likely to improve transparency and consistency in the way that regulatory deferral account balances and movements in those balances are presented, thereby highlighting the impact of recognising such items and improving comparability between those entities that recognise such balances in accordance with the Standard.

BC21 However, the IASB noted that, by issuing this Standard, it is not anticipating the outcome of the comprehensive Rate-regulated Activities project referred to in paragraph BC10. Consequently, regulatory deferral account balances are not described as regulatory assets or regulatory liabilities in this Standard because the IASB has yet to decide whether they meet the definitions of assets or liabilities in the *Conceptual Framework*. The separation of these balances from the amounts that are recognised as assets and liabilities in accordance with other Standards is designed to maintain the integrity of the application of existing Standards.

Scope

BC22 This Standard does not allow entities to recognise regulatory deferral account balances if those entities have a dominant position in a market and decide to self-regulate to avoid the potential government intervention that might occur if it were perceived to be abusing its dominant position. Instead, it requires there to be a formal rate regulator involved to ensure that the rate-regulatory mechanism in place is supported by statute or regulation and that the regulatory mechanism binds the entity.

BC23 However, the IASB does not intend to exclude entities that are regulated by their own governing body in cases in which:

(a) the governing body sets prices both in the interests of the customers and to ensure the financial viability of the entity within a specified framework; and

(b) the framework is subject to oversight and/or approval by an authorised body that is empowered by statute or regulation.

BC24 This situation could arise, for example, when the entity conducts previously state-run activities and the government delegates regulatory powers to an entity (that may be state-controlled) within a statutory framework that is overseen by an authorised body of the government. Another example is a co-operative that may be subject to some form of regulatory oversight in order to obtain preferential loans, tax relief or other incentives to maintain the supply of goods or services that the government consider to be essential or near essential.

BC25 This Standard does not address an entity's accounting for reporting to rate regulators (regulatory accounting). Rate regulators may require a regulated entity to maintain its accounts in a form that permits the rate regulator to obtain the information that is needed for regulatory purposes. Rate regulators' actions are based on many considerations. This Standard neither limits nor endorses a rate regulator's actions.

BC26 Although rate regulators can affect the timing of the recovery of the costs or the reversal of over-recoveries through future increases and decreases in rates, they cannot change the characteristics of assets and liabilities that exist and that are accounted for in accordance with IFRS. The IASB has not, therefore, introduced any changes to the accounting for assets or liabilities that are already addressed in other Standards. Those items should be accounted for in accordance with those Standards, irrespective of whether the entity is subject to rate regulation or not.

BC27 Consequently, the IASB decided that the scope of the Standard should be limited to specifying how an entity reports the differences that arise between the regulatory accounting requirements of rate regulators and the accounting that would otherwise be required in financial statements that are prepared in accordance with IFRS, in the absence of this Standard.

Recognition, measurement, impairment and derecognition

Temporary exemption from paragraph 11 of IAS 8

BC28 As noted in paragraph BC7, the established practice in IFRS has been that rate-regulated entities do not recognise regulatory deferral accounts in IFRS financial statements. Some IASB members are concerned that entities that will recognise regulatory deferral account balances in accordance with this Standard could give the appearance of being compliant with IFRS while being inconsistent with the stated objectives of the IASB, ie to provide users of financial statements with financial information that is transparent, comparable and of high quality. The IASB did not consider the exemption from parts of IAS 8 lightly, but introduced this interim step to lower a significant barrier to adopting IFRS for some jurisdictions, pending the completion of the comprehensive Rate-regulated Activities project. This step is also intended to minimise disruption, both for users (for example, a lack of continuity of information available for trend analyses) and preparers (for example, extensive system changes) when entities in these jurisdictions make the transition to IFRS.

BC29 The IASB has been told that the majority of the national standard-setting bodies that permit or require the recognition of regulatory deferral account balances in accordance with local GAAP do so using the requirements of US GAAP (Topic 980 *Regulated Operations* in the FASB *Accounting Standards Codification*®) or local requirements that are based on US GAAP. Consequently, the IASB does not expect there to be significant diversity in the accounting for regulatory deferral account balances in jurisdictions that currently apply regulatory accounting in financial statements.

BC30 Paragraph 12 of IAS 8 could permit Topic 980 or similar local GAAP requirements to be applied in IFRS financial statements, but only to the extent that those national GAAPs do not conflict with the sources of guidance listed in paragraph 11 of IAS 8 (ie other Standards and the *Conceptual Framework*). As noted in paragraph BC6, the Interpretations Committee concluded that the recognition criteria in SFAS 71 (now incorporated into Topic 980) were not fully consistent with the recognition criteria in IFRS. This is because some regulatory deferral account balances are specifically prohibited from being recognised as assets and liabilities by other Standards. It is this conflict with the sources listed in paragraph 11 of IAS 8 that has prevented almost all existing IFRS preparers from recognising regulatory deferral account balances. Consequently, the IASB has decided that entities within the scope of this Standard should be granted a temporary exemption from paragraph 11 of IAS 8 in order to overcome the restriction on the use of the sources of accounting guidance referred to in paragraph 12 of IAS 8.

BC31 When developing IFRS 4 *Insurance Contracts* and IFRS 6 *Exploration for and Evaluation of Mineral Resources*, the IASB considered whether they should require an entity to follow its national accounting requirements (ie national GAAP) when accounting for insurance contracts or the exploration for and evaluation of mineral resources respectively to prevent the selection of accounting policies that do not form a comprehensive basis of accounting. Consistent with its conclusions in those Standards, the IASB concluded that defining national GAAP

would have posed problems. Further definitional problems could have arisen because some entities do not apply the national GAAP of their own country. For example, some non-US entities with rate-regulated activities apply US GAAP (Topic 980). Moreover, it is unusual and, arguably, beyond the IASB's mandate to impose requirements set by another body.

BC32 Consequently, the IASB decided that an entity could continue to follow the accounting policies that it was using when it first applied the IFRS requirements, provided that they satisfy the requirements of paragraphs 10 and 12 of IAS 8. This should help to ensure that those policies are generally accepted in the local jurisdiction, either because the local GAAP allows the use of another standard-setter's pronouncement or because of accepted industry practice. The IASB decided to adopt the same approach in this Standard that it adopted with IFRSs 4 and 6, for the same reasons.

Changes in accounting policies

BC33 IAS 8 prohibits a change in accounting policies that is not required by a Standard, unless the change will result in information that is reliable and more relevant. Paragraph 15 of IAS 8 explains that this is because users of financial statements need to be able to compare the financial statements of an entity over time to identify trends in financial position, financial performance and cash flows. Consistent with its conclusions in IFRSs 4 and 6, the IASB decided to permit changes in accounting policies for regulatory deferral account balances if they make the financial statements more relevant and no less reliable, or more reliable and no less relevant, judged in accordance with the criteria in IAS 8.

BC34 As previously noted, the IASB has started the research phase of a comprehensive project to investigate how IFRS financial statements might reflect the effects of rate regulation (see paragraph BC10). Until that project is completed, the IASB wishes to minimise disruption to information used for trend analyses of IFRS financial statements and thus the limitation on changes in accounting policy is intended to be restrictive. The established practice in IFRS has been that almost all rate-regulated entities do not recognise regulatory deferral account balances in IFRS financial statements. Consequently, the IASB thinks that changing an accounting policy to start to recognise such balances, or to recognise a wider range of such balances by modifying a previous GAAP policy, when that changed policy might need to change again following the completion of the Rate-regulated Activities project, would not make the financial statements more reliable. The scope of this Standard and the restriction on changes in accounting policies in paragraphs 13–15, therefore, prohibit entities that currently do not recognise regulatory deferral account balances from starting to do so.

BC35 The IASB wished to avoid imposing unnecessary changes of accounting policy as a result of applying this Standard. However, it did not want to prevent entities that currently recognise regulatory deferral account balances from ceasing to recognise them when adopting IFRS because this would be consistent with the established IFRS practice. The IASB thinks that this would result in an entity presenting more comparable information with existing IFRS preparers, which would bring the financial statements closer to the criteria in IAS 8. The IASB

has, therefore, decided that the continued recognition of regulatory deferral account balances in accordance with this Standard should be optional. An entity that is eligible to apply this Standard but that elects not to apply it and, consequently, ceases to recognise its regulatory deferral account balances, is not required to apply any of the disclosure requirements of this Standard. However, such entities, and other entities that are not eligible to apply this Standard, are not prohibited from providing supplementary disclosures, such as those set out in paragraphs 30–36.

BC36 In addition, this Standard contains some specific accounting requirements for presentation that may require entities to change the presentation of regulatory deferral account balances that they recognise in accordance with their previous GAAP accounting policies. The IASB thinks that these changes, together with the specific disclosure requirements set out in this Standard, will improve comparability and understandability, and provide relevant information to users.

Interaction with other Standards

BC37 Any specific exception, exemption or additional requirements related to the interaction of this Standard with other Standards is contained within this Standard. The IASB thinks that, except for IFRS 1, other Standards should not be subject to consequential amendments relating only to this Standard because its application is restricted to a limited population of entities. In addition, it is intended to be applicable only as a short-term interim solution until the comprehensive Rate-regulated Activities project is completed.

BC38 As previously noted, in order to apply this Standard an eligible entity must elect to apply it in the entity's first IFRS financial statements. Consequently, a first-time adopter will initially apply this Standard at the same time as it applies IFRS 1. Paragraph D8B of IFRS 1 provides an exemption to allow first-time adopters to use, as the deemed cost at the date of transition to IFRS, the previous GAAP carrying amount of items of property, plant and equipment or intangible assets that are used, or were previously used, in operations subject to rate regulation. For the purposes of that exemption, paragraph D8B defined operations that are subject to rate regulation in the context of a cost-plus or cost-of-service type of rate regulation. The IASB has decided to make a consequential amendment to paragraph D8B of IFRS 1 to make the definition of rate regulation used in that paragraph consistent with the definition used in this Standard. This will ensure that a first-time adopter that applies this Standard is not prohibited from using the exemptions available to other first-time adopters in IFRS 1.

Recoverability

BC39 Although the approval by the rate regulator may not guarantee that a regulatory deferral account balance will be recovered (or reversed) through future sales, it does provide a high degree of assurance that the anticipated economic benefits will flow to or from the entity. In some cases, an entity may incur costs several months or even years before the rate regulator formally approves them. The IASB concluded that, in such cases, judgement is required to determine whether the costs can be considered recoverable. Consequently, the IASB decided not to develop specific recognition or impairment requirements for these

circumstances, but instead decided that an entity should continue to apply its previous GAAP accounting policies for the recognition and measurement of such amounts.

Presentation

Cost of self-constructed or internally generated assets

BC40 The IASB noted that in some cases, a rate regulator requires, for rate-setting purposes, an entity to include, as part of the cost of property, plant and equipment or other assets, amounts that would not be included by non-rate-regulated entities. For example, a rate regulator might specify how to calculate the carrying value of an item of property, plant and equipment for rate-setting purposes (the rate-base or regulatory value), which might differ from the method required by IAS 16.

BC41 The IASB acknowledges that at least two alternatives exist for accounting for these amounts: present them separately or include them within the amounts presented for property, plant and equipment or other assets. Proponents of the first alternative think that regulatory deferral account balances that would be recognised as a result of this Standard do not have the same characteristics as assets and liabilities that would be recognised in accordance with other Standards. Consequently, proponents of this alternative think that all amounts that qualify for recognition as regulatory deferral account balances should be presented separately from the assets and liabilities that are recognised in accordance with other Standards, instead of being included within the carrying amount of the item of property, plant and equipment or other asset.

BC42 Proponents of the second alternative think that some regulatory deferral account balances that would be recognised as a result of this Standard are so closely related to other assets of the entity that accounting for them separately does not provide additional information to users. Proponents of this alternative think that when regulatory assets are complementary to other assets and have similar useful lives, there is no need to incur the costs of separate accounting. Instead, they think that the other assets should be measured at the amount allowed for rate-regulatory purposes. In accordance with this alternative, an entity includes the regulatory deferral account balances in the cost of the asset that is recognised in accordance with other Standards as a single asset. This approach is consistent with that applied in US GAAP (Topic 980).

BC43 The IASB will consider this issue as part of the comprehensive Rate-regulated Activities project. For the purpose of this Standard, the IASB has decided to require the first alternative. This decision does not change the relief available to first-time adopters using the deemed cost exemption provided by paragraph D8B of IFRS 1 (see paragraph BC38). This is consistent with the IASB's decision not to introduce any changes to the accounting for assets and liabilities that are already addressed in other Standards (see paragraph BC26). Some IASB members think that this separate presentation is essential until the consideration of the more fundamental issues about accounting for rate-regulated activities is completed through the comprehensive project.

Separate presentation in the primary financial statements

BC44 Many of the items included in regulatory deferral account balances would not otherwise be capitalised as assets (or liabilities) in the absence of the temporary exemption from paragraph 11 of IAS 8 that is contained in this Standard (see paragraph BC30). Consequently, and consistent with the IASB's decision discussed in paragraph BC43, the Standard requires the total of all regulatory deferral account debit balances and the total of all regulatory deferral account credit balances to be presented as separate line items in the statement of financial position. Similarly, the net movement between the opening and closing balances is presented separately within the statement(s) of profit or loss and other comprehensive income, split between amounts related to other comprehensive income and amounts related to profit or loss. Any movements not related to profit or loss or other comprehensive income, such as amounts acquired or disposed of, are disclosed in the reconciliation of opening and closing balances required by paragraph 33.

BC45 In addition, the IASB concluded that presenting the regulatory impact separately would provide more useful information about the regulatory environment and would be consistent with the enhancing qualitative characteristic of comparability in paragraphs QC20–QC25 of the *Conceptual Framework*. In particular, it would enable users to more directly compare the property, plant and equipment or intangible assets of comparable rate-regulated entities (in addition to comparing them to those of non-rate-regulated entities), regardless of whether they recognise regulatory deferral account balances in their financial statements. This would also result in more consistent application of IFRS for all other transactions or activities, irrespective of whether an entity has rate-regulated activities and the type of rate-regulatory environment that the entity is subject to.

BC46 The IASB concluded that the separate presentation of regulatory deferral account balances, especially those amounts that are often permitted by national GAAP practices to be included within the carrying amounts of property, plant and equipment and other assets, is an important improvement because it contributes to increased transparency in financial reporting. The IASB noted that a first-time adopter of IFRS may apply the deemed cost exemption in paragraph D8B of IFRS 1, which allows adopters to use their previous GAAP carrying amounts at the date of transition to IFRS. This exemption provides relief for first-time adopters that would otherwise be required to separate out the regulatory component of the carrying amount of sometimes very large and old items of property, plant and equipment or intangible assets at the date of transition to IFRS, which may be impracticable. The IASB has made a consequential amendment to the scope of the IFRS 1 exemption to make it consistent with the scope of this Standard. Consequently, entities that apply this Standard will only need to isolate the regulatory deferral account amounts for those items on a prospective basis from the date of transition to IFRS. The IASB also noted that the information required for separate presentation on an ongoing basis is normally available in any case, due to the information requirements of rate regulators.

Current/non-current allocation and offset

BC47 Regulatory deferral account balances arise from specific individual costs (income) that the rate regulator requires or permits to be deferred to future periods. The rates charged for goods or services in the current period may be intended to recover a combination of past costs, current costs and, in some cases, anticipated future costs. Although the rate regulator may specify the period over which the recovery of the regulatory deferral account balances is intended, judgement may be needed to identify the costs that the revenue billed in a period recovers. This means that detailed scheduling of the timing of recovery or reversal of each regulatory deferral account debit or credit balance may be needed for the purpose of identifying which amounts should be classed as current or for determining which amounts would be recovered or reversed in the same period for the purposes of offsetting. Consequently, the IASB has decided that regulatory deferral account balances should not be presented as current or non-current and that debit and credit balances should not be offset in the statement of financial position. Instead, this Standard requires information about the period(s) over which regulatory deferral account balances are expected to be recovered or reversed to be disclosed. An entity is not, however, prohibited from identifying current and non-current amounts within the information disclosed if the relevant information is available.

Disclosure

BC48 In December 2012, the IASB launched a survey on disclosures, which was directed at preparers, users and others interested in or affected by disclosure requirements. The results were discussed in a public discussion forum on *Disclosures in Financial Reporting* in January 2013. The survey and the discussion forum were aimed at assisting the IASB to gain a clearer picture on the perceived "disclosure problem" (ie identifying disclosure requirements that create a burden for preparers but do not provide users with sufficient relevant information). The views of most financial statement preparers that took part in these events identified the primary problem as the disclosure requirements being too extensive, with not enough being done to exclude immaterial information, which has been referred to as "disclosure overload". Similarly, many users of financial statements felt that preparers could do more to improve the communication of relevant information within the financial statements, rather than leaving users to sift through large amounts of data.

BC49 With this in mind, this Standard sets out a general objective for disclosure as well as a list of detailed items that might be useful in achieving that objective. The IASB has previously concluded that it is unnecessary, in general, to state explicitly that specified disclosures relate only to material items because all Standards are governed by the concept of materiality as described in IAS 1 *Presentation of Financial Statements* and in IAS 8. The IASB has decided, consistent with its previous conclusions, not to specifically refer to materiality in this Standard. However, this Standard contains other explicit guidance to clarify that preparers should use their judgement to decide which of the detailed items are necessary to achieve the objective and what level of detail to provide.

BC50 The IASB thinks that an understanding of an entity's different types of rate-regulated activities is important for understanding the entity as a whole. In addition, an understanding of each class of regulatory deferral account is considered important because that can provide information about the nature of the rate regulation and the potential timing of related cash flows. Consequently, this Standard requires the disclosure of qualitative and quantitative information for each type of an entity's rate-regulated activities and each class of regulatory deferral account balance, because this will provide information that is more useful in assessing the impact of different rate-regulatory environments.

BC51 The IASB thinks that most entities that already recognise regulatory deferral account balances in accordance with US GAAP, or similar requirements or practices in other jurisdictions, currently provide most of the information required to be disclosed by paragraph 33 of this Standard. However, the IASB observed that the information is often disclosed in various places throughout the financial statements in a way that can make it difficult for a user to appreciate the overall effect that rate regulation has had on the amounts recognised in the financial statements. Consequently, this Standard requires that entities meet the disclosure requirements by providing a table, containing aggregated information, and showing a reconciliation of the movements in the carrying amounts in the statement of financial position of the various categories of regulatory items. This table will be required unless another format is more appropriate. The IASB noted that such a table, presenting information in a structured manner, would assist financial statement users in understanding how the entity's reported financial position and comprehensive income have been affected by rate regulation.

Location of qualitative disclosures

BC52 The IASB observed that many entities provide, often in the management commentary reports that accompany the financial statements, a qualitative description of the nature and extent of the effect of rate regulation on its activities. The IASB acknowledges that the nature and extent of rate regulation can have a significant impact on the amount and timing of revenue and cash flows of a rate-regulated entity. Hence, the IASB concluded that such disclosures should be part of the financial statements and they could be given either in the financial statements or incorporated by cross-reference from the financial statements to some other statement that is available to users of the financial statements on the same terms as the financial statements and at the same time. This approach is intended to reduce duplication of information and is consistent with some types of risk disclosure required by IFRS 7 *Financial Instruments: Disclosures*.

Effective date and transition

BC53 This Standard will only be available to first-time adopters of IFRS and will need to be applied retrospectively at the date of transition to IFRS. The IASB usually intends to allow a minimum of one year between the date when wholly new Standards or major amendments to Standards are issued and the date when

implementation is required. Consequently, the IASB has set 1 January 2016 as the effective date for this Standard. Earlier application is permitted to make the benefits outlined in paragraph BC20 available at the earliest opportunity.

BC54 The IASB concluded that no explicit relief from full retrospective application of the Standard is needed because existing recognition, measurement, impairment and derecognition policies are continued when this Standard is applied. 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 that allows first-time adopters to use their previous GAAP carrying amounts at the date of transition to IFRS. Consequently, they will only need to change their presentation policies for these items to isolate the regulatory deferral account amounts on a prospective basis from the date of transition to IFRS.

Summary of main changes from the Exposure Draft *Regulatory Deferral Accounts*

BC55 The proposed definition of the rate regulator included the term "or contract" when establishing the authority of the rate regulator. Some respondents to the Exposure Draft *Regulatory Deferral Accounts*, which was published in April 2013 (the '2013 ED'), were concerned that this term resulted in the definition being too broad. Those respondents assumed that the intention of including the entity's own governing body was to (appropriately) capture those cases in which an entity conducts previously state-run monopolistic activities and is consequently delegated regulatory powers by the government. However, the respondents were concerned that the scope could be applied, by analogy, to other commercial entities having monopolistic features. This concern was raised within the context of entities that, in the absence of an external regulator, self-regulate (for example, by formally agreeing this with investors through the articles of association or other contractual arrangement). Entities may do this to avoid potential government intervention if they might otherwise be perceived to be abusing their strong market position.

BC56 Consequently, the IASB decided to refine the definition of the rate regulator to exclude self-regulation and instead require the rate regulator to be supported by statute or other formal regulations.

BC57 In addition, the definitions of rate regulation and the rate regulator were further refined to clarify that the regulation can permit some flexibility in the prices to be charged, within a range of prices established or approved by the rate regulator.

BC58 The scope criterion in paragraph 7(b) of the 2013 ED, which proposed that the price established by regulation (the rate) should be designed to recover the entity's allowable costs of providing the regulated goods or services, has been removed. The IASB was persuaded by arguments from some respondents that this criterion was inconsistent with the underlying objective of the IASB to reduce barriers to the adoption of IFRS. In addition, retaining this criterion may be perceived as prejudging the outcome of the comprehensive project.

BC59 The other main changes from the proposals in the 2013 ED are as follows:

(a) application guidance has been added to:

(i) clarify some group accounting issues. Paragraph 19 of IFRS 10 *Consolidated Financial Statements* requires that a "parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances". Consequently, if a parent recognises regulatory deferral account balances in accordance with this Standard, it shall apply the same accounting policies for the recognition, measurement, impairment and derecognition of regulatory deferral account balances arising from the rate-regulated activities of all of its subsidiaries, even if some of those subsidiaries do not recognise such balances in their own financial statements. A similar requirement applies to an investor applying the equity method to investments in associates and joint ventures.

(ii) introduce a limited exception to IFRS 3 *Business Combinations* to require the continuation of the acquirer's previous GAAP accounting policies for the recognition and measurement of regulatory deferral account balances acquired or assumed in a business combination. The IASB noted that, if an acquirer does not recognise regulatory deferral account balances in accordance with this Standard, but subsequently acquires a subsidiary that does recognise such balances, the acquirer is not eligible to apply this Standard. Consequently, the acquirer is not eligible to recognise the acquiree's regulatory deferral account balances within the consolidated financial statements.

(iii) clarify that an entity is not prohibited from recognising new regulatory deferral account balances for timing differences that are created as a consequence of a change in an accounting policy for other items required by IFRS. The IASB noted that the recognition of timing differences between its applied accounting policies and rate-regulatory requirements is a key element of what regulatory deferral account balances represent. When an entity adopts IFRS, the accounting policies that it uses in its opening IFRS statement of financial position may differ from those that it used at the same date when it used its previous GAAP. Such changes in accounting policies may create new timing differences that will be recorded by the entity in regulatory deferral accounts. For example, the rate regulator might allow pension costs to be reflected in rates when benefits or other costs are paid. The previous GAAP accounting policy for pension costs may have been consistent with this 'as paid' policy and thus no regulatory deferral account balance would have existed for those costs. However, IAS 19 *Employee Benefits* requires pension costs to be attributed to periods of service in accordance with the plan's benefit formula, or in some cases on a straight-line basis. For defined benefit pension costs, this would create a new timing difference for which a regulatory deferral

account balance would be created. Some respondents were concerned that the prohibition to change accounting policies would prevent such newly created regulatory deferral account balances from being recognised. However, this was not the IASB's intention, because the recognition of such timing differences would be consistent with the recognition of other timing differences already recognised as regulatory deferral account balances.

(b) the requirement to continue previous GAAP accounting policies for the recognition, measurement and impairment of regulatory deferral account balances has been extended to include derecognition.

(c) the requirement to present the net movement in regulatory deferral account balances in the statement of profit or loss and other comprehensive income has been modified to require the net movement to be split between amounts related to items reported in profit or loss and those reported in other comprehensive income. The IASB was persuaded by those respondents that stated that the proposal to recognise all net movements in regulatory deferral account balances in a single line item in the profit or loss section of the statement of profit or loss and other comprehensive income could be confusing or misleading when a material portion of the movement related to items that are recognised in other comprehensive income.

(d) the references to materiality as a factor to consider in deciding the level of detail to disclose has been deleted. The IASB noted that the consideration of materiality is already dealt with in IAS 1 and IAS 8. The IASB is currently assessing the adequacy of the guidance contained in those Standards as part of its Disclosure Initiative project.

BC60 A few respondents to the 2013 ED asked for additional guidance for the application of IAS 34 *Interim Financial Reporting*. In particular, they requested that it should be made clear that separate line items for regulatory deferral account balances and movements therein should also be included in a condensed set of financial statements. However, the IASB did not agree that additional guidance is necessary. Paragraph 10 of IAS 34 requires that condensed financial statements "shall include, at a minimum, each of the headings and subtotals that were included in its most recent annual financial statements and the selected explanatory notes as required by this Standard." In addition, paragraphs 15–15A of IAS 34 require that an entity shall include an explanation of events and transactions that are significant to an understanding of the changes in the financial position and performance of the entity.

BC61 The IASB concluded that the existing requirements, together with the detailed year-end information required in this Standard, are sufficient to provide users with the relevant information to understand the regulatory deferral account balances that are recognised.

BC62 The Illustrative examples and the Basis for Conclusions on the 2013 ED contained some educational background information about rate regulation,

which was not related specifically to the contents of the proposed requirements. This background information has been deleted from this Standard.

Effects analysis

BC63 The IASB is committed to assessing and sharing knowledge about the likely costs of implementing new requirements and the likely ongoing costs and benefits of each new Standard. The costs and benefits are collectively referred to as 'effects'. The IASB gains insight on the likely effects of the proposals for new or revised Standards through its formal exposure of proposals, analysis and consultations with relevant parties.

BC64 In evaluating the likely effects of permitting rate-regulated entities that are first-time adopters of IFRS to continue to recognise regulatory deferral account balances, the IASB has considered the following factors:

(a) how the changes to the presentation of regulatory deferral account balances affect the financial statements of a rate-regulated entity;

(b) whether the changes improve the comparability of financial information between different reporting periods for a rate-regulated entity and between different rate-regulated entities in a particular reporting period;

(c) whether the changes improve the quality of financial information that is available to investors and its usefulness in assessing the future cash flows of a rate-regulated entity;

(d) whether users will benefit from better economic decision-making as a result of improved financial reporting;

(e) the likely effect on compliance costs for preparers, both on initial application and on an ongoing basis; and

(f) whether the likely costs of analysis for users are affected.

Financial statements of rate-regulated entities

BC65 The scope of this Standard is limited to first-time adopters of IFRS that already recognise regulatory deferral account balances in their financial statements in accordance with their previous GAAP. Consequently, the financial statements of rate-regulated entities that already apply IFRS, or that do not otherwise recognise such balances, will not be affected by this Standard.

BC66 This Standard permits rate-regulated entities within its scope to continue to apply their existing recognition, measurement, impairment and derecognition policies for regulatory deferral account balances. Consequently, the application of this Standard should have little or no impact on the net assets or the net profit reported in the financial statements.

BC67 However, the presentation of some regulatory deferral account balances will be changed to isolate the impact of their recognition and present this impact as separate line items within the statement of financial position and the statement of profit or loss and other comprehensive income. In particular, some regulatory deferral account balances that would be presented within the carrying amount of items of property, plant and equipment, intangible assets

and inventories in accordance with previous GAAP will, in future, be presented separately from those classes of asset in accordance with this Standard.

Comparability

BC68 The IASB acknowledges that the requirements of this Standard will reduce comparability in some ways, but thinks that this reduction will be outweighed by other improvements in comparability that will result from applying the requirements in this Standard.

BC69 As noted in paragraph BC19, permitting only a limited population of entities to recognise regulatory deferral account balances will introduce some inconsistency and diversity into IFRS practice, when it does not currently exist. However, this is mitigated by the requirements to isolate the regulatory deferral account balances, and the movements in those balances, into separate line items in the financial statements.

BC70 The IASB is aware that many rate-regulated entities view the inability to recognise regulatory deferral account balances in IFRS financial statements as a major barrier to the adoption of IFRS. Although many of these entities are understood to use similar policies for the recognition and measurement of these balances, they use different frameworks of accounting for the preparation and presentation of the financial statements as a whole. The IASB thinks that reducing the barriers for these entities to adopt IFRS will improve the comparability of the financial statements of rate-regulated entities across jurisdictions.

BC71 In addition, the IASB thinks that the requirements to isolate the regulatory deferral account balances, and the movements in those balances, from other items in the financial statements will increase the transparency of these items. This will provide greater comparability across those entities within the scope of this Standard. This will, as a result, assist users of financial statements to understand more clearly the impact of recognising regulatory deferral account balances, and will allow direct comparisons not only against those entities that will be permitted to recognise these balances, but also against entities that do not recognise them.

Usefulness in assessing the future cash flows of an entity

BC72 Rate regulation imposes a framework for establishing prices that can be charged to customers for goods or services. Consequently, a rate-regulated entity is usually unable to react quickly in order to change its selling price in response to changes in its operating or other costs. Many of those who support the recognition of regulatory deferral account balances in financial statements argue that these balances provide some indication of the impact of these time delays on the cash flows that will be generated through future sales that will be made at a higher or lower price. The disclosures required by this Standard should provide more information about the amount and expected timing of the recovery or reversal of the regulatory deferral account balances recognised.

Better economic decision-making

BC73 The IASB has been told by many users in jurisdictions that currently permit or require regulatory deferral account balances to be recognised in financial statements that the information about those balances is useful in making economic decisions. At the same time, many other users of IFRS financial statements have noted that the inclusion of such balances could be confusing because it is not clear whether they meet the definitions of assets and liabilities. As a result, these users think that it is unclear what these balances represent.

BC74 The IASB thinks that this Standard will allow entities within its scope to continue to provide information that some users find useful, but that the presentation requirements will provide clarity to avoid confusion for those who are not familiar with the recognition of regulatory deferral account balances.

BC75 In particular, the IASB thinks that the improvements in comparability noted in paragraphs BC69–BC71 will provide users of financial statements with more information to help them better understand the impact of rate regulation on those rate-regulated entities that will be able to continue to recognise regulatory deferral account balances in accordance with this Standard.

Effect on compliance costs for preparers

BC76 This Standard will not change the recognition or measurement policies of entities within its scope, and thus will not result in any cost change in this respect. However, the IASB acknowledges that the separate presentation of regulatory deferral account balances is likely to result in changes to most existing presentation policies. Existing policies of entities within the scope of this Standard usually require or permit certain regulatory deferral account balances to be included within the carrying amount of items of property, plant and equipment and other assets. The separate presentation required by this Standard may add some cost on an ongoing basis, because preparers would need to track some of the differences between the regulatory amounts and those reported in the financial statements in more detail than is currently required.

BC77 However, the cost on the initial application of this Standard would largely be mitigated by the exemption that is already contained in paragraph D8B of IFRS 1. This exemption applies to first-time adopters of IFRS that hold items of property, plant and equipment or intangible assets that are, or were previously, used in operations subject to rate regulation. It allows those first-time adopters to use the previous GAAP carrying amount of such an item at the date of transition to IFRS as deemed cost. Consequently, the additional administrative burden of tracking changes need only apply on a prospective basis for differences arising after the date of transition.

BC78 In addition, the IASB understands that in many regulatory regimes, the regulatory accounting requirements require that regulatory deferral account balances are recorded in separate accounts within the entity's financial record-keeping system, at least until such time that the regulator issues a formal rate decision. Consequently, the IASB thinks that the incremental costs of retaining this separation beyond the time normally required by the regulator should not be significant.

How the costs of analysis for users are affected

BC79 The likely effect of these requirements on the costs of analysis for users of financial statements is expected to be outweighed by the benefits of improved reporting. Some users have commented that information related to the impact that rate regulation has on the amount, timing and certainty of returns and cash flows is important. The IASB think that the segregated presentation and related disclosures required by this Standard will highlight more clearly this impact. As noted in paragraph BC66, the requirements should have little or no impact on the net assets or the net profit reported in the financial statements of those entities within the scope of this Standard. Consequently, there is expected to be little disruption to the information available for trend analyses. Although the changes to the presentation of the amounts may cause some initial costs to be incurred, the IASB thinks that the added transparency introduced by this Standard will provide users with clearer and more comparable information.

Dissenting opinions

Dissent of Messrs Edelmann, Gomes and Zhang

DO1 Messrs Edelmann, Gomes and Zhang voted against the publication of IFRS 14.

Reduced comparability and inconsistency with existing IFRS practice

DO2 The established practice in IFRS has been that rate-regulated entities do not recognise regulatory deferral account balances in IFRS financial statements. Consequently, almost all rate-regulated entities around the world that previously recognised regulatory deferral account balances in their financial statements in accordance with their previous GAAP did not continue to recognise such balances but instead, derecognised them when they first adopted IFRS. In the view of Messrs Edelmann, Gomes and Zhang, to now permit an unknown population of rate-regulated entities to recognise these balances when adopting IFRS will introduce inconsistent accounting treatment into IFRS reporting and will reduce existing comparability.

DO3 In addition, Messrs Edelmann, Gomes and Zhang disagree with permitting first-time adopters of IFRS to continue to measure the regulatory deferral account balances that are recognised in the statement of financial position using their previous GAAP accounting policies. They believe that further inconsistency might be introduced by entities continuing to apply existing practices that might not be comparable with other entities that have different existing practices. In their view, isolating the impact of recognising regulatory deferral account balances by presenting them separately is not sufficient to eliminate the effect of this inconsistency. Messrs Edelmann, Gomes and Zhang are also concerned that entities might encounter operational difficulties in applying other general Standards to regulatory deferral account balances because there is uncertainty as to whether these balances are assets and liabilities, and there is no single clear and consistent recognition and measurement policy for them. This in turn might create additional diversity and further reduce comparability in practice.

Creating uncertainty for potential future adopters of IFRS

DO4 Messrs Edelmann, Gomes and Zhang acknowledge that this Standard is intended to be a practical and short-term interim solution to address a significant barrier to the adoption of IFRS in some jurisdictions. They note that a major argument for this Standard is to avoid rate-regulated entities having to make a major change to their accounting policies when making the transition to IFRS (ie derecognise their regulatory deferral account balances in accordance with the current established practice in IFRS of almost all rate-regulated entities) until guidance can be developed through the comprehensive project on rate-regulated activities (see paragraph BC18). However, they also note that this argument is not new, and nor is it specific to this particular subject. Despite this argument, when developing major projects, the IASB does not usually introduce interim Standards to be applied only by first-time adopters of IFRS. In particular, the IASB did not decide to introduce an interim Standard when it worked on the

Exposure Draft *Rate-regulated Activities*, published in July 2009 (the '2009 ED'), which, at that time, would have equally avoided the issue for many entities in jurisdictions that have since adopted IFRS.

DO5 In addition, Messrs Edelmann, Gomes and Zhang note that the majority of IFRS Advisory Council members, at their meeting in October 2012, did not support the development of an interim Standard that would permit the continuation of existing previous GAAP policies. Many of those members warned against setting a precedent of implementing a policy of adopting an interim solution whenever a major standard-setting project is activated. Messrs Edelmann, Gomes and Zhang are concerned that developing an interim solution in this situation might create uncertainty as to what the IASB's approach might be when major projects are being researched in the future.

Recognition is contrary to the *Conceptual Framework for Financial Reporting*

DO6 Messrs Gomes and Zhang also disagree with permitting regulatory deferral account balances to be recognised in the statement of financial position because they do not think that all such balances meet the definitions of assets and liabilities in the IASB's *Conceptual Framework*. This is one of the issues that the comprehensive Rate-regulated Activities project is looking to resolve. Consequently, the IASB has stated that IFRS 14 does not anticipate the outcome of the comprehensive project, and uses the neutral term 'regulatory deferral account balances' instead of 'regulatory assets' and 'regulatory liabilities' (see paragraph BC21). However, Messrs Gomes and Zhang believe that permitting them to be included in the statement of financial position is equivalent to recognising them as assets and liabilities, which, in their view, is contrary to the current accounting principles in the *Conceptual Framework* and the application of existing Standards.

DO7 In addition, Messrs Gomes and Zhang are concerned that allowing regulatory deferral account balances to be recognised in the financial statements is contrary to the IASB's objectives of requiring high-quality, transparent and comparable information in financial statements by requiring similar transactions and events to be accounted for and reported in a similar way. The IASB acknowledges that rate regulators have different objectives for regulatory reporting than the IASB has for financial reporting. In the view of Messrs Gomes and Zhang, allowing regulatory deferral account balances to be recognised will effectively allow the objectives of the rate regulator(s) to take precedence over the objectives of general purpose financial reporting, as expressed in the *Conceptual Framework*. In particular, they believe that allowing regulatory deferral account balances to be recognised effectively allows the objectives of the rate regulator(s) for setting rates and smoothing out the volatility, which results from real economic events, to be reflected in the financial statements. Messrs Gomes and Zhang think that this is inconsistent with paragraph OB17 of the *Conceptual Framework*, which notes the importance of depicting the effects of transactions and other events and circumstances on a reporting entity's economic resources and claims in the periods in which those effects occur, even if the resulting cash receipts and payments occur in a different period.

