April 2013

16. Sitzung IFRS-FA am 17.05.2013
16_06b_IFRS-FA_130425_ED_regulatory_deferral

Exposure Draft ED/2013/5

Regulatory Deferral Accounts

Comments to be received by 4 September 2013

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Regulatory Deferral Accounts

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Exposure Draft ED/2013/5 *Regulatory Deferral Accounts* is published by the International Accounting Standards Board (IASB) for comment only. The proposals may be modified in the light of the comments received before being issued in final form. Comments on the Exposure Draft and the Basis for Conclusions need to be received by **4 September 2013** and should be submitted in writing to the address below or electronically via our website www.ifrs.org using the 'Comment on a proposal' page.

All responses will be put on the public record and posted on our website unless the respondent requests confidentiality. Confidentiality requests will not normally be granted unless supported by good reason, such as commercial confidence.

ISBN: 978-1-907877-89-6

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Introduction

Reasons for publishing the Exposure Draft

The International Accounting Standards Board (IASB) has developed this proposed interim International Financial Reporting Standard ([draft] interim Standard) for regulatory deferral accounts because:

(a) the requirements of some national accounting standard-setting bodies permit or require entities that are subject to rate regulation to capitalise and defer expenditures that would otherwise be recognised as expenses by non-rate-regulated entities. Similarly, rate-regulated entities are permitted or required to defer income that would otherwise be recognised in the statement of profit or loss and other comprehensive income by non-rate-regulated entities. These regulatory deferral account balances are presented in a variety of ways. They are often described as 'regulatory assets' and 'regulatory liabilities' but are sometimes incorporated within other line items in the financial statements, such as property, plant and equipment;

(b) there is currently no Standard in IFRS that specifically addresses the accounting for rate-regulated activities. Consequently, an entity is required to determine its accounting policy for the financial effects of rate regulation in accordance with paragraphs 10–12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. The IASB has not seen evidence of significant diversity in practice within jurisdictions that are applying IFRS because almost all entities have eliminated regulatory deferral account balances when making the transition to IFRS and thus do not recognise them in IFRS financial statements. However, despite this consistency of treatment within IFRS financial statements, there are different views within jurisdictions that have not yet adopted IFRS, and some others that have adopted IFRS, on how the effects of rate regulation should be accounted for. This has resulted in several requests to the IASB for guidance, which have asked whether regulatory deferral account balances might meet the definitions of assets and liabilities in the *Conceptual Framework for Financial Reporting* ('the *Conceptual Framework*'), depending on the terms of the rate regulation;

(c) the lack of specific guidance in IFRS has resulted in various jurisdictions that have not yet fully adopted IFRS taking different approaches to reporting the effects of rate regulation, which could reduce comparability and transparency for users of financial statements; and

(d) income and expenses that are subject to rate regulation are significant to entities that are engaged in rate-regulated activities, such as those in the utilities, telecommunications and transport industries. Consequently, the lack of guidance could be a significant barrier to the adoption of IFRS for those entities.

In December 2008, the IASB added a project to its agenda to develop guidance for entities that have activities that are subject to rate regulation. In July 2009 the IASB published an Exposure Draft *Rate-regulated Activities* (the 2009 ED).

Although the IASB recognised the importance of accounting for rate-regulated activities generally, it decided in September 2010 that it was not feasible to complete the detailed analysis that was required for this project, obtain the appropriate input from all of the interested parties and undertake the IASB's normal due process in a timely manner because of the complexities of the issue.

The IASB issued an Agenda Consultation in July 2011 and, as part of that process, asked interested parties whether the Rate-regulated Activities project should be restarted. As a result of views received from that consultation, a revised, comprehensive project was initiated in September 2012. This Rate-regulated Activities project has started with a research phase, the aim of which is to develop a Discussion Paper.

In December 2012, the IASB decided to add an additional phase to the Rate-regulated Activities project to develop an interim Standard. This interim Standard is intended to allow entities that adopt IFRS, and that currently recognise regulatory deferral accounts in accordance with their previous GAAP (as defined in IFRS 1 *First-time Adoption of International Financial Reporting Standards*, ie the basis of accounting that a first-time adopter used immediately before adopting IFRS), to continue to do so. This will allow those entities to avoid making major changes in accounting policy on transition to IFRS until guidance can be developed through the comprehensive project.

However, by publishing this [draft] interim Standard, the IASB is in no way anticipating the outcome of the Rate-regulated Activities project. The term 'regulatory deferral account balances' has been chosen as a neutral descriptor for the items that arise from rate-regulatory accounting requirements and that are within the scope of this [draft] interim Standard. In this proposal, such balances are not described as 'regulatory assets' or 'regulatory liabilities' because of differing views as to whether they meet the definitions of assets or liabilities in the *Conceptual Framework*. Consequently, the IASB's objectives for this [draft] interim Standard are to:

(a) 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 IASB's comprehensive Rate-regulated Activities project; and

(b) ensure that users of financial statements will be able to identify clearly the amounts of regulatory deferral account balances, and movements in those balances, in order to be able to compare the financial statements of entities that recognise such balances in accordance with this [draft] interim Standard against the financial statements of entities that do not recognise such balances.

Main features of the [draft] interim Standard

The [draft] interim Standard:

(a) permits 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 without specifically considering the requirements of paragraph 11 of IAS 8;

(b) requires entities 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) requires 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 this [draft] interim Standard.

Invitation to comment

The IASB invites comments on any aspect of the Exposure Draft of its proposed interim Standard *Regulatory Deferral Accounts*. It would particularly welcome answers to the questions set out below.

Comments are most helpful if they:

(a) comment on the questions as stated;

(b) indicate the specific paragraph or group of paragraphs to which they relate;

(c) contain a clear rationale; and

(d) include any alternative that the IASB should consider, if applicable.

Respondents need not comment on all of the questions and are encouraged to comment on any additional issues that, in their view, warrant comment.

The IASB is not seeking comments on aspects of the accounting for rate-regulated activities that are not addressed in this Exposure Draft. In particular, the IASB is not seeking views on whether regulatory deferral account balances meet the definitions of assets and liabilities in the *Conceptual Framework*. That question will be addressed in the Discussion Paper that is being developed as part of the comprehensive Rate-regulated Activities project.

The IASB will consider all comments received in writing by **4 September 2013**. When considering the comments, the IASB will base its conclusions on the merits of the arguments for and against each approach, not on the number of responses supporting each one.

Scope

Question 1
The Exposure Draft proposes to restrict the scope to those first-time adopters of IFRS that recognised regulatory deferral account balances in their financial statements in accordance with their previous GAAP. Is the scope restriction appropriate? Why or why not?

Question 2
The Exposure Draft proposes two criteria that must be met for regulatory deferral accounts to be within the scope of the proposed interim Standard. These criteria require that: (a) an authorised body (the rate regulator) restricts the price that the entity can charge its customers for the goods or services that the entity provides, and that price binds the customers; and (b) the price established by regulation (the rate) is designed to recover the entity's allowable costs of providing the regulated goods or services (see paragraphs 7–8 and BC33–BC34). Are the scope criteria for regulatory deferral accounts appropriate? Why or why not?

Question 3
The Exposure Draft proposes that if an entity is eligible to adopt the [draft] interim Standard it is permitted, but not required, to apply it. If an eligible entity chooses to apply it, the entity must apply the requirements to all of the rate-regulated activities and resulting regulatory deferral account balances within the scope. If an eligible entity chooses not to adopt the [draft] interim Standard, it would derecognise any regulatory deferral account balances that would not be permitted to be recognised in accordance with other Standards and the *Conceptual Framework* (see paragraphs 6, BC11 and BC49). Do you agree that adoption of the [draft] interim Standard should be optional for entities within its scope? If not, why not?

Recognition, measurement and impairment

Question 4
The Exposure Draft proposes to permit an entity within its scope to continue to apply its previous GAAP accounting policies for the recognition, measurement and impairment of regulatory deferral account balances. An entity that has rate-regulated activities but does not, immediately prior to the application of this [draft] interim Standard, recognise regulatory deferral account balances shall not start to do so (see paragraphs 14–15 and BC47–BC48). Do you agree that entities that currently do not recognise regulatory deferral account balances should not be permitted to start to do so? If not, why not?

Question 5

The Exposure Draft proposes that, in the absence of any specific exemption or exception contained within the [draft] interim Standard, other Standards shall apply to regulatory deferral account balances in the same way as they apply to assets and liabilities that are recognised in accordance with other Standards (see paragraphs 16–17, Appendix B and paragraph BC51).

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

Presentation

Question 6

The Exposure Draft proposes that an entity should apply the requirements of all other Standards before applying the requirements of this [draft] interim Standard. In addition, the Exposure Draft proposes that the incremental amounts that are recognised as regulatory deferral account balances and movements in those balances should then be isolated by presenting them separately from the assets, liabilities, income and expenses that are recognised in accordance with other Standards (see paragraphs 6, 18–21 and BC55–BC62).

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

Disclosure

Question 7

The Exposure Draft proposes disclosure requirements to enable users of financial statements to understand the nature and financial effects of rate regulation on the entity's activities and to identify and explain the amounts of the regulatory deferral account balances that are recognised in the financial statements (see paragraphs 22–33 and BC65).

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

Question 8

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

Is this approach appropriate? Why or why not?

Transition

Question 9
The Exposure Draft does not propose any specific transition requirements because it will initially be applied at the same time as IFRS 1, which sets out the transition requirements and relief available. Is the transition approach appropriate? Why or why not?

Other comments

Question 10
Do you have any other comments on the proposals in the Exposure Draft?

[Draft] International Financial Reporting Standard X *Regulatory Deferral Accounts* ([draft] IFRS X) is set out in paragraphs 1–33 and Appendices A–C. All the paragraphs have equal authority. Paragraphs in **bold** type state the main principles. Terms defined in Appendix A are in *italics* the first time that they appear in the [draft] interim Standard. Definitions of other terms are given in the Glossary for International Financial Reporting Standards. The [draft] interim Standard should be read in the context of its objective and the Basis for Conclusions, the *Preface to International Financial Reporting Standards* and the *Conceptual Framework for Financial Reporting*. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

[Draft] International Financial Reporting Standard X *Regulatory Deferral Accounts*

Objective

1 The objective of this [draft] interim Standard is to specify the financial reporting requirements for *regulatory deferral account balances* that arise when an entity provides goods or services to customers at a price or rate that is subject to *rate regulation*.

2 In meeting this objective, this [draft] interim Standard provides some exceptions to or exemptions from the requirements of other Standards. All specified requirements for reporting regulatory deferral account balances, and any exceptions to or exemptions from the requirements of other Standards that are related to those balances, are contained within this [draft] interim Standard instead of within those other Standards.

3 In particular, the [draft] interim Standard requires:

(a) limited improvements to existing *previous GAAP* accounting practices for regulatory deferral account balances, which are primarily related to the presentation of these accounts; and

(b) disclosures that:

(i) identify and explain the amounts recognised in the entity's financial statements that arise from rate regulation; and

(ii) help users of those financial statements to understand the amount, timing and uncertainty of future cash flows from any regulatory deferral account balances that are recognised.

Scope

4 An entity that recognised regulatory deferral account balances in its financial statements in accordance with its previous GAAP is permitted to apply the requirements of this [draft] interim Standard in its *first IFRS financial statements* and in its financial statements for subsequent periods.

5 The requirements of this [draft] interim Standard permit an entity within its scope to continue to account for regulatory deferral account balances in its financial statements in accordance with its previous GAAP when it adopts IFRS.

6 This [draft] interim Standard does not address other aspects of accounting by entities that are engaged in rate-regulated activities. By applying the requirements in this [draft] interim Standard, an entity recognises, as regulatory deferral account balances in the statement of financial position, amounts that would otherwise be recognised in the current or a prior period in the statement of profit or loss and other comprehensive income as an expense or income. Although rate regulators can affect the timing of the recovery of costs or the reversals of over-recoveries in rates, rate regulators do not change the

characteristics of assets and liabilities that exist and would be recognised in accordance with existing IFRS. Consequently, this [draft] interim Standard is only applicable to the incremental amounts that would not otherwise be recognised as assets or liabilities in accordance with other Standards and the *Conceptual Framework for Financial Reporting*.

7 **An entity that is eligible to and elects to apply this [draft] interim Standard shall apply all of its requirements to the regulatory deferral accounts arising from all of the entity's rate-regulated activities that meet the following criteria:**

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

8 The second scope criterion in paragraph 7 requires that there is an identifiable causal effect that links the regulatory deferral account balances to the rate-setting mechanism. This does not require a one-to-one matching of costs but does require that the rate-setting mechanism is designed to recover the entity's specified costs. Consequently, rate-setting mechanisms that determine rates based on targeted or assumed costs, for example, industry averages, without a link to the actual costs of the entity are not within the scope of this [draft] interim Standard.

Recognition, measurement and impairment

Temporary exemption from IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* paragraph 11

9 **An entity with activities that are subject to rate regulation and that is eligible to and elects to apply this [draft] interim Standard shall apply paragraphs 10 and 12 of IAS 8 when developing its accounting policies for the recognition, measurement and impairment of regulatory deferral account balances.**

10 Paragraphs 11–12 of IAS 8 specify sources of requirements and guidance that management is required or permitted to consider in developing an accounting policy for an item, if no relevant Standard applies specifically to that item. This [draft] interim Standard exempts an entity from applying paragraph 11 of IAS 8 to its accounting policies for the recognition, measurement and impairment of regulatory deferral account balances. Consequently, entities that recognise regulatory deferral account balances, either as separate items or as part of the carrying value of other assets and liabilities, in accordance with their previous GAAP, are permitted to continue to do so in accordance with this [draft] interim Standard through the exemption from paragraph 11 of IAS 8, subject to the presentation changes required by paragraphs 18–19 of this [draft] interim Standard.

Changes in accounting policies

11 Paragraphs 12–13 apply both to changes made on initial application of this [draft] interim Standard and to changes made in subsequent reporting periods.

12 An entity may change its accounting policies for recognising and measuring regulatory deferral account balances if the change makes the financial statements more relevant to the economic decision-making needs of users and no less reliable, or more reliable and no less relevant to those needs. An entity shall judge relevance and reliability using the criteria in IAS 8.

13 This [draft] interim Standard does not exempt entities from applying paragraph 10 of IAS 8. To justify changing its accounting policies for regulatory deferral account balances, an entity shall demonstrate that the change brings its financial statements closer to meeting the criteria in IAS 8. However, the change does not need to achieve full compliance with those criteria for the recognition, measurement and impairment of regulatory deferral account balances.

Continuation of existing accounting policies

14 On initial application of this [draft] interim Standard, an entity shall continue to apply its previous GAAP accounting policies for the recognition, measurement and impairment of regulatory deferral account balances, except for any changes permitted by paragraphs 11–13. However, the presentation of such items shall be changed when necessary to comply with the presentation requirements of this [draft] interim Standard (see paragraph 18).

15 An entity shall apply the policies identified in accordance with paragraph 14 consistently in subsequent periods, except for any changes permitted by paragraphs 11–13.

Interaction with general Standards

16 In the absence of any specific exception, exemption or additional requirement contained within this [draft] interim Standard, other Standards shall apply to regulatory deferral accounts in the same way as they apply to assets, liabilities, income and expenses that are recognised in accordance with other Standards. Paragraphs B2–B17 provide additional guidance.

17 In some situations, another Standard might need to be applied to a regulatory deferral account balance that has been measured in accordance with an entity's accounting policies that are established in accordance with paragraphs 14–15 in order to reflect that balance appropriately in the financial statements. For example, the entity might have rate-regulated activities in a foreign country for which the transactions and regulatory deferral account balances are denominated in a currency that is not the functional currency of the reporting entity. The regulatory deferral account balances and the movements in those balances are translated by applying IAS 21 *The Effects of Changes in Foreign Exchange Rates*.

Presentation

Changes in presentation

18 This [draft] interim Standard introduces presentation requirements, outlined in paragraphs 19–21, for regulatory deferral account balances that are recognised in accordance with paragraphs 14–15. As stated in paragraph 6, regulatory deferral account balances are the incremental amounts that are recognised in addition to the assets and liabilities that are recognised in accordance with other Standards. These presentation requirements separate the impact of recognising regulatory deferral account balances from the financial reporting requirements of other Standards.

19 In addition to the items that are required to be presented in the statement of financial position and in the statement of profit or loss and other comprehensive income in accordance with IAS 1 *Presentation of Financial Statements*, an entity applying this [draft] interim Standard shall present all regulatory deferral account balances and the movements in those balances in accordance with paragraphs 20–21.

Classification of regulatory deferral account balances

20 An entity shall present separate line items in the statement of financial position for:

(a) the total of all regulatory deferral account debit balances; and

(b) the total of all regulatory deferral account credit balances.

These separate line items shall be distinguished from the assets and liabilities that are presented in accordance with other Standards by use of sub-totals, which are drawn before the regulatory deferral account balances are presented.

Classification of movements in regulatory deferral account balances

21 An entity shall present, in the profit or loss section of the statement of profit or loss and other comprehensive income, or in the separate statement of profit or loss, the net movement in all regulatory deferral account balances for the reporting period, except for amounts acquired or disposed of. This separate line item shall be distinguished from the income and expenses that are presented in accordance with other Standards by the use of a sub-total for the amount of profit or loss before the net movement in regulatory deferral account balances.

Disclosure

Objective

22 An entity shall disclose information that enables users to evaluate:

(a) the nature of, and the risks associated with, the rate regulation that restricts the price that the entity can charge customers for the goods and services it provides; and

(b) the effects of that rate regulation on its financial position, financial performance and cash flows.

23 If any of the disclosures set out in paragraphs 25–33 are not considered relevant to meet the requirements in paragraph 22, they may be omitted from the financial statements. If the disclosures provided in accordance with paragraphs 25–33 are insufficient to meet the requirements in paragraph 22, an entity shall disclose additional information that is necessary to meet those requirements.

24 To meet the disclosure requirements in paragraph 22, an entity shall consider all of the following:

(a) whether the rate-regulated activities are material to the financial performance or position of the entity;

(b) the level of detail that is necessary to satisfy the disclosure requirements;

(c) how much emphasis to place on each of the various requirements;

(d) how much aggregation or disaggregation to undertake; and

(e) whether users of financial statements need additional information to evaluate the quantitative information disclosed.

Explanation of activities subject to rate regulation

25 To help a user of the financial statements assess the nature of, and the risks associated with, the rate regulation that restricts the price that the entity can charge customers for the goods and services it provides, an entity shall, for each portion of rate-regulated activities that is material to the financial performance or position of the entity, disclose:

(a) a brief description of the nature and extent of the rate-regulated activities and the nature of the regulatory rate-setting process;

(b) the identity of the rate regulator. If the rate regulator is a related party (as defined in IAS 24 *Related Party Disclosures*), the entity shall disclose a statement to that effect, together with an explanation of how it is related; and

(c) how the future recovery of each regulatory deferral account debit balance or reversal of each regulatory deferral account credit balance is affected by risks and uncertainty, for example:

  (i) demand risk (for example, changes in either consumer attitudes, the availability of alternative sources of supply, or the levels of competition);

  (ii) regulatory risk (for example, the submission or approval of a rate-setting application; or the entity's assessment of the expected future regulatory actions); and

  (iii) other risks (for example, currency or other market risks).

26 The disclosures required by paragraph 25 shall be given either in the financial statements or incorporated by cross-reference from the financial statements to some other statement, such as a management commentary or risk report, that is available to users of the financial statements on the same terms as the financial statements and at the same time. If the information is not included in the financial statements or incorporated by cross-reference, the financial statements are incomplete.

Explanation of recognised amounts

27 An entity shall disclose the basis on which regulatory deferral account balances are recognised and measured initially and subsequently, including how regulatory deferral account balances are assessed for recoverability and the allocation of any impairment loss.

28 For each portion of rate-regulated activities that is material to the financial performance or position of the entity and for others in aggregate, an entity shall disclose the following information for each category of regulatory deferral account (ie for each type of cost or income) that is individually material and for others in aggregate:

(a) a reconciliation of the carrying amount at the beginning and the end of the period, in a tabular format unless another format is more appropriate. The entity shall apply judgement in deciding the level of detail necessary (see paragraph 24), but the following components would usually be relevant:

  (i) the amounts that have been recognised in the current period in the statement of financial position as regulatory deferral account balances to be recovered or reversed in the current or future periods;

  (ii) the amount that is recognised in the statement of profit or loss and other comprehensive income relating to balances that have been recovered, amortised or reversed in the current period; and

  (iii) other amounts that affected the regulatory deferral account balances, such as items acquired or assumed in a business combination or items disposed of, or the effects of changes in foreign exchange rates, discount rates or estimated cash flows. If a single cause has a significant effect on a regulatory deferral account balance, the entity shall disclose it separately;

(b) the rate of return or discount rate (including a zero rate or a range of rates, when applicable) allowed, or required, by the rate regulator to reflect the time value of money that is applicable to each regulatory deferral account balance; and

(c) the remaining periods over which the entity expects to recover or amortise the carrying amount of each regulatory deferral account debit balance or to reverse each regulatory deferral account credit balance.

29 When regulatory accounting requirements affect the amount and timing of a rate-regulated entity's income tax payments, the entity shall identify, as a

separate category of deferral account in the reconciliation required by paragraph 28, the deferred tax that arises in respect of the regulatory deferral account debit and credit balances (see paragraphs B4–B6).

30 When an entity presents earnings per share in accordance with IAS 33 *Earnings per Share*, the entity shall present additional basic and diluted earnings per share, which are calculated using the earnings amounts required by IAS 33 but excluding regulatory amounts (see paragraphs B7–B8).

31 When an entity presents a discontinued operation or a disposal group in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, the entity shall include any related regulatory deferral account balances and the net movement in those balances, as applicable, as part of the regulatory deferral account balances and movements instead of within the disposal groups or discontinued operations (see paragraphs B11–B13).

32 When an entity provides disclosures in accordance with IFRS 12 *Disclosure of Interests in Other Entities* for an interest in a subsidiary, associate or joint venture that has rate-regulated activities and for which regulatory deferral account balances are recognised in accordance with this [draft] interim Standard, the entity shall disclose the amounts that are included for the regulatory deferral account debit and credit balances and the net movement in the balances for those interests (see paragraphs B14–B17).

33 When an entity concludes that a regulatory deferral account balance is no longer fully recoverable, it shall disclose that fact, the reason why it is not recoverable and the amount by which the regulatory deferral account balance has been reduced.

Appendix A
Defined terms

This appendix is an integral part of the [draft] interim Standard.

Allowable costs	The costs that are specific to the entity and for which the regulated rate is intended to provide recovery.
First IFRS financial statements	The first annual financial statements in which an entity adopts International Financial Reporting Standards (IFRS), by an explicit and unreserved statement of compliance with IFRS.
First-time adopter	An entity that presents its **first IFRS financial statements**.
Previous GAAP	The basis of accounting that a **first-time adopter** used immediately before adopting IFRS.
Rate-regulated activities	The portion of an entity's activities that is subject to **rate regulation**.
Rate regulation	A restriction on the setting of prices that can be charged to customers for services or products.
Rate regulator	An authorised body that is empowered by statute or contract to set rates that bind an entity's customers. The **rate regulator** may be a third-party body or may be the entity's own governing board, if that board is required by statute or contract to set rates both in the interest of the customers and to ensure the overall financial viability of the entity.
Regulatory deferral account balances	The balance of any expense (income) deferral or variance account that is included in the setting of the future rate(s) by the **rate regulator** and that would not otherwise be recognised as an asset or a liability in accordance with other Standards.

Appendix B
Application Guidance

This appendix is an integral part of the [draft] interim Standard.

Continuation of existing accounting policies

B1 As explained in paragraph 6, by applying the requirements in this [draft] interim Standard, an entity recognises, as regulatory deferral account debit or credit balances in the statement of financial position, amounts that would otherwise be recognised in the current or a prior period in the statement of profit or loss and other comprehensive income as an expense or income. In some cases, other Standards explicitly prohibit an entity from recognising, in the statement of financial position, amounts that might be recognised as regulatory deferral account balances in accordance with previous GAAP accounting policies. Consequently, in accordance with paragraph 14 of this [draft] interim Standard, an entity is permitted to continue to apply its previous GAAP accounting policies, including, for example, the following practices. However, paragraph 12 prohibits the introduction of the practices described:

(a) recognising a regulatory deferral account debit balance when the entity has the right, as a result of the actual or expected actions of the rate regulator, to increase rates in future periods in order to recover its allowable costs. Similarly, an entity is permitted to continue to recognise regulatory deferral account credit balances when it is required, as a result of the actual or expected actions of the rate regulator, to decrease rates in future periods in order to reverse over-recoveries of allowable costs (ie amounts in excess of the recoverable amount specified by the rate regulator). The following are examples of the types of allowable costs that rate regulators might include in rate-setting decisions and that an entity might, therefore, recognise in regulatory deferral account balances (the list is not exhaustive):

(i) volume or purchase price variances;

(ii) costs of approved 'green energy' initiatives (that are not capitalised as part of the cost of property, plant and equipment in accordance with IAS 16 *Property, Plant and Equipment*);

(iii) non-directly-attributable overhead costs;

(iv) project cancellation costs;

(v) storm damage costs; and

(vi) deemed interest (including amounts allowed for funds that are used during construction that provide the entity with a return on the owner's equity capital as well as borrowings);

(b) measuring regulatory deferral account balances on an undiscounted basis or on a discounted basis that uses the interest/discount rate specified by the rate regulator; and

(c) recognising a regulatory deferral account debit or credit balance, which is equivalent in amount to any loss or gain on the disposal or retirement of both items of property, plant and equipment and of intangible assets, which are expected to be recovered or reversed through future rates.

Applicability of other Standards

B2 An entity that is eligible to and elects to apply the requirements of this [draft] interim Standard shall continue to apply its previous GAAP accounting policies for the recognition, measurement and impairment of regulatory deferral account balances. However, paragraphs 16–17 state that, in some situations, other Standards might also need to be applied to regulatory deferral accounts in order to reflect them appropriately in the financial statements. The following paragraphs identify some of those existing Standards, in addition to IAS 21 (which is addressed in paragraph 17), and outline how they interact with the requirements of this [draft] interim Standard. In particular, the following paragraphs clarify the specific exceptions, exemptions and additional presentation and disclosure requirements that are applicable.

Application of IAS 10 *Events after the Reporting Period*

B3 An entity might need to use estimates and assumptions in the recognition and measurement of its regulatory deferral account balances. When events occur between the end of the reporting period and the date when the financial statements are authorised for issue, the entity shall apply IAS 10 to identify whether those estimates and assumptions should be adjusted to reflect those events.

Application of IAS 12 *Income Taxes*

B4 IAS 12 requires an entity to recognise a deferred tax liability and (subject to certain conditions) a deferred tax asset for all temporary differences, with certain limited exceptions. A rate-regulated entity shall apply IAS 12 to all of its activities, including its rate-regulated activities, to identify the amount of income tax expense that is to be recognised.

B5 In some rate-regulatory schemes, the rate regulator permits or requires an entity to increase its future rates in order to recover some or all of the entity's income tax expense. In such circumstances, this might result in the entity recognising a regulatory deferral account balance for income tax in the statement of financial position, in accordance with its continuing accounting policies. The recognition of this regulatory deferral account balance that relates to income tax might itself create an additional temporary difference for which a further deferred tax amount would be recognised.

B6 Notwithstanding the presentation and disclosure requirements of IAS 12, when an entity recognises a deferred tax asset or a deferred tax liability as a result of recognising a regulatory deferral account balance, the entity shall include that deferred tax amount within the related line item that is presented for regulatory deferral account balances or movements in those balances, instead of including it within the deferred tax liability (asset) or the tax expense (income). The entity may present the deferred tax amount as a separate item alongside that regulatory deferral account balance or movement or disclose it as part of the analysis of the regulatory line item(s) described by paragraphs 28–29 of this [draft] interim Standard.

Application of IAS 33 *Earnings per Share*

B7 Paragraph 66 of IAS 33 requires an entity to present, in the statement of profit or loss and other comprehensive income, basic and diluted earnings per share both for profit or loss from continuing operations and for profit or loss that is attributable to the ordinary equity holders of the parent entity. In addition, paragraph 68 of IAS 33 requires an entity that reports a discontinued operation to disclose the basic and diluted amounts per share for the discontinued operation, either in the statement of profit or loss and other comprehensive income or in the notes.

B8 For each earnings per share amount presented in accordance with IAS 33, an entity applying this [draft] interim Standard shall present additional basic and diluted earnings per share amounts that are calculated in the same way, except that those amounts shall exclude the net movement in the regulatory deferral account balances. An entity shall present all earnings per share with equal prominence for all periods presented.

Application of IAS 36 *Impairment of Assets*

B9 Paragraphs 14–15 require an entity to continue to apply its previous GAAP accounting policies for the identification, recognition and measurement of any impairment of its recognised regulatory deferral account balances. Consequently, IAS 36 shall not apply to the separate regulatory deferral account balances recognised.

B10 However, IAS 36 might require an entity to perform an impairment test on a cash-generating unit (CGU) that includes regulatory deferral account balances. This test might be required because the CGU also contains goodwill, or because one or more of the impairment indicators described in IAS 36 have been identified relating to the CGU. In such situations, paragraphs 74–79 of IAS 36 contain guidance about the required method for identifying the recoverable amount and the carrying amount of a CGU. Consequently, an entity shall apply that guidance to decide whether the regulatory balances recognised are included in the carrying amount of the CGU for the purpose of the impairment test. The remaining requirements of IAS 36 shall then be applied to any impairment loss that is recognised as a result of this test.

Application of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*

B11 Paragraphs 14–15 require an entity to continue to apply its previous accounting policies for the recognition and measurement of any impairment of regulatory deferral account balances. Consequently, the measurement requirements of IFRS 5 shall not apply to the regulatory balances recognised.

B12 Paragraphs 33–33A of IFRS 5 require a single discontinued operations amount to be presented in the statement of profit or loss and other comprehensive income. Notwithstanding the requirements of those paragraphs, when an entity presents a discontinued operation, it shall include the movement in regulatory deferral account balances that arose from the rate-regulated activities of the discontinued operation within the related line item that is presented for movements in the regulatory deferral account balances, instead of within the line items that are required by paragraphs 33–33A of IFRS 5. Similarly, notwithstanding the requirements of paragraph 38 of IFRS 5, when an entity presents a disposal group, the entity shall include the regulatory deferral account balances that are part of the disposal group within the related line item for the regulatory deferral account balances, instead of within the line items that are required by paragraph 38 of IFRS 5.

B13 The entity may present the total amount of regulatory deferral account debit and credit balances or the total movement in those balances that relate to the discontinued operation or disposal group as a separate line item alongside the regulatory deferral account balances or movement in those balances. Alternatively, it may be sufficient to disclose it as part of the analysis of the regulatory deferral account line item(s) described by paragraph 28 of this [draft] interim Standard.

Application of requirements for interests in other entities

B14 Paragraph 12(e) of IFRS 12 *Disclosure of Interests in Other Entities* requires an entity to disclose, for each of its subsidiaries that have non-controlling interests that are material to the reporting entity, the profit or loss that was allocated to non-controlling interests of the subsidiary during the reporting period. An entity that recognises regulatory deferral account balances in accordance with this [draft] interim Standard shall disclose the net movement in regulatory deferral account balances that is included within the amounts that are required to be disclosed by paragraph 12(e) of IFRS 12.

B15 Paragraph 12(g) of IFRS 12 also requires an entity to disclose, for each of its subsidiaries that have non-controlling interests that are material to the reporting entity, summarised financial information about the subsidiary, as specified in paragraph B10 of IFRS 12. Similarly, paragraph 21(b)(ii) of IFRS 12 requires an entity to disclose, for each joint venture and associate that is material to the reporting entity, summarised financial information as specified in paragraphs B12–B13 of IFRS 12. Paragraph B16 of IFRS 12 specifies the summary financial information that an entity is required to disclose for all other associates and joint ventures that are not individually material in accordance with paragraph 21(c) of IFRS 12.

B16 In addition to the information specified in paragraphs 12, 21, B10, B12–B13 and B16 of IFRS 12, an entity that recognises regulatory deferral account balances in accordance with this [draft] interim Standard shall also disclose the regulatory deferral account debit balance, the regulatory deferral account credit balance and the net movement in those balances for each entity for which those IFRS 12 disclosures are required.

B17 Paragraph 19 of IFRS 12 specifies the information that an entity is required to disclose when the entity recognises a gain or loss on losing control of a subsidiary, calculated in accordance with paragraph 25 of IFRS 10. In addition to the information required by paragraph 19 of IFRS 12, an entity shall disclose the portion of that gain or loss that is attributable to derecognising regulatory deferral account balances in the former subsidiary at the date when control is lost.

Appendix C
Effective date and transition

This appendix is an integral part of the [draft] interim Standard.

Effective date and transition

Effective date

C1 An entity shall apply this [draft] interim Standard in its first annual IFRS financial statements for periods beginning on or after [date to be inserted after exposure]. Earlier application is permitted. If an entity applies this [draft] interim Standard in its first annual IFRS financial statements for an earlier period, it shall disclose that fact.

Appendix D
[Draft] Amendments to other IFRSs

This appendix sets out the amendments to other Standards that the IASB expects to make when it finalises this [draft] interim Standard.

IFRS 1 *First-time Adoption of International Financial Reporting Standards*

Paragraph D8B is amended. New text is underlined and deleted text is struck through.

IFRS 1.D8B Some entities hold items of property, plant and equipment or intangible assets that are used, or were previously used, in operations subject to rate regulation. The carrying amount of such items might include amounts that were determined under previous GAAP but do not qualify for capitalisation in accordance with IFRSs. If this is the case, a first-time adopter may elect to use the previous GAAP carrying amount of such an item at the date of transition to IFRSs as deemed cost. If an entity applies this exemption to an item, it need not apply it to all items. At the date of transition to IFRSs, an entity shall test for impairment in accordance with IAS 36 each item for which this exemption is used. For the purposes of this paragraph, operations are subject to rate regulation if they provide goods or services to customers at prices (ie rates) established by an authorised body empowered to establish rates that bind the customers and that are designed to recover the ~~specific~~ <u>entity's allowable</u> costs ~~the entity incurs in~~ <u>of</u> providing the regulated goods or services<u>.</u> ~~and to earn a specified return. The specified return could be a minimum or range and need not be a fixed or guaranteed return.~~

Approval by the Board of the Exposure Draft *Regulatory Deferral Accounts* issued in April 2013

The Exposure Draft *Regulatory Deferral Accounts* was approved for publication by twelve of the fifteen[1] members of the International Accounting Standards Board (IASB). Messrs Edelmann, Gomes and Zhang voted against its publication. Their alternative views are set out after the Basis for Conclusions.

Hans Hoogervorst	Chairman
Ian Mackintosh	Vice-Chairman
Stephen Cooper	
Philippe Danjou	
Martin Edelmann	
Jan Engström	
Patrick Finnegan	
Amaro Luiz de Oliveira Gomes	
Prabhakar Kalavacherla	
Patricia McConnell	
Takatsugu Ochi	
Darrel Scott	
Chungwoo Suh	
Mary Tokar	
Wei-Guo Zhang	

1 At the date that this Exposure Draft was published, there were sixteen members of the IASB because Gary Kubareck joined the IASB on 15 April 2013. However, the IASB's approval process had been completed prior to this date.

CONTENTS

Basis for Conclusions on the Exposure Draft *Regulatory Deferral Accounts*

This Basis for Conclusions accompanies, but is not part of, the [draft] interim Standard.

Introduction

BC1 This Basis for Conclusions summarises the considerations of the International Accounting Standards Board (IASB) in reaching the tentative conclusions in the Exposure Draft *Regulatory Deferral Accounts*.

BC2 The IASB, and the IFRS Interpretations Committee (the Interpretations Committee), has 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 balance 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–BC13 and BC21), the term 'regulatory deferral account balances' has been chosen as a neutral descriptor for these items for the purpose of this [draft] interim Standard.

BC3 In June 2005, the Interpretations Committee received a request about the accounting standard issued by the US Financial Accounting Standards Board (FASB), SFAS 71 *Accounting for the Effects of Certain Types of Regulation*.[2] 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 and in the absence of specific guidance in IFRS.

BC4 US generally accepted accounting principles (US GAAP) have recognised the economic effect of certain types of rate regulation on US rate-regulated entities since at least 1962. In 1982, 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.

BC5 The Interpretations Committee 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*

2 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[3] … 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' 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 were received on the Interpretations Committee's tentative agenda decisions. Those comments pointed out that although divergence in 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 a definitive conclusion on whether the recognition of regulatory deferral account balances as assets or liabilities would be consistent with the *Conceptual Framework*.

BC9 Consequently, in December 2008, the IASB added a project on rate-regulated activities to its agenda and subsequently, in July 2009, issued an Exposure Draft *Rate-regulated Activities* (the 2009 ED). In September 2010, the IASB decided that the technical issues related to this topic could not be resolved quickly, and suspended the project until it had considered whether to include rate-regulated activities in its future agenda. A question on this issue was included in the 2011

3 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.

Agenda Consultation.[4] The responses to this consultation, received through comment letters and other outreach activities, persuaded the IASB to prioritise addressing this issue.

BC10 As a result of its agenda-setting process, in September 2012 the IASB decided to add to its agenda a research project on rate-regulated activities, with the aim of developing comprehensive guidance. 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.

Reasons for issuing the [draft] interim Standard

BC11 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 not only from jurisdictions that have not yet adopted IFRS and that currently recognise such regulatory items in accordance with their current GAAP, but also from entities in jurisdictions that already apply IFRS. The IASB notes that the established practice in IFRS has been that almost all rate-regulated entities eliminate regulatory deferral account balances from the statement of financial position when they adopt IFRS and do not recognise such balances in IFRS financial statements. However, many of these rate-regulated entities argue that recognising such balances as assets and liabilities would provide more relevant information and would be a more representationally faithful way of reporting their rate-regulated activities.

BC12 They argue that the terms of the rate regulation create 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. Those arguments were supported by the 2009 ED, which proposed that regulatory deferral account balances should be recognised when attached to activities that are subject to a specific type of rate regulation (referred to in the 2009 ED as 'cost-of-service rate regulation'). The IASB acknowledges that many respondents to the 2009 ED, and currently some members of the IASB, do not think that the regulatory deferral account balances meet the *Conceptual Framework* definitions of assets and liabilities and, therefore, should not be recognised in IFRS financial statements.

BC13 However, the proposals in the 2009 ED raised expectations that the IASB agreed that there was merit to the arguments used to support the tentative conclusion proposed in the 2009 ED that such items meet the definition of assets and liabilities within the *Conceptual Framework*. 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 that are being widely applied in accordance with some national GAAPs,

4 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 and to further enhance public accountability and legitimacy.

and that are familiar to many users of financial statements in those jurisdictions that currently permit or require the recognition of rate-regulated items.

BC14 The IASB acknowledges the difficult practice problems related to this issue. The responses to the 2009 ED raised complex and fundamental issues at a conceptual level that cannot be resolved quickly. Consequently, the IASB has started a research project to investigate these complex issues. In addition, the *Conceptual Framework* is currently being reviewed and updated. The outcome of the rate-regulated research project will be influenced by the outcome of the *Conceptual Framework* project. The initial objective of each of these projects is to develop a Discussion Paper that the IASB hopes will form a strong basis for developing guidance in the long term.

BC15 The IASB recognises that discontinuing the recognition of regulatory deferral account balances in advance 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. 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' 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.

BC16 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 allow a reasonable level of comparability of the treatment of the regulatory deferral account balances across jurisdictions. However, different approaches to accommodating existing practice for such balances has 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.

BC17 The IASB has, therefore, decided to issue this [draft] interim Standard, which proposes to allow those 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. Consequently, an entity that does not recognise regulatory deferral account balances in the period immediately preceding its first IFRS financial statements is not eligible to apply this [draft] interim Standard in order to start recognising such balances. An entity would not, therefore, be eligible if, for example, the entity did not have any relevant rate-regulated activities in the period before it made the transition to IFRS or the entity is a newly formed business and adopts IFRS in its first financial statements. 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 do not recognise such balances in accordance with IFRS.

BC18 An interim Standard that permits first-time adopters of IFRS to continue to apply their existing policies for recognising and measuring 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 guidance is developed through the comprehensive Rate-regulated Activities project. This would enable many rate-regulated entities to make the transition to IFRS, thus overcoming the barrier noted in paragraph BC15. In order to improve comparability between those IFRS preparers that are subject to rate-regulation but do not recognise regulatory deferral account balances and those entities that will be permitted to recognise such balances in accordance with this [draft] interim Standard, the IASB proposes some changes to the presentation of these balances. However, the presentation and disclosure proposals should help to reduce the disruption to trend information for these entities on transition to IFRS, until the IASB can consider these issues in its comprehensive project.

BC19 The IASB acknowledges that the proposal to permit 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. However, the IASB thinks that the proposed presentation and disclosure accounting requirements in this [draft] interim 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 the proposed interim Standard justify introducing this diversity:

(a) it is likely to remove a major barrier to the adoption of IFRS for many 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 will recognise such balances in accordance with the proposed interim Standard.

BC21 However, the IASB noted that, by publishing this [draft] interim Standard, it is in no way anticipating the outcome of the comprehensive Rate-regulated Activities project referred to in paragraph BC14. Consequently, regulatory deferral account balances are not described as ‘regulatory assets’ or ‘regulatory liabilities’ in this [draft] interim 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.

Background

BC22 For the purpose of this [draft] interim Standard, rate regulation is a restriction on the setting of prices that can be charged to customers for goods or services. Generally, rates are regulated when an entity provides goods or services that are often considered essential and has a monopoly or a dominant market position that gives it excessive market power. In such situations, there is a lack of effective competition to constrain the prices that the entity can charge. To compensate, governments impose rate regulation through legislative powers; this usually is done by establishing a rate-regulatory authority (the 'rate regulator') and giving it the power to approve the rates of a specific entity or categories of entities (for example, electricity distribution utilities). Entities within the jurisdiction of the rate regulator are not allowed to charge prices for regulated goods or services other than those approved by the rate regulator.

BC23 A number of rate-regulatory methodologies exist and, for each, application can vary by rate regulator, the entity that is being regulated and the particular circumstances. The objective of many methodologies is to set 'just and reasonable' rates, ie rates that balance both customer and investor interests. Rate regulators that use such methodologies establish rates that charge customers a fair price and are reasonably stable from year to year. At the same time, these rate regulators wish to ensure that the entity that is providing the regulated goods or services remains financially viable. Consequently, they may set rates to not only recover the costs of providing the goods or services, but also to provide a fair return to the entity's owners.

BC24 Cost-of-service rate regulation (for example, return-on-rate-base regulation) is one such methodology. Rates are set by working backwards from the desired return on the investment made by the entity to provide the regulated goods or services (the rate-base) and the allowable costs, which establishes the amount of revenue (the revenue requirement) that the rate regulator considers reasonable to achieve the regulatory objective. The rate regulator uses this revenue requirement, together with an estimate of future volume, to establish the rate or range of rates that the entity can charge customers or groups of customers.

BC25 In recent years there has been a trend towards incentive-based regulatory methodologies, such as so-called 'price-cap' regulation. With price-cap regulation, initial rates may reflect the cost of service, but are allowed to increase, or are required to decrease, over time in accordance with a formula. Hybrid methodologies that are combinations of price-cap and cost-of-service approaches also exist. Some of these hybrid methodologies use incentive-based rate-setting mechanisms with intermittent cost-of-service rebasing, which retains a causal effect between the rate-base and allowable costs and the setting of future prices.

BC26 Regardless of the regulatory methodology that is used, the economic reality of an entity with operations that are subject to rate regulation is shaped in part by the actions of its rate regulator. By restricting prices, rate regulation can affect the amount and timing of the entity's revenues and cash flows, thereby affecting its financial position and performance.

Accounting for rate-regulation purposes

BC27 In the types of rate regulatory schemes that are intended to be within the scope of this [draft] interim Standard, there is a strong link between the amounts that the rate regulator decides are included as allowable costs when determining the customer rates and the amounts that eventually are recognised through the entity's statement of profit or loss and other comprehensive income for financial reporting purposes. This is because the rate-setting mechanism is designed to recover the costs incurred by the entity (plus, when applicable, an allowed return on the investment by the owners of the entity). However, a rate regulator's actions may cause differences between the accounting treatment of a transaction or event for rate-setting purposes and its treatment for IFRS financial reporting purposes. These differences may result from differences in classification or timing, for example:

(a) A rate regulator may allow a 'deemed' cost of equity to be treated as an allowable cost for rate-making purposes. The aim of this treatment is to try to ensure that the regulated rate is designed both to recover the costs incurred by the entity and provide a reasonable rate of return on the investment for the entity's owners. For IFRS financial reporting purposes, this cost of equity is not recognised as an expense, nor is it included as part of the cost of construction of the item of property, plant and equipment or intangible asset. Instead, dividends that are paid or payable to the entity's owners are presented as a distribution of profit.

(b) In a cost-of-service regime, all of the entity's expenditures that could have a significant effect on rates are usually subject to a prudency review by the rate regulator. This includes expenditures for the construction of property, plant and equipment and some intangible assets. The capital investment aspects of an entity's rate-setting application may be reviewed by the rate regulator after the related expenditures have been incurred (and, sometimes, after the plant or other asset has been placed in service). The rate regulator will consider whether those expenditures are approved for recovery through customer rates. These allowable costs are usually included in the rate-base cost of the asset for regulatory purposes, even if they would not be capitalised for financial reporting purposes in accordance with the relevant Standard, such as IAS 16 or IAS 38. Costs that are deemed imprudent or otherwise ineligible by the rate regulator are disallowed and treated as expenses for regulatory purposes, even if they would otherwise be capitalised for financial reporting purposes. Consequently, these disallowed costs are not intended to be recovered through the rates charged to customers and are borne instead by the entity's owners.

(c) The rate-setting process is usually forward-looking because rates are established on the basis of forecast costs and volumes. However, actual costs and revenues inevitably vary from forecast costs and revenues. Regulatory deferral accounts are used to record these variances and other timing differences between the period in which the revenue is earned and the expenses are incurred (and are therefore usually recognised for financial reporting purposes) and when such amounts are recognised as income or expenses for regulatory rate-setting purposes. Rate regulators often use these deferral accounts for rate-setting purposes so that any excess costs can be recovered (or over-recoveries can be reversed) through the rates charged to customers in future years. Deferral account balances usually are amortised for rate-regulation purposes over a period that is specified by the regulator.

BC28 Deferral accounts can be short, medium or long term in nature, depending on the time frame in which they are expected to be recovered or reversed. An example of a short-term deferral account is one for ongoing variances in an entity's energy supply costs. Another example is an account that is intended to capture volume variances, ie differences between actual volumes that were billed and forecast volumes that were used to set the regulated rate. A medium-term deferral account might be used for unusual items such as storm damage costs that the rate regulator specifies will be recovered in rates over a future period of maybe ten to fifteen years.

BC29 Long-term deferral accounts often reflect the policy decisions made by the rate regulator. For example, in some jurisdictions a rate regulator may require that decommissioning costs, pension costs and income taxes must be accounted for on a cash basis for rate-setting purposes. Regulatory deferral account balances arising from such decisions capture the differences from the accrual accounting that is required by general purpose financial reporting standards. Another example relates to property, plant and equipment. A rate regulator may encourage the entity to invest more in infrastructure to increase supply or improve its reliability. Consequently, the rate regulator may allow indirect costs to be included in the rate-base cost of the infrastructure assets, which would not be capitalised as part of the cost of the asset in accordance with IAS 16. In addition, the rate regulator might allow that rate-base cost to be depreciated more quickly for regulatory purposes than would be appropriate in accordance with IAS 16.

BC30 Often the rate regulator's determination of the regulated rate allows the rate-regulated entity to earn a return on a deferral account debit balance (ie deferred costs) to compensate it for having to finance the delay in the cash recovery. In the case of over-recoveries (ie excess revenues) to be reversed through lower future rates, the rate regulator may apply a financing fee to the deferral account credit balance when determining the regulated rate. This discount or interest rate may be set by the rate regulator and may differ from the rate that would otherwise be used for financial reporting purposes.

Scope

BC31 As noted in paragraph BC17, this [draft] interim Standard proposes to allow, but not require, those 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. Consequently, an entity can only start to apply this [draft] interim Standard if it applies IFRS 1 *First-time Adoption of International Financial Reporting Standards* at the same time.

BC32 Historically, rate regulation tended to apply to all activities of an entity. However, with acquisitions, diversification and deregulation, rate regulation often now applies to only a portion of an entity's activities, resulting in it having both regulated and non-regulated activities. The [draft] interim Standard applies only to the rate-regulated activities that meet the two criteria set out in paragraph 7, regardless of the type of entity or industry to which it belongs.

BC33 The IASB does not intend to allow entities to recognise regulatory deferral account balances if those entities have a monopoly position in a market and decide to self-regulate to avoid the potential government intervention that might occur if they were perceived to be abusing their monopoly position. Consequently, the first scope criterion in paragraph 7 requires there to be a formal rate regulatory mechanism in place that is supported by statute or contract and that binds the entity's customers.

BC34 The second scope criterion in paragraph 7 requires that there is an identifiable causal effect that links the regulatory deferral account balances to the rate-setting process. Consequently, rate-setting processes that determine rates based on targeted or assumed costs, for example, industry averages that do not intend to represent the actual allowable costs incurred or that are expected to be incurred by the entity, are not within the scope of this [draft] interim Standard. The IASB intends for this criterion to provide reasonable assurance that the deferred amounts will be recovered through future rates. This is intended to address the concerns of some respondents to the 2009 ED that the implementation of a Standard without any recognition threshold may be onerous and lead to the recognition of regulatory deferral account balances for which there is a low probability of cash flows occurring.

BC35 The [draft] interim Standard does not address an entity's accounting for reporting to 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. The [draft] interim Standard would neither limit nor endorse a rate regulator's actions.

BC36 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, therefore, is not proposing any changes to the accounting for assets or liabilities that are already addressed in other Standards (see paragraphs BC39 and BC51). Those items should be accounted for in accordance with those Standards, irrespective of whether the entity is subject to rate regulation or not.

BC37 Consequently, the IASB decided that the scope of the [draft] interim 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 the [draft] interim Standard.

Recognition, measurement and impairment

Can rate regulation create assets and liabilities?

BC38 The 2009 ED proposed that rate-regulated entities should recognise regulatory deferral account balances relating to activities within its scope. As indicated in paragraph BC14, the responses to those proposals were mixed and raised complex and fundamental issues at a conceptual level. A fundamental issue that still needs to be addressed is whether the effects of rate regulation results in items that meet the definitions of assets and liabilities in the *Conceptual Framework*. If the answer is yes, then another fundamental issue is to identify what type of asset or liability is created. These questions will be addressed as part of the comprehensive Rate-regulated Activities project that is being undertaken by the IASB.

BC39 Until there are answers to these questions, the IASB is not able to establish the most appropriate recognition, measurement and impairment requirements for reporting the effects of rate regulation in IFRS financial statements. In addition, the IASB is not in a position to determine whether existing Standards should be amended to reflect the effects of rate regulation on assets and liabilities that are currently accounted for in accordance with those Standards. In the meantime, the IASB thinks that those assets and liabilities, such as property, plant and equipment, should be accounted for by rate-regulated entities in the same way as they are by non-rate-regulated entities, irrespective of whether regulatory deferral account balances are recognised in IFRS financial statements. Consequently, this [draft] interim Standard proposes that an entity can only continue to apply its existing, previous GAAP recognition, measurement and impairment policies to its regulatory deferral account balances, as defined in the [draft] interim Standard—ie the incremental amounts that the rate regulator permits/requires to be recovered/reversed and that would not otherwise be recognised as assets and liabilities in accordance with other Standards.

Temporary exemption from paragraph 11 of IAS 8

BC40 The IASB is aware that some national standard-setting bodies permit entities that are subject to rate regulation to apply accounting policies for financial reporting purposes that are similar to those determined by the rate regulator for regulatory accounting purposes. This allows rate-regulated entities to recognise certain amounts in the statement of financial position that would otherwise be recognised in the statement of profit or loss and other comprehensive income. In addition, this allows rate-regulated entities to recognise certain other amounts as revenue or expenses in profit or loss in a different reporting period than would otherwise be reported in the absence of the regulatory accounting requirements.

BC41 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 broadly based on US GAAP. Consequently, the IASB does not expect there to be significant diversity in practice in the accounting for regulatory deferral account balances in jurisdictions that currently apply regulatory accounting in financial statements. In addition, the IASB thinks that many entities will be able to apply this [draft] interim Standard, and to make the transition to IFRS, before the comprehensive Rate-regulated Activities project is completed.

BC42 However, as noted in paragraph BC11, 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 [draft] interim 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 does not propose the exemption from parts of IAS 8 lightly, but proposes this 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 trend data) and for preparers (for example, extensive system changes) when entities in these jurisdictions make the transition to IFRS.

BC43 IFRS 4 *Insurance Contracts* and IFRS 6 *Exploration for and Evaluation of Mineral Resources* provide a temporary exemption from paragraphs 10–12 and 11–12 of IAS 8, respectively. The rationale for those exemptions is explained in the Basis for Conclusions for each of those Standards. The exemption in IFRS 4 is broader than that in IFRS 6, which, in turn, is broader than the exemption proposed in this [draft] interim Standard. This is because the range of issues that are not addressed for rate-regulated activities is narrower than the range of issues that are not addressed in both IFRS 4 and IFRS 6. In this case, the issue is limited to the impact of paragraph 11 of IAS 8, as explained in paragraph BC44.

BC44 Paragraph 12 of IAS 8 could permit Topic 980 *Regulated Operations* or similar local GAAP requirements to be applied in IFRS financial statements, but only to the extent that they 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 (see paragraph BC27–BC29). 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 is proposing that entities within the scope of this [draft] interim 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.

BC45 When developing IFRS 4 and IFRS 6, 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. Consistently 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. Moreover, it is unusual and, arguably, beyond the IASB's mandate to impose requirements set by another body.

BC46 Consequently, the IASB tentatively 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.

Changes in accounting policies

BC47 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 IFRS 4 and IFRS 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.

BC48 As previously noted, the IASB has started a research project to investigate how IFRS financial statements might reflect the effects of rate regulation (see paragraph BC14). Until that project is completed, the IASB wishes to minimise disruption to trend information for users of IFRS financial statements and so the proposed restriction 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. This [draft] interim Standard, therefore, proposes that entities that currently do not recognise regulatory deferral account balances would not be permitted to start doing so on application of this [draft] interim Standard.

BC49 The IASB wished to avoid imposing unnecessary changes of accounting policy in this [draft] interim Standard. However, the IASB did not want to prevent entities that currently recognise regulatory deferral account balances from ceasing to recognise them because this would be consistent with the established IFRS practice. The IASB thinks that this would result in an entity presenting more comparable information, which would bring the financial statements closer to the criteria in IAS 8. The IASB is, therefore, proposing that the continued recognition of regulatory deferral account balances in accordance with this [draft] interim Standard should be optional.

BC50 In addition, the [draft] interim Standard proposes 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 will improve comparability and reliability, and provide relevant information to users.

Interaction with other Standards

BC51 The [draft] interim Standard proposes that, in the absence of any specific exception, exemption or additional requirements contained within this [draft] interim Standard, other Standards shall apply to regulatory deferral accounts in the same way as they apply to assets and liabilities recognised in accordance with other Standards. The IASB thinks that other Standards should not be subject to consequential amendments relating only to this [draft] interim 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. Consequently, any specific exception, exemption or additional requirements related to the interaction of this [draft] interim Standard with other Standards are contained within this [draft] interim Standard, instead of amending existing Standards.

Recoverability

BC52 The [draft] interim Standard does not propose any specific impairment requirements. Instead, an entity would continue to apply its previous GAAP impairment policies to its regulatory deferral account balances. Although some members of the IASB expressed concern that the combination of the lack of explicit recognition criteria and the lack of specific impairment requirements might lead to the overstatement of amounts recognised, the IASB thinks that the scope criteria discussed in paragraph BC34 will address much of this concern.

BC53 For the purposes of this [draft] interim Standard, a regulatory deferral account balance is defined as the “balance of any expense (income) deferral or variance account that is included in the setting of future rate(s) by the rate regulator and that would not otherwise be recognised as an asset or a liability in accordance with other Standards”. As already noted in paragraph BC34, the scope criteria require an identifiable causal effect between the regulatory deferral account balances and the regulated rate. If the expenses (income) that give rise to a regulatory deferral account balance are not included within the regulated rate, then those expenses (income) are outside the scope of the [draft] interim Standard. Expenses (income) may be outside the regulated rate because, for example, the amounts are not expected to be accepted as allowable by the rate regulator or because they are not within the scope of the rate regulation. Consequently, such an item is recognised as income or expense as incurred, unless another Standard permits or requires it to be included in the carrying amount of another asset.

BC54 Although the approval by the rate regulator does not guarantee that the regulatory balance will be recovered through future sales, it does provide reasonable 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.

Presentation

Cost of self-constructed or internally generated assets

BC55 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 intangible 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 cost or regulatory value), which might differ from the method required by IAS 16.

BC56 The IASB acknowledges that at least two alternatives exist for accounting for these costs. Proponents of the first alternative think that regulatory deferral account balances that would be recognised as a result of the [draft] interim 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 regulatory deferral account balances should be presented separately from the assets and liabilities that are recognised in accordance with other Standards. Consequently, any difference between the carrying amount of the item that is recognised in accordance with IAS 16 and the amount that is calculated in accordance with the regulatory requirements should be classified as a regulatory deferral account balance, instead of being included within the carrying amount of the item of property, plant and equipment.

BC57 Proponents of the second alternative think that some regulatory deferral account balances that would be recognised as a result of the [draft] interim 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. 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).

BC58 The IASB is proposing the first alternative. 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

BC59 Many of the items currently included in regulatory deferral accounts would not otherwise be capitalised as assets (or liabilities) in the absence of the temporary exemption from paragraph 11 of IAS 8 that is proposed in this [draft] interim Standard (see paragraph BC44). Consequently, and consistently with the IASB's decision discussed in paragraph BC58, the [draft] interim Standard contains proposals to require the total of all regulatory deferral account debit and credit balances to be presented as separate line items in the statement of financial position. Similarly, movements between the opening and closing balances, except for acquisitions and disposals, would be presented as a single line item within the statement of profit or loss and other comprehensive income.

BC60 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 those of non-rate-regulated entities), regardless of whether they recognise regulatory deferral account balances in their financial statements. This would also result in 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.

BC61 The IASB concluded that the separate presentation of regulatory deferral account balances, especially those amounts that are often permitted by existing national GAAP practices to be included within the carrying amounts of property, plant and equipment and intangible 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 from otherwise being 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 propose to make a consequential amendment to the scope of this exemption to make it consistent with the scope of this [draft] interim Standard. Consequently, entities that apply this [draft] interim 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 at hand in any case, due to the information requirements of regulators.

Current/non-current allocation and offset

BC62 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 deferral balances is intended, significant judgement is needed to identify the costs that the revenue billed in a period recovers. This means that complex and detailed scheduling of the timing of recovery or reversal of each regulatory deferral account debit or credit balance would be needed for the purpose of identifying which amounts should be classed as current or to determine which amounts would be recovered or reversed in the same period for the purposes of offsetting. Consequently, the IASB propose that regulatory deferral account balances should not be classified as current and that debit and credit balances should not be offset.

Disclosure

BC63 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 those 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.

BC64 With this in mind, the [draft] interim 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 *Accounting Policies, Changes in Accounting Estimates and Errors*. However, the [draft] interim Standard contains more explicit guidance, including a reference to materiality, to clarify that preparers should use their judgement to decide which of these detailed items are necessary to achieve the objective and what level of detail to provide. In addition, 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. Consequently, the [draft] interim Standard proposes the disclosure of qualitative and quantitative information for each portion of an entity's rate-regulated activities that is material to the financial performance or position of the entity because this will provide information that is more useful in assessing the impact of different rate-regulatory environments.

BC65 The IASB is aware 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 proposed to be disclosed by paragraphs 28–29 of the [draft] interim 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, the [draft] interim Standard proposes that entities meet the proposed disclosure requirements by providing a table, containing aggregated information, and showing a reconciliation of the movement 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 and focused 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

BC66 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 that 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 consistent with certain risk disclosures required by IFRS 7 *Financial Instruments: Disclosures*.

Effective date and transition

BC67 The IASB will set the effective date for the proposals in the [draft] interim Standard when it approves the resulting interim Standard. 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. Early adoption would be permitted to facilitate first-time adoption of IFRS by those entities within the scope of the [draft] interim Standard that currently follow national standards or practices that permit or require the recognition of regulatory deferral account balances.

BC68 The IASB concluded that no explicit relief from full retrospective application of the [draft] interim Standard is needed because existing recognition and measurement policies are continued when the [draft] interim 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 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.

Effects analysis

BC69 The IASB is committed to assessing and sharing knowledge about the likely costs of implementing proposed 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. Consequently, the IASB is confident that it will learn more about the costs and benefits of these proposals through the outreach and consultation associated with this Exposure Draft.

BC70 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 proposed changes to the presentation of regulatory deferral account balances affect the financial statements of a rate-regulated entity;

(b) whether those 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 will improve the quality of the 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

BC71 The scope of the proposed interim Standard is limited to those 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 the [draft] interim Standard.

BC72 The [draft] interim Standard proposes that rate-regulated entities within its scope continue to apply their existing recognition, measurement and impairment policies for regulatory deferral account balances. Consequently, the proposals should have little or no impact on the net assets or on the net profit reported in the financial statements.

BC73 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 [draft] interim Standard.

Comparability

BC74 The IASB acknowledges that these proposals will reduce comparability in some ways, but thinks that this reduction will be outweighed by other improvements in comparability that would result from applying the proposals.

BC75 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 proposal to isolate the regulatory deferral account balances, and the movements in those balances, into separate line items in the financial statements.

BC76 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 many jurisdictions.

BC77 In addition, the IASB thinks that the proposals 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 the [draft] interim 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

BC78 Rate regulation is a restriction on the setting of 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 proposed in this [draft] interim 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

BC79 The IASB has been told by many users in those 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.

BC80 The IASB thinks that the proposals in the [draft] interim Standard will continue to provide information that some users find useful, but that the presentation proposals will provide clarity to avoid confusion for those who are not familiar with the recognition of regulatory deferral account balances.

BC81 In particular, the IASB thinks that the improvements in comparability noted in paragraphs BC76–BC77 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 these proposals.

Effect on compliance costs for preparers

BC82 The proposals in the [draft] interim Standard would not change the recognition or measurement policies of entities within its scope, and so would not result in any cost change in this respect. However, the IASB acknowledges that the proposal for separate presentation of regulatory deferral account balances is likely to result in changes to most existing presentation policies. These existing policies usually require or permit certain regulatory deferral account balances to be included within the carrying amount of items of property, plant and equipment and intangible assets. This separate presentation may add some cost on an ongoing basis, because preparers would need to track in more detail the differences between the regulatory amounts and those reported in the financial statements.

BC83 However, the cost on the initial adoption of the [draft] interim 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.

BC84 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

BC85 The likely effect of these proposals on the costs of analysis for users of financial statements is expected to be outweighed by the benefits of improved reporting. As noted in paragraph BC72, the proposals should have little or no impact on the net assets or on the net profit reported in the financial statements of those entities within the scope of the [draft] interim Standard. Consequently, there is expected to be little disruption to trend data. Although the changes to the presentation of the amounts (which may require changes to an entity's accounting systems to identify the line items affected) may cause some initial costs to be incurred, the IASB thinks that the added transparency introduced by the proposals will provide users with clearer and more comparable information.

Alternative views on the Exposure Draft

Alternative views of Messrs Edelmann, Gomes and Zhang

AV1 Messrs Edelmann, Gomes and Zhang voted against the publication of the Exposure Draft.

Reduced comparability and inconsistency with existing IFRS practice

AV2 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.

AV3 In addition, Messrs Edelmann, Gomes and Zhang disagree with the proposal to permit 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 practice. In their view, the proposal to isolate 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

AV4 Messrs Edelmann, Gomes and Zhang acknowledge that the proposal is intended to be a practical and short-term solution to address a significant barrier to the adoption of IFRS in some jurisdictions. They note that a major argument for the proposal 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 of the 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*, issued 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.

AV5 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*

AV6 Messrs Gomes and Zhang also disagree with the proposal to permit 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 the Exposure Draft 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.

AV7 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 like transactions and events to be accounted for and reported in a like 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 effectively allows the rate regulators' objectives 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 will effectively allow the regulators' objectives for setting rates and smoothing out the volatility that 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.

IFRS X *Regulatory Deferral Accounts* [Draft] Illustrative examples

These examples accompany, but are not part of, the [draft] interim Standard.

Regulatory deferral account balances

Example 1—Regulatory deferral account debit balance

IE1 To reduce volatility in rates charged to customers, regulators usually require differences between actual and estimated costs to be recovered or reversed over time. The cumulative adjustments for the under- or over-collection of these costs are recognised as regulatory deferral account balances in the statement of financial position, until they affect future billings to customers.

IE2 The example below illustrates the effect of variations in the cost of gas on an entity's rate-regulated activities over a three-year period. In this case, the rate regulator has separated the cost of the gas supplied to customers from the cost of the gas distribution service. The rate-regulated entity is prohibited from earning a return on the supply of gas. However, it is permitted to recover its gas supply costs on the basis of a one-for-one pass through to customers. The rate-setting mechanism requires the entity to amortise any over- or under-recovery of gas costs on a straight-line basis over three years.

IE3 During 20X1, sales volume was lower than expected and natural gas prices increased as a result of supply shortages in the region. The table below shows the entity's actual gas supply costs and the amount charged to customers in rates for each of the three years:[5]

	20X3 CU	20X2 CU	20X1 CU
Actual gas supply costs	978	1,040	1,034
Amount charged to customers in rates	1,055	1,085	917

IE4 The entity did not recover gas supply costs of CU117 (CU1,034 – CU917) in year 20X1. For this example, assume that as of 1 January 20X1, the entity has a nil balance in its gas cost variance account. The amount not recovered is recognised as a regulatory deferral account debit balance for CU117 in the statement of financial position in 20X1 and is recognised as a credit movement in the regulatory deferral account line item in the statement of profit or loss and other comprehensive income for this period. The entity will report revenue of CU917 and the cost of gas sales of CU1,034 for the period.

IE5 In 20X2, the net amount recovered in excess of cost is calculated as follows:

5 In these examples, monetary amounts are denominated in 'currency units (CU)'.

20X2	CU
Amount charged to customers in rates	1,085
Actual gas supply costs	1,040
Difference	45
Amortisation of prior period balance	(39)[a]
Net excess recovery in 20X2	**6**[b]

(a) The entity is entitled to recover CU39 during 20X2 (CU117 over three years) related to costs that were not recovered in 20X1, leaving CU78 to be recovered in the next two years.
(b) The entity recognises a regulatory deferral account credit balance for the net excess recovery of CU6 in 20X2, which the entity is required to reverse on a straight-line basis over the next three years. The entity also recognises a corresponding debit movement in the regulatory deferral account line item in the statement of profit or loss and other comprehensive income for this period.

IE6 In 20X3, the net amount recovered in excess of cost is calculated as follows:

20X3	CU
Amount charged to customers in rates	1,055
Actual gas supply costs	978
Difference	77
Amortisation of prior period balance (from 20X1)	(39)[a]
Reversal of prior period balance (from 20X2)	2[b]
Net excess recovery in 20X3	**40**[c]

(a) The entity is entitled to recover CU39 during 20X3 (CU117 over three years) related to costs that were not recovered in 20X1, leaving CU39 to be recovered in the following year.
(b) The entity is required to reverse CU2 during 20X3 (CU6 over three years) related to excess recoveries in 20X2, leaving CU4 to be reversed in the next two years.
(c) The entity recognises a regulatory deferral account credit balance for the net excess recovery of CU40 in 20X3, which the entity is required to reverse on a straight-line basis over the next three years. The entity also recognises a corresponding debit movement in the regulatory deferral account line item in the statement of profit or loss and other comprehensive income for this period.

IE7 The statement of financial position includes line items for the regulatory deferral accounts showing the debit and credit balances at the end of each period:

	20X3 CU	20X2 CU	20X1 CU
Gas cost variances – debit balances	39	78	117
Gas cost variances – credit balances	44	6	–

IE8 The statement of profit or loss and other comprehensive income shows the following line items that are related to gas revenue and costs and the regulatory deferral account:

	20X3 CU	20X2 CU	20X1 CU
Revenue (from gas sales in the period)	1,055	1,085	917
Cost of gas purchased in the period	978	1,040	1,034
Gross profit/(loss)	77	45	(117)
Net debit/(credit) movement in regulatory deferral account balances	77	45	(117)
Note: the net movement comprises:			
Current period (under-)/over-recovery	40	6	(117)
Amounts recovered/(reversed) during the period	37	39	–

Note: normally the regulator would permit the entity to recover a return on the outstanding balance to reflect the deferred payment. However, to simplify the example, such amounts are not included in the calculations.

Example 2—Regulatory deferral account credit balance

IE9 An electricity distribution company sells land originally purchased to construct its operations centre for CU20 (carrying amount of the land is CU1). The entity is building two new operations centres at other locations and their cost will be included in the rate-base when they are complete.

IE10 The rate regulator approved the sale of the land but the entity expects, based on past experience and comments from the rate regulator, that it will be required to return 100 per cent of the gains to customers by reducing the rates charged to customers in the future. Consequently, the entity recognises the following amounts when the sale takes place:

Sale of property

	Dr	Cr
Cash (statement of financial position—SFP)	20	
Land (SFP)		1
Gain on sale of property (statement of profit or loss and other comprehensive income—SCI)		19

Recognition of the regulatory deferral account credit balance arising from the gain on sale of land

	Dr	Cr
Net regulatory deferral account movement (SCI)	19	
Regulatory deferral account credit balance (SFP)		19

IE11 In the following year, the entity files its rate-setting application and, as expected, the rate regulator includes the gain in the calculation of the entity's rate. The rate regulator decides that the regulatory deferral account balance (ie the deferred gain) will be reversed over the next 10 years. Consequently, the entity will record the following entry in each subsequent year:

	Dr	Cr
Regulatory deferral account credit balance (SFP)	1.9	
Net movement debit/(credit) in regulatory deferral account balances (SCI)		1.9

Note: normally the regulator would also require the entity to provide a return on the outstanding regulatory deferral account balance to reflect its deferred settlement. However, to simplify the example, these amounts are excluded.

Example 3—Illustrative presentation of financial statements

IE12 Paragraphs 20–21 of the [draft] interim Standard require that an entity shall present regulatory deferral account debit and credit balances and the net movement in those balances as separate line items in the statement of financial position and the statement of profit or loss and other comprehensive income respectively. Sub-totals are drawn before the regulatory line items are presented. In addition, paragraph 30 requires an entity to present additional basic and diluted earnings per share, which are calculated by excluding the net movement in regulatory deferral account balances, when the entity presents earnings per share in accordance with IAS 33. Example 3 illustrates how these requirements might be met, but is not intended to illustrate all aspects of this [draft] interim Standard or IFRS more generally.

XYZ Group—Statement of financial position as at 31 December 20X7

(in thousands of currency units)

	31 Dec 20X7	**31 Dec 20X6**
ASSETS		
Non-current assets		
Property, plant and equipment	350,700	360,020
Goodwill	80,800	91,200
Other intangible assets	227,470	227,470
Investments in associates	100,150	110,770
Investments in equity instruments	142,500	156,000
	901,620	945,460
Current assets		
Inventories	135,230	132,500
Trade receivables	91,600	110,800
Other current assets	25,650	12,540
Cash and cash equivalents	212,160	220,570
	464,640	476,410
Total assets before regulatory balances	**1,366,260**	**1,421,870**
Regulatory deferral account debit balances	100,240	102,330
Total assets	**1,466,500**	**1,524,200**

XYZ Group—Statement of financial position as at 31 December 20X7
(in thousands of currency units)

	31 Dec 20X7	31 Dec 20X6
EQUITY AND LIABILITIES		
Equity attributable to owners of the parent		
Share capital	650,000	600,000
Retained earnings	243,500	161,700
Other components of equity	10,200	21,200
	903,700	782,900
Non-controlling interests	70,050	48,600
Total equity	**973,750**	**831,500**
Non-current liabilities		
Long-term borrowings	120,000	160,000
Deferred tax	28,800	26,040
Long-term provisions	28,850	52,240
	177,650	238,280
Current liabilities		
Trade and other payables	87,140	111,150
Short-term borrowings	80,000	200,000
Current portion of long-term borrowings	10,000	20,000
Current tax payable	35,000	42,000
Short-term provisions	5,000	4,800
	217,140	377,950
Total liabilities before regulatory balances	**394,790**	**616,230**
Regulatory deferral account credit balances	97,960	76,470
Total liabilities	**492,750**	**692,700**
Total equity and liabilities	**1,466,500**	**1,524,200**

XYZ Group—Statement of profit or loss and other comprehensive income for the year ended 31 December 20X7
(illustrating the presentation of profit or loss and other comprehensive income in one statement and the classification of expenses within profit or loss by function)
(in thousands of currency units)

	20X7	**20X6**
Revenue	390,000	355,000
Cost of sales	(245,000)	(230,000)
Gross profit	145,000	125,000
Other income	44,247	16,220
Distribution costs	(9,000)	(13,700)
Administrative expenses	(20,000)	(31,500)
Other expenses	(2,100)	(1,200)
Finance costs	(8,000)	(7,500)
Share of profit of associates	35,100	15,100
Profit before tax and regulatory account movements	**185,247**	**102,420**
Income tax expense	(40,417)	(32,000)
Net movement in regulatory deferral accounts	(23,580)	(4,920)
PROFIT FOR THE YEAR	**121,250**	**65,500**
Profit attributable to:		
Owners of the parent	97,000	52,400
Non-controlling interests	24,250	13,100
	121,250	65,500
Earnings per share (in currency units):		
Basic and diluted	0.46	0.30
Basic and diluted before net movement in regulatory deferral accounts	0.57	0.33

Note: to simplify the example, it is assumed that all regulatory deferral accounts relate to activities that are carried out in wholly-owned subsidiaries, and so no amounts are attributable to non-controlling interests.

IE13 For each material portion of rate regulated activities, paragraph 28 requires an entity to present, for each category of regulatory deferral account, a reconciliation of the carrying amount at the beginning and the end of the period. This example illustrates how that requirement may be met, but is not intended to illustrate all aspects of this [draft] interim Standard or IFRS more generally.

Regulatory deferral account debit balances	**20X7**	**Under-/ over-recoveries**	**Recovery/ reversal**	**20X6**	**Remaining recovery/ reversal period (years)**
Electricity distribution					
Construction costs[a]	24,080	5,440	(80)	18,720	4–10
Storm damage	52,350	–	(12,060)	64,410	4
Other regulatory accounts[b]	7,640	2,320	(950)	6,270	4–10
Gas distribution					
Pension costs	12,270	10,120	(2,980)	5,130	N/A
Gas cost variances	3,900	–	(3,900)	7,800	1
	100,240	**17,880**	**(19,970)**	**102,330**	
Regulatory deferral account credit balances					
Electricity distribution					
Land disposal	19,000	19,000	–	–	10
Deferred taxation	8,474	3,207	(1,093)	6,360	1–10
Gas distribution					
Gas cost variances	4,400	4,000	(200)	600	2–3
Deferred taxation	4,236	1,603	(547)	3,180	1–10
Decommissioning costs	61,850	(2,030)	(2,450)	66,330	3–20
	97,960	**25,780**	**(4,290)**	**76,470**	

(a) These are costs that are not permitted to be included in the cost of property, plant and equipment in accordance with IAS 16 *Property, Plant and Equipment*.
(b) These are regulatory deferral account debit balances that are individually immaterial.

Example 4—Discontinued operations and taxation

IE14 Paragraphs 29 and 31 of the [draft] interim Standard require an entity to disclose the regulatory deferral account debit and credit balances and the net movement in those balances that relate to deferred taxes and discontinued operations and disposal groups respectively. Paragraph B4–B6 and B11–B13 provide additional guidance relating to these disclosures. In particular, paragraphs B6 and B13 permit an entity to present the regulatory deferral account amounts that are related to tax or discontinued operations or disposal groups alongside the other regulatory deferral account amounts that are presented in the statement of financial position or the statement of profit or loss and other comprehensive income, or disclose them in the table that is required by paragraph 28. Example 4 illustrates how these requirements might be met, but is not intended to illustrate all aspects of this [draft] interim Standard or IFRS more generally.

IE15 In this example, the entity is in the process of disposing of one of its wholly-owned, rate-regulated subsidiaries and, consequently, is presenting the assets and liabilities of that subsidiary as a disposal group in the statement of financial position in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. In addition, the results of that subsidiary are presented in a single line item in the statement of profit or loss as a discontinued operation. The entity has decided that the amounts related to the regulatory deferral account balances included in the disposal group should be presented separately in the statement of financial position as permitted by paragraph B13.

IE16 In addition, the entity has decided to present the regulatory deferral account balance relating to taxation expenses that is expected to be recovered through future rates by presenting additional line items for this balance and the movement on it, as permitted by paragraph B6.

XYZ Group—Statement of financial position as at 31 December 20X7 (extract)

(in thousands of currency units)

	31 Dec 20X7	**31 Dec 20X6**
ASSETS		
Non-current assets		
AAA	x	x
	901,620	945,460
Current assets		
BBB	x	x
	x	x
Disposal group assets	15,200	–
	464,640	476,410
Total assets before regulatory balances	**1,366,260**	**1,421,870**
Regulatory deferral account debit balances directly associated with disposal group	9,800	–
Other regulatory deferral account debit balances	90,440	102,330
Total assets	**1,466,500**	**1,524,200**

XYZ Group—Statement of financial position as at 31 December 20X7 (extract)
(in thousands of currency units)

	31 Dec 20X7	31 Dec 20X6
EQUITY AND LIABILITIES		
Equity attributable to owners of the parent	x	x
Non-controlling interests	x	x
Total equity	**973,750**	**831,500**
Non-current liabilities		
DDD	x	x
	177,650	238,280
Current liabilities		
EEE	x	x
	x	x
Disposal group liabilities	2,540	–
	217,140	377,950
Total liabilities before regulatory balances	**394,790**	**616,230**
Regulatory deferral account credit balances directly associated with disposal group	17,460	–
Deferred tax liability associated with regulatory deferral account credit balances	12,710	9,540
Other regulatory deferral account credit balances	67,790	66,930
Total liabilities	**492,750**	**692,700**
Total equity and liabilities	**1,466,500**	**1,524,200**

XYZ Group—Statement of profit or loss and other comprehensive income for the year ended 31 December 20X7 (extract)
(illustrating the presentation of profit or loss and other comprehensive income in one statement)
(in thousands of currency units)

	20X7	**20X6**
Revenue	390,000	355,000
FFF	x	x
Profit before tax and regulatory account movements	188,747	102,420
Income tax expense	(40,417)	(32,000)
Net movement in tax regulatory deferral account	(3,170)	(12,320)
Net movement in other regulatory deferral accounts	(20,410)	7,400
Profit for the year from continuing operations	**124,750**	**65,500**
Loss for the year from discontinued operations	(3,500)	–
PROFIT FOR THE YEAR	**121,250**	**65,500**

Regulatory deferral account balances

Regulatory deferral account debit balances	20X7	Under-/over-recoveries	Recovery/reversal	Transfer	20X6	Remaining period (years)
Electricity distribution						
Construction costs	24,080	5,440	(80)	–	18,720	4–10
Storm damage	42,550	–	(12,060)	(9,800)	64,410	4
Other regulatory balances	7,640	2,320	(950)	–	6,270	4–10
Gas distribution						
Pension costs	12,270	10,120	(2,980)	–	5,130	N/A
Gas cost variances	3,900	–	(3,900)	–	7,800	1
	90,440	17,880	(19,970)	(9,800)	102,330	
Disposal group	9,800	–	–	9,800	–	
	100,240	**17,880**	**(19,970)**	**–**	**102,330**	
Regulatory deferral account credit balances						
Electricity distribution						
Land disposal	19,000	19,000	–	–	–	10
Deferred taxation	8,474	3,207	(1,093)	–	6,360	1–10
Gas distribution						
Gas cost variance	4,400	4,000	(200)	–	600	2–3
Deferred taxation	4,236	1,603	(547)	–	3,180	1–10
Decommissioning costs	44,390	(2,030)	(2,450)	(17,460)	66,330	3–20
	80,500[(a)]	**25,780**	**(4,290)**	**(17,460)**	**(76,470)**	
Disposal group	17,460	–	–	17,460	–	
	97,960	**25,780**	**(4,290)**	**–**	**76,470**	

(a) This total includes deferred taxation of CU12,710 (20X6: CU9,540) and other regulatory deferral account balances of CU67,790 (20X6: CU66,930).