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International Accounting Standards Board
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ED/2013/5 Regulatory Deferral Accounts

Grant Thornton International Ltd is pleased to comment on the International Accounting Standards Board's (the Board) Exposure Draft ED/2013/5 *Regulatory Deferral Accounts* (the ED). We have considered the ED, as well as the accompanying draft Basis for Conclusions.

We support the Board's objective in developing an interim solution pending the completion of a comprehensive project on rate-regulation. We also support the proposed limitations in its application to first-time adopters that recognised regulatory balances in accordance with local GAAP.

There are of course certain disadvantages and risks inherent in this approach. In particular:

- experience suggests that "interim" Standards, such as IFRS 4 *Insurance Contracts* and IFRS 6 *Exploration for and Evaluation of Mineral Resources*, can remain in force for many years
- the Board makes clear that this ED is not intended to anticipate the conclusions of the comprehensive project. We suggest nonetheless that the publication of an interim Standard will have implications for the development of a subsequent, "permanent" Standard. Permitting the recognition of regulatory deferrals at this stage, even if only for first-time adopters, could in practice increase the pressure on the Board to maintain this approach on a permanent basis
- the proposed scope limitation to first-time adopters that have previously recognised regulatory assets and liabilities would create a non-level playing field for entities applying IFRSs, depending on when they transitioned and the requirements of local GAAP.

That said, we recognise that the current lack of clarity as to whether IFRSs permit or require the recognition of regulatory assets and liabilities in particular circumstances is unsatisfactory and has proved to be a barrier to the adoption of IFRSs by rate-regulated entities in some jurisdictions. We consider that the ED's proposals are a pragmatic response to address this situation and we support them for that reason.

However, before proceeding we suggest that the Board should carefully evaluate the likely effectiveness of the amendments in achieving wider adoption of IFRSs by rate-regulated entities in the key jurisdictions being targeted. We suggest this because, in some jurisdictions rate-regulated entities may be permitted to choose between IFRSs or an alternative financial reporting framework such as US GAAP. Given that the ED's proposals would not permit a complete "grandfathering" of local GAAP requirements on rate-regulated activities, it is not entirely clear to us that entities that have such a choice would in fact select IFRSs in preference to an alternative financial reporting framework that enables them to retain all their existing accounting practices in this area.

Our responses to the questions in the ED's Invitation to Comment are set out in the Appendix.

If you have any questions on our response, or wish us to amplify our comments, please contact our Executive Director of International Financial Reporting, Andrew Watchman (andrew.watchman@gti.gt.com or telephone + 44 207 391 9510).

Yours sincerely,



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Responses to Invitation to Comment questions

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?

Yes, we believe that restricting the scope to first-time adopters is appropriate.

We recognise that limiting the scope to first-time adopters can be criticised on the grounds that it creates a non-level playing field. However, we also note that one of the Board's main objectives in developing an interim solution is to remove a practical barrier to the adoption of IFRSs by certain rate-regulated entities. The proposed scope is consistent with that objective.

As noted in our cover letter, we suggest however that the Board should also evaluate the likely effectiveness of the amendments in achieving wider adoption of IFRSs by rate-regulated entities in the key jurisdictions being targeted.

Question 2

The Exposure Draft proposes two criteria that must be met for regulatory deferral accounts to be within the scope of the proposed interim Standard. These criteria require that:

- (a) an authorised body (the rate regulator) restricts the price that the entity can charge its customers for the goods or services that the entity provides, and that price binds the customers; and**
- (b) the price established by regulation (the rate) is designed to recover the entity's allowable costs of providing the regulated goods or services (see paragraphs 7–8 and BC33–BC34).**

Are the scope criteria for regulatory deferral accounts appropriate? Why or why not?

We agree with the proposed scope criteria subject to some detailed comments set out below. Given that the objective is to address a practical barrier to the adoption of IFRSs for certain entities, it is important that the scope is limited to those entities and forms of rate regulation where it is most needed.

We recognise that, in publishing the ED, the Board does not wish to pre-empt the outcome of a comprehensive project on rate regulation or the future work on the definitions of assets and liabilities in the conceptual framework project. That said, we believe that an interim solution should aim to limit the recognition of amounts in the statement of financial position to forms of rate regulation that can at least be reasonably argued to create additional assets and liabilities. We believe that the proposed limitation to cost-based regulation with external price control is consistent with that goal.

We have the following detailed comments:

- we note that the proposed definition of "rate regulator" includes the entity's own governing board if that body is required by statute or contract to set rates. This seems to suggest to us a rather broad view of regulatory price-setting. It may be difficult to distinguish situations where a governing board is effectively performing the role of an external regulator from those in which the board exercises more general statutory responsibility. We suggest that, when the entity's governing body sets prices, this should be subject to a specific framework and substantive oversight and/or approval by the external regulator. We assume that the Board's outreach to date has identified situations in which rate-setting activity is delegated to the entity's own governing body and has concluded that this broader definition is necessary
- we note that the scope criteria refer to the restriction of prices and to those prices binding customers. We suggest that the final guidance should clarify that this could include models whose objective is to regulate revenues while offering the entity some discretion to set prices for specific items (eg a so-called "tariff basket") approach.

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?

Yes, we agree that the interim Standard should be optional for entities within its scope. This is consistent with the customary approach to practical expedients in IFRSs and with other prior GAAP "grandfathering" exemptions in IFRS 1 *First-time Adoption of International Financial Reporting Standards*. Existing interim Standards, IFRS 4 and IFRS 6, also provide flexibility in the selection of accounting policies.

Recognition, measurement and impairment

Question 4

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

Do you agree that entities that currently do not recognise regulatory deferral account balances should not be permitted to start to do so? If not, why not?

We agree. We note that the scope of the proposed Standard would be limited to first-time adopters, and we believe it is very unlikely that entities that did not recognise regulatory balances in accordance with local GAAP would wish to start to do so when adopting IFRSs.

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?

Yes, we believe this approach is appropriate.

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?

Yes, we believe this approach is appropriate.

As noted in our comment letter on the 2009 ED, we believe the inclusion of regulatory adjustments in the carrying value of property, plant and equipment and intangible assets would impair comparability between entities within the proposed scope of the Standard and those outside its scope. We continue to believe that regulatory balances should be clearly distinguished from conventional assets and liabilities in the statement of financial position.

Disclosure

Question 7

The Exposure Draft proposes disclosure requirements to enable users of financial statements to understand the nature and financial effects of rate regulation on the entity's activities and to identify and explain the amounts of the regulatory deferral account balances that are recognised in the financial statements (see paragraphs 22–33 and BC65). Do the proposed disclosure requirements provide decision-useful information? Why or why not? Please identify any disclosure requirements that you think should be removed from, or added to, the [draft] interim Standard.

We agree with the proposed disclosure requirements.

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?

Yes, we consider this approach appropriate. In particular we think it is helpful to emphasise the role of materiality in determining what information to disclose and how best to disclose it.

Transition

Question 9

The Exposure Draft does not propose any specific transition requirements because it will initially be applied at the same time as IFRS 1, which sets out the transition requirements and relief available.

Is the transition approach appropriate? Why or why not?

We agree with the proposed transition approach. Specific transition provisions are unnecessary if the interim Standard applies only to first-time adopters of IFRSs.

Other comments

Question 10

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

We have the following additional comments:

- interaction with IFRS 3 *Business Combinations* – we suggest that the operation of the proposed option might usefully be clarified for scenarios in which:
 - an acquirer that applies the prior GAAP option acquires a rate-regulated entity that has not (ie whether the acquirer would, in its consolidated financial statements, be permitted to extend its accounting policy to its new subsidiary's rate-regulated activities)
 - an acquirer that has not applied the prior GAAP option acquires a rate-regulated entity that has done so (ie whether the acquirer would be permitted to maintain the subsidiary's accounting in its consolidated financial statements and whether the acquired regulatory balances would be considered to be identifiable assets acquired and liabilities assumed for IFRS 3 purposes)
- interaction with IFRS 11 *Joint Arrangements* – we question whether a joint operator (or party to a joint operation) should regard a joint operation's regulatory deferral balances as assets and liabilities when applying asset and liability accounting in accordance with that Standard
- the Illustrative Examples (IE12 – 14) indicate that regulatory deferral balances should or may be included in sub-totals for 'total assets' and 'total liabilities' in the statement of financial position. This seems somewhat inconsistent with the Board's intention to avoid concluding at this time on whether these balances represent assets and liabilities
- the same examples indicate that regulatory deferral balances should or need not be classified as current or non-current items in the statement of financial position. If this is the intention we suggest it might usefully be stated in the body of a final Standard.