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IFRS Developments

The IASB issues IFRS 14 - interim standard on regulatory deferral accounts

What you need to know

- IFRS 14 allows rate-regulated entities to continue recognising regulatory deferral accounts in connection with their first-time adoption of IFRS. Existing IFRS preparers are prohibited from adopting this standard.
- Entities that adopt IFRS 14 must present the regulatory deferral accounts as separate line items on the statement of financial position and present movements in these account balances as separate line items in the statement of profit or loss and other comprehensive income.
- The standard requires disclosures on the nature of, and risks associated with, the entity's rate regulation and the effects of that rate regulation on its financial statements.
- The standard is effective for annual periods beginning on or after 1 January 2016. Earlier application is permitted.
- The IASB is continuing its comprehensive rate-regulated activities project, which could result in a standard on rate regulation or a decision not to develop specific requirements. By issuing IFRS 14, the IASB is not anticipating the outcome of the comprehensive project.

IFRS 14 is intended to encourage rate-regulated entities to adopt IFRS while the IASB works on the comprehensive rate-regulated activities project.

Highlights

On 30 January 2014, the International Accounting Standards Board (IASB or the Board) issued IFRS 14 *Regulatory Deferral Accounts* to ease the adoption of International Financial Reporting Standards (IFRS) for rate-regulated entities. The standard allows an entity to continue applying most of its existing accounting policies for regulatory deferral account balances upon adoption of IFRS. This interim standard provides first-time adopters of IFRS with relief from derecognising rate-regulated assets and liabilities until a comprehensive project on accounting for such assets and liabilities is completed by the IASB. IFRS 14 is intended to encourage rate-regulated entities to adopt IFRS while bridging the gap with entities that already apply IFRS, but do not recognise regulatory deferral accounts. This would be achieved by requiring separate presentation of the regulatory deferral account balances (and movements in these balances) in the statement of financial position and statement of profit or loss and comprehensive income.

Building a better working world

Existing IFRS preparers are prohibited from adopting IFRS 14.

Scope of IFRS 14

An entity can only adopt IFRS 14 in connection with the application of IFRS 1 *First-time Adoption of International Financial Reporting Standards*. IFRS 14 cannot be adopted by entities that are currently preparing their financial statements under IFRS. Also, an entity whose current GAAP does not allow the recognition of rate-regulated assets and liabilities, or that has not adopted such policy under its current GAAP, would not be allowed to recognise them through the adoption of IFRS 14.

The IASB refined the scope in IFRS 14, stating that, "an entity is permitted to apply the requirements of [IFRS 14] in its first IFRS financial statements if and only if it:

(a) conducts rate-regulated activities; and

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

The evaluation of whether an entity conducts rate-regulated activities is based on whether an entity's activities are subject to rate regulation, which is defined in IFRS 14 as, "A framework for establishing the prices that can be charged to customers for goods or services and that framework is subject to oversight and/or approval by a rate regulator." Contrary to what the Board proposed in the exposure draft *Regulatory Deferral Accounts* (the ED), the price established by the regulation does not need to be designed to recover the entity's allowable cost of providing the regulated goods or services.

How we see it

IFRS 14's definition of rate regulation has been expanded from the definition in the April 2013 ED. This enhancement removes the scope restriction that required prices to recover the entity's allowable costs and will allow more entities to consider the adoption of the new standard.

Recognition and measurement

Upon adoption of IFRS 14, an entity would continue to apply its previous GAAP accounting policies to the recognition, measurement, impairment and derecognition of regulatory deferral account balances. As such, the application of IFRS 14 would be rather straight-forward for regulatory deferral account balances that are recognised and measured separately from other standards. For example, storm damage costs and volume or purchase price variances that will be recovered in future rates are frequently recorded in separate regulatory deferral accounts.

However, additional effort will be required to measure regulatory deferral accounts that historically have not been recorded or tracked separately. For example, rate-regulated property, plant and equipment (PP&E) accounts recognised under an entity's previous GAAP will likely include activity that is unique to a rate-regulated jurisdiction as well as activity that would be recognised under IAS 16 *Property, Plant and Equipment*. The measurement of these regulatory deferral account balances would effectively entail a two-step process. An entity would first determine the carrying amount of its assets and liabilities under IFRS, excluding IFRS 14. These amounts would then be compared with the assets and liabilities determined under the entity's previous GAAP presentation (i.e., its rate-regulated balances). The differences would represent the regulatory deferral debit or credit account balances recognised by the entity.

Regulatory deferral account balances, and the net movements in these account balances, are presented on separate line items on the statement of financial position and statement of profit or loss and comprehensive income.

Presentation

IFRS 14 requires regulatory deferral account balances to be presented as separate line items on the statement of financial position. In addition, the total of all regulatory deferral debit balances must be separated from the total of all regulatory deferral credit balances. The net movements in these account balances must be presented, net of the applicable deferred income taxes, as a separate line item on the statement of profit or loss. The net movements in regulatory deferral account balances that relate directly to other comprehensive income are also presented separately.

The IASB believes that presenting the regulatory deferral accounts separately on the statement of financial position and the statement of profit or loss and other comprehensive income would enhance comparability with entities that already apply IFRS and thus do not recognise regulatory deferral accounts.

Disclosure

IFRS 14 requires an entity to disclose information that enables users to assess: (a) the nature of, and risks associated with, the rate regulation that establishes prices; and (b) the effects of the rate regulation on the entity's financial statements. Some of the disclosure requirements include:

- A description of the rate-regulated activities and regulatory rate-setting process
- An explanation of how the future recovery or reversal of each class of regulatory deferral account balance is affected by risks and uncertainties, such as demand and regulatory risks
- The basis on which regulatory deferral account balances are recognised and measured initially and subsequently
- A reconciliation of the carrying amount of each class of regulatory deferral account balance as of the beginning and end of the reporting period

In addition, the description of the rate-regulated activities and explanation of the future recovery or reversal of regulatory deferral account balances may be provided in the financial statements or incorporated by cross-reference to information that is readily available to users of the financial statements (e.g., management commentary or risk report).

Interaction with other standards

IFRS 14 contains additional presentation and disclosure requirements, as follows:

- An entity is required to present additional earnings per share (EPS) amounts. Although entities would continue presenting basic and diluted EPS in accordance with IAS 33 *Earnings per Share*, they are also required to present basic and diluted EPS excluding the net movement in the regulatory deferral account balances.
- When an entity that has adopted IFRS 14 acquires a business, its accounting policies must be applied to the acquiree's regulatory deferral account balances as of the date of acquisition.
- Regulatory deferral accounts, and the related net movement, must be excluded from discontinued operations or disposal group amounts presented in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.
- Disclosures under IFRS 12 *Disclosure of Interests in Other Entities* must include separate disclosure of the regulatory deferral accounts and the related net movement for subsidiaries.

Transition and effective date

IFRS 14 is to be applied on a full retrospective basis. It is effective for annual periods beginning on or after 1 January 2016. Earlier application is permitted.

Looking ahead

The IASB has clarified that the issuance of IFRS 14 is not intended to anticipate the outcome of its comprehensive rate-regulated activities project. In addition, there are differing views as to whether rate-regulated assets and liabilities meet the current definitions of assets and liabilities set out in the conceptual framework or the definitions included in the discussion paper on the IASB's project to revise the conceptual framework. Therefore, it is important for rate-regulated entities to stay tuned to the IASB's progress on both of these projects. A discussion paper on the comprehensive rate-regulated activities project is expected in Q2 2014 while re-deliberations on the conceptual framework will continue during 2014.

How we see it

Entities that elect to adopt IFRS 14 should be aware that the regulatory deferral account balances may need to be derecognised from their financial statements if the IASB decides not to issue a separate standard upon completion of the comprehensive rate-regulated activities project.

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