KPMG
cutting through complexity

# Accounting for rate-regulated activities

## Interim relief for first-time adopters

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**IN THE HEADLINES**

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> “These proposals are expected to remove barriers to the adoption of IFRS in some jurisdictions.”

– Phil Dowad, KPMG’s global IFRS revenue recognition and provisions leader

## Re-opening the debate

Although some national accounting bodies provide specific guidance on accounting for the effects of rate regulation, IFRS does not contain any equivalent guidance. In December 2012, the IASB reactivated its project on rate regulation and decided to:

- issue an interim standard to provide temporary guidance; and
- undertake a comprehensive project – a process that is likely to take several years.

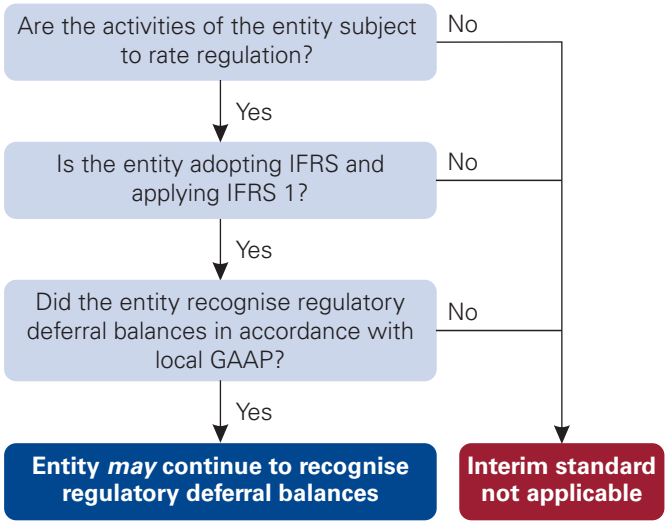
This issue of *In the Headlines* looks at the exposure draft (ED) of the interim standard. In the meantime, it will remain unclear whether or when regulatory balances can be recognised under IFRS in the future, which the IASB is considering in its comprehensive project.

## Interim relief

First-time adopters of IFRS that are subject to rate regulation – and that apply recognition and measurement principles to regulatory balances in accordance with their previous local reporting standards – could opt to continue to recognise regulatory balances in their statement of financial position until the IASB finalises the comprehensive project. This is often referred to as ‘grandfathering’, and is similar to the approach previously taken by the IASB for the insurance and extractive industries.

The proposals would result in increased diversity in practice, because different entities would follow different principles and different measurement requirements. Consequently, the interim standard proposes separating the presentation of regulatory deferral balances. This would help users of the financial statements to identify the impact of regulatory deferral balances.

The proposals would be applied as follows.




## Relief for first-time adopters only

Under the proposals, the interim relief would only be available to first-time adopters of IFRS if they recognised regulatory balances in their financial statements under the reporting requirements applied immediately prior to:

- transition to IFRS; and
- the initial application of the interim standard.

The interim standard would therefore allow entities to ease their transition to IFRS, because they would not need to make any significant changes to their accounting policies on rate regulation until the comprehensive project has been finalised. The ED does not propose that entities that already apply IFRS would be allowed to change back to their previous local accounting approach and to reinstate regulatory balances that they eliminated when they adopted IFRS.

## Extensive new disclosures

Under the proposals, an entity that recognises regulatory deferral accounts in its financial statements would provide extensive disclosures to enable users of the financial statements to understand:

- the features and nature of, and risks associated with, rate regulation; and
- the effect of rate regulation on the entity's financial position, performance and cash flows.

The disclosures would therefore need to meet the specific needs of users in understanding the rate regulation to which the entity is subject.

## Decision has lasting implications

An entity would subsequently be able to change its accounting policy in order to discontinue recognition of regulatory deferral accounts. However, a subsequent change in accounting policy to start recognising regulatory deferral balances would not be permitted. Therefore, although an entity may opt to continue its existing practice of recognising and measuring regulatory balances, it would not be allowed to reverse a decision not to recognise such balances on transition.

## Transition impact on other IFRSs

Although the interim standard would ease the transition to IFRS for entities subject to rate regulation, and although the volatility in profit or loss may be reduced by recognising regulatory balances, entities may need to consider the interaction of regulatory balances with the application of other IFRSs on transition. Applying the interim proposals may impact the way certain other IFRS requirements are applied – for example:

- the additional presentation requirements in order to isolate the presentation of regulatory balances;
- the computation of income taxes separately for regulatory balances;
- the additional presentation requirements of earnings per share including and excluding the impact of regulatory deferral balances;
- the way in which the standard on the impairment of assets applies to a cash generating unit with regulatory balances.

## Key management considerations

The decision to continue to recognise regulatory balances would impact an entity's working capital ratios and other financial ratios. This may affect not only internal reporting requirements, but also compliance with, for example, debt covenants.

It might also result in the entity maintaining multiple records based on IFRS and previous GAAP requirements, and for any specific requirements of the rate regulator. Different policies within a group may result in complexity on consolidation.

## Next steps

First-time adopters of IFRS need to start thinking about whether they would continue to recognise regulatory balances, bearing in mind the implications for the application of other IFRSs.

Meanwhile, those entities in jurisdictions that have already transitioned to IFRS may wish to comment on the interim proposals.

For more information on the proposals, please go to the IASB press release or speak to your usual KPMG contact.

> "Countries such as Brazil and Korea that recently transitioned to IFRS will have mixed views. They would have welcomed the relief offered by the interim standard."

– Ramon Jubels,
Partner, KPMG in Brazil

## Basic facts

ED/2013/5 *Regulatory Deferral Accounts* was issued by the IASB on 25 April 2013. The ED proposes interim guidance on accounting for regulatory deferral accounts by first-time adopters of IFRS that would apply while the IASB considers more comprehensive guidance on accounting for the effects of rate regulation. The comment period for the proposals ends on 4 September 2013.

For these purposes, a 'regulatory deferral balance' would be any expense (income) deferral or variance account that:

- is or will be permitted by the rate regulator to be included in a future rate-setting decision; and
- would not otherwise be recognised as an asset or liability under IFRS.

In order to apply the ED, an entity has to be rate-regulated – in other words:

- an authorised body restricts the price that the entity can charge its customers, and that price is binding on its customers; and
- the price established is designed to recover the entity's allowable costs of providing regulated goods or services.

## Timeline

**25 April 2013:**
ED published for interim standard

**4 September 2013:**
Comment period ends for the interim ED

**Unknown:**
Earliest date of adoption for the interim standard

**Unknown:**
Earliest annual financial statements for which the interim standard would apply



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