

# Accounting for rate-regulated activities

Interim relief for first-time adopters

January 2014, Issue 2014/01

**IN THE HEADLINES**

[kpmg.com/ifrs](http://kpmg.com/ifrs)



“The interim standard is good news for Canada – elsewhere, all eyes will be on the comprehensive project.”

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

## First specific IFRS guidance on rate-regulated activities

The first specific guidance on accounting for the effects of rate regulation under IFRS has been issued, with the publication of an interim standard – IFRS 14 *Regulatory Deferral Accounts*. This will permit first-time adopters of IFRS to continue using previous GAAP to account for regulatory deferral account balances while the IASB completes its comprehensive project in this area.

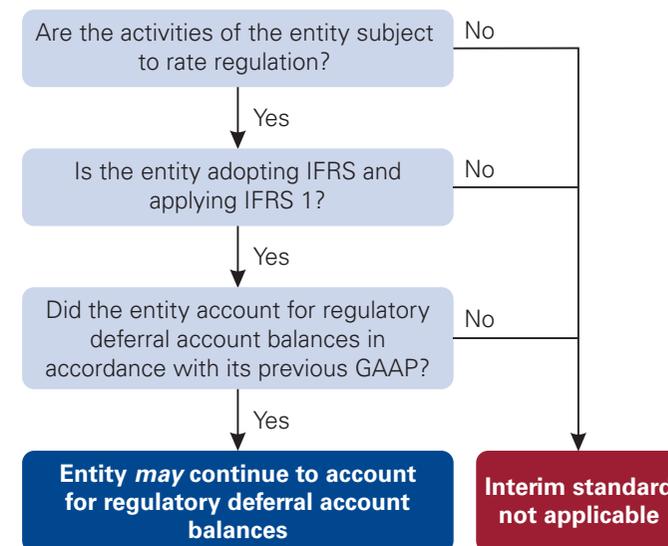
Although the IASB has moved forward with its comprehensive project, a final comprehensive standard is likely to be several years away. It remains unclear whether or when regulatory deferral account balances could be recognised under IFRS in the future. The research phase of the comprehensive project has explored the distinguishing features of rate regulation and the rights and obligations expected to arise from these features. A discussion paper is expected later this year.

## Interim relief through ‘grandfathering’

Continuing to account for specific balances in accordance with previous reporting standards is often referred to as ‘grandfathering’, and is an approach that the IASB has used before, for the insurance and extractive industries.

Entities can apply the interim standard only if they accounted for regulatory deferral account balances in their financial statements immediately before transition to IFRS. Adoption of the interim standard is optional for those entities that are eligible to use it, but the decision to apply it has to be taken in an entity’s first IFRS financial statements.

The interim standard eases the transition to IFRS, because eligible entities do not need to make significant changes to their accounting policies on rate regulation until the comprehensive project has been finalised. However, it does not permit entities that already apply IFRS to reinstate regulatory balances that they eliminated when they adopted IFRS.



## Separate presentation

The interim standard requires regulatory deferral account balances and movements therein to be presented as separate line items on the face of the financial statements, distinguished from assets, liabilities, income and expenses that are recognised in accordance with other IFRSs. The presentation requirements will help users of the financial statements to compare entities that do and do not apply the interim standard by transparently reporting the impact of recognising regulatory deferral account balances.

These requirements may differ from existing practices – e.g. entities should not classify regulatory deferral account balances as current or non-current line items. Presenting regulatory deferral account balances separately may affect an entity’s working capital ratios and other financial ratios. This may impact not only internal reporting requirements, but also compliance with, for example, debt covenants. It may also require changes to an entity’s systems and processes, as regulatory deferral account balances that are

currently embedded in property, plant and equipment or intangible assets will need to be accounted for separately.

## Additional disclosure requirements

Under the interim standard, an entity that recognises regulatory deferral account balances in its financial statements is required to 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.

Entities should consider the level of detail and extent of disclosures necessary to meet the specific needs of users in understanding the rate regulation to which the entity is subject.

## Decision has lasting implications

An entity may subsequently change its accounting policy in order to *stop* accounting for regulatory deferral account balances, but cannot change its policy in order to *start* accounting for them. Therefore, if an entity decides *not* to account for such balances on transition, it cannot reverse that decision.

## Transition impact on other IFRSs

Although the interim standard eases the transition to IFRS for entities subject to rate regulation, and although the volatility in profit or loss may be reduced by recognising regulatory deferral account balances, entities need to consider the interaction of regulatory deferral account balances with the application of other IFRSs on transition.

Applying the interim standard may impact the way other IFRS requirements are applied – for example:

- the presentation of income taxes with the regulatory deferral account balances instead of within income tax line items;
- the application of consistent accounting policies in the consolidated financial statements, which may result in the recognition on consolidation of regulatory deferral account balances that were not previously recognised by a subsidiary;
- the presentation of earnings per share both including and excluding the net movement in the regulatory deferral account balances;
- the application of business combinations guidance, with an exception for the recognition and measurement of an acquiree's regulatory deferral account balances; and
- the way in which the standard on the impairment of assets applies to a cash-generating unit that includes regulatory deferral account balances.

## Next steps

As the interim standard is only available to first-time adopters of IFRS, eligible entities need to move forward with developing and implementing transition plans. In particular, staff training requirements and the sufficiency of information systems and existing accounting processes will need to be evaluated.

Entities should also evaluate the effects of the presentation requirements on their systems and processes, key performance indicators and financial ratios. They may be required, or may wish, to communicate the anticipated impacts to key stakeholders.

For more information on the interim standard, please go to the [IASB announcement](#), or speak to your usual KPMG contact.

“ For rate-regulated entities that have deferred transition to IFRS, now is the time for action. ”

– Michel Picard,  
Partner, Accounting Advisory  
Services, KPMG in Canada

## Basic facts

IFRS 14 *Regulatory Deferral Accounts* was issued by the IASB on 30 January 2014. It provides interim guidance on accounting for regulatory deferral account balances by first-time adopters of IFRS while the IASB considers more comprehensive guidance on accounting for the effects of rate regulation. The interim standard is effective for financial reporting periods beginning on or after 1 January 2016, although early adoption is permitted.

In order to apply the interim standard, an entity has to be rate-regulated – i.e. the establishment of prices that can be charged to its customers for goods or services is subject to oversight and/or approval by an authorised body. The term ‘regulatory deferral account balance’ has been chosen as a neutral descriptor for any expense (income) deferral or variance account that:

- is included or is expected to be included by the rate regulator in establishing the rate(s) that can be charged to customers; and
- would not otherwise be recognised as an asset or liability under other IFRSs.

## Timeline



**18 December 2012:**  
IASB reactivates project on rate regulation



**25 April 2013:**  
Exposure draft published for interim standard



**30 January 2014:**  
Interim standard published



**1 January 2016:**  
Effective date (early adoption permitted)



**31 December 2016:**  
First annual financial statements for which the interim standard applies

© 2014 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

The KPMG name, logo and “cutting through complexity” are registered trademarks or trademarks of KPMG International.

Publication name: *In the Headlines – Accounting for rate-regulated activities*

Publication number: Issue 2014/01

Publication date: January 2014

KPMG International Standards Group is part of KPMG IFRG Limited.

KPMG International Cooperative (“KPMG International”) is a Swiss entity that serves as a coordinating entity for a network of independent firms operating under the KPMG name. KPMG International provides no audit or other client services. Such services are provided solely by member firms of KPMG International (including sublicensees and subsidiaries) in their respective geographic areas. KPMG International and its member firms are legally distinct and separate entities. They are not and nothing contained herein shall be construed to place these entities in the relationship of parents, subsidiaries, agents, partners, or joint venturers. No member firm has any authority (actual, apparent, implied or otherwise) to obligate or bind KPMG International or any other member firm, in any manner whatsoever.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.