

MEMBERS' HANDBOOK

Update No. 138

(Issued 24 February 2014)

This Update relates to the issuance of:

- HKFRS 14 *Regulatory Deferral Accounts*

<u>Document Reference and Title</u>	<u>Instructions</u>	<u>Explanations</u>
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<u>HKFRS 14 <i>Regulatory Deferral Accounts</i></u>	Insert these pages after HKFRS 13 <i>Fair Value Measurement</i> .	- Note 1

Note:

1. HKFRS 14 permits first-time adopters to continue to recognise amounts related to rate regulation in accordance with their previous GAAP requirements when they adopt HKFRS. However, to enhance comparability with entities that already apply HKFRS and do not recognise such amounts, the Standard requires that the effect of rate regulation must be presented separately from other items. An entity that already presents HKFRS financial statements is not eligible to apply the Standard.

The amendments are effective for annual periods beginning on or after 1 January 2016 with earlier application permitted.



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Hong Kong Financial Reporting Standard 14

Regulatory Deferral Accounts



Hong Kong Institute of
Certified Public Accountants
香港會計師公會

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Hong Kong Financial Reporting Standard 14 *Regulatory Deferral Accounts* (HKFRS 14) is set out in paragraphs 1–36 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 Standard. Definitions of other terms are given in the Glossary for Hong Kong Financial Reporting Standards. The Standard should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for Financial Reporting*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Introduction

- IN1 HKFRS 14 *Regulatory Deferral Accounts* (this 'Standard'), describes regulatory deferral account balances as amounts of expense or income that would not be recognised as assets or liabilities in accordance with other Standards, but that qualify to be deferred in accordance with this Standard because the amount is included, or is expected to be included, by the rate regulator in establishing the price(s) that an entity can charge to customers for rate-regulated goods or services.
- IN2 This Standard permits a first-time adopter within its scope to continue to account for regulatory deferral account balances in its first HKFRS financial statements in accordance with its previous GAAP when it adopts HKFRS. However, HKFRS 14 introduces limited changes to some previous GAAP accounting practices for regulatory deferral account balances, which are primarily related to the presentation of these accounts.
- IN3 The scope of this Standard is limited to first-time adopters that recognised regulatory deferral account balances in their financial statements in accordance with their previous GAAP, as defined in HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards* (ie the basis of accounting that a first-time adopter used immediately before adopting HKFRS). An entity that is within the scope of, and that elects to apply, this Standard in its first HKFRS financial statements continues to apply it in the entity's subsequent financial statements.
- IN4 This Standard is effective for annual periods beginning on or after 1 January 2016. Earlier application is permitted.

Reasons for publishing this Standard

- IN5 The Hong Kong Institute of Certified Public Accountants (HKICPA) has issued this Hong Kong Financial Reporting 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 non-rate-regulated entities would recognise as expenses. Similarly, these rate-regulated entities are permitted or required to defer income that non-rate-regulated entities would recognise in the statement of profit or loss and other comprehensive income. The resulting 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 International Financial Reporting Standards (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 International Accounting Standards Board (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 also within 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.

IN6 In September 2012, the IASB started a comprehensive Rate-regulated Activities project, starting with a research phase to develop a Discussion Paper.

IN7 In December 2012, the IASB decided to add an additional phase to the Rate-regulated Activities project to develop a limited-scope Standard to provide a short-term, interim solution for rate-regulated entities that had not yet adopted IFRS. This Standard is intended to allow entities that are first-time adopters of IFRS, and that currently recognise regulatory deferral accounts in accordance with their previous GAAP, to continue to do so on transition to IFRS. This will allow those entities to avoid making major changes in accounting policy for regulatory deferral accounts on transition to IFRS until the comprehensive project is completed.

IN8 However, by publishing this Standard, the IASB is not anticipating the outcome of the comprehensive Rate-regulated Activities project. The term 'regulatory deferral account balances' has been chosen as a neutral descriptor for the items that arise from rate regulation and that are within the scope of this Standard. In this Standard, 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 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 clearly identify 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 Standard against the financial statements of entities that do not recognise such balances.

Main features of this Standard

IN9 This Standard:

- (a) permits an entity that adopts HKFRS to continue to use, in its first and subsequent HKFRS financial statements, its previous GAAP accounting policies for the recognition, measurement, impairment and derecognition of regulatory deferral account balances without specifically considering the requirements of paragraph 11 of HKAS 8;

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- (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 separate line items in the statement of profit or loss and other comprehensive income; and
- (c) requires specific disclosures to identify 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 Standard.

Hong Kong Financial Reporting Standard 14

Regulatory Deferral Accounts

Objective

- 1 The objective of this 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, the Standard requires:
 - (a) limited changes to the accounting policies that were applied in accordance with previous generally accepted accounting principles (*previous GAAP*) 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 the financial statements to understand the amount, timing and uncertainty of future cash flows from any regulatory deferral account balances that are recognised.
- 3 The requirements of this 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 HKFRS, subject to the limited changes referred to in paragraph 2 above.
- 4 In addition, this 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 Standard instead of within those other Standards.

Scope

- 5 **An entity is permitted to apply the requirements of this Standard in its *first HKFRS 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.**
- 6 **An entity shall apply the requirements of this Standard in its financial statements for subsequent periods if and only if, in its first HKFRS financial statements, it recognised regulatory deferral account balances by electing to apply the requirements of this Standard.**

- 7 This Standard does not address other aspects of accounting by entities that are engaged in rate-regulated activities. By applying the requirements in this Standard, any amounts that are permitted or required to be recognised as assets or liabilities in accordance with other Standards shall not be included within the amounts classified as regulatory deferral account balances.
- 8 **An entity that is within the scope of, and that elects to apply, this Standard shall apply all of its requirements to all regulatory deferral account balances that arise from all of the entity's rate-regulated activities.**

Recognition, measurement, impairment and derecognition

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

- 9 **An entity that has rate-regulated activities and that is within the scope of, and elects to apply, this Standard shall apply paragraphs 10 and 12 of HKAS 8 when developing its accounting policies for the recognition, measurement, impairment and derecognition of regulatory deferral account balances.**
- 10 Paragraphs 11–12 of HKAS 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 Standard exempts an entity from applying paragraph 11 of HKAS 8 to its accounting policies for the recognition, measurement, impairment and derecognition 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 recognise those balances in accordance with this Standard through the exemption from paragraph 11 of HKAS 8, subject to any presentation changes required by paragraphs 18–19 of this Standard.

Continuation of existing accounting policies

- 11 **On initial application of this Standard, an entity shall continue to apply its previous GAAP accounting policies for the recognition, measurement, impairment and derecognition of regulatory deferral account balances, except for any changes permitted by paragraphs 13–15. However, the presentation of such amounts shall comply with the presentation requirements of this Standard, which may require changes to the entity's previous GAAP presentation policies (see paragraphs 18–19).**
- 12 An entity shall apply the policies established in accordance with paragraph 11 consistently in subsequent periods, except for any changes permitted by paragraphs 13–15.

Changes in accounting policies

- 13 **An entity shall not change its accounting policies in order to start to recognise regulatory deferral account balances. An entity may only change its accounting policies for the recognition, measurement, impairment and derecognition of regulatory deferral account balances if the change makes the financial statements more relevant to the economic decision-making needs of users and no less reliable¹, or more reliable and no less relevant to those needs. An entity shall judge relevance and reliability using the criteria in paragraph 10 of HKAS 8.**
- 14 This Standard does not exempt entities from applying paragraphs 10 or 14–15 of HKAS 8 to changes in accounting policy. 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 paragraph 10 of HKAS 8. However, the change does not need to achieve full compliance with those criteria for the recognition, measurement, impairment and derecognition of regulatory deferral account balances.
- 15 Paragraphs 13–14 apply both to changes made on initial application of this Standard and to changes made in subsequent reporting periods.

Interaction with other Standards

- 16 **Any specific exception, exemption or additional requirements related to the interaction of this Standard with other Standards are contained within this Standard (see paragraphs B7–B28). In the absence of any such exception, exemption or additional requirements, other Standards shall apply to regulatory deferral account balances in the same way as they apply to assets, liabilities, income and expenses that are recognised in accordance with other Standards.**
- 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 11–12 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 HKAS 21 *The Effects of Changes in Foreign Exchange Rates*.

Presentation

Changes in presentation

- 18 This Standard introduces presentation requirements, outlined in paragraphs 20–26, for regulatory deferral account balances that are recognised in accordance with paragraphs 11–12. When this Standard is applied, the regulatory deferral account balances are recognised in the statement of financial position 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.

¹ In October 2010, the HKICPA replaced the *Framework for the Preparation and Presentation of Financial Statements* with the *Conceptual Framework for Financial Reporting*. The term “faithful representation” encompasses the main characteristics that the previous *Framework* called “reliability”. The requirement in paragraph 13 of this Standard is based on the requirements of HKAS 8, which retains the term “reliable”.

- 19 In addition to the items that are required to be presented in the statement of financial position and in the statement(s) of profit or loss and other comprehensive income in accordance with HKAS 1 *Presentation of Financial Statements*, an entity applying this Standard shall present all regulatory deferral account balances and the movements in those balances in accordance with paragraphs 20–26.

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.**

- 21 **When an entity presents current and non-current assets, and current and non-current liabilities, as separate classifications in its statement of financial position, it shall not classify the totals of regulatory deferral account balances as current or non-current. Instead, the separate line items required by paragraph 20 shall be distinguished from the assets and liabilities that are presented in accordance with other Standards by the use of sub-totals, which are drawn before the regulatory deferral account balances are presented.**

Classification of movements in regulatory deferral account balances

- 22 **An entity shall present, in the other comprehensive income section of the statement of profit or loss and other comprehensive income, the net movement in all regulatory deferral account balances for the reporting period that relate to items recognised in other comprehensive income. Separate line items shall be used for the net movement related to items that, in accordance with other Standards:**

- (a) **will not be reclassified subsequently to profit or loss; and**
- (b) **will be reclassified subsequently to profit or loss when specific conditions are met.**

- 23 **An entity shall present a separate line item 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, for the remaining net movement in all regulatory deferral account balances for the reporting period, excluding movements that are not reflected in profit or loss, such as amounts acquired. 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, which is drawn before the net movement in regulatory deferral account balances.**

- 24 When an entity recognises a deferred tax asset or a deferred tax liability as a result of recognising regulatory deferral account balances, the entity shall present the resulting deferred tax asset (liability) and the related movement in that deferred tax asset (liability) with the related regulatory deferral account balances and movements in those balances, instead of within the total presented in accordance with HKAS 12 *Income Taxes* for deferred tax assets (liabilities) and the tax expense (income) (see paragraphs B9–B12).

- 25 When an entity presents a discontinued operation or a disposal group in accordance with HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, the entity shall present any related regulatory deferral account balances and the net movement in those balances, as applicable, with the regulatory deferral account balances and movements in those balances, instead of within the disposal groups or discontinued operations (see paragraphs B19–B22).
- 26 When an entity presents earnings per share in accordance with HKAS 33 *Earnings per Share*, the entity shall present additional basic and diluted earnings per share, which are calculated using the earnings amounts required by HKAS 33 but excluding the movements in regulatory deferral account balances (see paragraphs B13–B14).

Disclosure

Objective

- 27 **An entity that elects to apply this Standard shall disclose information that enables users to assess:**
- (a) **the nature of, and the risks associated with, the rate regulation that establishes the price(s) that the entity can charge customers for the goods or services it provides; and**
 - (b) **the effects of that rate regulation on its financial position, financial performance and cash flows.**
- 28 If any of the disclosures set out in paragraphs 30–36 are not considered relevant to meet the objective in paragraph 27, they may be omitted from the financial statements. If the disclosures provided in accordance with paragraphs 30–36 are insufficient to meet the objective in paragraph 27, an entity shall disclose additional information that is necessary to meet that objective.
- 29 To meet the disclosure objective in paragraph 27, an entity shall consider all of the following:
- (a) the level of detail that is necessary to satisfy the disclosure requirements;
 - (b) how much emphasis to place on each of the various requirements;
 - (c) how much aggregation or disaggregation to undertake; and
 - (d) whether users of financial statements need additional information to evaluate the quantitative information disclosed.

Explanation of activities subject to rate regulation

- 30 To help a user of the financial statements assess the nature of, and the risks associated with, the entity's rate-regulated activities, an entity shall, for each type of rate-regulated activity, disclose:
- (a) a brief description of the nature and extent of the rate-regulated activity and the nature of the regulatory rate-setting process;

- (b) the identity of the rate regulator(s). If the rate regulator is a related party (as defined in HKAS 24 *Related Party Disclosures*), the entity shall disclose that fact, together with an explanation of how it is related;
- (c) how the future recovery of each class (ie each type of cost or income) of regulatory deferral account debit balance or reversal of each class of regulatory deferral account credit balance is affected by risks and uncertainty, for example:
 - (i) demand risk (for example, changes in consumer attitudes, the availability of alternative sources of supply or the level 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).

31 The disclosures required by paragraph 30 shall be given in the financial statements either directly in the notes 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 directly or incorporated by cross-reference, the financial statements are incomplete.

Explanation of recognised amounts

32 An entity shall disclose the basis on which regulatory deferral account balances are recognised and derecognised, and how they are measured initially and subsequently, including how regulatory deferral account balances are assessed for recoverability and how any impairment loss is allocated.

33 For each type of rate-regulated activity, an entity shall disclose the following information for each class of regulatory deferral account balance:

- (a) a reconciliation of the carrying amount at the beginning and the end of the period, in a table unless another format is more appropriate. The entity shall apply judgement in deciding the level of detail necessary (see paragraphs 28–29), 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;
 - (ii) the amounts that have been recognised in the statement(s) of profit or loss and other comprehensive income relating to balances that have been recovered (sometimes described as amortised) or reversed in the current period; and
 - (iii) other amounts, separately identified, that affected the regulatory deferral account balances, such as impairments, items acquired or assumed in a business combination, items disposed of, or the effects of changes in foreign exchange rates or discount rates;

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- (b) the rate of return or discount rate (including a zero rate or a range of rates, when applicable) used to reflect the time value of money that is applicable to each class of regulatory deferral account balance; and
 - (c) the remaining periods over which the entity expects to recover (or amortise) the carrying amount of each class of regulatory deferral account debit balance or to reverse each class of regulatory deferral account credit balance.
- 34 When rate regulation affects the amount and timing of an entity's income tax expense (income), the entity shall disclose the impact of the rate regulation on the amounts of current and deferred tax recognised. In addition, the entity shall separately disclose any regulatory deferral account balance that relates to taxation and the related movement in that balance.
- 35 When an entity provides disclosures in accordance with HKFRS 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 Standard, the entity shall disclose the amounts that are included for the regulatory deferral account debit and credit balances and the net movement in those balances for the interests disclosed (see paragraphs B25–B28).
- 36 When an entity concludes that a regulatory deferral account balance is no longer fully recoverable or reversible, it shall disclose that fact, the reason why it is not recoverable or reversible 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 Standard.

First HKFRS financial statements	The first annual financial statements in which an entity adopts Hong Kong Financial Reporting Standards (HKFRS), by an explicit and unreserved statement of compliance with HKFRS.
First-time adopter	An entity that presents its first HKFRS financial statements .
Previous GAAP	The basis of accounting that a first-time adopter used immediately before adopting HKFRS.
Rate-regulated activities	An entity's activities that are subject to rate regulation .
Rate regulation	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 .
Rate regulator	An authorised body that is empowered by statute or regulation to establish the rate or a range of rates that bind an entity. The rate regulator may be a third-party body or a related party of the entity, including the entity's own governing board, if that body is required by statute or regulation to set rates both in the interest of the customers and to ensure the overall financial viability of the entity.
Regulatory deferral account balance	The balance of any expense (or income) account that would not be recognised as an asset or a liability in accordance with other Standards, but that qualifies for deferral because it is included, or is expected to be included, by the rate regulator in establishing the rate(s) that can be charged to customers.

Appendix B Application Guidance

This appendix is an integral part of the Standard.

Rate-regulated activities

- B1 Historically, rate regulation applied to all activities of an entity. However, with acquisitions, diversification and deregulation, rate regulation may now apply to only a portion of an entity's activities, resulting in it having both regulated and non-regulated activities. This Standard applies only to the rate-regulated activities that are subject to statutory or regulatory restrictions through the actions of a rate regulator, regardless of the type of entity or the industry to which it belongs.
- B2 An entity shall not apply this Standard to activities that are self-regulated, ie activities that are not subject to a pricing framework that is overseen and/or approved by a rate regulator. This does not prevent the entity from being eligible to apply this Standard when:
- (a) the entity's own governing body or a related party establishes rates both in the interest of the customers and to ensure the overall financial viability of the entity within a specified pricing framework; and
 - (b) the framework is subject to oversight and/or approval by an authorised body that is empowered by statute or regulation.

Continuation of existing accounting policies

- B3 For the purposes of this Standard, a regulatory deferral account balance is defined as the balance of any expense (or income) account that would not be recognised as an asset or a liability in accordance with other Standards, but that qualifies for deferral because it is included, or is expected to be included, by the rate regulator in establishing the rate(s) that can be charged to customers. Some items of expense (income) may be outside the regulated rate(s) because, for example, the amounts are not expected to be accepted 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 an asset or liability.
- B4 In some cases, other Standards explicitly prohibit an entity from recognising, in the statement of financial position, regulatory deferral account balances that might be recognised, either separately or included within other line items such as property, plant and equipment in accordance with previous GAAP accounting policies. However, in accordance with paragraph 11 of this Standard, an entity that elects to apply this Standard in its first HKFRS financial statements applies the exemption from paragraph 11 of HKAS 8 in order to continue to apply its previous GAAP accounting policies for the recognition, measurement, impairment, and derecognition of regulatory deferral account balances. Such accounting policies may include, for example, the following practices:
- (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 (ie the costs for which the regulated rate(s) is intended to provide recovery);

- (b) recognising, as a regulatory deferral account debit or credit balance, an amount that is equivalent to any loss or gain on the disposal or retirement of both items of property, plant and equipment and of intangible assets, which is expected to be recovered or reversed through future rates;
- (c) recognising a regulatory deferral account credit balance when the entity 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); and
- (d) measuring regulatory deferral account balances on an undiscounted basis or on a discounted basis that uses an interest or discount rate specified by the rate regulator.

B5 The following are examples of the types of costs that rate regulators might allow in rate-setting decisions and that an entity might, therefore, recognise in regulatory deferral account balances:

- (i) volume or purchase price variances;
- (ii) costs of approved 'green energy' initiatives (in excess of amounts that are capitalised as part of the cost of property, plant and equipment in accordance with HKAS 16 *Property, Plant and Equipment*);
- (iii) non-directly-attributable overhead costs that are treated as capital costs for rate regulation purposes (but are not permitted, in accordance with HKAS 16, to be included in the cost of an item of property, plant and equipment);
- (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).

B6 Regulatory deferral account balances usually represent timing differences between the recognition of items of income or expenses for regulatory purposes and the recognition of those items for financial reporting purposes. When an entity changes an accounting policy on the first-time adoption of HKFRS or on the initial application of a new or revised Standard, new or revised timing differences may arise that create new or revised regulatory deferral account balances. The prohibition in paragraph 13 that prevents an entity from changing its accounting policy in order to start to recognise regulatory deferral account balances does not prohibit the recognition of the new or revised regulatory deferral account balances that are created because of other changes in accounting policies required by HKFRS. This is because the recognition of regulatory deferral account balances for such timing differences would be consistent with the existing recognition policy applied in accordance with paragraph 11 and would not represent the introduction of a new accounting policy. Similarly, paragraph 13 does not prohibit the recognition of regulatory deferral account balances arising from timing differences that did not exist immediately prior to the date of transition to HKFRS but are consistent with the entity's accounting policies established in accordance with paragraph 11 (for example, storm damage costs).

Applicability of other Standards

- B7 An entity that is within the scope of, and that elects to apply, the requirements of this Standard shall continue to apply its previous GAAP accounting policies for the recognition, measurement, impairment and derecognition 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 account balances in order to reflect them appropriately in the financial statements. The following paragraphs outline how some other Standards interact with the requirements of this Standard. In particular, the following paragraphs clarify specific exceptions to, and exemptions from, other Standards and additional presentation and disclosure requirements that are expected to be applicable.

Application of HKAS 10 *Events after the Reporting Period*

- B8 An entity may need to use estimates and assumptions in the recognition and measurement of its regulatory deferral account balances. For events that occur between the end of the reporting period and the date when the financial statements are authorised for issue, the entity shall apply HKAS 10 to identify whether those estimates and assumptions should be adjusted to reflect those events.

Application of HKAS 12 *Income Taxes*

- B9 HKAS 12 requires, with certain limited exceptions, an entity to recognise a deferred tax liability and (subject to certain conditions) a deferred tax asset for all temporary differences. A rate-regulated entity shall apply HKAS 12 to all of its activities, including its rate-regulated activities, to identify the amount of income tax that is to be recognised.
- B10 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 in the statement of financial position related to income tax, in accordance with its accounting policies established in accordance with paragraphs 11–12. 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.
- B11 Notwithstanding the presentation and disclosure requirements of HKAS 12, when an entity recognises a deferred tax asset or a deferred tax liability as a result of recognising regulatory deferral account balances, the entity shall not include that deferred tax amount within the total deferred tax asset (liability) balances. Instead, the entity shall present the deferred tax asset (liability) that arises as a result of recognising regulatory deferral account balances either:
- (a) with the line items that are presented for the regulatory deferral account debit balances and credit balances; or
 - (b) as a separate line item alongside the related regulatory deferral account debit balances and credit balances.
- B12 Similarly, when an entity recognises the movement in a deferred tax asset (liability) that arises as a result of recognising regulatory deferral account balances, the entity shall not include the movement in that deferred tax amount within the tax expense (income) line item that is presented in the statement(s) of profit or loss and other comprehensive income in accordance with HKAS 12. Instead, the entity shall present the movement in the deferred tax

asset (liability) that arises as a result of recognising regulatory deferral account balances either:

- (a) with the line items that are presented in the statement(s) of profit or loss and other comprehensive income for the movements in regulatory deferral account balances; or
- (b) as a separate line item alongside the related line items that are presented in the statement(s) of profit or loss and other comprehensive income for the movements in regulatory deferral account balances.

Application of HKAS 33 *Earnings per Share*

- B13 Paragraph 66 of HKAS 33 requires some entities 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 profit or loss that is attributable to the ordinary equity holders of the parent entity. In addition, paragraph 68 of HKAS 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.
- B14 For each earnings per share amount presented in accordance with HKAS 33, an entity applying this 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. Consistent with the requirement in paragraph 73 of HKAS 33, an entity shall present the earnings per share required by paragraph 26 of this Standard with equal prominence to the earnings per share required by HKAS 33 for all periods presented.

Application of HKAS 36 *Impairment of Assets*

- B15 Paragraphs 11–12 require an entity to continue to apply its previous GAAP accounting policies for the identification, recognition, measurement and reversal of any impairment of its recognised regulatory deferral account balances. Consequently, HKAS 36 does not apply to the separate regulatory deferral account balances recognised.
- B16 However, HKAS 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 contains goodwill, or because one or more of the impairment indicators described in HKAS 36 have been identified relating to the CGU. In such situations, paragraphs 74–79 of HKAS 36 contain requirements for identifying the recoverable amount and the carrying amount of a CGU. An entity shall apply those requirements to decide whether any of the regulatory deferral account balances recognised are included in the carrying amount of the CGU for the purpose of the impairment test. The remaining requirements of HKAS 36 shall then be applied to any impairment loss that is recognised as a result of this test.

Application of HKFRS 3 *Business Combinations*

- B17 The core principle of HKFRS 3 is that an acquirer of a business recognises the assets acquired and the liabilities assumed at their acquisition-date fair values. HKFRS 3 provides limited exceptions to its recognition and measurement principles. Paragraph B18 of this Standard provides an additional exception.

- B18 Paragraphs 11–12 require an entity to continue to apply its previous GAAP accounting policies for the recognition, measurement, impairment and derecognition of regulatory deferral account balances. Consequently, if an entity acquires a business, it shall apply, in its consolidated financial statements, its accounting policies established in accordance with paragraphs 11–12 for the recognition and measurement of the acquiree’s regulatory deferral account balances at the date of acquisition. The acquiree’s regulatory deferral account balances shall be recognised in the consolidated financial statements of the acquirer in accordance with the acquirer’s policies, irrespective of whether the acquiree recognises those balances in its own financial statements.

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

- B19 Paragraphs 11–12 require an entity to continue to apply its previous accounting policies for the recognition, measurement, impairment and derecognition of regulatory deferral account balances. Consequently, the measurement requirements of HKFRS 5 shall not apply to the regulatory deferral account balances recognised.
- B20 Paragraph 33 of HKFRS 5 requires a single amount to be presented for discontinued operations in the statement(s) of profit or loss and other comprehensive income. Notwithstanding the requirements of that paragraph, when an entity that elects to apply this Standard presents a discontinued operation, it shall not include the movement in regulatory deferral account balances that arose from the rate-regulated activities of the discontinued operation within the line items that are required by paragraph 33 of HKFRS 5. Instead, the entity shall present the movement in regulatory deferral account balances that arose from the rate-regulated activities of the discontinued operation either:
- (a) within the line item that is presented for movements in the regulatory deferral account balances related to profit or loss; or
 - (b) as a separate line item alongside the related line item that is presented for movements in the regulatory deferral account balances related to profit or loss.
- B21 Similarly, notwithstanding the requirements of paragraph 38 of HKFRS 5, when an entity presents a disposal group, the entity shall not include the total of the regulatory deferral account debit balances and credit balances that are part of the disposal group within the line items that are required by paragraph 38 of HKFRS 5. Instead, the entity shall present the total of the regulatory deferral account debit balances and credit balances that are part of the disposal group either:
- (a) within the line items that are presented for the regulatory deferral account debit balances and credit balances; or
 - (b) as separate line items alongside the other regulatory deferral account debit balances and credit balances.
- B22 If the entity chooses to include the regulatory deferral account balances and movements in those balances that are related to the disposal group or discontinued operation within the related regulated deferral account line items, it may be necessary to disclose them separately as part of the analysis of the regulatory deferral account line items described by paragraph 33 of this Standard.

Application of HKFRS 10 *Consolidated Financial Statements* and HKAS 28 *Investments in Associates and Joint Ventures*

- B23 Paragraph 19 of HKFRS 10 requires that a “parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances”. Paragraph 8 of this Standard requires that an entity that is within the scope of, and elects to apply, this Standard shall apply all of its requirements to all regulatory deferral account balances arising from all of the entity’s rate-regulated activities. Consequently, if a parent recognises regulatory deferral account balances in its consolidated financial statements in accordance with this Standard, it shall apply the same accounting policies to the regulatory deferral account balances arising in all of its subsidiaries. This shall apply irrespective of whether the subsidiaries recognise those balances in their own financial statements.
- B24 Similarly, paragraphs 35–36 of HKAS 28 require that, in applying the equity method, an “entity’s financial statements shall be prepared using uniform accounting policies for like transactions and events in similar circumstances”. Consequently, adjustments shall be made to make the associate’s or joint venture’s accounting policies for the recognition, measurement, impairment and derecognition of regulatory deferral account balances conform to those of the investing entity in applying the equity method.

Application of HKFRS 12 *Disclosure of Interests in Other Entities*

- B25 Paragraph 12(e) of HKFRS 12 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 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 HKFRS 12.
- B26 Paragraph 12(g) of HKFRS 12 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 HKFRS 12. Similarly, paragraph 21(b)(ii) of HKFRS 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 HKFRS 12. Paragraph B16 of HKFRS 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 HKFRS 12.
- B27 In addition to the information specified in paragraphs 12, 21, B10, B12–B13 and B16 of HKFRS 12, an entity that recognises regulatory deferral account balances in accordance with this Standard shall also disclose the total regulatory deferral account debit balance, the total regulatory deferral account credit balance and the net movements in those balances, split between amounts recognised in profit or loss and amounts recognised in other comprehensive income, for each entity for which those HKFRS 12 disclosures are required.
- B28 Paragraph 19 of HKFRS 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 HKFRS 10. In addition to the information required by paragraph 19 of HKFRS 12, an entity that elects to apply this Standard 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 Standard.

Effective date and transition

Effective date

- C1 An entity shall apply this Standard if its first annual HKFRS financial statements are for a period beginning on or after 1 January 2016. Earlier application is permitted. If an entity applies this Standard in its first annual HKFRS financial statements for an earlier period, it shall disclose that fact.

Appendix D

Consequential amendments to HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards*

This appendix sets out an amendment to HKFRS 1 First-time Adoption of Hong Kong Financial Reporting Standards that is a consequence of issuing HKFRS 14 Regulatory Deferral Accounts. The amended paragraph is shown with new text underlined and deleted text struck through. An entity shall apply that amendment when it applies HKFRS 1.

HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards*

Paragraph 39V is added.

- 39V HKFRS 14 *Regulatory Deferral Accounts*, issued in February 2014, amended paragraph D8B. An entity shall apply that amendment for annual periods beginning on or after 1 January 2016. Earlier application is permitted. If an entity applies HKFRS 14 for an earlier period, the amendment shall be applied for that earlier period.

In Appendix D, paragraph D8B is amended. New text is underlined and deleted text is struck through.

- 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 HKFRSs. 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 HKFRSs 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 HKFRSs, an entity shall test for impairment in accordance with HKAS 36 each item for which this exemption is used. For the purposes of this paragraph, operations are subject to rate regulation if they are governed by 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 (as defined in HKFRS 14 *Regulatory Deferral Accounts*). ~~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 costs the entity incurs in providing the regulated goods or services and to earn a specified return. The specified return could be a minimum or range and need not be a fixed or guaranteed return.~~

HKFRS 14 BC
Issued February 2014

*Basis for Conclusions on
Hong Kong Financial Reporting Standard 14*

Regulatory Deferral Accounts



Hong Kong Institute of
Certified Public Accountants
香港會計師公會

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Basis for Conclusions

HKFRS 14 *Regulatory Deferral Accounts*

HKFRS 14 is based on IFRS 14 *Regulatory Deferral Accounts*. In approving HKFRS 14, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IASB's Basis for Conclusions on IFRS 14. Accordingly, there are no significant differences between HKFRS 14 and IFRS 14. The IASB's Basis for Conclusions is reproduced below. The paragraph numbers of IFRS 14 referred to below generally correspond with those in HKFRS 14.

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Basis for Conclusions on IFRS 14 *Regulatory Deferral Accounts*

This Basis for Conclusions accompanies, but is not part of, IFRS 14.

Introduction

- BC1 This Basis for Conclusions summarises the considerations of the International Accounting Standards Board (IASB) in reaching the conclusions in IFRS 14 *Regulatory Deferral Accounts*. Individual IASB members gave greater weight to some factors than to others.
- BC2 The IASB and the IFRS Interpretations Committee (the ‘Interpretations Committee’) 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 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–BC12 and BC21), the term ‘regulatory deferral account balances’ has been chosen as a neutral descriptor for these items for the purpose of this Standard.
- BC3 US generally accepted accounting principles (US GAAP) have recognised the economic effect of certain types of rate regulation since at least 1962. In 1982, the US national standard-setter, the Financial Accounting Standards Board (FASB) issued SFAS 71 *Accounting for the Effects of Certain Types of Regulation*.¹ 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.
- BC4 In June 2005, the Interpretations Committee received a request about SFAS 71. 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 in the absence of specific guidance in IFRS.
- BC5 The Interpretations Committee previously 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 Preparation and Presentation of Financial Statements*² ... 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’ only to the extent that they meet the criteria to be recognised as assets in accordance with existing IFRS.

¹ 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*[®].

² 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.

- 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 had been received on the Interpretations Committee's tentative agenda decisions. Those comments pointed out that although divergence in IFRS 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 definitive guidance on the recognition of regulatory deferral account balances as assets or liabilities.
- BC9 Consequently, in December 2008, the IASB added a project on rate-regulated activities to its agenda and subsequently, in July 2009, published an Exposure Draft Rate-regulated Activities (the '2009 ED'). The responses to the 2009 ED raised complex and fundamental issues at a conceptual level. In September 2010, the IASB decided that the complex technical issues could not be resolved quickly, and suspended the project until it had considered whether to include rate-regulated activities in its future agenda. The 2011 Agenda Consultation asked stakeholders to provide their views as to which projects the IASB should give priority.³ The responses to this consultation, received through comment letters and other outreach activities, persuaded the IASB to prioritise addressing the unresolved issues related to rate-regulated activities.
- BC10 As a result of its agenda-setting process, in September 2012 the IASB decided to add to its agenda a comprehensive project on rate-regulated activities to investigate these complex issues. In addition, the *Conceptual Framework for Financial Reporting* (the '*Conceptual Framework*') is currently being reviewed and updated. The outcome of the Rate-regulated Activities project will be influenced by the outcome of the *Conceptual Framework* project. The initial objective is to develop a Discussion Paper for each of these projects, which the IASB hopes will provide a basis for developing guidance in the long term.⁴ 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. This Standard is the result of that decision.

Reasons for issuing this Standard

- BC11 Many rate-regulated entities think that recognising regulatory deferral account balances as assets and liabilities would provide more relevant information and would provide a more faithful representation of their rate-regulated activities than the established practice in IFRS

³ 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.

⁴ The IASB published, in July 2013, the Discussion Paper *A Review of the Conceptual Framework for Financial Reporting*. The deadline for comments was 14 January 2014.

currently. They suggest that rate regulation creates 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. The 2009 ED, which proposed that regulatory deferral account balances should be recognised when arising from activities that are subject to a specific type of rate regulation (referred to in the 2009 ED as “cost-of-service rate regulation”), raised expectations that the IASB had agreed that there was merit to the arguments used to support recognition of such balances as assets and liabilities.

- BC12 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. These policies are being widely applied in accordance with some national GAAPs, and are familiar to many users of financial statements in jurisdictions that currently permit or require the recognition of rate-regulated items.
- BC13 The IASB recognises that discontinuing the recognition of regulatory deferral account balances in advance of the conclusion of the comprehensive Rate-regulated Activities project could be a significant barrier to the adoption of IFRS for 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.
- BC14 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 provide a reasonable level of comparability for regulatory deferral account balances across jurisdictions. However, different approaches to accommodating existing practice for such balances have 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.
- BC15 The IASB acknowledges the difficult practice problems related to this issue. The IASB has, therefore, decided to issue this Standard, which allows 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. In accordance with paragraph 5, an entity is only eligible to apply this Standard if it:
- (a) is subject to oversight and/or approval from an authorised body (the rate regulator);
 - (b) recognised regulatory deferral account balances in its financial statements in accordance with its previous GAAP; and
 - (c) elected to apply the requirements of this Standard in its first IFRS financial statements.
- BC16 Consequently, an entity that does not recognise regulatory deferral account balances in accordance with its previous GAAP in the period immediately preceding its first IFRS

financial statements is not eligible to apply this Standard in order to start recognising such balances. An entity would not, therefore, be eligible if, for example:

- (a) the entity did not have any relevant rate-regulated activities in the period before it made the transition to IFRS but then acquires or commences rate-regulated activities after the date that it adopts IFRS; or
- (b) the entity is a newly formed business and adopts IFRS in its first IFRS financial statements.

BC17 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 already prepare IFRS financial statements and do not recognise such balances.

BC18 A Standard that permits first-time adopters of IFRS to continue to apply their existing policies for the recognition, measurement, impairment and derecognition of 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 the comprehensive Rate-regulated Activities project is completed. The related presentation and disclosure requirements should help to reduce the disruption to information available for trend analyses for these entities on transition to IFRS, until the IASB can consider these issues in its comprehensive project. This would enable rate-regulated entities to overcome the barrier noted in paragraph BC13 and, consequently, to make the transition to IFRS.

BC19 Although comparability will be improved overall by having more entities applying IFRS, the IASB acknowledges that permitting 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. In order to improve comparability between IFRS preparers that are subject to rate regulation but that do not recognise regulatory deferral account balances and entities that are permitted to recognise such balances in accordance with this Standard, the IASB decided to require segregated presentation of these balances. The IASB thinks that the resulting presentation and disclosure requirements in this 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 this Standard justify introducing this diversity:

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

BC21 However, the IASB noted that, by issuing this Standard, it is not anticipating the outcome of the comprehensive Rate-regulated Activities project referred to in paragraph BC10. Consequently, regulatory deferral account balances are not described as regulatory assets or regulatory liabilities in this 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.

Scope

BC22 This Standard does not allow entities to recognise regulatory deferral account balances if those entities have a dominant position in a market and decide to self-regulate to avoid the potential government intervention that might occur if it were perceived to be abusing its dominant position. Instead, it requires there to be a formal rate regulator involved to ensure that the rate-regulatory mechanism in place is supported by statute or regulation and that the regulatory mechanism binds the entity.

BC23 However, the IASB does not intend to exclude entities that are regulated by their own governing body in cases in which:

- (a) the governing body sets prices both in the interests of the customers and to ensure the financial viability of the entity within a specified framework; and
- (b) the framework is subject to oversight and/or approval by an authorised body that is empowered by statute or regulation.

BC24 This situation could arise, for example, when the entity conducts previously state-run activities and the government delegates regulatory powers to an entity (that may be state-controlled) within a statutory framework that is overseen by an authorised body of the government. Another example is a co-operative that may be subject to some form of regulatory oversight in order to obtain preferential loans, tax relief or other incentives to maintain the supply of goods or services that the government consider to be essential or near essential.

BC25 This Standard does not address an entity's accounting for reporting to rate 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. This Standard neither limits nor endorses a rate regulator's actions.

BC26 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 has not, therefore, introduced any changes to the accounting for assets or liabilities that are already addressed in other Standards. Those items should be accounted for in accordance with those Standards, irrespective of whether the entity is subject to rate regulation or not.

BC27 Consequently, the IASB decided that the scope of the 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 this Standard.

Recognition, measurement, impairment and derecognition

Temporary exemption from paragraph 11 of IAS 8

- BC28 As noted in paragraph BC7, 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 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 did not consider the exemption from parts of IAS 8 lightly, but introduced this interim 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 information available for trend analyses) and preparers (for example, extensive system changes) when entities in these jurisdictions make the transition to IFRS.
- BC29 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 based on US GAAP. Consequently, the IASB does not expect there to be significant diversity in the accounting for regulatory deferral account balances in jurisdictions that currently apply regulatory accounting in financial statements.
- BC30 Paragraph 12 of IAS 8 could permit Topic 980 or similar local GAAP requirements to be applied in IFRS financial statements, but only to the extent that those national GAAPs 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. 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 has decided that entities within the scope of this 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.
- BC31 When developing IFRS 4 *Insurance Contracts* and IFRS 6 *Exploration for and Evaluation of Mineral Resources*, 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. Consistent 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 (Topic 980). Moreover, it is unusual and, arguably, beyond the IASB's mandate to impose requirements set by another body.
- BC32 Consequently, the IASB 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. The IASB decided to adopt the same approach in this Standard that it adopted with IFRSs 4 and 6, for the same reasons.

Changes in accounting policies

- BC33 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 IFRSs 4 and 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.
- BC34 As previously noted, the IASB has started the research phase of a comprehensive project to investigate how IFRS financial statements might reflect the effects of rate regulation (see paragraph BC10). Until that project is completed, the IASB wishes to minimise disruption to information used for trend analyses of IFRS financial statements and thus the limitation 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. The scope of this Standard and the restriction on changes in accounting policies in paragraphs 13–15, therefore, prohibit entities that currently do not recognise regulatory deferral account balances from starting to do so.
- BC35 The IASB wished to avoid imposing unnecessary changes of accounting policy as a result of applying this Standard. However, it did not want to prevent entities that currently recognise regulatory deferral account balances from ceasing to recognise them when adopting IFRS because this would be consistent with the established IFRS practice. The IASB thinks that this would result in an entity presenting more comparable information with existing IFRS preparers, which would bring the financial statements closer to the criteria in IAS 8. The IASB has, therefore, decided that the continued recognition of regulatory deferral account balances in accordance with this Standard should be optional. An entity that is eligible to apply this Standard but that elects not to apply it and, consequently, ceases to recognise its regulatory deferral account balances, is not required to apply any of the disclosure requirements of this Standard. However, such entities, and other entities that are not eligible to apply this Standard, are not prohibited from providing supplementary disclosures, such as those set out in paragraphs 30–36.
- BC36 In addition, this Standard contains 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, together with the specific disclosure requirements set out in this Standard, will improve comparability and understandability, and provide relevant information to users.

Interaction with other Standards

- BC37 Any specific exception, exemption or additional requirements related to the interaction of this Standard with other Standards is contained within this Standard. The IASB thinks that, except for IFRS 1, other Standards should not be subject to consequential amendments relating only to this 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.

- BC38 As previously noted, in order to apply this Standard an eligible entity must elect to apply it in the entity's first IFRS financial statements. Consequently, a first-time adopter will initially apply this Standard at the same time as it applies IFRS 1. Paragraph D8B of IFRS 1 provides an exemption to allow first-time adopters to use, as the deemed cost at the date of transition to IFRS, the previous GAAP carrying amount of items of property, plant and equipment or intangible assets that are used, or were previously used, in operations subject to rate regulation. For the purposes of that exemption, paragraph D8B defined operations that are subject to rate regulation in the context of a cost-plus or cost-of-service type of rate regulation. The IASB has decided to make a consequential amendment to paragraph D8B of IFRS 1 to make the definition of rate regulation used in that paragraph consistent with the definition used in this Standard. This will ensure that a first-time adopter that applies this Standard is not prohibited from using the exemptions available to other first-time adopters in IFRS 1.

Recoverability

- BC39 Although the approval by the rate regulator may not guarantee that a regulatory deferral account balance will be recovered (or reversed) through future sales, it does provide a high degree of 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. Consequently, the IASB decided not to develop specific recognition or impairment requirements for these circumstances, but instead decided that an entity should continue to apply its previous GAAP accounting policies for the recognition and measurement of such amounts.

Presentation

Cost of self-constructed or internally generated assets

- BC40 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 other 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 or regulatory value), which might differ from the method required by IAS 16.
- BC41 The IASB acknowledges that at least two alternatives exist for accounting for these amounts: present them separately or include them within the amounts presented for property, plant and equipment or other assets. Proponents of the first alternative think that regulatory deferral account balances that would be recognised as a result of this 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 amounts that qualify for recognition as regulatory deferral account balances should be presented separately from the assets and liabilities that are recognised in accordance with other Standards, instead of being included within the carrying amount of the item of property, plant and equipment or other asset.
- BC42 Proponents of the second alternative think that some regulatory deferral account balances that would be recognised as a result of this 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. Instead, they think that the other assets should be measured at the amount allowed for rate-regulatory purposes. 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).

- BC43 The IASB will consider this issue as part of the comprehensive Rate-regulated Activities project. For the purpose of this Standard, the IASB has decided to require the first alternative. This decision does not change the relief available to first-time adopters using the deemed cost exemption provided by paragraph D8B of IFRS 1 (see paragraph BC38). This is consistent with the IASB's decision not to introduce any changes to the accounting for assets and liabilities that are already addressed in other Standards (see paragraph BC26). 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

- BC44 Many of the items included in regulatory deferral account balances would not otherwise be capitalised as assets (or liabilities) in the absence of the temporary exemption from paragraph 11 of IAS 8 that is contained in this Standard (see paragraph BC30). Consequently, and consistent with the IASB's decision discussed in paragraph BC43, the Standard requires the total of all regulatory deferral account debit balances and the total of all regulatory deferral account credit balances to be presented as separate line items in the statement of financial position. Similarly, the net movement between the opening and closing balances is presented separately within the statement(s) of profit or loss and other comprehensive income, split between amounts related to other comprehensive income and amounts related to profit or loss. Any movements not related to profit or loss or other comprehensive income, such as amounts acquired or disposed of, are disclosed in the reconciliation of opening and closing balances required by paragraph 33.
- BC45 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 comparing them 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 more 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.
- BC46 The IASB concluded that the separate presentation of regulatory deferral account balances, especially those amounts that are often permitted by national GAAP practices to be included within the carrying amounts of property, plant and equipment and other 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 for first-time adopters that would otherwise be 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 has made a consequential amendment to the scope of the IFRS 1 exemption to make it consistent with the scope of this Standard. Consequently, entities that apply this 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 available in any case, due to the information requirements of rate regulators.

Current/non-current allocation and offset

- BC47 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 regulatory deferral account balances is intended, judgement may be needed to identify the costs that the revenue billed in a period recovers. This means that detailed scheduling of the timing of recovery or reversal of each regulatory deferral account debit or credit balance may be needed for the purpose of identifying which amounts should be classed as current or for determining which amounts would be recovered or reversed in the same period for the purposes of offsetting. Consequently, the IASB has decided that regulatory deferral account balances should not be presented as current or non-current and that debit and credit balances should not be offset in the statement of financial position. Instead, this Standard requires information about the period(s) over which regulatory deferral account balances are expected to be recovered or reversed to be disclosed. An entity is not, however, prohibited from identifying current and non-current amounts within the information disclosed if the relevant information is available.

Disclosure

- BC48 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 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.
- BC49 With this in mind, this 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. The IASB has decided, consistent with its previous conclusions, not to specifically refer to materiality in this Standard. However, this Standard contains other explicit guidance to clarify that preparers should use their judgement to decide which of the detailed items are necessary to achieve the objective and what level of detail to provide.
- BC50 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. In addition, an understanding of each class of regulatory deferral account is considered important because that can provide information about the nature of the rate regulation and the potential timing of related cash flows. Consequently, this Standard requires the disclosure of qualitative and quantitative information for each type of an entity’s rate-regulated activities and each class of regulatory deferral account balance, because this will provide information that is more useful in assessing the impact of different rate-regulatory environments.

BC51 The IASB thinks 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 required to be disclosed by paragraph 33 of this 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, this Standard requires that entities meet the disclosure requirements by providing a table, containing aggregated information, and showing a reconciliation of the movements 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 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

BC52 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 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 intended to reduce duplication of information and is consistent with some types of risk disclosure required by IFRS 7 *Financial Instruments: Disclosures*.

Effective date and transition

BC53 This Standard will only be available to first-time adopters of IFRS and will need to be applied retrospectively at the date of transition to IFRS. 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. Consequently, the IASB has set 1 January 2016 as the effective date for this Standard. Earlier application is permitted to make the benefits outlined in paragraph BC20 available at the earliest opportunity.

BC54 The IASB concluded that no explicit relief from full retrospective application of the Standard is needed because existing recognition, measurement, impairment and derecognition policies are continued when this 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 first-time 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.

Summary of main changes from the Exposure Draft *Regulatory Deferral Accounts*

BC55 The proposed definition of the rate regulator included the term "or contract" when establishing the authority of the rate regulator. Some respondents to the Exposure Draft *Regulatory Deferral Accounts*, which was published in April 2013 (the '2013 ED'), were concerned that this term resulted in the definition being too broad. Those respondents assumed that the intention of including the entity's own governing body was to (appropriately)

capture those cases in which an entity conducts previously state-run monopolistic activities and is consequently delegated regulatory powers by the government. However, the respondents were concerned that the scope could be applied, by analogy, to other commercial entities having monopolistic features. This concern was raised within the context of entities that, in the absence of an external regulator, self-regulate (for example, by formally agreeing this with investors through the articles of association or other contractual arrangement). Entities may do this to avoid potential government intervention if they might otherwise be perceived to be abusing their strong market position.

BC56 Consequently, the IASB decided to refine the definition of the rate regulator to exclude self-regulation and instead require the rate regulator to be supported by statute or other formal regulations.

BC57 In addition, the definitions of rate regulation and the rate regulator were further refined to clarify that the regulation can permit some flexibility in the prices to be charged, within a range of prices established or approved by the rate regulator.

BC58 The scope criterion in paragraph 7(b) of the 2013 ED, which proposed that the price established by regulation (the rate) should be designed to recover the entity's allowable costs of providing the regulated goods or services, has been removed. The IASB was persuaded by arguments from some respondents that this criterion was inconsistent with the underlying objective of the IASB to reduce barriers to the adoption of IFRS. In addition, retaining this criterion may be perceived as prejudging the outcome of the comprehensive project.

BC59 The other main changes from the proposals in the 2013 ED are as follows:

- (a) application guidance has been added to:
 - (i) clarify some group accounting issues. Paragraph 19 of IFRS 10 *Consolidated Financial Statements* requires that a "parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances". Consequently, if a parent recognises regulatory deferral account balances in accordance with this Standard, it shall apply the same accounting policies for the recognition, measurement, impairment and derecognition of regulatory deferral account balances arising from the rate-regulated activities of all of its subsidiaries, even if some of those subsidiaries do not recognise such balances in their own financial statements. A similar requirement applies to an investor applying the equity method to investments in associates and joint ventures.
 - (ii) introduce a limited exception to IFRS 3 *Business Combinations* to require the continuation of the acquirer's previous GAAP accounting policies for the recognition and measurement of regulatory deferral account balances acquired or assumed in a business combination. The IASB noted that, if an acquirer does not recognise regulatory deferral account balances in accordance with this Standard, but subsequently acquires a subsidiary that does recognise such balances, the acquirer is not eligible to apply this Standard. Consequently, the acquirer is not eligible to recognise the acquiree's regulatory deferral account balances within the consolidated financial statements.
 - (iii) clarify that an entity is not prohibited from recognising new regulatory deferral account balances for timing differences that are created as a consequence of a change in an accounting policy for other items required by IFRS. The IASB noted that the recognition of timing differences between its applied accounting policies and rate-regulatory requirements is a key

element of what regulatory deferral account balances represent. When an entity adopts IFRS, the accounting policies that it uses in its opening IFRS statement of financial position may differ from those that it used at the same date when it used its previous GAAP. Such changes in accounting policies may create new timing differences that will be recorded by the entity in regulatory deferral accounts. For example, the rate regulator might allow pension costs to be reflected in rates when benefits or other costs are paid. The previous GAAP accounting policy for pension costs may have been consistent with this ‘as paid’ policy and thus no regulatory deferral account balance would have existed for those costs. However, IAS 19 *Employee Benefits* requires pension costs to be attributed to periods of service in accordance with the plan’s benefit formula, or in some cases on a straight-line basis. For defined benefit pension costs, this would create a new timing difference for which a regulatory deferral account balance would be created. Some respondents were concerned that the prohibition to change accounting policies would prevent such newly created regulatory deferral account balances from being recognised. However, this was not the IASB’s intention, because the recognition of such timing differences would be consistent with the recognition of other timing differences already recognised as regulatory deferral account balances.

- (b) the requirement to continue previous GAAP accounting policies for the recognition, measurement and impairment of regulatory deferral account balances has been extended to include derecognition.
- (c) the requirement to present the net movement in regulatory deferral account balances in the statement of profit or loss and other comprehensive income has been modified to require the net movement to be split between amounts related to items reported in profit or loss and those reported in other comprehensive income. The IASB was persuaded by those respondents that stated that the proposal to recognise all net movements in regulatory deferral account balances in a single line item in the profit or loss section of the statement of profit or loss and other comprehensive income could be confusing or misleading when a material portion of the movement related to items that are recognised in other comprehensive income.
- (d) the references to materiality as a factor to consider in deciding the level of detail to disclose has been deleted. The IASB noted that the consideration of materiality is already dealt with in IAS 1 and IAS 8. The IASB is currently assessing the adequacy of the guidance contained in those Standards as part of its Disclosure Initiative project.

BC60 A few respondents to the 2013 ED asked for additional guidance for the application of IAS 34 *Interim Financial Reporting*. In particular, they requested that it should be made clear that separate line items for regulatory deferral account balances and movements therein should also be included in a condensed set of financial statements. However, the IASB did not agree that additional guidance is necessary. Paragraph 10 of IAS 34 requires that condensed financial statements “shall include, at a minimum, each of the headings and subtotals that were included in its most recent annual financial statements and the selected explanatory notes as required by this Standard.” In addition, paragraphs 15–15A of IAS 34 require that an entity shall include an explanation of events and transactions that are significant to an understanding of the changes in the financial position and performance of the entity.

BC61 The IASB concluded that the existing requirements, together with the detailed year-end information required in this Standard, are sufficient to provide users with the relevant information to understand the regulatory deferral account balances that are recognised.

BC62 The Illustrative examples and the Basis for Conclusions on the 2013 ED contained some educational background information about rate regulation, which was not related specifically to the contents of the proposed requirements. This background information has been deleted from this Standard.

Effects analysis

BC63 The IASB is committed to assessing and sharing knowledge about the likely costs of implementing 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.

BC64 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 changes to the presentation of regulatory deferral account balances affect the financial statements of a rate-regulated entity;
- (b) whether the 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 improve the quality of 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

BC65 The scope of this Standard is limited to 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 this Standard.

BC66 This Standard permits rate-regulated entities within its scope to continue to apply their existing recognition, measurement, impairment and derecognition policies for regulatory deferral account balances. Consequently, the application of this Standard should have little or no impact on the net assets or the net profit reported in the financial statements.

BC67 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 Standard.

Comparability

- BC68 The IASB acknowledges that the requirements of this Standard will reduce comparability in some ways, but thinks that this reduction will be outweighed by other improvements in comparability that will result from applying the requirements in this Standard.
- BC69 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 requirements to isolate the regulatory deferral account balances, and the movements in those balances, into separate line items in the financial statements.
- BC70 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 jurisdictions.
- BC71 In addition, the IASB thinks that the requirements 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 this 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

- BC72 Rate regulation imposes a framework for establishing 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 required by this 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

- BC73 The IASB has been told by many users in 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.

- BC74 The IASB thinks that this Standard will allow entities within its scope to continue to provide information that some users find useful, but that the presentation requirements will provide clarity to avoid confusion for those who are not familiar with the recognition of regulatory deferral account balances.
- BC75 In particular, the IASB thinks that the improvements in comparability noted in paragraphs BC69–BC71 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 this Standard.

Effect on compliance costs for preparers

- BC76 This Standard will not change the recognition or measurement policies of entities within its scope, and thus will not result in any cost change in this respect. However, the IASB acknowledges that the separate presentation of regulatory deferral account balances is likely to result in changes to most existing presentation policies. Existing policies of entities within the scope of this Standard usually require or permit certain regulatory deferral account balances to be included within the carrying amount of items of property, plant and equipment and other assets. The separate presentation required by this Standard may add some cost on an ongoing basis, because preparers would need to track some of the differences between the regulatory amounts and those reported in the financial statements in more detail than is currently required.
- BC77 However, the cost on the initial application of this 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.
- BC78 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

- BC79 The likely effect of these requirements on the costs of analysis for users of financial statements is expected to be outweighed by the benefits of improved reporting. Some users have commented that information related to the impact that rate regulation has on the amount, timing and certainty of returns and cash flows is important. The IASB think that the segregated presentation and related disclosures required by this Standard will highlight more clearly this impact. As noted in paragraph BC66, the requirements should have little or no impact on the net assets or the net profit reported in the financial statements of those entities within the scope of this Standard. Consequently, there is expected to be little disruption to the information available for trend analyses. Although the changes to the presentation of the amounts may cause some initial costs to be incurred, the IASB thinks that the added transparency introduced by this Standard will provide users with clearer and more comparable information.

Dissenting opinions

Dissent of Messrs Edelmann, Gomes and Zhang

DO1 Messrs Edelmann, Gomes and Zhang voted against the publication of IFRS 14.

Reduced comparability and inconsistency with existing IFRS practice

DO2 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.

DO3 In addition, Messrs Edelmann, Gomes and Zhang disagree with permitting 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 practices. In their view, isolating 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

DO4 Messrs Edelmann, Gomes and Zhang acknowledge that this Standard is intended to be a practical and short-term interim solution to address a significant barrier to the adoption of IFRS in some jurisdictions. They note that a major argument for this Standard 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 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*, published 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.

DO5 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 for Financial Reporting*

- DO6 Messrs Gomes and Zhang also disagree with permitting 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 IFRS 14 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.
- DO7 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 similar transactions and events to be accounted for and reported in a similar 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 will effectively allow the objectives of the rate regulator(s) 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 effectively allows the objectives of the rate regulator(s) for setting rates and smoothing out the volatility, which 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.

HKFRS 14 IE
Issued February 2014

Illustrative Examples
Hong Kong Financial Reporting Standard 14

Regulatory Deferral Accounts



Hong Kong Institute of
Certified Public Accountants
香港會計師公會

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IFRS 14 *Regulatory Deferral Accounts* **Illustrative examples**

These examples accompany, but are not part of, IFRS 14

Regulatory deferral account balances

Example 1—Illustrative presentation of financial statements

IE1 Paragraphs 20–25 of this Standard require an entity to present regulatory deferral account debit balances and credit balances and any related deferred tax asset (liability) and the net movement in those balances as separate line items in the statement of financial position and the statement(s) of profit or loss and other comprehensive income respectively. Sub-totals are drawn before the regulatory line items are presented. In addition, paragraph 26 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 *Earnings per Share*. Example 1 illustrates how these requirements might be met, but is not intended to illustrate all aspects of this Standard or IFRS more generally.

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

(in 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	129,790	146,460
	<u>888,910</u>	<u>935,920</u>
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
	<u>464,640</u>	<u>476,410</u>
Total assets	1,353,550	1,412,330
Regulatory deferral account debit balances and related deferred tax asset	112,950	111,870
Total assets and regulatory deferral account debit balances	<u>1,466,500</u>	<u>1,524,200</u>

Note: The aggregated total that is presented for regulatory deferral account debit balances and the related deferred tax asset includes the sum of the regulatory deferral account debit balances of CU100,240 (20X6 – CU102,330) plus the deferred tax asset that is related to the recognition of regulatory deferral account balances of CU12,710 (20X6 – CU9,540). This aggregated presentation is permitted by paragraphs 24 and B11 of this Standard. An alternative disaggregated presentation is illustrated in Example 2.

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

(in 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	164,500
Other components of equity	10,200	21,200
	<u>903,700</u>	<u>785,700</u>
Non-controlling interests	<u>70,050</u>	<u>45,800</u>
Total equity	<u>973,750</u>	<u>831,500</u>
Non-current liabilities		
Long-term borrowings	120,000	160,000
Deferred tax	28,800	26,040
Long-term provisions	28,850	52,240
	<u>177,650</u>	<u>238,280</u>
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
	<u>217,140</u>	<u>377,950</u>
Total liabilities	<u>394,790</u>	<u>616,230</u>
Total equity and liabilities	<u>1,368,540</u>	<u>1,447,730</u>
Regulatory deferral account credit balances	97,960	76,470
Total equity, liabilities and regulatory deferral account credit balances	<u>1,466,500</u>	<u>1,524,200</u>

Note: regulatory deferral account balances are not described as assets or liabilities for the purposes of this Standard. The sub-totals described as “Total assets” and “Total liabilities” are comparable to those that would be presented if the regulatory deferral account balances were not recognised. The difference between these two sub-totals represents the net balance of all regulatory deferral account balances recognised and any related deferred tax asset (liability) that arises as a result of recognising regulatory deferral account balances, which would otherwise be recognised within retained earnings or other components of equity.

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 currency units)

	20X7	20X6
Revenue	390,000	358,784
Cost of sales	<u>(237,062)</u>	<u>(230,000)</u>
Gross profit	152,938	128,784
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	<u>35,100</u>	<u>15,100</u>
Profit before tax	193,185	106,204
Income tax expense	<u>(43,587)</u>	<u>(44,320)</u>
Profit for the year before net movements in regulatory deferral account balances	149,598	61,884
Net movement in regulatory deferral account balances related to profit or loss and the related deferred tax movement	<u>(27,550)</u>	<u>3,193</u>
Profit for the year and net movements in regulatory deferral account balances	122,048	65,077
Other comprehensive income: Items that will not be reclassified to profit or loss		
Remeasurement of defined benefit pension plans	(7,938)	(3,784)
Net movement in regulatory deferral account balances related to other comprehensive income	<u>7,140</u>	<u>4,207</u>
Other comprehensive income for the year, net of income tax	<u>(798)</u>	<u>423</u>
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	<u>121,250</u>	<u>65,500</u>
Profit and net movements in regulatory deferral account balances attributable to:		
Owners of the parent	97,798	51,977
Non-controlling interests	<u>24,250</u>	<u>13,100</u>
	<u>122,048</u>	<u>65,077</u>
Total comprehensive income attributable to:		
Owners of the parent	97,000	52,400
Non-controlling interests	<u>24,250</u>	<u>13,100</u>
	<u>121,250</u>	<u>65,500</u>
Earnings per share (in currency units):		
Basic and diluted	<u>0.61</u>	<u>0.35</u>
Basic and diluted including net movement in regulatory deferral account balances	<u>0.46</u>	<u>0.30</u>

Notes:

- (1) To simplify the example, it is assumed that all regulatory deferral account balances relate to activities that are carried out in wholly-owned subsidiaries and thus no amounts are attributable to non-controlling interests.
- (2) The aggregated total that is presented for the net movement in regulatory deferral account balances related to profit or loss and the related deferred tax movement includes the net movement in regulatory deferral account balances of CU30,720 (20X6 – CU9,127) and the movement in the related deferred tax asset that is related to the recognition of regulatory deferral account balances, which is CU3,170 (20X6 – CU12,320). This aggregated presentation is permitted by paragraphs 24 and B12 of this Standard. An alternative disaggregated presentation is illustrated in Example 2.

IE2 For each type of rate-regulated activity, paragraph 33 requires an entity to present, for each class of regulatory deferral account balance, a reconciliation of the carrying amount at the beginning and the end of the period. This example illustrates how that requirement may be met for an entity with two types of rate-regulated activity (electricity distribution and gas distribution), but is not intended to illustrate all aspects of this Standard or IFRS more generally.

Regulatory deferral account balances

Regulatory deferral account debit balances	20X6	Balances arising in the period	Recovery/reversal	20X7	Remaining recovery/reversal period (years)
<i>Electricity distribution</i>					
Construction costs	18,720	5,440	(80)	24,080	4–10
Storm damage	64,410	–	(12,060)	52,350	4
Other regulatory accounts	6,270	2,320	(950)	7,640	4–10
<i>Gas distribution</i>					
Pension costs	5,130	10,120	(2,980)	12,270	N/A
Gas cost variances	7,800	–	(3,900)	3,900	1
	102,330	17,880	(19,970)	100,240	

Regulatory deferral account credit balances

<i>Electricity distribution</i>					
Land disposal	–	19,000	–	19,000	10
Income tax	6,360	3,207	(1,093)	8,474	1–10
<i>Gas distribution</i>					
Gas cost variances	600	4,000	(200)	4,400	2–3
Income tax	3,180	1,603	(547)	4,236	1–10
Decommissioning costs	66,330	(2,030)	(2,450)	61,850	3–20
	76,470	25,780	(4,290)	97,960	

Notes:

- (1) Construction costs consist of 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*.
- (2) Other regulatory accounts include regulatory deferral account debit balances that are individually immaterial.
- (3) The net movement in the pension costs regulatory deferral account balance of CU7,140 (CU12,270 – CU5,130) relates to the remeasurement of the defined benefit pension plan, which is presented in other comprehensive income in accordance with IAS 19 *Employee Benefits*. In accordance with paragraph 22 of this Standard, the related movement in the regulatory deferral account balance is also presented in other comprehensive income.
- (4) The recovery from, or refund to, customers of future income taxes through future rates is recognised as a regulatory deferral account balance. The company has recognised a deferred tax asset of CU12,710 (20X6 – CU9,540) arising from the recognition of regulatory deferral account balances and a corresponding regulatory deferral account credit balance of CU12,710 (20X6 – CU9,540). The deferred tax asset balance is presented within the total regulatory deferral account debit balances presented in the statement of financial position.
- (5) The net movement of CU30,720 in the remaining regulatory deferral account balances is presented in the profit or loss section of the statement of profit or loss and other comprehensive income, net of the movement in the deferred tax asset related to the regulatory deferral account balances of CU3,170 [CU (8,474 – 6,360) + CU (4,236 – 3,180)]. The remaining net movement of CU30,720 consists of:

Decrease in regulatory deferral account debit balances (CU100,240 – CU102,330)	(2,090)
Less: increase in pension cost regulatory deferral account debit balance presented in other comprehensive income (CU12,270 – CU5,130)	<u>(7,140)</u>
	(9,230)
Increase in regulatory deferral account credit balances (CU97,960 – CU76,470)	<u>(21,490)</u>
Net movement in regulatory deferral account balances presented in profit or loss	<u>30,720</u>

Example 2—Discontinued operations and taxation

- IE3 Paragraphs 25 and 34 of this Standard require an entity to disclose the regulatory deferral account debit and credit balances and the net movement in those balances that relate to discontinued operations and disposal groups and to deferred taxes respectively. Paragraphs B19–B22 provide additional guidance relating to these disclosures. In particular, paragraphs B20–B21 permit an entity to present the regulatory deferral account amounts that are related to 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 33. Example 2 illustrates how these requirements might be met, but is not intended to illustrate all aspects of this Standard or IFRS more generally.

- IE4 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 B20.
- IE5 In addition, the entity has decided to present separately the deferred tax asset balance that relates to the recognition of regulatory deferral account balances that are expected to be recovered (reversed) through future rates by presenting additional line items for the deferred tax asset balance and the movement in it, as permitted by paragraphs 24 and B11–B12.

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

(in currency units)

	31 Dec 20X7	31 Dec 20X6
ASSETS		
Non-current assets		
AAA	x	x
	<u>888,910</u>	<u>935,920</u>
Current assets		
BBB	x	x
	x	x
Disposal group assets	<u>15,200</u>	<u>–</u>
	<u>464,640</u>	<u>476,410</u>
Total assets	1,353,550	1,412,330
Regulatory deferral account debit balances directly related to disposal group	9,800	–
Other regulatory deferral account debit balances	90,440	102,330
Deferred tax asset associated with regulatory deferral account balances	<u>12,710</u>	<u>9,540</u>
Total assets and regulatory deferral account debit balances	<u>1,466,500</u>	<u>1,524,200</u>

XYZ Group—Statement of financial position as at 31 December 20X7 (extract)
(in 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	394,790	616,230
Total equity and liabilities	1,368,540	1,447,730
Regulatory deferral account credit balances directly related to disposal group	17,460	–
Other regulatory deferral account credit balances	80,500	76,470
Total equity, liabilities and regulatory deferral account credit balances	1,466,500	1,524,200

Note: regulatory deferral account balances are not described as assets or liabilities for the purposes of this Standard. The sub-totals described as “Total assets” and “Total liabilities” are comparable to those that would be presented if the regulatory deferral account balances were not recognised. The difference between these two sub-totals represents the net balance of all regulatory deferral account balances recognised and any related deferred tax asset (liability) that arises as a result of recognising regulatory deferral account balances, which would otherwise be recognised within retained earnings or other components of equity.

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 currency units)

	20X7	20X6
Revenue	390,000	358,784
FFF	<u>x</u>	<u>x</u>
Profit before tax	196,685	106,204
Income tax expense	<u>(43,587)</u>	<u>(44,320)</u>
Profit for the year from continuing operations	153,098	61,884
Loss for the year from discontinued operations	<u>(3,500)</u>	<u>—</u>
Profit for the year before net movements in regulatory deferral account balances	149,598	61,884
Net movement in regulatory deferral account balances related to profit or loss	(30,720)	(9,127)
Net movement in the deferred tax asset arising from regulatory deferral account balances related to profit or loss	<u>3,170</u>	<u>12,320</u>
Profit for the year and net movements in regulatory deferral account balances	122,048	65,077
Other comprehensive income: Items that will not be reclassified to profit or loss		
Remeasurement of defined benefit pension plans	(7,938)	(3,784)
Net movement in regulatory deferral account balances related to other comprehensive income	<u>7,140</u>	<u>4,207</u>
Other comprehensive income for the year, net of income tax	<u>(798)</u>	<u>423</u>
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	<u>121,250</u>	<u>65,500</u>

REGULATORY DEFERRAL ACCOUNTS

Regulatory deferral account balances

Regulatory deferral account debit balances	20X6	Balances arising in the period	Recovery/reversal	Other movements	20X7	Remaining recovery/reversal period (years)
<i>Electricity distribution</i>						
Construction costs	18,720	5,440	(80)	–	24,080	4–10
Storm damage	64,410	–	(12,060)	(9,800)	42,550	4
Other regulatory balances	6,270	2,320	(950)	–	7,640	4–10
<i>Gas distribution</i>						
Pension costs	5,130	10,120	(2,980)	–	12,270	N/A
Gas cost variances	7,800	–	(3,900)	–	3,900	1
	102,330	17,880	(19,970)	(9,800)	90,440	
<i>Disposal group</i>	–	–	–	9,800	9,800	
	102,330	17,880	(19,970)	–	100,240	

Regulatory deferral account credit balances

<i>Electricity distribution</i>						
Land disposal	–	19,000	–	–	19,000	10
Income tax	6,360	3,207	(1,093)	–	8,474	1–10
<i>Gas distribution</i>						
Gas cost variances	600	4,000	(200)	–	4,400	2–3
Income tax	3,180	1,603	(547)	–	4,236	1–10
Decommissioning costs	66,330	(2,030)	(2,450)	(17,460)	44,390	3–20
	76,470	25,780	(4,290)	(17,460)	80,500	
<i>Disposal group</i>	–	–	–	17,460	17,460	
	76,470	25,780	(4,290)	–	97,960	

Notes:

- (1) The net movement in the pension costs regulatory deferral account balance of CU7,140 (CU12,270 – CU5,130) relates to the remeasurement of the defined benefit pension plan, which is presented in other comprehensive income in accordance with IAS 19 *Employee Benefits*. In accordance with paragraph 22 of this Standard, the related movement in the regulatory deferral account balance is also presented in other comprehensive income.

REGULATORY DEFERRAL ACCOUNTS

- (2) The recovery from, or refund to, customers of future income taxes through future rates is recognised as a regulatory deferral account balance. The company has recognised a deferred tax asset of CU12,710 (20X6 – CU9,540) arising from the recognition of regulatory deferral account balances and a corresponding regulatory deferral account credit balance of CU12,710 (20X6 – CU9,540). The deferred tax asset balance is presented separately alongside the total of regulatory deferral account debit balances in the statement of financial position. Similarly, the net movement in the deferred tax asset related to the regulatory deferral account balances of CU3,170 [CU(8,474 – 6,360) + CU(4,236 – 3,180)] is presented separately in the statement of profit or loss.
- (3) The net movement of CU30,720 in the remaining regulatory deferral account balances is presented in the profit or loss section of the statement of profit or loss and other comprehensive income. This remaining net movement consists of:

Decrease in regulatory deferral account debit balances (CU100,240 – CU102,330)	(2,090)
Less: increase in pension cost regulatory deferral account debit balance presented in other comprehensive income (CU12,270 – CU5,130)	<u>(7,140)</u>
	(9,230)
Increase in regulatory deferral account credit balances (CU97,960 – CU76,470)	<u>(21,490)</u>
Net movement in regulatory deferral account balances presented in profit or loss	<u><u>(30,720)</u></u>

- (4) In this example, the other movements represent transfers to the disposal group and have been shown separately in accordance with paragraph 33(a)(iii). If there are other movements that require separate disclosure, such as those caused by impairments or the effects of changes in foreign exchange rates or discount rates, these could be shown in a separate column or another method of disclosure, such as a footnote to the table.