

## Power & Utilities Spotlight

# Regulatory Accounting Goes Global — IASB Issues IFRS 14

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## The Bottom Line

IFRS 14 is intended to serve as an interim solution until the IASB completes its comprehensive project on RRAs.

- On January 30, 2014, the International Accounting Standards Board (IASB) issued IFRS 14.<sup>1</sup> This optional standard allows first-time adopters of International Financial Reporting Standards (IFRSs) that currently recognize regulatory deferral accounts in accordance with existing local GAAP to continue doing so as they transition to IFRSs.
- IFRS 14 is intended to serve as an interim solution until the IASB completes its comprehensive rate-regulated activities (RRAs) project and will enable entities to transition to IFRSs without requiring them to make major changes to their accounting policies for regulatory deferral accounts.
- This standard is elective and applicable only upon the initial adoption of IFRSs (i.e., when an entity initially applies IFRS 1<sup>2</sup>) and therefore is not available to entities that have previously adopted IFRSs. Further, to be eligible to apply IFRS 14, an entity must meet the standard's criteria related to RRAs.
- IFRS 14 requires first-time IFRS adopters to apply all other IFRSs before applying the new standard. Therefore, regulatory deferral accounts represent incremental amounts approved by the regulator that are recognized over and above those amounts that are recognized under other IFRSs.
- IFRS 14 specifies requirements for presenting amounts associated with regulatory deferral accounts that are recorded in the statement of financial position and statement of profit or loss. In addition, the standard requires disclosures about the nature of, and the risks associated with, the specific rate regulation regime and the effects of that rate regulation on the reporting entity's financial position, financial performance, and cash flows.
- IFRS 14 should be applied in an entity's first annual IFRS financial statements for periods beginning on or after January 1, 2016. Earlier application is permitted.

<sup>1</sup> IFRS 14, *Regulatory Deferral Accounts*.

<sup>2</sup> IFRS 1, *First-time Adoption of International Financial Reporting Standards*.

# Beyond the Bottom Line

This *Power & Utilities Spotlight* discusses the development and issuance of IFRS 14 and summarizes the standard's key provisions, including its scope, presentation and disclosure requirements, and effective date and transition.

## Background

### Comprehensive Project on Rate Regulation

Under IFRSs, there is no guidance equivalent to ASC 980,<sup>3</sup> which addresses the recognition and measurement of regulatory assets and liabilities. The IASB previously attempted to provide for such an equivalent in 2009 by issuing an exposure draft (ED) of a proposed standard on RRAs, but the project stalled during the first half of 2010. Meanwhile, in certain jurisdictions (e.g., Canada), utilities that are subject to cost-based regulations similar to those in the United States and that have traditionally applied accounting principles similar to U.S. GAAP have struggled with the adoption of IFRSs in the absence of such a standard. These utilities have taken multiple paths, including (1) taking advantage of the continued IFRS deferrals for qualifying utilities, (2) adopting U.S. GAAP for local filings when permitted, (3) listing securities and filing in the United States under U.S. GAAP, (4) lobbying for legislation that would allow certain government-controlled utilities to apply a special accounting framework consisting of IFRSs and ASC 980, and (5) proceeding with IFRS adoption (with some companies writing off regulatory balances and a few that, in certain situations, recognize regulatory assets and liabilities as financial assets and liabilities). U.S. energy companies have continued to advocate for the retention of existing U.S. accounting guidance that recognizes the economic effects of rate regulation in the event that the United States eventually adopts IFRSs without an equivalent standard in place.

In response to these concerns, the International Financial Reporting Interpretations Committee (IFRIC) proposed a project on a narrow group of issues that ultimately delayed work on a 2009 ED. On IFRIC's recommendation and on the basis of feedback the IASB received on its three-year agenda consultation process, the IASB announced in the spring of 2012 that it would give priority to reactivating a comprehensive international project on RRAs. In September 2012, the IASB formally authorized its staff to draft a discussion paper (DP) on these issues and indicated its intention to align the project on RRAs with its separate project on an overall conceptual framework, components of which included the definition of assets and liabilities and related recognition requirements. Given that the previous project stalled because of debate about whether and, if so, with whom a "unit of account" existed between utilities, customers, and regulators and whether associated rights and obligations met the existing definition and recognition requirements for assets and liabilities, it is clear that the alignment of these projects is meant to "test" any changes related to the definitions and recognition requirements proposed in the conceptual framework project. Further, it is clear that the IASB intends to study various regulatory regimes and the related accounting issues, not just the cost-of-service model commonly employed in North America and elsewhere.

The IASB issued a [request for information](#) (RFI) in March 2013, with comments due by May 2013. Marking an early stage in the RRAs research project, the RFI was aimed at identifying a range of rate-regulatory schemes to establish the project's scope. The IASB plans to issue its DP on RRAs in the first half of 2014.

### Interim IFRS

In December 2012, the IASB tentatively decided to initiate a short-term project to develop an interim standard as a temporary measure pending the completion of its comprehensive RRAs project. The interim standard would permit a certain level of grandfathering of existing local GAAP recognition and measurement accounting policies for rate-regulated

In September 2012, the IASB indicated its intention to align the project on RRAs with its separate project on an overall conceptual framework.

<sup>3</sup> FASB Accounting Standards Codification Topic 980, *Regulated Operations*.

entities that have not transitioned to IFRSs. In addition, such a standard would include presentation and disclosure requirements designed to help users understand the effects of rate regulation on the financial statements.

As part of this short-term project, in April 2013 the IASB issued an ED on regulatory deferral accounts that proposed an interim standard as a short-term solution for first-time IFRS adopters. Under this proposal, first-time adopters of IFRSs would generally be allowed the option to carry forward RRA accounting as prescribed by their previous local GAAP. Companies electing to carry forward their local GAAP RRA accounting would be required to present regulatory deferral accounts and related activities separately on their balance sheet and income statement. Further, they would be subject to certain disclosure requirements (e.g., they would need to disclose the nature and risks of rate regulation). Comments on the proposal were due by September 4, 2013.

Upon considering the feedback received on this proposal at its October 2013 meeting, the IASB tentatively decided to proceed with an interim standard that would apply, as a policy choice, to first-time IFRS adopters that previously recognized regulatory assets and liabilities (or similarly labeled items) in their financial statements in accordance with the GAAP of their local jurisdiction. The IASB's short-term project culminated in the issuance of IFRS 14. The Board has stated that "by publishing [IFRS 14], the IASB is not anticipating the outcome of the comprehensive [RRAs] project," which is still in its early stages.

## Key Provisions of IFRS 14

### Scope

IFRS 14 is elective. It is applicable only upon the initial adoption of IFRSs (i.e., when an entity initially applies IFRS 1) and therefore is not available to entities that have previously adopted IFRSs.

To apply IFRS 14, an entity must meet the standard's eligibility criteria. Specifically, the entity has to conduct RRAs (as defined by IFRS 14) and must have recognized amounts that qualify as regulatory deferral account balances in its financial statements in accordance with the GAAP it previously applied.

IFRS 14 is not mandatory for first-time IFRS adopters that meet the standard's eligibility criteria. However, if a first-time adopter of IFRSs is eligible to apply IFRS 14 and chooses to do so, the standard applies to all regulatory deferral account balances that arise from all of the entity's RRAs.

### Terminology

IFRS 14 replaces the commonly used Canadian and U.S. GAAP terms "regulatory assets" and "regulatory liabilities" with "regulatory deferral account debit balances" and "regulatory deferral account credit balances," respectively (collectively referred to as "regulatory deferral account balances"). The standard uses this terminology because the IASB has not yet determined whether such balances qualify as assets and liabilities under IFRSs. The Board's comprehensive RRAs project is expected to address this issue.

"Rate-regulated activities," "rate regulation," and "rate regulator" are all defined terms in IFRS 14. Their definitions are important because the eligibility criteria noted above will require rate regulation and the rate regulator in the first-time adopter's jurisdiction to possess the characteristics those definitions describe.

IFRS 14 defines rate regulation as a "framework for establishing the prices that can be charged to customers for goods or services [that] is subject to oversight and/or approval by a rate regulator." The standard defines a rate regulator as an "authorised body that is empowered by statute or regulation to establish the rate or a range of rates that bind an entity" and further states that it "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."

IFRS 14 is applicable only upon the initial adoption of IFRSs.

Under IFRS 14, amounts that are permitted or required to be recognized as assets or liabilities in accordance with other standards cannot be classified as regulatory deferral account balances.

## Application of Other Standards

IFRS 14 requires that all other IFRSs be applied first by the first-time adopter for both initial and subsequent measurement to ensure that all assets and liabilities in the statement of financial position (e.g., property, plant, and equipment; income taxes; and employee benefit obligations) are recognized in a manner that complies with the requirements in the other IFRSs. Notably, IFRS 1 includes certain exemptions and elections that may provide some relief to a first-time adopter on the date of transition, such as the deemed cost exemption for property, plant, and equipment or intangible assets used in operations that are subject to rate regulation. Therefore, under IFRSs, the regulatory deferral accounts will represent incremental amounts that are recognized over and above the assets and liabilities recognized under the other standards. Under IFRS 14, amounts that are permitted or required to be recognized as assets or liabilities in accordance with other standards cannot be classified as regulatory deferral account balances.

IFRS 14 also includes specific guidance on how other standards (e.g., IAS 10,<sup>4</sup> IAS 12,<sup>5</sup> IAS 33,<sup>6</sup> IAS 36,<sup>7</sup> IFRS 3,<sup>8</sup> and IFRS 5<sup>9</sup>) should be applied to regulatory deferral account balances or movements in such balances.

## Presentation Requirements

In addition to complying with the presentation requirements of IAS 1,<sup>10</sup> entities must present regulatory deferral account balances and related items in their statement of financial position and statements of profit or loss and other comprehensive income as required by IFRS 14. Under IFRS 14, the sum of current and long-term assets (or current and long-term liabilities) recognized under other standards would be presented as a subtotal in the statement of financial position and then added to the regulatory deferral debit balances and the related deferred tax asset (or the regulatory deferral credit balances and the related deferred tax liability). The resulting sum would be presented as total assets and regulatory deferral account debit balances (or as total liabilities and regulatory deferral account credit balances). Regulatory deferral account balances cannot be segregated into current and noncurrent components.

In summary, the statement of financial position would present assets in the following manner, with similar treatment for liabilities:

### Example — Presentation in Statement of Financial Position

Current assets	XXX
Long-term assets	XXX
Total assets	XXX
Regulatory deferral debit balances and related deferred tax asset <sup>(a)</sup>	XXX
Total assets and regulatory deferral account debit balances	XXX

<sup>(a)</sup> Under IFRS 14, the deferred tax balance that results from the recognition of regulatory deferral account balances may be presented (1) on an aggregated basis with the regulatory deferral account balances or (2) as a separate line item alongside the related regulatory deferral account balances.

Just as IFRS 14 requires regulatory deferral account balances to be presented separately from assets and liabilities in the statement of financial position, so does it require movements in the regulatory deferral account balances to be presented separately from profit or loss in the statement of profit or loss. That is, the statement of profit or loss

<sup>4</sup> IAS 10, *Events After the Reporting Period*.

<sup>5</sup> IAS 12, *Income Taxes*.

<sup>6</sup> IAS 33, *Earnings per Share*.

<sup>7</sup> IAS 36, *Impairment of Assets*.

<sup>8</sup> IFRS 3, *Business Combinations*.

<sup>9</sup> IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*.

<sup>10</sup> IAS 1, *Presentation of Financial Statements*.

An entity will need to exercise judgment about how much emphasis to place on each of the various disclosure requirements, how much aggregation or disaggregation to undertake, and whether users of the financial statements need additional information to evaluate the quantitative information disclosed.

would have to present a subtotal of profit or loss for the year before taking into account net movements in all regulatory deferral account balances, as shown in the following example:

#### Example — Presentation in Statement of Profit or Loss

Revenue	XXXX
Cost of sales	<u>(XXX)</u>
Gross profit	XXXX
Expenses	<u>XXXX</u>
Profit before tax	XXXX
Income tax expense	<u>(XXX)</u>
Profit for the year before net movements in regulatory deferral account balances	XXXX
Net movement in regulatory deferral account balances related to profit or loss and the related deferred tax movement <sup>(a)</sup>	<u>(XXX)</u>
Profit for the year and net movements in regulatory deferral account balances	<u>XXXX</u>

<sup>(a)</sup> Under IFRS 14, the deferred tax movement that results from movements in the regulatory deferral account balances may be presented (1) on an aggregated basis with the movement in regulatory deferral account balances or (2) as a separate line item alongside the related line items that are presented as movements in regulatory deferral account balances.

IFRS 14 further provides that when IAS 33 requires basic and diluted earnings per share to be presented in the statement of profit or loss, entities must “present additional basic and diluted earnings per share, which are calculated using the earnings amounts required by IAS 33 but excluding the movements in regulatory deferral account balances.” In effect, earnings per share must be shown both before and after the impact of rate regulation on profit or loss. The additional measure of earnings per share required by IFRS 14 and the usual measure of earnings per share required by IAS 33 must be presented “with equal prominence.”

### Disclosure Requirements

IFRS 14 delineates disclosure requirements aimed at enabling users to evaluate the nature of, and the risks associated with, the specific rate regulation regime and the effects of that rate regulation on the reporting entity’s financial position, financial performance, and cash flows. When determining the level of detail to provide, an entity will need to exercise judgment about how much emphasis to place on each of the various disclosure requirements, how much aggregation or disaggregation to undertake (even if the entity operates in multiple jurisdictions involving different rate regulators), and whether users of the financial statements need additional information to evaluate the quantitative information disclosed.

IFRS 14 requires entities to explain activities that are subject to rate regulation by disclosing (1) the nature and extent of the RRA, (2) the identity of the rate regulator and whether the rate regulator is a related party, and (3) how future recovery of each class of regulatory deferral account debit balance or reversal of each class of regulatory deferral account credit balance is affected by risks and uncertainty. These disclosures can be presented in the notes to the financial statements or incorporated in the financial statements by cross-reference to another statement, such as MD&A, provided that the regulator permits such alternative treatment.<sup>11</sup>

<sup>11</sup> In the United States, for example, the SEC requires registrants to provide all required accounting disclosures in the audited financial statements or related notes and would not permit incorporating this information by cross-reference to other areas of a filing, such as MD&A.

The standard should be applied in an entity's first annual IFRS financial statements for periods beginning on or after January 1, 2016. Earlier application is permitted.

In addition, the standard requires disclosures about (1) how regulatory deferral account balances are recognized and derecognized, (2) how they are measured initially and subsequently, (3) how they are assessed for recoverability, and (4) how any related impairment loss is allocated. For each type of RRA, entities must disclose specified information about each class of regulatory deferral account balance, including reconciliations of the carrying amount, rates of return or discount rates, and the impact of rate regulation on current and deferred income taxes.

### **Effective Date and Transition**

The standard should be applied in an entity's first annual IFRS financial statements for periods beginning on or after January 1, 2016. Earlier application is permitted.

### **Thinking Ahead**

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## Contacts

If you have questions about this publication, please contact the following Deloitte industry professionals:

### Bill Graf

U.S. AERS Sector Leader, Power & Utilities  
Industry Professional Practice  
Director, Power & Utilities  
Deloitte & Touche LLP  
+1 312 486 2673  
[wgraf@deloitte.com](mailto:wgraf@deloitte.com)

### Karen Higgins, FCPA, FCA

Canadian National Director of Accounting  
Deloitte Canada  
+1 416 601 6238  
[khiggins@deloitte.ca](mailto:khiggins@deloitte.ca)

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