

IFRS 14: Regulatory Deferral Accounts



Agenda

- Overview
- Key definitions
- Scope
- Recognition and measurement
- Presentation and disclosure

Overview

Objective and commencement

- 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.
- *Applicable for annual reporting periods commencing on or after 01 January 2016.*

Overview (continued)

Why was the Standard issued?

Many governments regulate the supply and pricing of particular types of activity by private entities, including utilities such as gas, electricity and water.

- These regulations are often designed to allow the suppliers to recover specified costs and other amounts through the prices they charge to customers.
- However, rate regulation is also designed to protect the interests of customers.

Consequently, the rate regulation may defer the recovery of these amounts in order to reduce price volatility. The suppliers usually keep track of these deferred amounts in separate regulatory deferral accounts until they are recovered through future sales of the regulated goods or services.

Overview (continued)

Key Definitions

- **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.

Overview (continued)

Why was the Standard issued? (Continued)

Some national accounting standard-setting bodies permit or require entities that are subject to certain types of rate regulation to capitalise and defer expenditures (or income) that would otherwise be recognised as expenses (or income).

The amounts are often referred to as 'regulatory deferral' (or 'variance') accounts.

Therefore the lack of specific guidance in IFRSs addressing the accounting for rate-regulated activities resulted in a number of requests to the IASB for guidance.

Overview (continued)

Illustration of regulatory deferral account balances

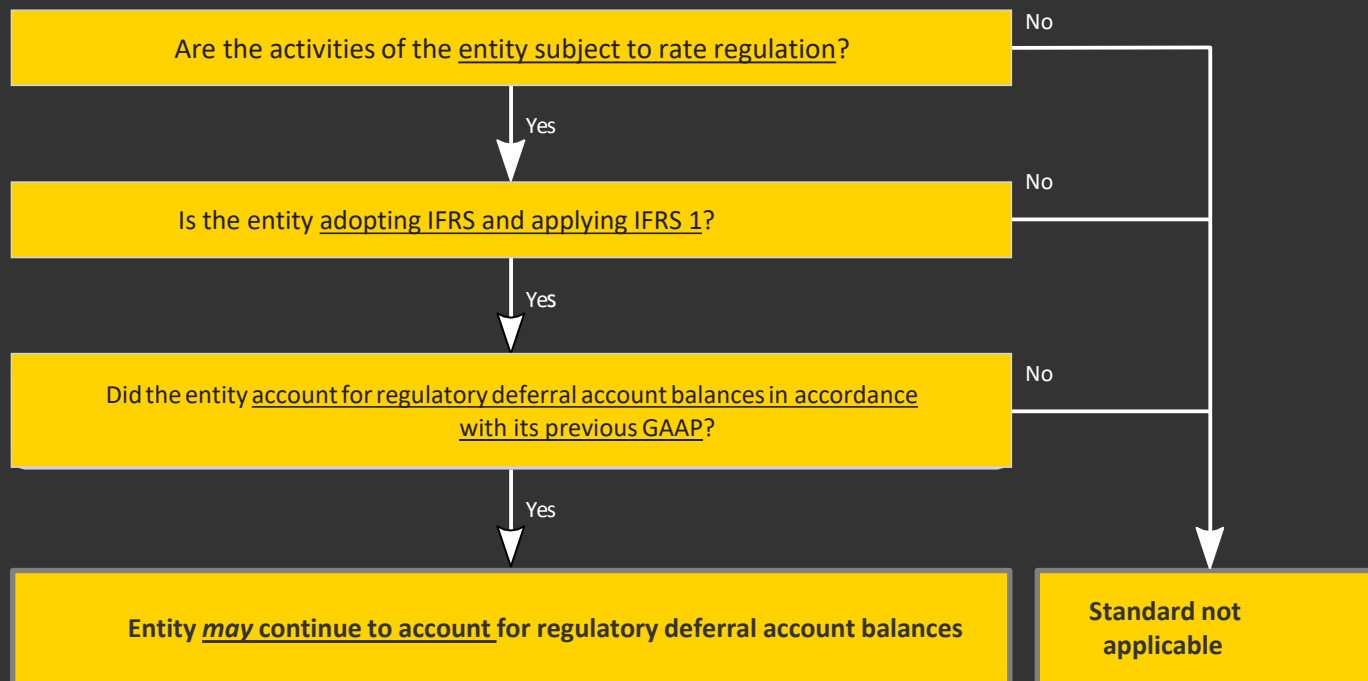
Assume Entity A is a gas company in Country X that is price-regulated. The entity is entitled to recover the input costs it incurs in supplying goods to customers. The regulated rates for Year 1 and 2 are set to recover estimated input costs of CU100. However, the actual input costs for Year 1 totalled CU120.

The regulatory agreement allows the entity to recover the CU20 input costs under-recovered in Year 1 by an increase the regulated rates it will charge customers for goods to be supplied in Year 2.

(CU '000')	Year 1	Year 2
Amount charged to customers based on regulated rates	100	120
Part of rate that recovers deficit/surplus in prior years	-	(20)
Input Costs	120	100
Net amount of (under)/over recovery of costs	(20)	-

Scope of the Standard

The following chart explains the scope of the standard



Therefore an entity may only apply IFRS 14 upon the adoption of IFRSs if it has previously recognised regulatory deferral account balances in its Financial Statements under its previous GAAP.

Recognition and measurement

First annual IFRS financial statements

- An entity within the scope of IFRS 14 is able to make a voluntary irrevocable election in its first annual IFRS financial statements whether or not to recognise regulatory deferral balances in accordance with IFRS 14.
- An entity that has elected to apply IFRS 14 in its first annual IFRS financial statements, continues to apply the recognition, measurement, impairment and derecognition requirements in accordance with its previous GAAP to *all* its regulatory deferral account balances.
- IFRS 14 does not apply to amounts that are permitted or required to be recognised as assets or liabilities in accordance with other Standards.

Recognition and measurement (continued)

Accounting Policies

An entity that elects to apply this Standard shall **apply paragraphs 10 and 12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* when developing its accounting policies** for the recognition, measurement, impairment and derecognition of regulatory deferral account balances.

Changes in accounting policies

- An entity **shall not change its accounting policies** in order to start to recognise regulatory deferral account balances.

- Changes are **only permitted** if they result in the financial statements being either:
 - **More relevant** and no less reliable, or
 - **More reliable** and no less relevant

Interaction with other Standards

The requirements of other IFRSs are required to be applied to regulatory deferral account balances, subject to specific exceptions, exemptions and additional requirements contained in IFRS 14. These are briefly summarised below:

IAS 10 <i>Events After the Reporting Period</i>	Requirements of <u>IAS 10 are applied</u> when determining which events after the end of the reporting period should be <u>taken into account in the recognition and measurement of regulatory deferral account balances</u>
IAS 12 <i>Income Taxes</i>	Deferred tax assets and liabilities arising from regulatory deferral account balances are <u>presented separately from total deferred tax</u> amounts and movements in those deferred tax balances are presented separately from tax expense (income)
IAS 33 <i>Earnings Per Share</i>	Entities applying FRS 14 are required to <u>present an additional basic and diluted earnings per share that excludes the impacts of the net movement in regulatory deferral account balances</u>
IAS 36 <i>Impairment of Assets</i>	Regulatory deferral account balances are <u>included in the carrying amount of any relevant cash-generating unit (CGU) and are treated in the same way as other assets and liabilities where an impairment loss arise</u>

Interaction with other Standards

<i>IFRS 3 Business Combinations</i>	The entity's <u>accounting policies for regulatory deferral account balances are used in applying the acquisition method</u> , which can result in the recognition of regulatory deferral account balances in respect of an acquiree, regardless of whether the acquiree itself recognised such balances
<i>IFRS 5 Non-current Assets Held for Sale and Discontinued Operations:</i>	The measurement requirements of <u>IFRS 5 do not apply to regulatory deferral account balances</u> , and <u>modifications are made to the presentation of information about discontinued operations and disposal groups in relation to such balances</u>
<i>IFRS 10 Consolidated Financial Statements and IAS 28 Investments in Associates and Joint Ventures:</i>	The <u>entity's accounting policies in respect of regulatory deferral account balances are required to be applied in an entity's consolidated financial statements</u> or in the determination of equity accounted information of associates or joint ventures, notwithstanding that the entity's investees may not have recognised regulatory deferral account balances in their financial statements
<i>IFRS 12 Disclosure of Interests in Other Entities:</i>	Separate <u>disclosure of regulatory deferral account balances and net movements in those balances recognised in profit or loss or other comprehensive income</u> are required for various IFRS 12 disclosures

Presentation and Disclosure

PRESENTATION

Statement of financial position

- The total of regulatory deferral account debit balances, and regulatory deferral account credit balances, are **presented separately from, and after, all other items.**
- They are **not** split into current and non-current portions.

Statement of profit or loss and other comprehensive income

- The net movements in regulatory deferral account balances related to both:
 - Profit or loss, and
 - Other comprehensive income.
- Are presented separately from, and after, all other items and sub-totalled appropriately.

Presentation and Disclosure

Statement of Financial Position

Illustration of the asset section of the Statement of Financial Position

Non-current assets	XXX
Current assets	<u>XXX</u>
Total assets	XXX
Regulatory deferral account debit balances	XXX
Deferred tax asset related to regulatory deferral account balances*	<u>XXX</u>
Total assets and regulatory deferral account debit balances	<u>XXX</u>

* The related deferred tax asset may also be presented within the regulatory deferral account debit balances line item.

Presentation and Disclosure (Continued)

Income Statement

Income Statement illustration

Revenue	xxx
Cost of sales	<u>(xxx)</u>
Gross profit	xxx
Other income	xxx
Distribution costs	<u>(xxx)</u>
Administrative expenses	<u>(xxx)</u>
Other expenses	<u>(xxx)</u>
Finance costs	<u>(xxx)</u>
Profit before tax	xxx
Income tax expense	<u>(xxx)</u>
Profit for the year before net movement on regulatory deferral account balances	xxx
Net movement in regulatory deferral account balances related to profit or loss	xxx
Net movement in deferred tax arising from regulatory deferral account balances related to profit or loss*	<u>(xxx)</u>
Profit for the year and net movement in regulatory deferral account balances	<u>xxx</u>

* The related deferred tax movement may also be presented within the net movement in regulatory deferral account balances line item.

Presentation and Disclosure

Key disclosure requirements

Some of the key disclosure requirements include:

Key disclosure requirements

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

Case Study

Assume Entity A is a gas company in Country X that reports under US GAAP and has a December year end. In order to reduce volatility in rates charged to customers, the regulator in Country X requires Entity A to recover the differences between actual and estimated costs over time.

Under US GAAP, the deferred gas costs meet the asset recognition criteria and are presented as “Other assets and deferred costs” on Entity A’s balance sheet as at 31 December 20X1. There are no other assets included in this line item on the balance sheet aside from these deferred costs.

The rate regulator permitted Entity A to recover its gas supply costs on the basis of a one-for-one pass through to customers. Under the rate-setting mechanism, it also requires the entity to amortise any net over or under-recovery of gas costs on a straight-line basis over three years.

Entity A decides to adopt IFRS in its 20X3 financial statements.

Case Study (continued)

On the date of IFRS adoption (1 January 20X2), Entity A has a carrying amount of CU117,000 presented as Other assets and deferred costs on its US GAAP balance sheet, which relates to the net under-recovery of gas costs to be deferred over the next three years.

- a) Comment on accounting for under recovered of gas costs on adoption of IFRS by entity A
- b) Provide presentation of how Entity A will account for recovery cost in subsequent periods using IFRS 14 based the following information:-
 - ✓ 20x1 – Amount charged to customers based on regulated rates CU 917 and actual gas cost incurred CU 1034
 - ✓ 20x2 - Amount charged to customers based on regulated rates CU 1,124 and actual gas cost incurred CU 1040
 - ✓ 20x3 - Amount charged to customers based on regulated rates CU 1079 and actual gas cost incurred CU 980

Case Study – Debrief

Part (a) accounting for under recovered of gas costs

Accounting for under recovered of gas costs on adoption of IFRS by entity A

- ▶ *Entity A has assessed that these deferred costs do not meet the requirements to be recognised as assets under IFRS.*
- ▶ *Consequently, the regulatory deferral account balances to be recognised under IFRS 14 amount to CU 117,000, which is the difference between the deferred costs capitalised and recognised under US GAAP and what would have been recognised under IFRS without the adoption of IFRS 14 (i.e., CU Nil).*

Amortisation expense of CU39,000 (CU117,000/3 years) will be recognised annually during the three year recovery period.

Case Study

Part (b) Calculating the regulatory deferral account balances in subsequent periods

(CU'000)	20x1	20x2	20x3
Amount charged to customers based on regulated rates	917	1,124	1,079
Part of rate that recovers deficit/surplus in prior years	<u>-</u>	<u>(39)</u>	<u>(24)</u>
Net amount charged to customers in respect of current year	917	1,085	1,055
Actual gas supply costs of current year	<u>1,034</u>	<u>1,040</u>	<u>980</u>
Net amount of (under)/over recovery of costs (i.e., regulatory deferral account (debit)/credit balance)	<u>(117)</u>	<u>45</u>	<u>75</u>

- ✓ As discussed in Part (a) above, due to the under-recovery of gas costs, a debit regulatory deferral balance of CU117,000 was recognised as at 1 January 20x2 on application of IFRS 14.
- ✓ This regulatory deferral account debit balance will be amortised over three years, with an annual charge of CU39,000.
- ✓ In year 20x2, the over-recovery of gas costs of CU(45,000) results in a regulatory deferral credit balance which will also be amortised over three years, with an annual credit of CU(15,000).

Case Study – Debrief

Part (b) Movements in the net regulatory deferral account balances over the three-year period

Regulatory deferral account balances, net (CU'000)	20x1	20x2	20x3
Beginning balance	-	117	33
Net under-recovery of gas costs during the year	117	-	-
Net over-recovery of gas costs during the year	-	(45)	(75)
<u>Amortisation of:</u>			
• Under-recovery of gas costs incurred in Year 20x1	-	(39)	(39)
• Over-recovery of gas costs incurred in Year 20x2	-	-	15
Net movement	117	(84)	(99)
Ending balance	117	33	(66)

- Under IFRS 14, the net movement in the debit and credit balances will flow to the statement of profit or loss and OCI.

Q & A

IFRS 6: Exploration for and Evaluation of Mineral Resources



EY

Building a better
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Agenda

- Overview
- Scope
- Selection of Accounting policies
- Recognition and measurement
- Impairment
- Presentation and disclosure

Overview

- The objective of this Standard is to specify the financial reporting for the exploration for and evaluation (E&E) of mineral resources.
- *Applicable for annual reporting periods commencing on or after 01 January 2006.*

Overview

Key definitions

Mineral resources

Although the term used in the standard is 'mineral resources', the definitions in IFRS 6 clarify that this extends to cover:-

- ✓ Mineral oils;
- ✓ Natural gas; and
- ✓ Other similar non-regenerative resources.

The standard therefore applies across the **extractive industry sector**.

Overview

Why was the standard issued

Until IFRS 6 was issued,

- **No applicable standard** - There was no International Financial Reporting Standard covering the recognition, measurement and disclosure of exploration and evaluation assets.
- **Accounting policies concern** - There had been widespread concern that entities engaged in extractive activities and adopting IFRSs for the first time would encounter difficulties and Uncertainty in determining which accounting policies were acceptable using the criteria set out in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Any accounting policies arrived at using those criteria would also be subject to further major changes once the Board had finalised its comprehensive Standard on this topic

Therefore, the principal objective of IFRS 6 is to limit the need for entities to change their existing accounting policies for exploration and evaluation assets.

Overview

Key Features

Main features of IFRS 6

To permit an entity adopting IFRS 6 to continue to use the accounting policies applied immediately before adopting the IFRS without requiring major changes

To require an impairment test of exploration and evaluation assets when facts and circumstances suggest that the carrying amount of the assets may exceed their recoverable amount

To require disclosures that identify and explain the amounts arising from the exploration for and evaluation of mineral resources

Scope of the Standard

The scope of IFRS 6 is limited to the recognition, measurement and disclosure of expenditure incurred in the phase covering the **Exploration** & **Evaluation** of mineral resources.



This standard **does not apply** to expenditures incurred:

- **Before** - the exploration for and evaluation of mineral resources, e.g. expenditures incurred before the entity has obtained the legal rights to explore a specific area
- **After** - the technical feasibility and commercial viability of extracting a mineral resource are demonstrable

Selection of accounting policies for exploration and evaluation assets

- A wide variety of accounting policies are followed by entities engaged in the exploration for and evaluation of mineral resources ranging from:-
 - a) deferring on the balance sheet - nearly all exploration and evaluation expenditures, to*
 - b) recognising all such expenditures in profit or loss as incurred.*
- IFRS 6 does not require or prohibit any specific accounting policies for the recognition and measurement of exploration and evaluation assets rather, it permits entities to continue to use their existing accounting policies provided that they comply with the requirements of **paragraph 10 of IAS 8** – i.e. that they result in information that is relevant to the economic decision-making needs of users, and that is reliable.

IFRS 6 grants a temporary exemption from applying paragraphs 11 and 12 of IAS 8 until the Board addresses these issues as part of a comprehensive project.

Changes in accounting policy

An entity may change its accounting policies for exploration and evaluation expenditures if the change makes the financial statements;

- more relevant - and no less reliable to the economic decision-making needs of users, or
- more reliable - and no less relevant to those needs, judged using the criteria in IAS 8.

IFRS 6 specifically states that, in order to justify a change in accounting policy for exploration and evaluation expenditures, the entity is required to demonstrate that the change brings its financial statements closer to meeting the criteria in IAS 8.

Recognition and Measurement

Initial Measurement

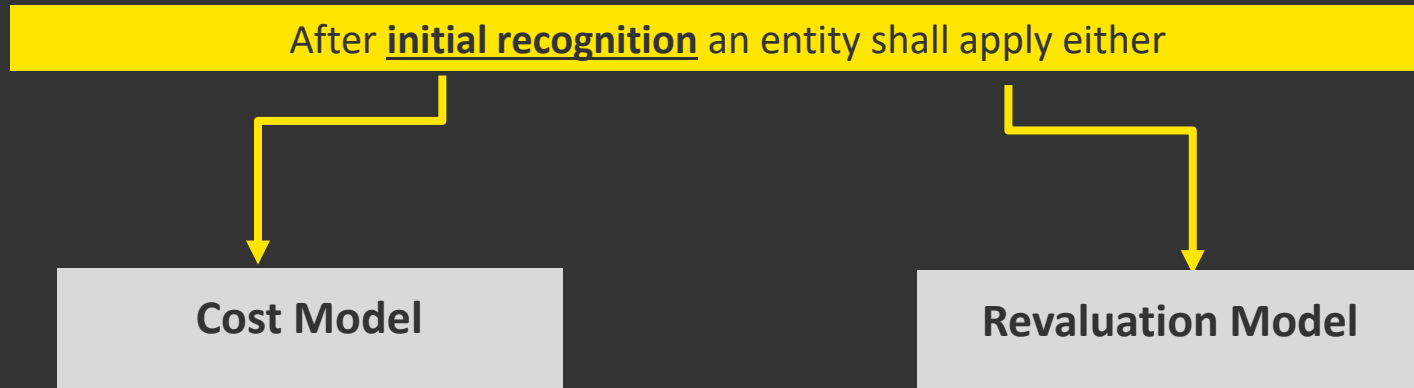
Exploration and evaluation assets shall be measured at cost at recognition.

The following are examples of expenditures that might be included in the initial measurement of exploration and evaluation assets (the list is not exhaustive):

- acquisition of rights to explore
- topographical, geographical, geochemical and geophysical studies
- exploratory drilling
- trenching
- sampling
- activities in relation to evaluating the technical feasibility and commercial viability of extracting a mineral resource

Recognition and Measurement

Subsequent Measurement



Where the revaluation model is selected, the rules of **IAS 16 *Property, Plant and Equipment*** are applied to exploration and evaluation assets classified as tangible assets, and the rules of **IAS 38 *Intangible Assets*** are applied to those classified as intangible assets.

Impairment

Impairment testing shall be undertaken when facts and circumstances suggest that the carrying amount of the exploration and evaluation asset may exceed its recoverable amount.

The impairment loss shall be measured, presented and disclosed in accordance with IAS 36.

One or more of the following facts and circumstances indicate that an entity should test exploration and evaluation asset for impairment (the list is not exhaustive):

Impairment Triggers

- The period for which the entity has the right to explore in the specific area has expired during the period or will expire in the near future, and is not expected to be renewed
- Substantive expenditure on further exploration for and evaluation of mineral resources in the specific area is neither budgeted nor planned;
- Exploration for and evaluation of mineral resources in the specific areas have not led to the discovery of commercially viable quantities of mineral resources and the entity has decided to discontinue such activities in the specific area;
- Sufficient data exist to indicate that, although a development in the specific area is likely to proceed, the carrying amount of the exploration and evaluation assets is unlikely to be recovered in full from the successful development or by sale.

Case study 1

Company A is exploring for oil in a known oil basin in West Africa. The oil basin stretches across the borders of countries X and Y. Company A is carrying out E&E activities in both countries and, out of 40 specified exploration areas, has the rights to areas 1,2, 20, 26,27 and 40. Areas 1, 2 and 20 are located in country X, and areas 26,27 and 40 are located in country Y. Areas 1 and 2 are adjacent to each other as are areas 26 and 27, and 20 and 40.

Company A has started to drill a planned total of 1,000 test wells in area 26. Five wells have been completed, with only water having been found. Company A intends to continue with its test drilling.

Question

Does the failure of the first five test wells to find oil represent an impairment trigger under the requirements of IFRS 6?

Debrief – Case Study 1

- This question will typically arise when an entity follows a policy of capitalising all eligible E&E expenditure.
- Under this approach, the unit of account for purposes of accounting for E&E assets could be determined as being the area over which Company A has a right to explore. Because Company A intend to continue its E&E activities in Area 26, this indicates that *an impairment trigger has not occurred*.
- The costs associated with the five test wells are carried forward as an E&E asset, on the basis that the result of drilling provide useful information about the license area as a whole.

Case study 2

Company A has a 31 December financial year end, with its annual report being approved in March 20X3. An exploratory drilling programme was undertaken during the period from October 20X2 to January 20x3, with the results being evaluated in February 20x3. The analysis shows that no commercial deposits exist and Company A determines that it will cease to carry out E&E activities.

Question

Is Company A required to include a charge for impairment of the E&E asset in its financial statement for the year ended 20x2?

Debrief – Case Study 2

Yes

This is because the test results provide information about the exploration are about conditions that existed at the financial year end (there are no commercial deposits), all E&E expenditure that has been capitalized up to 31 December 20x2 is required to be written off.

Presentation

Classification of exploration and evaluation assets

- The assets shall be classified as tangible or intangible according to the nature of the assets acquired. Examples of tangible and intangible exploration and evaluation assets are:-
 - **Tangible** - vehicles and drilling rigs
 - **Intangible** - drilling rights
- To the extent that a tangible asset is consumed in developing an intangible asset, the amount reflecting that consumption is part of the cost of the intangible asset. However, using a tangible asset to develop an intangible asset does not change a tangible asset into an intangible asset.

Presentation (continued)

Reclassification of exploration and evaluation assets

- An exploration and evaluation asset shall no longer be classified as such when the technical feasibility and commercial viability of extracting a mineral resource are demonstrable (i.e. it becomes a development asset).
- Exploration and evaluation assets shall be assessed for impairment, and any impairment loss recognised, before reclassification.

Disclosure

An entity discloses information that identifies and explains the amounts recognised in its financial statements arising from the exploration for and evaluation of mineral resources.

An entity discloses:

- Its accounting policies for exploration and evaluation expenditures and evaluation assets
- The amounts of assets, liabilities, income and expense and operating and investing cash flows arising from the exploration for and evaluation of mineral resources.

Exploration and evaluation assets are disclosed as a separate class of assets in the disclosures required by IAS 16 *Property, Plant and Equipment* or IAS 38 *Intangible Assets*.

Q & A

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