The Institute of Chartered Accountants of Pakistan

CA PAKISTAN

Topic wise Selected Opinions

IFRS 14 - Regulatory Deferral Accounts

1. Guidance on the Implementation of IFRS 14 'Regulatory Deferral Accounts'

Brief facts of the enquiry:

The Accounting Standards Board (the Board) received following enquiries and concerns related to the implementation of IFRS 14 Regulatory Deferral Accounts, from a listed utility company (the Company):

a) Whether the application of IFRS 14 requirements are 'optional' for first time adopters of IFRS Standards?

b) Whether IFRS 14 is only applicable on the first time adopters of IFRS Standards?

c) Whether the differential margin/tariff adjustments of utility companies in Pakistan qualify to be treated as regulatory deferral account balances under IFRS 14?

d) The application of IFRS 14 presentation requirements may distort overall presentation of financial statements and affect the stakeholder confidence.

Opinion:

A. Whether the application of IFRS 14 requirements are 'optional' for first time adopters of IFRS Standards?

The Board noted that under IFRS Standards the regulatory deferral account balances do not meet the definition and recognition criteria for 'assets' and 'liabilities'.

However, under IFRS 14 Regulatory Deferral Accounts, an entity can recognise and present regulatory deferral account balances in its financial statements.

IFRS 14 outlines a 'Grandfathering approach' for the recognition and measurement of regulatory deferral account balances.

Paragraph 5 of IFRS 14 'permits' the entities to continue applying the previous generally accepted accounting policies (GAAP) to the recognition, measurement, impairment of regulatory deferral account balances on transition to full IFRS Standards.

While following the previous GAAP based accounting policies for the recognition and measurement of regulatory deferral account balances, the presentation and disclosure requirements of IFRS 14 should be followed.

The Board concluded that under IFRS 14:

a) a first time adopter of IFRS Standards is 'permitted' to continue application of previous GAAP accounting policies for regulatory deferral account balances.

b) If an entity does not avail this permission, then it cannot recognise regulatory deferral account balances in its financial statements.

c) an entity is not permitted to change an accounting policy to start recognizing regulatory deferral account balances, or to recognise a wider range of such balances by modifying a previous GAAP policy.

B. Whether IFRS 14 is only applicable on the first time adopters of IFRS Standards?

The Companies Act, 2017 (the Companies Act) specifies the financial reporting requirements for companies.

Under the Companies Act, the Securities & Exchange Commission of Pakistan (SECP), notified the adoption of IFRS 14, through S.R.O 1480/(I) of 2019 (dated November 27, 2019).

IFRS 14 is effective for annual periods beginning on or after July 01, 2019 for all companies that are required to follow the IFRS notified by SECP, under the Companies Act.

Relevant wordings of SECP notification are as under:

> *"…… is pleased to notify that the International Financial Reporting Standard (IFRS) 14 – "Regulatory Deferral Accounts" and any further revisions issued by the International Accounting Standards Board shall be followed for the preparation of financial statements for the annual reporting periods beginning on or after 1st July 2019 by all classes of companies that are required by the Act to follow IFRS as notified by the Commission."*
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> (Emphasis is ours)

The Board noted that paragraph 5 of IFRS 14 outlines that an entity is eligible to apply IFRS 14 only if it:

a) conducts rate-regulated activities;

b) accounted for regulatory deferral account balances in its financial statements immediately before the adoption of IFRS 14; and

c) elects to apply requirements of IFRS 14 in its first IFRS financial statements.

It is to be noted that the Board and Institute while considering and recommending the adoption of IFRS 14 after due process, were cognizant to the fact that many Pakistani companies, noticeably, utility companies would be meeting the criteria noted in (a) and (b), above. However, these companies, in general, would not be preparing financial statements under full IFRS Standards. Rather, these would be preparing their statutory financial statements in accordance with the IFRS notified by SECP.

The Board observed that SECP has notified adoption and application of IFRS 14 for all companies that are preparing their financial statements in accordance with IFRS notified by SECP.

The Board with the objective to provide enhanced and common understanding to all stakeholders regarding the scope and application of IFRS 14 in Pakistan, suggested that SECP may consider issuing a clarification/guidance on the scope of IFRS 14 as it can be applied by companies that are preparing statutory financial statements under the Companies Act and not transitioning to full IFRS Standards.

The Board concluded that IFRS 14 can be applied by a company while preparing statutory financial statements under the Companies Act. Such a company for the preparation of statutory financial statements may:

a) elect to apply the requirements of IFRS 14 in its first IFRS financial statements; or

b) elect to apply the requirements of IFRS 14 in its financial statements prepared in accordance with the IFRS notified by SECP.

Importantly, if a company does not elect to apply IFRS 14 then it cannot recognise regulatory deferral account balances in its statutory financial statements.

C. Whether the differential margin/tariff adjustments of Utility Companies qualify to be treated as regulatory deferral account balances under IFRS 14?

The Board noted that the settlement mechanism of:

a) shortfall in revenue requirement for indigenous natural gas; and

b) both shortfall and surplus in revenue requirement of RLNG business,

provide for the adjustments in future tariffs as a part of determination of final revenue requirements.

Whereas, the settlement of the surplus in revenue requirement for indigenous natural gas is paid in cash to the Federal Government as the Gas Development Surcharge (GDS) under the Natural Gas (Development Surcharge) Ordinance, 1967. Since, the settlement mechanism of GDS does not fulfill the conditions of defined rate regulation under IFRS 14, therefore, GDS would be scoped in and accounted for under other applicable IFRS Standards.

The Board highlighted that its analysis and conclusion on the enquired matter is based on the settlement mechanism of the surplus or deficit in the revenue requirements as laid down in the Oil & Gas Regulatory Authority (OGRA) Ordinance, 2002 and the policy decisions of the Federal Government. Therefore, as part of its analysis and determination of accounting implications of the enquired matter, the Board had not considered any other possible settlement mechanisms for differential margin/tariff adjustments which are not currently provided under the existing regulatory framework. Therefore, any future decision of the Federal Government for an alternative settlement mechanism of differential margin/tariff adjustments would need to be considered and assessed separately considering its particular facts and features.

The Board concluded that the existing settlement mechanism of:

a) shortfall in revenue requirement for indigenous natural gas; and

b) both shortfall and surplus in revenue requirement of RLNG business,

in substance represents the defined rate regulation as envisaged under IFRS 14 and IASB's standard-setting project on the rate regulated activities.

D. The application of IFRS 14 presentation requirements may distort overall presentation of financial statements and affect the stakeholder confidence.

It is to be noted that the Board extensively approached all the relevant stakeholders for consultation purposes, prior to recommending the adoption of IFRS 14 to the SECP. The objectives of the Board's outreach and consultations were to create stakeholders' awareness and seek comments on IFRS 14.

The Board noted that the objective of IFRS Standards (including IFRS 14) is to report information that faithfully represents transactions and other events based on their economic substance. Moreover, Paragraph 15 of IAS 1 Presentation of Financial Statements states that financial statements shall present fairly the financial position, financial performance and cash flows of an entity. 14. The Board further explained that globally, utility companies engaged in rate regulated activities have effectively implemented IFRS 14. Based on the limited research of financial statements of few international rate regulated companies, it was noted that significant amounts of regulatory deferral account balances were reported in the financial statements consequent to adoption of IFRS 14.

The Board concluded that the specific presentation and disclosure requirements outlined in IFRS 14 would enable the users to have a more relevant understanding of the nature and financial impact of the regulatory deferral account balances of an entity in respect of its rate regulated activities. The Board also noted that a company in its financial statements may provide additional explanatory disclosures as permitted in IAS 1, to provide useful and relevant information to stakeholder's for understanding the impacts of IFRS 14.

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