

ICAP HEAD OFFICE

Chartered Accountants Avenue,
Block 8, Clifton, Karachi, 75600
Pakistan.

U: (+92 21) 111 000 422

F: (+92 21) 99251626

W: www.icap.org.pk

Reach Us Out:



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ALL MEMBERS OF THE INSTITUTE

Clarification on applicability of IFRS 14 *Regulatory Deferral Accounts*

Dear Member,

It has come to the attention of the Accounting Standards Board (ASB), through the Securities and Exchange Commission of Pakistan (SECP), that some companies in Pakistan, despite operating in sectors with rate-regulated activities, are not adhering to the requirements of IFRS 14. This non-compliance is based on the interpretation of Paragraph 5 of IFRS 14, which allows an entity to apply the standard in its first IFRS financial statements. Since full IFRS application is not currently mandated in Pakistan, these companies believe IFRS 14 does not apply to them.

The ASB would like to clarify that IFRS 14 was notified by the SECP on the ASB's recommendation. Paragraph 5 of IFRS 14 permits an entity to apply the standard in its first IFRS financial statements if it:

- a. Conducts rate-regulated activities; and
- b. Recognized amounts that qualify as regulatory deferral account balances in its financial statements under its previous GAAP.

Regulatory deferral account balances do not meet the definition and recognition criteria for assets and liabilities under the existing IFRS Conceptual Framework and the IFRS Standards notified by SECP in Pakistan. The term 'permitted' in Paragraph 5 of IFRS 14 allows entities transitioning to IFRS Standards to continue recognizing regulatory deferral account balances according to pre-transition accounting policies, while following IFRS 14's presentation and disclosure requirements. Since IFRS 14 has been adopted in Pakistan, entities can only continue to recognize their rate-regulated balances that meet the definition of regulatory deferral account balances in line with IFRS 14.

IFRS 14 applies to the accounting of deferral account balances arising from activities subject to rate regulations. It defines:

- Rate-regulated activities as activities subject to rate regulation.
- Rate regulation as a framework for establishing prices charged to customers for goods or services, subject to oversight and/or approval by a rate regulator.
- Regulatory deferral account balances as the balance of any expense (or income) account that would not be recognized as an asset or a liability under other Standards but qualifies for deferral because it is included, or expected to be included, by the rate regulator in establishing the rates charged to customers.

Paragraph B3 of IFRS 14 further explains what constitutes a regulatory deferral account balance.

REGISTERED OFFICE

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The SECP, through S.R.O. 1480 (I)/2019 dated November 27, 2019, notified the adoption of IFRS 14, as follows:

"In exercise of the powers conferred by section 510 read with sub section 1 of section 225 of the Companies Act, 2017 (XIX of 2017) (the "Act") the Securities and Exchange Commission of Pakistan (the Commission), in continuation of its earlier S.R.O. 633 (I)/2014, dated 10th July 2014, 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." (Italic and Underlining Ours)

This notification states that IFRS 14 and any further revisions issued by the International Accounting Standards Board shall be followed for preparing financial statements for annual reporting periods beginning on or after July 1, 2019, by all classes of companies required by the Companies Act, 2017 to follow IFRS as notified by the SECP.

It is important to note that while IFRS 14 allows only first-time adopters of IFRS Accounting Standards to recognize regulatory deferral accounts, the SECP has mandated that companies in Pakistan, which prepare financial statements in accordance with accounting and reporting standards applicable in Pakistan and already recognize regulatory deferral account balances, must apply IFRS 14 without transitioning to full IFRS Accounting Standards.

Based on the above, it is clarified that the SECP has made the adoption and application of IFRS 14, as recommended by ASB, effective for all classes of companies without transitioning to first-time adoption of full IFRS Accounting Standards. Therefore, all companies required by the Companies Act, 2017 to follow IFRS as notified by SECP (including companies which operate under the ambit of rate regulators such as NEPRA and OGRA) must apply IFRS 14 for the measurement, presentation, and disclosure of regulatory deferral account balances.

Yours truly,


Muhammad Imran Khan
Director, Technical Services