

26 March 2014

Mr Idésio da Silva Coelho Júnior
Chair of International Affairs
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Dear Mr Idésio da Silva Coelho Júnior

IFRS 14 *Regulatory Deferral Accounts*

Thank you for your letter outlining your concerns about IFRS 14 *Regulatory Deferral Accounts*, issued in January 2014. I and my fellow IASB members do understand that the issue of regulatory accounting is very sensitive in Brazil, especially for the electricity distribution companies. In making our decisions about IFRS 14, we were aware that it was very difficult for those companies and others when they eliminated their regulatory deferral account balances from the financial statements when adopting IFRS in 2010. This, we appreciate, created a lot of work to explain the issue to the users of those financial statements and to find an alternative way to communicate the regulatory balance information. I can, therefore, assure you that the IASB did not take lightly the decision to restrict its application only to first-time adopters of IFRS.

The temporary nature of IFRS 14 is not the main reason for restricting its application to future first-time adopters of IFRS. As explained in the Basis for Conclusions on IFRS 14, rate regulation raises complex and fundamental accounting issues. In the IASB's view, the solution to these difficult issues is by no means as straightforward as your letter suggests.

I will try to explain why we made this difficult decision and why we could not follow the three proposals that you raised in your comment letter on the Exposure Draft and have repeated in your letter to me dated 19 March 2014. I will focus on the three proposals in reverse order because I think that this will help to explain more clearly our reasons for restricting the scope of IFRS 14 to future first-time adopters.

The Conceptual Framework project

In developing new Standards or making changes to existing IFRS, including the *Conceptual Framework for Financial Reporting* (the *Conceptual Framework*), we are required to carry out an extensive international consultation process.

At this time, it is too early to say how the existing *Conceptual Framework*, which sets out the concepts that underlie the preparation and presentation of financial statements, will change as a result of the review that we are currently undertaking. We still have a long way to go through our extensive consultation and decision-making procedures (our 'due process') to ensure that any changes that we do make are supported and contribute to clearer and stronger concepts, which will underlie the development of future Standards. These concepts must be robust enough to provide a clear framework on which to address a wide variety of accounting issues across a broad range of industries.

We are monitoring the interaction of this project with the Rate-regulated Activities project, but we cannot yet anticipate whether any potential changes to the *Conceptual Framework* would strengthen or weaken the arguments for recognising regulatory balances as assets or liabilities.

The comprehensive Rate-regulated Activities project

We respect your strongly held view that regulatory balances should be recognised as assets and liabilities. However, during the previous and the current Rate-regulated Activities projects, we have heard equally strong but opposing views that such regulatory balances should not be recognised in the financial statements as assets or liabilities.

To help us reconcile these strongly opposing views, we have focused our resources since restarting the project on gaining a much clearer understanding of how rate regulation works globally. To help us, we have established an expert Consultative Group, which includes Brazilian representation. This group has helped us to understand and analyse the detailed information that we received from Brazil and many other countries in response to our Request for Information *Rate Regulation*, published in March 2013. We are continuing to work with the Consultative Group to develop a Discussion Paper, which we aim to publish in mid-2014.

This Discussion Paper will set out various arguments both for and against the recognition of regulatory balances as assets and liabilities. In accordance with our extensive consultation procedures, we will seek feedback on these arguments through both comment letters and outreach discussions, which we hope will involve Latin American participation. We strongly encourage CPC and other Brazilian stakeholders to commit themselves to this process to provide us with strong evidence in support of your views. This will be vital to ensure that we receive a balance of evidence, because we are expecting to continue to receive contrary evidence from those who hold the opposing view.

Until our due process procedures are completed, we cannot anticipate whether or not the outcome of our ongoing Rate-regulated Activities project will result in regulatory balances being recognised as assets and liabilities in IFRS financial statements.

The applicability of IFRS 14

The IASB did consider, in public meetings both during the development of the Exposure Draft and in the redeliberations of the proposals, whether to make the interim solution available to a wider range of entities, as you suggested in your comment letter on the Exposure Draft. I provide a summary of the outcome of these discussions in the Appendix to this letter.

In particular, the IASB are mindful of the high degree of uncertainty as to the outcome of the ongoing project. This is because there is no guarantee that the project will result in entities being able to recognise regulatory balances as assets and liabilities in the same way as permitted in IFRS 14 or as previously permitted in accordance with some national GAAPs. Consequently, we decided not to require or even permit existing IFRS preparers to make a major change to their existing accounting policies to start (or restart) to recognise regulatory balances, which may then have to be eliminated again or be significantly modified in the near future when the comprehensive project concludes. We decided that the risk involved in making such major policy changes over a short period of time was too great. Such changes or potential changes would not only be costly but would seriously risk creating significant confusion and greater uncertainty for preparers, auditors, analysts and investors.

On balance, we considered that the best course of action was to complete the interim project as quickly as possible with a limited scope so that we, and our stakeholders with an interest in rate-regulated activities, could focus resources on the ongoing project. We are conscious that, because IFRS 14 is available only to a limited population of entities, we need to resolve quickly the fundamental issue as to whether rate regulation creates 'regulatory assets' and 'regulatory liabilities' and, if so, what the nature of these assets and liabilities is and how should they be accounted for in IFRS financial statements.

Consequently, I hope that CPC and other interested parties in Brazil will engage strongly in the work being done in the ongoing Rate-regulated Activities project. If you have any questions about that project or how you can contribute to it, please do contact directly my fellow Board member Mr Amaro Gomes (agomes@ifrs.org) or the project manager Mrs Jane Pike (jpike@ifrs.org).

Yours sincerely

Amaro Gomes,



Hans Hoogervorst
IASB Chairman

Appendix: Why the scope of IFRS 14 is restricted to first-time adopters of IFRS

The IASB's reasons for issuing IFRS 14 *Regulatory Deferral Accounts* are set out in paragraphs BC11-BC21 of the Basis for Conclusions on IFRS 14, which are consistent with the reasons proposed in the Basis for Conclusions on the Exposure Draft issued in April 2013. Having considered the responses to the Exposure Draft, the IASB decided that IFRS 14 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 (paragraph BC17).

While there were some respondents to the Exposure Draft who advocated a wider scope, they did not propose a clear solution as to how this could be achieved. Some suggested that entities should return to the policies that they used before making the transition to IFRS; others suggested allowing entities to develop their own policies; and others suggested that the IASB should determine what policies should be applied.

Consequently, the IASB took the difficult decision to restrict the application of IFRS 14 to first-time adopters for many reasons, including:

- IFRS 14 “is likely to remove a major barrier to the adoption of IFRS”, which “should reduce the risk of entities adopting locally developed [solutions] that would otherwise create greater diversity of accounting treatment and greater confusion for users of financial statements” (paragraphs BC20(a)-(b) of the Basis for Conclusions on IFRS 14).
- Allowing entities to return to previous policies or to develop new policies would introduce more inconsistency and diversity in the treatment of regulatory balances.
- If we had tried to develop more detailed guidance in the interim project to enable more consistent policies to apply, this would have seriously delayed the main Rate-regulated Activities project (the main purpose of which is to identify how to identify appropriate accounting policies for the effects of rate regulation). This would have been contrary to the strong message that we received in our international consultation process, which was to try to complete the main project as quickly as possible.
- IFRS 14 does not anticipate the outcome of the main project (paragraph BC21).
- IFRS 14 is intended to help 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 (paragraph BC18).
- Permitting or requiring entities to make a major change to their existing accounting policies to start (or restart) to recognise regulatory balances would not only risk prejudicing the outcome of the main project, but would create confusion and greater uncertainty because there is no guarantee that the outcome of the main project will be to recognise regulatory balances as assets and liabilities in the same way as permitted in IFRS 14 or previously permitted in accordance with some national GAAPs.