



**REGULATORY ASSETS AND LIABILITIES: THEIR RELEVANCE FOR
ACCOUNTING INFORMATION.**

A STUDY OF BRAZILIAN ENERGY ELECTRICITY MARKET.

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Thanks first to God who granted me the grace of life.

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1. INTRODUCTION

1.1. Context of the research

This research is developed concerning the importance of accounting information for decision-making by managers and investors, in which it is included as an important element that instructs such agents in the performance of their roles.

On that basis, the accounting information is an essential resource for the development of business in an economic environment of deep competitiveness and in which access to information is near real-time.

Thus, for the purposes of this study will be analyzed the Brazilian electricity sector, which has experienced significant regulatory changes recently. Additionally, it is an industry that focuses substantial investment and that in recent years, Brazil has undergone relevant structural change as a result of the review of the concession contracts for electric power generation.

On the other hand, in recent years in Brazil, there was an important alignment of local accounting rules to those issued by the International Accounting Standards Board (IASB).

Such changes in the Brazilian accounting standards, with the adoption of International Financial Reporting Standards (IFRS) issued by the IASB, had the effect of introducing recognition practices and accounting disclosure different from those previously in force in Brazil.

Specifically, in relation to the electricity sector some of the accounting rules introduced with the adoption of IFRS led to substantial changes in asset composition of these companies.

Many of these effects are derived from the adoption of International Accounting Standards (IAS) 17 - Leases, IFRIC 12 - Service Concession Arrangements and the non-recognition of regulatory assets and liabilities under IFRS.

1.2. Goals

This research aims to present the Brazilian way to adopt the accounting standard issued by the IASB and additionally discuss the main effects of IFRS on the financial statements of companies in the Brazilian electric sector.

The main goal of this research focuses on analyzing, from the point of view of the relevance of accounting information, the non-recognition of regulatory assets and liabilities as set out in the accounting standards issued by the IASB does not contribute significantly to the improvement of financial information provided by companies to their principal users.

1.3. Research framework

The first section will show a brief overview of the Brazilian electric sector. In that part will be provided a brief history of the Brazilian electricity sector as well as an extract of the main characteristics of this sector. In addition, the functioning of the regulatory environment surrounding the sector and presented an overview of his recent performance will be addressed.

Then it will be drawn the way how was developed the adoption of accounting standard issued by the IASB. In this section will be discussed the initiatives undertaken by the various actors (public and private) in order to align Brazilian accounting practices to international. A more particular way, will be discussed the major effects of the adoption of IFRS on the financial statements of companies in the Brazilian electricity sector.

The penultimate section is intended to lead a discussion about the so-called "regulatory accounting" especially in relation to its function in the context of the Brazilian electric sector. This debate will be developed vis-a-vis the role of accounting information on how it is put in the very Conceptual Framework of the IASB, in short, provide useful and reliable specific information to support decision making by managers, investors and other stakeholders.

Finally, the last section presents the final considerations of this study regarding the maintenance of the characteristics of accounting information, as IASB conceptual framework assumptions, in the context of the Brazilian electric sector regarding to the recognition of regulatory assets and liabilities.

2. CONTEXT OF THE BRAZILIAN ELECTRIC SECTOR

2.1. History

Is possible to set some historical landmarks that enable us to analyze the evolution of the Brazilian electric sector. A country with continental dimensions and huge population such as Brazil, has a great demand for electricity to support economic growth and households welfare.

This section is based on Bauer & McDonald (1997) and Gomes & Vieira (2009) studies. The first research realized that there is historical periods which are characterized by the same economic, regulatory and governmental context. The second one has prepared a linear description of historical facts, with emphasis on crucial events, which were detailed and analyzed, showing the main social players, their interest and their influences in these events.

The survey produced by Gomes & Vieira (2009) provides a fairly comprehensive set of information which allows us to clearly understand how was the development of the Brazilian electric sector.

The authors reported various historical events and their kind of political, economic and social contexts, focused on the transformation of companies that were, and still operate in the Brazilian electric sector, so that it was possible to prepare a framework that briefly describes the main characteristics at each stage in the formation of the Brazilian electric sector.

Thus, we reproduce below the table showing the formative stages of the Brazilian electric sector according to the study Gomes & Vieira (2009).

Chart 1

Major formative stages of the Brazilian electric sector

Period	Main events
1880-1930	Private monopoly - beginning of the use of electricity in Brazil, with the implementation of the first national and foreign enterprises, dominated from the 1920s by foreign-funded enterprises. Corresponds to the period of the Old Republic.
1941-45	State presence - the State shall prepare the first regulations in the sector, highlighting the implementation of the Water Code in 1934. The acceleration of Brazilian economic development corresponds to an increase in energy demand that has no counterpart in investments. It corresponds to the Getúlio Vargas government.
1946-62	Inductor State - with the fall of Vargas, greater involvement of the state is established in the electricity sector, increasing public investment, especially in state level concessions. Eletrobras establishment in 1962.
1963-79	State model - Eletrobras is now inducing the nationalization and state-owned control process of the electricity sector, making large investments. It is consolidated a new institutional model that reached its peak in 1979.
1980-92	Institutional crisis - the economic crisis worsening, the growth of the electricity sector is affected. In 1992, bad debt is widespread and the state model is questioned.
1993-2002	Hybrid model - enacted Law 8.631/93, which equates debts. Start the institutional changes in the Brazilian electric sector. At the end of 2002, the generation and transmission were mostly in state-owned enterprises and the distribution was mainly private.

Source: Gomes & Vieira (2009). Free translation by the author.

As reported by Taffarel, Silva & Clemente (2013), in 2004 there was a comprehensive review of the Brazilian electric sector rules by issuing of the law 10,847 / 04 (authorizing the creation of the Empresa de Pesquisa Energética - EPE) and 10,848/04 (which implemented new rules for electricity trading). Thus the New Model of Energy, established in 2004, has as main objectives: to ensure security of energy supply, promote low tariffs and promote the social integration of the electricity sector by universal service programs.

2.2. Market characteristics

According to the Statistical Yearbook of Electricity 2015 (base year 2014), produced by the Energy Research Company (Empresa de Pesquisa Energética - EPE)¹, Brazil on 2014 consumed 475.432 Giga-Watt hour (GWh) of electricity and owned 77,171 consumers.

The table below, in a historical series 2010-2014, shows in detail the electricity consumption and the amount of consumers by economic sector:

Table 1
Consumption and amount of electricity consumers in Brazil

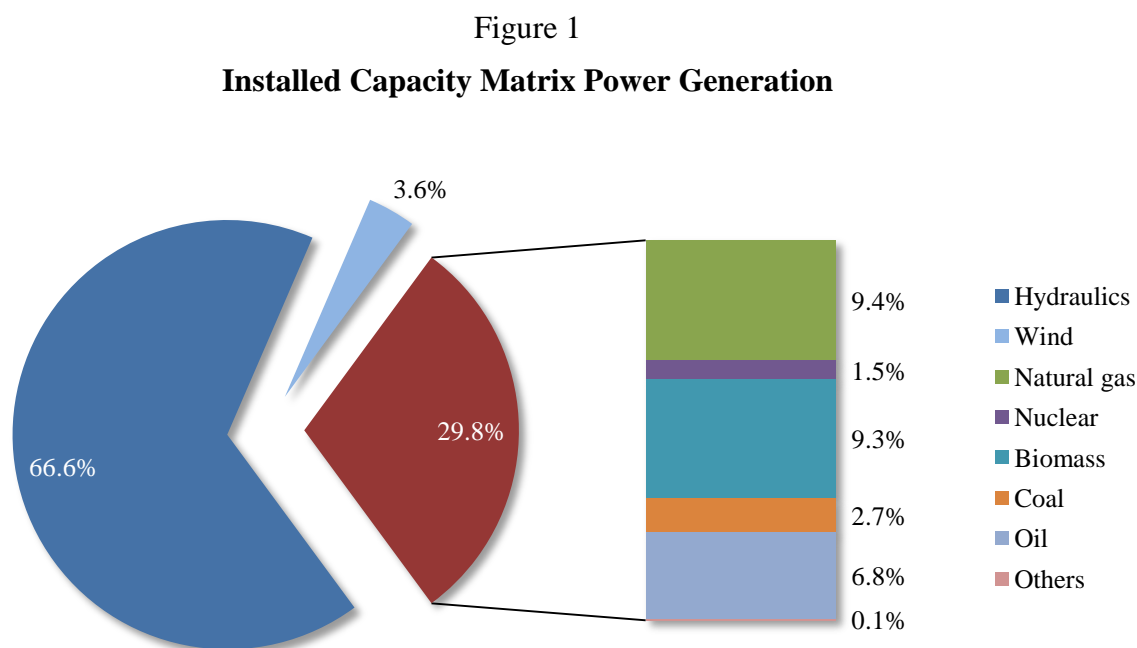
	2010	2011	2012	2013	2014	$\Delta\%$ (2014/2013)	Part. % (2014)
Consumption (GWh)	415,668	433,016	448,177	463,134	475,432	2.7	100
Residential	107,215	111,971	117,646	124,908	132,399	6.0	27.8
Industrial	179,478	183,576	183,475	184,685	179,618	-2.7	37.8
Commercial	69,170	73,482	79,226	83,704	89,840	7.3	18.9
Rural	18,906	21,027	22,952	23,455	25,671	9.4	5.4
Public Sector	12,817	13,222	14,077	14,653	15,354	4.8	3.2
Public lighting	12,051	12,478	12,916	13,512	14,043	3.9	3.0
Public service	13,589	13,983	14,525	14,847	15,242	2.7	3.2
Own Use	2,441	3,277	3,360	3,371	3,265	-3.4	0.7
Consumers (thousand)	67,907	70,323	72,377	74,814	77,171	3.2	100
Residential	58,006	59,907	61,697	63,862	66,007	3.4	85.5
Industrial	554	558	573	584	574	-1.8	0.7
Commercial	4,902	5,120	5,271	5,445	5,566	2.2	7.2
Rural	3,785	4,055	4,129	4,200	4,279	1.9	5.5
Public Sector	507	521	536	544	561	3.3	0.7
Public lighting	74	79	83	87	88	1.1	0.1
Public service	68	71	76	79	84	5.2	0.1
Own Use	12	12	12	12	14	9.7	0.0

Source: Statistical Yearbook of Electricity 2015 (EPE, 2015).

¹ Brazilian state-owned company which role is providing research services in order to support the Brazilian energy planning.

Based on data from the US Energy Information Administration, tabulated and presented by EPE in its Statistical Yearbook 2015, Brazil is among the top ten countries with installed capacity of electricity generation, with 121 GW of installed capacity in 2012 (last measurement available) .

The statistical yearbook of the EPE shows that in 2014 the installed capacity of electricity generation in Brazil was 133 GW, representing a 10% expansion in comparison to the year 2012. The Brazilian Electricity Sector Monitoring Monthly Bulletin, issued by the Ministry of Mines and Energy for the month of December 2014, shows the composition of the various sources that make up the Brazilian energy matrix, as shown in Figure 1 below.



Source: Brazilian Electricity Sector Monitoring Monthly Bulletin (December, 2014).

Regarding with to hydroelectric power generation, Brazil remains the world's second largest producer in the period within 2008 and 2012, according to a survey presented by EPE in its statistical yearbook based on data from the US Energy Information Administration. In 2014, according to EPE, the installed capacity of Brazilian hydroelectric power generation was 89 GW.

From the point of view of the Brazilian electricity sector infrastructure, it is worth mentioning the National Interconnected Power System (NIPS), which according to the Electric System National Operator (ONS)², is defined as follows:

With size and characteristics indicating that it unique worldwide, the system of production and electricity transmission in Brazil is a large hydrothermal system, with strong predominance of hydroelectric plants and with multiple owners. The National Interconnected Power System is formed by companies in the South, Southeast, Midwest, Northeast and part of the northern region. Only 1.7% of the energy required by the country lies outside the NIPS, in small isolated systems located mainly in the Amazon region.

Regarding with the complexity and dimension to the operation of this system, in relation to the transmission segment, the Brazilian electricity sector consists of 125,149 km (equivalent to approximately 77 miles) of transmission lines, according to the Brazilian Electricity Sector Monitoring Monthly Bulletin.

Table 2
Electricity transmission lines in the Brazilian Electric Sector

Voltage Class (kV)	Transmission lines in operation	%Total
230 kV	51,951	41.5%
345 kV	10,314	8.2%
440 kV	6,728	5.4%
500 kV	40,716	32.5%
600 kV (CC)	12,756	10.2%
750 kV	2,683	2.1%
Total	125,149	100%

Source: Brazilian Electricity Sector Monitoring Monthly Bulletin (December, 2014).

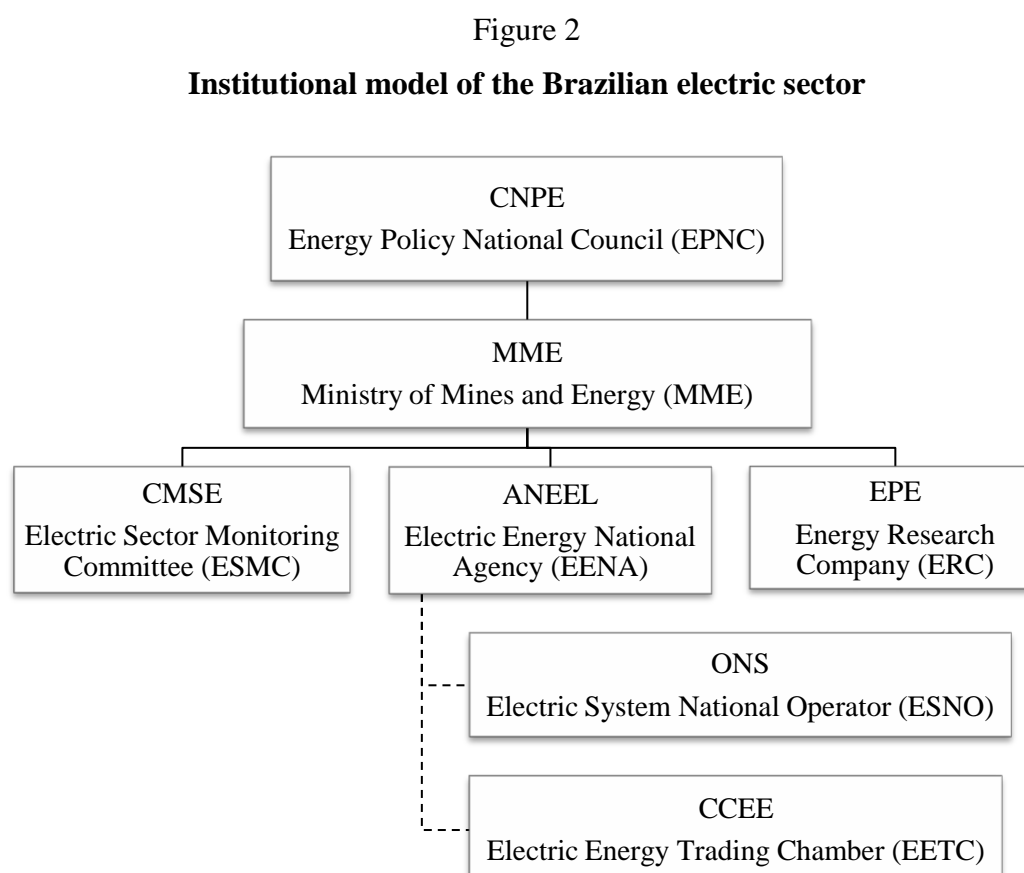
² The Electric System National Operator is a private right entity, non-profitable, created on 26 August 1998, responsible for coordinating and controlling the operation of generation and transmission facilities in the National Interconnected Power System (NIPS) under supervision and regulation of the Electric Energy National Agency (ANEEL).

2.3. Regulatory environment

As previously mentioned, the Brazilian electricity industry has undergone numerous changes especially since 1990. As Taffarel, Silva & Clemente (2013) tell us, in this period were developed mathematical and economic models in order to add value to electric power transmission services, together with the deverticalization plan and privatization of some electric utilities.

The authors also added that due to power rationing crisis of 2001 were necessary to implement changes in the regulatory structure of the country, especially the new configuration of buying and selling activities of energy and the entry of large consumers in the free market.

Figure 2, below, shows the new model of the electric sector.



Source: Cuberos (2008). p. 21. Free translation by the author.

As noted, the structure of the electricity model in force, the Energy Policy National Council (EPNC) is the highest entity of representation of the electricity system in Brazil, on which is connected directly to the Ministry of Mines and Energy (MME) and below this the Electric Energy National Agency. The following chart presents a summary of the functions of each one of those involved in the new model of the Brazilian electric sector.

Chart 3

Brazilian electric sector entities role

Entity	Role
CNPE - Energy Policy National Council (EPNC)	Approval of energy policy, in conjunction with other public policies.
MME - Ministry of Mines and Energy (MME)	Formulation and implementation of policies for the energy sector, according to the EPNC guidelines.
CMSE - Electric Sector Monitoring Committee (ESMC)	Service conditions monitoring and preventive actions recommendation to ensure supply security.
EPE - Energy Research Company (ERC)	Execution of studies to define the energy matrix and planning the expansion of the electricity sector (generation and transmission).
ANEEL - Electric Energy National Agency (EENA)	Regulation and supervision, ensuring the quality of service, universal service and the tariffs determination for end consumers, while preserving the economic and financial viability of Selling Agents.
ONS - Electric System National Operator (ESNO)	Coordination and control of the NIPS operation; transmission management.
CCEE - Electric Energy Trading Chamber (EETC)	Contract administration, short-term market settlement, electricity energy public sales.

Source: Taffarel, Silva & Clemente (2013). p. 128. Free translation by the author.

2.4. Recent panorama

The most important change occurred in recent years in the Brazilian electric sector was the issuance of Provisional Measure number 579 on September 11, 2012, converted into Law 12,783 of January 14, 2013.

This act of the Federal Government aimed mainly at reducing the cost of electricity through two actions: reduction of sector fees and renewal of hydro concessions and transmission lines whose contracts expire between 2015 and 2017.

According to the purposes of this research, among major effects from Law 12,783/13, this research will focus on the point concerning the renewal of hydroelectric concession contracts and transmission lines.

As reported by Castro et al (2013), the physical volume involved in the renewal of concessions was significant (corresponding to 22.341 MW and 85.326 km of transmission lines), which is why the measure has caused quite debate among the various sector players.

The authors describe as follows the terms of renewal of the concession contracts of the Law 12,783/13:

[...] the government opted for alternative renewal of concessions, but within a strictly legalistic approach: the return of the assets to the Federal Treasury with the current concessionaires option to maintain concession assets, since they accepted the anticipation of winning contract and pass to the condition of simple operators and maintainers of hydroelectric plants and was awarded a fee for the cost of these activities. Thus, the companies owning the generation assets pass to the service providers position, no more selling electricity at market price. As an illustration, the reduction is significant coming from a position of R\$ 95.00 per MWh to less than R\$ 30.00 per MWh. The same applies

to the transmission concessionaires, which are now remunerated at a rate that will cover only operating costs and maintenance. The calculation of O&M was set by ANEEL based on a close approach to that applied to the distribution companies and using database information used as a basis for fixing the ceiling prices of energy and transmission auctions. It should be noted that the impact of the renewal of concessions will occur primarily on generators and transmission companies, given that distribution companies are already regulated in order to transfer productivity gains to consumers every periodical tariff review cycle.

According to Castro et al (2013), the mechanism used by the Federal Government promotes a structural change between the captive and free markets (FTAs and RTAs) in order to establish a government policy of strengthening the captive market.

The authors explain that prior to the entry into force of the new measure, generating companies assumed the onus and bonuses by power generation. This situation occurred because these companies had power sales contracts with the free and captive market and optimize its revenue from the ongoing analysis of the hydrological risk.

With the renewal of the contracts the companies holding the hydroelectric plants began to be remunerated at a rate of O&M stipulated in advance by ANEEL (the mechanism adopted by the Federal Government for contracting of energy by distributions companies is similar to the one which is already in course for electricity produced by Itaipu Binacional: quotas).

3. THE IFRS ADOPTION IN BRAZIL

3.1. History

The alignment of Brazilian accounting practices with those issued by the International Accounting Standards Board (IASB), as reported by Lima (2010), was established so that, among others, the following objectives are met: (a) unlink the corporate accounting of tax aspects and leave it focused on stakeholders external users (investors and creditors); (b) to make the process of normalization is not grounded in normative acts prepared by government agencies, but in bodies whose members are companies that produce the financial statements, users of these standards, accountants, analysts, investors, stock exchanges, independent auditors and investment professionals; (c) increase the transparency and reliability of financial information to enable a lower cost in access of domestic enterprises to external financing sources; and (d) to encourage new investment in the domestic market.

Whereas in Brazil much of the accounting rules are defined by law, especially the Corporate Law (Law 6,404, of December 15, 1976), an important action in pursuit of the international accounting practices occurred with the issue Law 11,638 of December 27, 2007, amending the Corporate Law, building the foundation for the complete alignment of Brazilian accounting practices to international one.

Unlike what happened in the European Union, where the full set of IASB standards was adopted from 2005 and on, Brazilian companies have adopted international standards in two phases: (i) first, the financial statements of December 31, 2008 and December 31, 2009, when a selection of some rules of the IASB became mandatory; (ii) the second phase took place

from the financial statements of December 31, 2010, moment from which became mandatory full IFRS adoption in the consolidated financial statements.

In addition to previously mentioned, there is another important action in this context, it is the creation of a new private entity, whose purpose is to issue accounting pronouncements based on those issued by the IASB. This new entity, called the Comitê de Pronunciamentos Contábeis - CPC (Brazilian Accounting Pronouncements Committee), as well as the major changes in the Corporate Law will be addressed in greater detail in the next section.

3.2. Major initiatives

3.2.1. Changes in corporate law

In order to create the basis for the adoption of IASB accounting rules, important changes were made in the Corporate Law by the law 11,638/07 and the law 11,941 of May 27, 2009.

Both legal instruments were responsible for introducing the legal Brazilian environment fundamental concepts for the introduction of international accounting standards. As summarized by Lima (2010), we present below some of the innovations implemented by changes in the Brazilian Corporate Law:

- i. Mandatory preparation, auditing and disclosure of the statement of cash flows in place of the statement of sources and uses of funds;
- ii. New accounts group was created in the balance sheet: non-current assets that considers subgroups of assets in long-term investments, fixed assets, intangible (new). Additionally the heading "fixed assets" is no longer presented and the group "deferred assets" was deleted;

- iii. In fixed assets, in addition to tangible assets, assets arising from transactions where there is a benefit, risk and control transfer to the company regardless of whether the transfer of ownership (financial leasing). In intangible assets is contemplated rights whose subjects are intangible assets intended for maintenance of corporate purpose or used for this purpose, including acquired goodwill;
- iv. New asset measurement criteria: it was established that certain assets should be valued at their fair value and not at their acquisition cost: investments in financial instruments, including derivatives; rights classified under intangible assets are stated at cost incurred upon purchase deducted from the balance of the respective amortization account; the assets arising from long-term operation will be adjusted to present value, short-term ones being adjusted when any significant effect. Reference should be made to the new rule on recovery of amounts of fixed assets / intangible, so that assets are not accounted for more than amounts that can be recovered through use or sale (impairment test);
- v. The incorporation, merger and spin-off made between independent parties and linked to effective transfer of control, the assets and liabilities of the company to be merged or resulting from the merger or spin-off will be recorded at their fair value;
- vi. Untying financial accounting in order to calculate the income tax basis, establishing the tax neutrality to adjustments resulting from the adoption of International Financial Reporting Standards (IFRS) by the Brazilian companies who opt for the transition tax regime.

Most recently with the end of the transition tax regime in December 31, 2014, the law 12,973, of May 13, 2014, established a new legal framework with regard to taxes income basis, which takes into account the new accounting rules.

3.2.2. The new Brazilian Accounting Standards Committee

As specified in its electronic website the Brazilian Accounting Pronouncements Committee was established in 2005 by Resolution 1,055 of the Federal Accounting Council in order to:

[...] study, prepare and issue Technical Pronouncements on accounting procedures and to disseminate the information of this nature to allow emission standards by the Brazilian regulator, aimed at centralizing and standardizing its production process, always taking into account the convergence of Brazilian accounting to international standards.

The CPC consists of the following entities: ABRASCA (Brazilian Listed Companies Association), APIMEC (National Association of Capital Market Investment Professionals and Analysts), BM&FBOVESPA (Brazilian Stock Exchange and Mercantile & Future Exchange), CFC (Federal Accounting Council), FIPECAFI (Financial and Accounting Research Institute Foundation) and IBRACON (Brazilian Institute of Independent Auditors).

The CPC that bases its existence on international convergence need of Brazilian accounting standards, on centralize the issuance of such rules and on representation and democratic process in the production of such information, issued to date a total of 48 technical pronouncements, 20 technical interpretations and 8 technical orientations. All these documents are in line with those issued by the IASB and are issued through a process of public hearings.

In addition, the CPC operates jointly with the Comissão de Valores Mobiliários - CVM (Brazilian Securities and Exchange Commission), a government body that has the power to enforce the technical pronouncements issued by CPC. The following section will describe how CVM has played and plays a role in the process of international convergence of Brazilian GAAP.

3.2.3. The role of Brazilian Securities and Exchange Commission

The Brazilian Securities and Exchange Commission, as the federal agency responsible for the regulation and supervision of the Brazilian capital market, played a key role in driving the internationalization process of Brazilian accounting rules.

In this sense, the CVM together with the CPC promoted the public hearings that enabled the debate with the various market players concerned about the rules that would be put into force.

In addition, after completion of the phase of public hearings and issuing technical pronouncements by the CPC, CVM made the CPC pronouncements mandatory through the issuance of regulatory acts within its competence.

As in the period 2005-2008 the CVM issued a number of normative acts that set the stage for implementing the new concepts introduced in corporate law by Law 11,638/07.

Thus, Brazilian companies apply in its financial statements to December 31, 2008, a set of certain rules correlated with those issued by the IASB (a total of 13 technical pronouncements have been issued in that period).

Over the years 2008 and 2009, the rest of the standards were issued correlated with those of the IASB whose application was set to the financial statements of December 31, 2010, thus completing the process of full IFRS first adoption.

3.3. Financial statements of Brazilian electricity companies: the IFRS era

Since the full adoption of IFRS in Brazil, some issues led to a very significant debate among market players, especially those related to electricity companies.

One of these issues relates to the accounting recognition, measurement and disclosure method applied for service concession arrangements owned by electric energy transmission and distribution companies, as well as operation and maintenance services that are normally set out in the concession contracts.

The second issue caused a significant effect on the financial position of companies in the electricity sector, with greater impact on business of the electricity distribution companies. This theme constitutes itself part of the aim of this research: the non-recognition of regulatory assets and liabilities within the scope of full IFRS standards.

Both subjects will be treated in more detail in the two following sections.

3.3.1. Service concession arrangements (IFRIC 12)

As is defined in the ICPC 01 - Concession contracts³, this technical interpretation is scoped contracts involving a private entity (operator) constructing the infrastructure used to provide public services or improve it (for example, increased capacity) as well as operate it during specific time.

³ Technical interpretation issued by the Brazilian Accounting Standards Committee correlated with IFRIC 12 - Service concession arrangements.

As reported by Brugni, Rodriguez and Cruz (2011), in countries such as Brazil and the United States were introduced contractual services agreements by governments in order to attract the private sector to the development, financing, operation and maintenance of this infrastructure.

The authors remember that licensee or operator is a obliged entity, according to the contractual terms of the concession, which supplies public services within certain limits set by the grantor (the body that controls or regulates the services provided by licensee).

From an accounting point of view, the interpretation IFRIC 12 is the standard that defines the accounting treatment to be applied to transactions relating to concession contracts. Cruz, Silva & Rodrigues (2009) state that the interpretation IFRIC 12 was developed in response to widespread concerns about the lack of guidance on the accounting for transactions under service concession contracts.

This standard represents a significant change in the accounting treatment of concession contracts, particularly in Brazil. Until the entry into force of this standard (2010), in Brazil, the accounting recognition of the concession assets was held in fixed assets, due to the absence of a specific rule on this topic in the local GAAP.

As can be seen in the following quote from Brugni, Rodrigues and Cruz (2011) research, the central point that sets how the IFRIC 12 requires the recognition of transactions related to concession contracts, from a conceptual point of view, lies in the definition of "assets" as the IASB's Conceptual Framework:

According to the IASB's Conceptual Framework, an asset is "a resource controlled by the entity arising from past events for which the entity expects future economic benefits". This concept also accepted and recognized by the CPC, translates the origin and essence of the changes brought by IFRIC 12 insofar as their application is specifically designed to transactions where the grantor is who controls (or regulates) various operating and financial characteristics of service (IFRIC 12, §5).

According to Andrade and Martins (2009, p.88) until the end of 2007 companies from Australia, France, UK and Spain accounted for the concession operations under the various principles intrinsic to the IASB standards (it would be the concept of the principle oriented widespread in Europe [...]). In Brazil, during the same period, the accounting entries relating to infrastructure under the control of the granting authority, generally the state and its authorities, were recorded in the fixed assets of the utility. From 2008 on EU, and 2010 in Brazil, because of the assets not being contractually force, under the control and ownership of the operator, the recognition of the asset ceases to be recorded in the fixed assets of the operator [IFRIC 12 §11; Andrade and Martins (2010 p. 15)]. The cash amount paid by the grantor to the concessionaire for construction, expansion or improvement of infrastructure is now recognized (always at fair value) and recorded as a financial asset or as intangible assets (IFRIC 12 §15) as by understanding the standard, so you configure a concession within the IFRIC 12 scope, the party that grants the service should only transfer the responsibility for it, not transferring control nor ownership of the assets or the indefinite right to use the its assets.

Thus, in Brazil since the financial statements of December 31, 2010 the electricity companies, whose concession contracts were in the scope of IFRIC 12 / ICPC 01 (especially the transmission companies and energy distributors) started to present its financial position quite differently from how it was done previously.

In that way, the recognition of assets by the licensee within the scope of IFRIC 1 / ICPC 01 will be as summarized in the chart below:

Chart 2
Triggers to assets recognition

Payment mechanisms	Asset to recognize by the licensee
Grantor pays a fixed amount to the licensee	Financial Asset
Grantor (or normal users) pays an amount that varies depending on the use of infrastructure	Intangible Asset
Grantor (or users) pays a variable amount depending on the infrastructure demand and also a fixed amount established in the contract.	Financial and Intangible Asset

Source: Brugni, Rodrigues & Cruz (2011).

As an example of these changes, it can be seen in the financial statements of December 31, 2010, the large magnitude of the adjustments resulting from the adoption of IFRIC 12. The following table shows the effect of the adoption of IFRIC 12 in two power distribution companies (one which operates in the state of Rio de Janeiro and one in São Paulo).

Chart 3
IFRIC 12 adoption - the financial and intangible asset model

Company	Adjust	Amount (BRL Thousands)	
AES Eletropaulo (São Paulo)	Transfer of fixed assets to intangible and financial assets	Financial asset	615,690
		Intangible asset	5,683,530
		Fixed asset	(6,299,220)
Light S.A (Rio de Janeiro)	Transfer of fixed assets to intangible and financial assets	Financial asset	304,229
		Intangible asset	2,986,674
		Fixed asset	(3,290,903)

Source: Prepared by the author.

As observed only two companies amount to an adjustment of about \$10 billion (BRL) in reclassification of assets. In addition, the adoption of IFRIC 12 leads to new measurement criteria and accounting disclosure.

By the introduction of IFRIC 12 / ICPC 01 the criteria of accounting, by operators, transactions involving the concession contract was changed. As the operator does not recognize the infrastructure as part of its fixed assets, for the reasons already described, the accounting of financial and/or intangible assets is given in return for revenue recognition (construction and services).

Despite new rules introduced that became effective for the statutory financial statements (for use of the market in general), for regulatory purposes ANEEL has no valid the methodology in IFRIC 12 / ICPC 01, remaining the previous GAAP.

The table below shows the differences between the accounting models for concession services contracts from the point of view of regulatory rules of ANEEL and IFRIC 12 / ICPC 01.

Chart 4

Accounting recognition differences between regulatory rule and IFRIC 12

Characteristics	Regulatory purposes	IFRIC 12/ ICPC 01
Fixed assets in progress account (account used to record ongoing expenditures on construction, expansion and / or improvement)	Held by regulatory rules of ANEEL.	For statutory purposes an adjustment account was created to transfer those balances to the account "construction costs" as IFIRC 12 and financial assets and intangible.
Fixed assets in service account (used to record expenses for construction, expansion and / improvement of assets that are ready for being used)	Held by regulatory rules of ANEEL.	For statutory purposes the account was extinguished with transfer your balance for the financial and intangible assets accounts.
Construction revenue account	Does not exist in regulatory rules.	Created for corporate purposes to record the fair value of the construction activities.
Financial income account	Does not exist in regulatory rules.	Created for statutory purposes to record the updating of cash amount that will be paid by the grantor, which is accounted as financial asset.

Source: Adapted form Brugni, Rodrigues e Silva (2011).

3.3.2. Regulatory assets and liabilities

Under the Brazilian electricity sector, the concession contracts for power distribution companies is valid for 30 years. During this period the tariff undergo revisions and adjustments through processes conducted by the regulator, ANEEL.

These review processes and rate adjustments aimed at meeting the interests of the population and ensuring the economic and financial balance of the agents who provide the power distribution service.

The rate structure defined by ANEEL, in short, classifies operating costs of the companies into two groups: manageable costs (Component B) and non-manageable costs (Component A). These non-manageable costs are passed on to consumers each tariff adjustment process (there is the possibility of a reduction or increase in the tariff).

Thus, based on the regulatory requirements of the sector, the operator incurs costs which will later be reimbursed through a rate adjustment, which will be the result of a process to be run by the regulator (ANEEL).

Based on the previous GAAP at the time such non-manageable costs were incurred, the operator accounted that as "receivables", and it would be done to the extent that, in the future, was approved by ANEEL rate adjustments (the same procedure is applied in event of a reduction of tariff - this fact would lead to the recognition of a liability). This asset or liability described, is called regulatory asset or liability.

Until the introduction of the IASB accounting rules in Brazil, this event was accounted by the criteria as described above. However from the financial statements of December 31, 2010, the companies of the Brazilian electric sector had to write-off such regulatory assets and

liabilities. That is because in the context of IFRS, the cash flows of such assets and liabilities depend on uncertain future event.

This intrinsic concept to IASB rules caused great debate among major actors in the Brazilian electricity sector, which resulted in the adoption of the rules of the IASB in the financial statements for statutory purposes and for regulatory purposes maintaining the previous GAAP, ie, maintenance of accounting recognition of regulatory assets and liabilities.

In recent years, this debate became wider particularly because the energy costs for utilities, have been increased due to hydrological crisis faced by Brazil. As a result the energy made available to distributors has been thermal source, which has a higher cost compared to the cost of energy from hydropower.

The difference in cost of power reported above, from the regulatory point of view, grants the right to the operator to recognize a regulatory asset. However, for statutory purposes that possibility does not exist.

Accordingly, the CPC has manifested to IASB in the sense that this concept should be reviewed in the context of international accounting standards because of the way this issue is dealt, there is a clear loss of the usefulness and relevance of accounting information.

It must be noted that the IASB is reviewing the issue, and issued IFRS 14 - Regulatory Deferral Account, which comes into force on 1st January 2016. As pointed by Ernst Young report, the new rule is intended to the first-time adopters IFRS only.

The rule was drafted with the aim of retaining the pattern recognition of regulatory assets and liabilities, while the IASB continues to deliberate the comprehensive rate-regulated activities project.

In this regard, CPC wrote the following to IASB⁴:

The temporary condition of IFRS 14 is by no means a substantive reason for denying the right to recognize regulatory deferral accounts in the financial statements of early-adopter jurisdictions. We strongly believe that all entities that meet the recognition criteria for regulatory accounts, and when previous GAAP allowed such recognition, must be permitted to recognize such accounts, and not just those that shall adopt IFRS for first time from now on. This permission, besides ensuring fair treatment among jurisdictions, would also favor comparability between entities across a given industry and among countries.

[...]

Based on IFRS 14, we strongly believe and are aligned with power distribution companies in Brazil that recording Regulatory Deferral Accounts reflects the economic impacts of the actions of the rate regulators and faithfully represents regulated companies' financial position and results of operation - it is definitely, in their and our view, a much more appropriate portrait of the underlying economics of their business under the prevailing Brazilian conditions - which including is supported by Federal Government assurance that the Deferrals shall have positive economic and financial consequences.

In response, the IASB reasoned that as your project on Rate Regulated Activities is not yet completed the option to recognize regulatory assets and liabilities is allowed only for new countries that adopt IFRS. In the IASB's view, allow countries that have already adopted the IFRS recognition of regulatory assets and liabilities without its comprehensive project to be completed could cause greater harm than good, since IFRS 14 does not anticipate the conclusion of the IASB about nature of these assets and liabilities.

⁴ The full version of CPC's letter and the IASB response are available in the Appendix.

4. CONCLUSIONS

As shown during the research the electricity sector in Brazil has faced significant challenges, whether from the regulatory point of view as far as the adoption of financial disclosure standards aligned with those used in developed markets.

Given the Brazilian territorial and demographic size, the electric power industry is an economic sector of relevance that supports the economic development of the country by providing the necessary infrastructure to businesses and households meet the economic roles that fit them.

In this sense, considering the scope of this research, the dissemination of financial information that faithfully represent the economic nature of the activities undertaken by companies in the Brazilian electricity sector is crucial to securing confidence to investors, lenders and other market participants.

The introduction of accounting standards used in developed countries and internationally accepted was an important step for the Brazilian market, from the point of view of reducing the capital cost for companies, as well as the creation of a path towards the disclosure of financial reports with a higher level of transparency.

Nevertheless, the introduction of international accounting standards in Brazil, must take into account features existing in certain regulated markets, such as the electricity sector. This is important because if not considered, places under suspicion the usefulness of financial reporting as a basis for investment and financing decision-making.

Such harmful effects, as indicated by this research can be found in the Brazilian electricity sector. This occurs as a consequence of the non recognition of assets and liabilities related to

the regulatory rules that govern the business of electric utilities in Brazil, especially those operating in the electricity distribution business.

In light of the regulatory framework of the Brazilian electric sector, regulatory assets and liabilities, that are possibly generated, will produce economic consequences. This characteristic is essential for the recognition of assets and liabilities as set in the IASB's Conceptual Framework.

Therefore, it is absolutely essential that there is a redirection of the IASB board's position on this subject. The IASB's initiative with the issuance of IFRS 14 only causes increased wear of their position on the subject. Because it allows only new jurisdictions that adopt the IFRS to maintain the recognition of regulatory assets and liabilities (not in this extensive practice those which have already adopted IFRS).

Finally, based on all the above, it is apparent that the non-recognition of regulatory assets and liabilities in Brazil, leads to disclosure that does not represent adequately the economic events that affect the operations of the Brazilian electricity sector companies.

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APPENDIX



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March 19, 2014

Mr. Hans Hoogervorst – Chairman
 International Accounting Standards Board
 30 Cannon Street
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 United Kingdom

RE: IFRS 14 – Regulatory Deferral Accounts

Dear Mr. Chairman of the BOARD,

The Comitê de Pronunciamentos Contábeis - CPC (Brazilian Accounting Pronouncements Committee)¹ believes that it is relevant to formally inform you its concerns about IFRS 14 – Regulatory Deferral Accounts issued by the International Accounting Standards Board – IASB.

In our comment letter dated August 26, 2013, in general we agreed with the substance of the Exposure Draft 2013/5 - Regulatory Deferral Accounts, which became IFRS 14, but we did not agree with the restrictions of its applicability. Therefore, at that time we proposed the following:

- 1) The recognition of regulatory deferral accounts should be applicable to all regulated entities and not just entities that shall adopt IFRS for the first time in the future.
- 2) The recognition of regulatory account balances as established in the ED should be included in the definitive pronouncement on regulatory assets and liabilities;
- 3) The basic conceptual framework under review should be changed in order to allow recognition of these regulatory assets and liabilities.

¹ The Brazilian Accounting Pronouncements Committee (CPC) is a standard-setting body engaged in the study, development and issuance of accounting standards, interpretations and guidance for Brazilian companies. Our members are nominated by the following entities: ABRASCA (Brazilian Listed Companies Association), APIMEC (National Association of Capital Market Investment Professionals and Analysts), BMFBOVESPA (Brazilian Stock Exchange and Mercantile & Future Exchange), CFC (Federal Accounting Council), FIPECAFI (Financial and Accounting Research Institute Foundation) and IBRACON (Brazilian Institute of Independent Auditors).

The temporary condition of IFRS 14 is by no means a substantive reason for denying the right to recognize regulatory deferral accounts in the financial statements of early-adopter jurisdictions. We strongly believe that all entities that meet the recognition criteria for regulatory accounts, and when previous GAAP allowed such recognition, must be permitted to recognize such accounts, and not just those that shall adopt IFRS for the first time from now on. This permission, besides ensuring fair treatment among jurisdictions, would also favour comparability between entities across a given industry and among countries.

Brazilian accounting standards in force prior to the first-time adoption of IFRS on this issue did permit recognition of Regulatory Deferral Accounts. Besides being based on sound economic and legal bases, in Brazil, Regulatory Deferral Accounts are sensitive issues mainly for power distribution (electricity) companies. All such companies had Regulatory Deferral Accounts recorded in their financial statements as a standard practice at the time of IFRS first time adoption in Brazil until 31st December 2009; once Brazil decided to fully converge towards IFRS as from 31st December 2010, all those companies were required to fully write-off in the 2010 closing the existing balances at that date – which, incidentally, provoked considerable stress among those preparers, their auditors and the Capital Markets regulator. Considering that now IFRS 14 allows to record Regulatory Deferral Accounts for newly adopters of IFRS without any sound economic reason, we see that all those companies in Brazil may (and eventually will) challenge this untimely and regrettable IASB position.

Based on IFRS 14, we strongly believe and are aligned with power distribution companies in Brazil that recording Regulatory Deferral Accounts reflects the economic impacts of the actions of the rate regulators and faithfully represents regulated companies' financial position and results of operation – it is definitely, in their and our view, a much more appropriate portrait of the underlying economics of their business under the prevailing Brazilian conditions – which including is supported by Federal Government assurance that the Deferrals shall have positive economic and financial consequences.

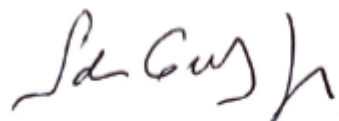
We at CPC are asked to start a dialogue with many market participants to discuss which may be the alternatives on this matter to ultimately allow Brazilian companies to record Regulatory Deferral Accounts (Regulatory receivable or payables) on their balance sheets on an accrual basis as permitted in the IFRS 14 for new IFRS adopters.

We all feel that IFRS 14, as it is, is not fair; we regret the decision we took to have completely converged towards full IFRSs since 2010; if we had postponed that decision until today, we would be benefited with this new IASB position which, being repetitive, is closer to the economics of the businesses than the write-offs called for and booked in 2010 in Brazil!

This letter intends to express the common view of all members of CPC to the Board.

If you have any questions about our comments, please contact us at operacoes@cpc.org.br.

Yours sincerely,



Idésio da Silva Coelho Júnior
Chair of International Affairs
Comitê de Pronunciamentos Contábeis (CPC)



26 March 2014

Mr Idésio da Silva Coelho Júnior
 Chair of International Affairs
 Comitê de Pronunciamentos Contábeis (CPC)
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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 *Alexis Amaro*,

A handwritten signature in black ink, appearing to read "Hans Hoogervorst", with a long horizontal line extending to the right.

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.