STAFF PAPER

15–16 May 2012

IFRS Interpretations Committee Meeting

Project	**IAS 18 *Revenue*, IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, and IAS 39 *Financial Instruments: Recognition and Measurement***
Paper topic	Regulatory assets and liabilities

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Introduction

1. In March 2012, the IFRS Interpretations Committee (the Committee) received a request to address issues related to rate-regulated activities. Specifically, the submitter requested the Committee to clarify whether a population of customers can be regarded as a single unit of account, and if so, whether a regulated entity should recognise a regulatory asset or liability when the entity has a right to recover specific costs, or an obligation to refund some amounts of collections irrespective of whether services are rendered in future periods.
2. The objective of this paper is to provide the Committee with the background to this issue and the staff's research and analysis. This paper also contains questions to the Committee.

History of discussions by Board and Committee

3. Before this submission, issues related to the accounting for rate-regulated activities had been discussed by the Board and the Committee (under its former name, the IFRIC).
4. In June 2005, the Committee received a request to clarify whether the US standard SFAS 71 *Accounting for the Effects of Certain Types of Regulation* could

be applied in accordance with the hierarchy in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to select an accounting policy in the absence of specific guidance in IFRSs. As a result of its consideration of the issue at that time, the Committee concluded "that entities applying IFRSs should recognise only assets that qualified for recognition in accordance with the IASB's *Framework for the Preparation and Presentation of Financial Statements* and relevant accounting standards, such as IAS 11 *Construction Contracts*, IAS 18 *Revenue*, IAS 16 *Property, Plant and Equipment* and IAS *38 Intangible Assets*". Following this first request, the Committee published an agenda decision in August 2005 not to add this issue to its agenda.

5. In January 2008, the Committee received a second request to consider whether regulated entities could or should recognise a liability (or an asset) as a result of regulation by regulatory bodies or governments. The Committee again decided not to add the issue to its agenda for several reasons. Importantly, it concluded that divergence in practice did not seem to be significant in practice for entities that were already applying IFRSs. However, the Committee also noted that rate regulation is widespread and significantly affects the economic environment of many entities.
6. In the light of the on-going requests for guidance on this issue, in December 2008 the Board added a project on regulatory assets and liabilities to its agenda. As a result of this project, in July 2009 the Board published for public comment an exposure draft *Rate-regulated Activities*. However, in September 2010 the Board decided that the technical issues involved could not be resolved quickly; and the Board therefore decided that the next step should be to consider whether to include rate-regulated activities in its future agenda.
7. In July 2011, the Board published *Request for Views—Agenda Consultation 2011* requesting inputs on its future work plan by 30 November 2011. The consultation document included requests for views on what form a future project might take, if such a project were to be restarted, to address rate-regulated activities. Currently the Board is deliberating the comments received on the consultation with the aim of publishing the feedback statement in Q2 of 2012.

Explanation of the issue

8. Rate regulation is a restriction on the setting of prices that can be charged to customers for services or products. A number of regulatory methodologies exist and, for each, application can vary by regulator, the entity being regulated and the particular circumstances. In the submission, the submitter describes a specific situation under cost-of-service regulation. Under cost-of-service regulation, the regulator sets rates to provide a rate-regulated entity with the opportunity to recover its costs and earn a return on its investment. For example, a regulation might permit a regulated entity to recover specific costs or require the entity to refund collections by adjusting future invoices to the customer.
9. As stated above, the submitter is asking the Committee to clarify whether a utility entity should recognise a regulated asset or liability in a particular situation under cost-of-service regulation. The submitter limits the scope of the discussions to a situation under cost-of-service regulation in which **the rights to recover specific costs, or the obligations to refund some amounts, exist independently of the delivery of services to the customers in future periods.** For ease of reference, the text of the submissions is reproduced in **Appendix A** to this paper.
10. The submitter also states that the discussions in the submission would not be applicable to incentive-based regulation, which generally establishes rate-setting mechanisms in such a way that the rates encourage a regulated entity to be more efficient by, for example, incorporating targets into the rate-setting mechanism.

Assumptions in the submission

11. The submitter describes a situation in which the operation of the local law or regulation specifically permits the costs to be recovered, or requires overbillings to be refunded, **irrespective of whether services are delivered in future periods**, although for administrative convenience recovery and refund will usually take place through future billings.
12. In other words, in the particular circumstances described, the rights or obligations **exist separately from the delivery of services to the customer in future periods**. For example, a regulated entity might be specifically entitled to recover

costs, or required to refund amounts, to customers independently of future services or to recover costs from an incoming operator or the regulator if circumstances change and cause it to cease providing service in the market.

Issues

13. In the context of the situation assumed above, the submitter asks the following two specific questions:

- Question 1: **Unit of account**—can the population of customers be regarded as a single unit of account?
- Question 2: **Recognition of regulated assets and liabilities**—if the population is a single unit of account, is it acceptable to recognise an asset or liability for over- or underbilling in a particular period when these items will, as a matter of convenience, be recovered or refunded through adjustments to invoices for future services or another mechanism?

Summary of the view in the submission

14. The submitter thinks that the issue could be approached by the following guidance depending on terms and conditions of each transaction:

Relevant guidance	**Revenue recognition (IAS 18)**	**Provisions and reimbursement assets (IAS 37)**	**Financial assets or liabilities (IAS 32)**
Basis for application	Arise from an over- or underbilling that results in an obligation to pay an **excess billing (deferred income)** or an entitlement to additional consideration for services already performed **(unbilled income).**	Arise from **unplanned costs** when it is virtually certain that the costs will be reimbursed by customers through future rate increases or amounts that will be refunded to customers **independently of delivering future services.**	Generally not applicable because the rights and obligations are usually established **by legislation or regulation rather than by contract.**
Examples	Volume-driven timing differences Commodity cost passed through to customers	Unplanned storm costs Environmental obligations Gain/loss on sale of assets Removal costs Pension expenses Overbilling that would be refunded independently of	

		future service	

IAS 18 model

15. The submitter thinks that IAS 18 might be applied to support the recognition of regulatory assets or liabilities, because it requires a utility that over- or underbills its customers to recognise an obligation to pay a customer excess billing **(liability-deferred income)** or an entitlement to collect additional consideration for services already performed **(asset-unbilled income)**. The submitter thinks that this logic might be applied to an over- or under billing to a single customer. However, the submitter thinks that the logic might be applied to a portfolio of customers if:

- there are separate portfolios of customers that can be viewed as **a single unit of account** in each rate-setting jurisdiction; and
- the right or obligation to adjust future billing is **legally enforceable**.

IAS 37 model (reimbursement assets or provisions)

16. The submitter states that this model addresses the situation **in which the refund or reimbursement was not a known component of the current revenue arrangement.** A regulated utility might incur expenses that were not allowed for in current billing rates but are expected to be recovered through a future rate-setting process. On the other hand, the utility might be required to refund customers or reduce future bills even in the absence of overbilling (based on regular costs); for example, following an asset disposal.
17. The submitter thinks that an analogy to IAS 37 might be made to allow recognition of a reimbursement asset for costs for which an expense has been recognised when it is virtually certain that the expenses will be recovered. Paragraph 65 of IAS 16 *Property, Plant and Equipment* has similar guidance

when an entity is entitled to compensation for the impairment of property, plant and equipment.

<u>*Reimbursement assets (emphasis added)*</u>

IAS 37.53 Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement shall be recognised when, and only when, ***it is virtually certain*** *that reimbursement will be received if the entity settles the obligation. The reimbursement shall be treated as a separate asset. The amount recognised for the reimbursement shall not exceed the amount of the provision.*

<u>*Compensation for impairment (emphasis added)*</u>

IAS 16.65 Compensation from third parties for items of property, plant and equipment that were impaired, lost or given up shall be included in profit or loss when the compensation ***becomes receivable.***

18. The submitter states that whether or not there is sufficient evidence to conclude that the virtually certain threshold has been met is a matter of judgement for management, based on the facts and circumstances.
19. IAS 37 requires that a provision is to be recognised only when there is a probable outflow of resources. The submitter states that lower future billing is not necessarily an outflow of resources, **although there might be circumstances in which the refund obligation exists independently of future billing, as explained above**. The submitter thinks that the guidance in IAS 37 should be applied in these circumstances to determine whether a legal or constructive obligation exists to refund the costs **independently of the future supply of services.**

IAS 32 and IAS 39 (or IFRS9) model (financial assets or liabilities)

20. According to the submitter a regulated entity's rights or obligations to recover or refund amounts to or from customers are usually established by legislation or regulation rather than by contract. Consequently, the submitter thinks that IAS 32 and IAS 39 do not usually apply in this type of situation.

Staff analysis

Decisions made by the Committee in the past

21. As explained above, the Committee has discussed issues related to rate-regulated assets and liabilities in the past. The staff note that even though the Committee decided not to add these issues to its agenda, the decisions did not preclude the recognition of regulatory assets and regulatory liabilities. Instead, the decisions indicated that an entity can recognise regulatory assets or liabilities **if they meet the recognition criteria in the IASB's Conceptual Framework or other applicable IFRSs**.

IAS 38 Regulatory asset (August 2005)

The IFRIC considered a request for guidance for operations subject to price regulation. The request concerned situations in which a regulatory agreement allowed the entity to increase its prices in future years to recover outflows of economic resources during the current or previous years. The IFRIC was asked whether US SFAS 71 Accounting for the Effects of Certain Types of Regulation could be applied under the hierarchy in IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors for selection of an accounting policy in the absence of specific guidance in IFRSs

The IFRIC observed that it had previously discussed whether a regulatory asset should be recognised in the context of service concession arrangements, either as deferred costs or as an intangible asset to reflect an expectation that the entity will recover these costs as part of the price charged in future periods. <u>It had concluded that entities applying IFRSs should recognise only assets that qualified for recognition in accordance with the IASB's Framework for the Preparation and Presentation of Financial Statements and relevant accounting standards, such as IAS 11 Construction Contracts, IAS 18 Revenue, IAS 16 Property, Plant and Equipment and IAS 38 Intangible Assets.</u>

The IFRIC had noted that SFAS 71 required entities to recognise regulatory assets when certain conditions were met. However, the IFRIC had concluded that the recognition criteria in SFAS 71 were not fully consistent with recognition criteria in IFRSs, and would require the recognition of assets under certain circumstances which would not meet the recognition criteria of relevant IFRSs. Thus the requirements of SFAS 71 were not indicative of the requirements of IFRSs.

Since it already had concluded that the special regulatory asset model of SFAS 71 could not be used without modification, the IFRIC noted that expenses incurred in performing price-regulated activities should be recognised in accordance with applicable IFRSs and decided not to add a project on regulatory assets to its agenda.

IAS 37 Provisions, Contingent Liabilities and Contingent Assets/IAS 38 Intangible Assets—Regulatory assets and liabilities (March 2009)

The IFRIC received a request to consider whether regulated entities could or should recognise a liability (or an asset) as a result of rate regulation by regulatory bodies or governments.

At the IFRIC meeting in November 2008, the IFRIC considered detailed background information, an analysis of the issue and an assessment of the issue against its agenda criteria. The IFRIC noted that:

- *rate regulation is widespread and significantly affects the economic environment of regulated entities.*
- *currently, divergence does not seem to be significant in practice.*
- *resolving the issue would require interpreting the definitions of assets and liabilities set out in the Framework and their interaction with one or more IFRSs.*
- *The issue is now being considered specifically in an active Board project and it relates to more than one active Board project.*

The IFRIC concluded that the agenda criteria were not met, mainly because divergence in practice does not seem to be significant. In addition, there is now a project on rate regulated activities on the Board's active agenda. Therefore, the IFRIC decided not to add the issue to its agenda.

Discussions by the Board

22. As noted above, the Board last discussed the issue of rate regulated activities in September 2010. The Board's conclusions at that time, as reported in IASB Update were:

> At its September 2010 meeting, the Board continued its discussions on rate-regulated activities. The Board received papers that focused on:

- whether the effect of regulators should be analysed in the context of IAS 38 Intangible Assets and IAS 37 Provisions, Contingent Liabilities and Contingent Assets.
- whether the effect of regulators should be recognised in financial statements that are prepared in accordance with existing IFRSs.
- the status of the Rate-regulated Activities project as a stand-alone project.
- whether IFRSs should be amended to require specific disclosure requirements related to the impact of regulations on an entity that is subject to regulations.

The Board did not reach conclusions on any technical issues at this meeting.

The Board reconfirmed its earlier view that the matter could not be resolved quickly. Accordingly the Board decided that the next step should be to consider whether to include rate regulated activities in its future agenda.

The Board therefore decided to include in its public consultation on its future agenda a request for views on what form a future project might take, if any, to address rate-regulated activities. The feedback received will assist the Board in setting its future agenda. The potential future steps include, but are not limited to:

- a disclosure only standard
- an interim standard, similar to IFRS 4 *Insurance Contracts* or IFRS *6 Exploration for and Evaluation of Mineral Resources*, to grandfather previous GAAP accounting practices with some limited improvements

- a medium term project focused on the effects of rate-regulation
- a comprehensive project on intangible assets.

Summary

23. We note that the Committee reached a conclusion when it discussed the issue in 2005 that an entity should recognise only assets that qualify for recognition in accordance with the IASB's conceptual framework and relevant IFRSs such as IAS 11 *Construction Contracts*, IAS 18 *Revenue*, IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*. We note that no major changes have been made to these IFRSs since the Committee made that observation, and we think that the conclusions drawn by the Committee at that time are still valid.
24. We also note that when the Board last discussed the issue in September 2010 this was in the context of developing new guidance to change IFRSs to require the recognition of regulatory assets and liabilities. At that time the comments received on the exposure draft and the views of the Board members were divided about whether such regulatory assets and liabilities should be recognised. The Board concluded that the matter could not be resolved quickly and that the next step should be to consider whether to include a project on rate regulated activities in its future agenda. The Board therefore included reference to such a project in its Agenda Consultation. The Board is part-way through its consideration of the feedback received on that consultation and further discussions are expected in the May and June Board meetings.
25. We think that given the status reached by the Board in September 2010 that the issues could not be resolved quickly, we think that this issue is too broad for the Committee to address. We recognise the significance of the issues to those operating in a price-regulated environment, and so if the Committee is in agreement, we propose that the Committee highlights the submission to the Board and encourages it to add the issue to its agenda in the short term.

Assessment against agenda criteria and staff recommendation

26. The agenda criteria of the Committee as follows:

    (a) *The issue is widespread and has practical relevance.*

    (b) *The issue indicates that there are significant divergent interpretations (either emerging or existing in practice).*

    (c) *Financial reporting would be improved through the elimination of the diverse reporting methods.*

    (d) *The issue can be resolved efficiently within the confines of existing IFRSs and the Framework, and the demands of the interpretation process.*

    (e) *It is probable that the Committee will be able to reach a consensus on the issue on a timely basis.*

    (f) *If the issue relates to a current or planned IASB project, is there a pressing need for guidance sooner than would be expected from the IASB project?*

27. On the basis of the discussions above, we recommend that the Committee should not add this issue to its agenda, because we think this issue is too broad for the Committee to deal with. Instead, we recommend that the Committee should bring this issue to the Board's attention and encourage the Board to add the issue to its future agenda. We have included draft rejection wording in **Appendix B** to this paper.

Questions for the Committee

Questions for the Committee
1. Does the Committee agree with the staff recommendation?
2. If the Committee agrees with the staff recommendation, does the Committee agree with the proposed rejection wording in Appendix B?

Appendix A—Extract of submission

Michael

I have attached for consideration by the Interpretations Committee a paper addressing the accounting by entities subject to rate regulation.

The issue

Accounting by entities subject to rate regulation continues to be a source of diversity in practice in the application of IFRS. There is different legislation in each territory and many different regulatory regimes. There are likely to be a number of additional issues and complexities arising from the detailed features of each arrangement. This submission does not therefore describe the specific features and accounting implications of each regime, but explores a possible solution and asks the Committee to consider two specific questions.

The legislation in some jurisdictions might permit or require a regulated entity to recover specific costs or to refund collections irrespective of whether services are delivered in future periods. For example, a regulated entity might be specifically entitled to recover costs or refund amounts to customers independently of future services or to recover costs from an incoming operator or the regulator if circumstances change and cause it to cease providing service in the market. These amounts are often recovered or refunded through future invoices to the customer as a matter or administrative convenience, but this does not change the rights or obligations that exist separately from the delivery of services to the customer in future periods. It might be difficult to determine whether the rights and obligations exist separately particularly when there is no history of recovery or refund other than through invoices for future service. Judgment is therefore necessary based on the specific laws, regulations and practice in each territory.

The questions

Consider a situation in which an entity has a licence from a regulator to be the sole supplier of an essential service, such as electricity or water, to users in a specified area. The users have no realistic choice but to use the service, are not involved in setting the price or service standards, and there is no alternative supplier. The services to be delivered and the price charged to users are agreed between the entity and the regulator for a fixed period of time. The regulator fixes the total amount to be charged to users in the specified area in the relevant period. The price for each period usually includes the recovery of under and over billing from previous years and/or the recovery of certain specified costs incurred by the entity. Local law, regulation and practice give the entity an enforceable right and obligation to recover or refund amounts from or to customers, which is usually effected through adjustments to future billings.

We request that the Committee consider:

Question 1 – Unit of account

Is the substance of the licence and the requirement to agree with the regulator the price charged to users each period a single arrangement between the entity and its customers? Does the requirement for customers to delegate negotiation of conditions of service, including price, to a regulator mean that the population of users might be a single unit of account?

Question 2 – Recognition of assets and liabilities

If the population is a single unit of account, is it acceptable to recognise an asset or liability for over or under billing in a particular period or for costs that can be recovered in future periods when these items will, as a matter of convenience be recovered or refunded through adjustments to invoices for future services or another mechanism?

Many thanks and kind regards.

[submitter]

Rate regulated accounting – cost based regulation

Background

The IASB initiated a project on rate regulated activities in 2009 with the objective of clarifying in what circumstances entities should recognise assets or liabilities arising from rate regulation. The project has been postponed indefinitely due to the time required to complete other agenda items. It will next be considered in the context of the IASB's agenda consultation. Accounting for rate regulated activities continues to be a significant difference between IFRS and US GAAP and presents significant challenges for some entities in transitioning territories that previously applied the specific US GAAP guidance for rate regulated accounting.

This paper explains a framework for the recognition of assets and liabilities arising from rate regulation in accordance with existing guidance in IFRS. The paper does not examine individual situations in which assets or liabilities might arise. The application of this framework in specific situations and under the legislation in individual jurisdictions is a judgment for management.

Right and obligations under the relevant legislation

The legislation in some jurisdictions might permit or require a regulated entity to recover specific costs or to refund collections irrespective of whether services are delivered in future periods. For example, a regulated entity might be specifically entitled to recover costs or refund amounts to customers independently of future services or to recover costs from an incoming operator or the regulator if circumstances change and cause it to cease providing service in the market. These amounts are often recovered or refunded through future invoices to the customer as a matter or administrative convenience, but this does not change the rights or obligations that exist separately from the delivery of services to the customer in future periods.

It is appropriate to recognise an asset for the recovery of actual costs incurred or a liability for the refund of amounts over billed whenever the right or obligation exists independently of the delivery of future services. It might be difficult to determine whether the rights and obligations exist separately, particularly when there is no history of recovery or refund other than through invoices for future service. Judgment is therefore necessary based on the specific laws, regulations and practice in each jurisdiction.

It is assumed throughout the rest of this paper that the operation of the local law specifically permits or requires the costs or over billings covered by this paper to be recovered or refunded irrespective of the provision of service, although recovery and refund will usually take place through future billings for administrative convenience.

Revenue recognition and IAS 18

IAS 18 requires that revenue is either accrued or deferred to reflect differences between the amount billed and the revenue earned in any given period. IAS 18 might be applied to support the recognition of regulatory assets or liabilities because it requires a utility that over or under bills its customers to recognise an obligation to pay a customer rebate (liability – deferred income) or an entitlement to collect additional consideration for services already performed (asset – unbilled income). This logic might be applied to an over or under billing to a single customer (for example, a time and material contract might be billed based on a schedule of estimated costs but the seller would record revenue based on actual costs incurred to date). It might also be applied to a portfolio of customers when the circumstances support the portfolio being the unit of account.

The application of IAS 18 to a portfolio of customers in the context of rate regulated activities might be appropriate if:

- There are separate portfolios of customers that can be viewed as a single unit of account in each rate making jurisdiction; and
- the right or obligation to adjust future billing is legally enforceable.

Single unit of account

The unit of account used to determine the 'buyer' is often a key consideration in determining the timing and measurement of revenue recognition. IAS 18 requires that transactions are combined when they are linked in such a way that the commercial effect cannot be understood without the combination.

The following characteristics might suggest it is appropriate to combine specific groups of customers in a rate making jurisdiction into a single unit of account:

- Monopoly – the utility is a monopoly or a near monopoly for basic needs. The customers cannot switch suppliers and are unlikely to opt out of receiving the good or service.
- Revenue formula – the utility's rates are determined based on total revenue for the entire population of customers in each rate making jurisdiction. The revenue to which the utility is entitled is therefore based on regulating its total income, which is then invoiced as a rate per unit.
- Customer management – customers are managed as a single portfolio.

Right or obligations to adjust future billings is legally enforceable

The conceptual framework provides guidance on the definition of an asset or liability; it requires the existence of a right to future economic benefits that is controlled by an entity (asset) or a present obligation (liability). The following characteristics might support recognition of an asset or liability arising from rate regulation:

- the utility has the existing authority or obligation to recover or refund over and under billings through the adjustment of future rates to all customers receiving service in the future regardless of whether the individual customer was receiving service when the over or under billing arose;

- the utility is expected to recover or refund the over and under billings; and
- the utility can estimate reliably the over or under billing for the customers as a whole (the 'unit of account').

Provisions, reimbursement assets and IAS 37

A regulated utility might incur expenses that were not contemplated in current billing rates but are expected to be recovered through a future rate setting process or it might be required to refund customers as a result of the recovery of costs in excess of those required to provide the service. The most common recovery or repayment mechanism is a future billing adjustment. Some future billing adjustments can be addressed by reference to IAS 18 as discussed above but in other circumstances it might not be appropriate to recognise unbilled or deferred income under IAS 18 because the refund or reimbursement was not a known component of the current revenue arrangement. In these circumstances, entities might consider the guidance in IAS 37 to determine whether to recognise a reimbursement asset or a provision.

Reimbursement assets

The reimbursement guidance in IAS 37 applies where some of the expenditure required to settle a provision is to be reimbursed by another party. There is similar guidance when an entity is entitled to compensation for the impairment of an asset. The reimbursement right is recognised only when it is virtually certain that it will be received. An analogy to IAS 37 might be made to allow recognition of a reimbursement asset for costs for which an expense has been recognised when it is virtually certain that the expenses will be recovered. Facts that might indicate the virtually certain threshold has been met include:

- there is a legal opinion confirming the utility has a legal right to recover the costs;
- there is a monopoly or near monopoly, which means future sales are virtually certain;
- the utility holds a regulatory order confirming the charges that can be recovered;
- the billing adjustment will be made via a rate rider; and
- the utility (and others in the same regulatory environment) have an established history of recovering / refunding these cost variances in future periods.

Whether or not there is sufficient evidence to conclude the virtually certain threshold has met is a matter of judgment for management based on the facts. It might, however, be difficult to conclude that the reimbursement right is virtually certain in the absence of legally enforceable right to recover the costs and a monopoly or near monopoly position and a history of recovery is unlikely to support a virtually certain conclusion in the absence of a legal right to recover the costs.

Provisions

It is difficult under IAS 18 to recognise a liability for deferred revenue when the utility has not billed more than the amount it is permitted to bill. There might be circumstances where a utility is required to refund customers or reduce future bills without over billing, for example, following an asset disposal.

IAS 37 requires that a provision is recognised only when there is a probable outflow of resources. Lower future billing is not necessarily an outflow of resources, although there might be circumstances in which the refund obligation exists independently of future billing as explained above. The guidance in IAS 37 should be applied in these circumstances to determine whether a legal or constructive obligation exists to refund the costs independently of the future supply of services.

IAS 32 and IAS 39 - financial assets and liabilities

A utility’s rights and obligations to recover or refund amounts to or from customer are usually established by legislation or regulation rather than by contract. IAS 32 and IAS 39 do not apply in this situation. There might, however, be circumstances in which an entity has a contractual right or obligation to recover or refund amounts from or to its customers and in these situations the guidance in IAS 32 and IAS 39 should be applied.

Measurement of assets and liabilities

The assets and liabilities that arise from rate regulation are frequently recovered or refunded over a long period. The initial recognition of such assets and liabilities should reflect the time value of money in these circumstances.

Application to recognised expenses

The guidance in this paper should be applied to the right or obligation to recover or refund amounts related to expenses actually charged in the income statement. It should not be applied to items that are not charged to the income statement under IFRS, for example, the allowance for funds used during construction.

Summary of application of guidance to common regulatory asset and liabilities

Each transaction or type of transaction should be evaluated individually to determine if an asset or liability can be recognised applying the guidance in this paper. The following table provides some examples of how the guidance might be applied.

Relevant guidance	**Revenue recognition (IAS 18)**	**Provisions and reimbursement assets (IAS 37)**
Basis for application	Arise from an over or under billing which results in an obligation to pay a rebate (deferred income) or an entitlement to additional consideration for services already performed (unbilled income).	Arise from unplanned costs that are expected to be reimbursed by customers through future rate increases or amounts that will be refunded to customers independent of delivering future services.
Examples		

	• Volume driven timing differences • Commodity cost passed through to customers	• Unplanned storm costs • Environmental obligations • Gain/loss on sale of assets • Removal costs • Pension expenses • Overbilling that would be refunded independently of future service

Appendix A – Common regulatory balance arising from application of FAS 71

This appendix describes regulatory assets and liabilities that commonly arise upon the application of the rate regulation guidance in US GAAP (FAS 71). Inclusion on the list does not confirm that an asset or liability can be recognised. The guidance in this paper should be applied to determine whether it is appropriate to recognise an asset or a liability. The list is also not exhaustive.

Volume driven timing differences - The utility allocates revenue per unit based on the expected total units delivered. Actual units delivered will vary from expected.

Commodity costs passed through to customers - If the utility procures the commodity (gas/power), the cost is generally directly passed on to the customers. The utility is required to minimise cost (ie. through forward contracts / hedging), but the actual cost might differ from the amount forecast.

Unplanned storm costs – The utility incurs unexpected costs as a result of a storm and has the ability to recover those costs.

Environmental provisions – The utility has an obligation to restore or remediate contaminated land. It recovers costs from customer in accordance with rate order or when cash is paid.

Gain/loss on sale of assets – A regulated asset is sold at a gain or loss. The gain or loss is returned to or recovered from customers through future rate adjustments.

Pension expenses – Pension costs are often recovered based on actual/estimated cash payments. A regulatory asset/liability is recorded as an equal offset to the pension asset/liability.

Removal costs – Rates are set to recover depreciation which includes the recovery of removal costs (negative salvage value). The asset arises from the amount collected for removal where no ARO has been recorded. It is likely that the guidance in IAS 37 would be applied to asset decommissioning obligations.

Deferred tax expense – Tax expense is recovered by the utility from customers on a cash basis. Deferred tax assets and liabilities are offset by regulatory liabilities and assets, respectively. Deferred tax liability is normally a reduction to the rate base.

AFUDC - A credit to income representing capitalised cost of debt and equity as required by US GAAP (FAS 71). The guidance in this paper is unlikely to apply to AFUDC.

Appendix B—Proposed wording for tentative agenda decision

The staff propose the following wording for the tentative agenda decision:

IAS 18 *Revenue*, IAS 37 *Provisions, Contingent Liabilities and Contingent Assets, and* IAS 39 *Financial Instruments: Recognition and Measurement—Regulatory assets and liabilities*

The Interpretations Committee received a request seeking clarification on whether a regulatory asset or regulatory liability should be recognised in a particular situation in which a regulated entity is permitted to recover costs, or required to refund some amounts, independently of the delivery of future services. Specifically, the submitter asked two questions for the accounting under this situation:

- Can the population of customers be regarded as a single unit of account?
- If the population is a single unit of account, is it acceptable to recognise an asset or liability?

The Committee noted that the Committee reached a conclusion when it discussed whether or not it would be appropriate to recognise a regulatory asset in 2005 that an entity should recognise only assets that qualify for recognition in accordance with the IASB's conceptual framework and relevant IFRSs such as IAS 11 *Construction Contracts*, IAS 18 *Revenue*, IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*. The Committee also noted that its past conclusions are still valid because no major changes have been made to these IFRSs since the Committee reached that conclusion.

The Committee also noted that in the Board's project on rate-regulated activities, the Board concluded that the issue could not be resolved quickly, and therefore included requests for views on future plans for this project in its Agenda Consultation published in July 2011. Given the status reached by the Board, the Committee observed that this issue is too broad for the Committee to address within the confines of existing IFRSs and the conceptual framework. Instead, the Committee observed that it should bring the submission to the Board's attention and encourage it to add a project addressing rate-regulated activities to its future agenda.

On the basis of the above, the Committee [decided] not to add this issue to its agenda.