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International Accounting Standards Board

INFORMATION FOR OBSERVERS

IFRIC meeting:	**September 2008, London**
Project:	**Regulatory assets and liabilities—Examples (Agenda Paper 5A)**

Regulatory Assets and Liabilities — Examples

1. Agenda Paper 5 describes various types of regulatory regimes in general terms. The staff thought it would be useful for the IFRIC to be able to consider the analysis in that paper in connection with some specific examples.

2. The description of these 'regulatory' assets and liabilities was provided by a Canadian natural gas utility. They illustrate a variety of regulatory mechanisms that have differing effects on rates for differing goods/services.

Grants paid

3. Grants paid are mainly amounts given to customers to help cover the cost of converting their equipment to natural gas so they can sign a service contract with the company. These amounts are deferred and then amortized over the periods covered by the contracts (generally five years).

    - Staff comment – we do not believe that these grants need to be considered assets arising from rate regulation. The company doe so because the regulator requires it to offer the grants. However, they are more in the nature of customer/contract acquisition costs and the treatment is in accordance with IFRSs for similar costs.

Amounts related to energy supply

4. The regulatory rules in a number of Canadian provinces and U.S. States do not allow distributors to make a profit or loss on the supply of energy, natural gas in this case. Therefore, the company charges customers two rates – one for the cost of energy and another for the costs of distribution. It is this separation that permits customers to obtain their energy from suppliers other than the distributor.

5. The company determines the difference between the revenue received at the rate charged and the purchase price of the commodity each month. This difference is then returned to or recovered from customers beginning the next month in the form of adjustments to the rates charged for natural gas over a period of 12 months. Thus, the rate charged based on the expected cost of natural gas to be supplied in September is adjusted for one-twelfth of any profit or loss on gas supply made in August (as well of the accumulated adjustments from the previous 11 months).

    - Staff comment – because by law the customer is required to pay the actual cost of energy supplied, the company's view is that in the absence of rate regulation these amounts would simply be recognised as customer receivables/payables.

Amounts related to weather (temperature and wind)

6. Rates for distribution as well as consumption are based on volumes. Distribution rates are approved annually. Therefore, in order to determine the rate to charge per unit for gas distributed the company must estimate the total volume to be delivered in a year. Obviously, the volume distributed will be affected by weather, especially winter temperatures.

7. The objective of normalizing temperatures is to spread over future periods the difference between actual revenues and revenues derived from rates based on historical average temperatures. The normalisation calculation involves a

regression analysis of customers' consumption based on average temperatures for the past 30 years, assuming heating starts to have an impact starting at a temperature of 13 degrees Celsius. If the actual temperature is warmer than normal, the difference will be recorded as an asset (revenues to recover from customers) and the opposite will occur if the temperature is colder than normal. The calculation is done monthly (during the heating season) from October to May.

8. The variation is determined annually and is amortized so as to be recovered in rates over five years. Because rates are set based on budgets before the annual actual is determined, the rate adjustment begins the second year after the one in which it occurs (that is, the amount determined for 2008 will affect rates beginning in January 2010). However, customers (or the company) are compensated for the year delay in adjusting rates as the amount of the adjustment also includes interest at the company's cost of capital for that year.

9. The regulator believes that this rate stabilization account provides protection from variations in volume caused by weather (a perfect hedge) for both the company and its customers at no cost and is therefore preferable to the imperfect results that could be achieved using weather derivatives.

Amounts related to the cost of distribution

10. The company operates under a hybrid return on rate base form of regulation. The performance incentive mechanism allows it to keep 25% of the amount by which the actual return exceeds the return allowed by the regulator (referred to as 'overearnings'). The regulator requires the customers' share of the overearnings (75%) be returned to them in the form of rate reductions over 3 years commencing in the fiscal year following its approval of such overearnings. If the company earns less that the return allowed by the regulator, it is permitted to increase rates in the following 3 years to recover 50% of the difference. Once again, the amount is adjusted by interest at the company's cost of capital to compensate the party receiving the payment for the delay in recovery.

- Staff comment – the permitted return is determined based on an assumed capital structure and an amount of capital determined in accordance with regulation.