STAFF PAPER

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Rate-regulated Activities Consultative Group

Project	**Rate Regulation**
Paper topic	Scope issues: Use of variance or deferral accounts

CONTACT(S) Jane Pike jpike@ifrs.org +44 (0)20 7246 6925

Variance and deferral accounts – a common feature of rate-regulatory schemes

1. The introduction to the Request for Information *Rate Regulation*, published in March 2013 (the RFI), defined rate regulation as "the mechanism by which a rate regulator imposes control over the setting of prices that can be charged to customers for services or products".

2. As noted in the summary of responses to that RFI (agenda paper 4 for this meeting), such price- or rate-setting mechanisms that are used by rate regulators vary widely. However, a feature that is common to almost all of the mechanisms described in those responses is the use of variance or deferral accounts to record differences between the estimated and actual amounts for certain types of income or expenditure. There is then usually some mechanism to enable or require the balance on those accounts to be recovered or reversed.

3. The common mechanisms for recovery or reversal are set out in paragraph 40 agenda paper 4 and are summarised here for ease of reference:

    (a) Recovery / reversal through retrospective billing to past customers;

    (b) Recovery / reversal through adjustment to future rates;

    (c) Recovery / reversal through cash payment from or to the rate regulator or other designated body; and

    (d) Recovery / reversal by sale or transfer to another entity.

4. In one case, a utility was able to sell or factor a variance/deferral account debit balance to a bank in exchange for cash.

5. In many jurisdictions where the effects of regulatory accounting are recognised as assets and liabilities in general-purpose financial statements, the amounts recognised reflect the balances of regulatory variance and deferral accounts, ie the differences between estimated and actual amounts used in the rate-setting mechanism. We are not aware of any specific accounting requirements in those jurisdictions that address other aspects of rate regulation (see paragraphs 9-10 below).

Purpose of this paper

6. The previous IASB Rate-regulated Activities project, which was suspended in September 2010, did not resolve the following questions:

   (a) Does rate regulation create assets and liabilities that satisfy the definitions of those elements in the IFRS Conceptual Framework?

   (b) If so, what type of asset (or assets) and liability (or liabilities) are created?

7. The purpose of this paper is not to answer those two questions (they will be considered later in the development of the IASB's Rate-regulated Activities project planned Discussion Paper ('the planned rate regulation DP' or 'the planned DP'). The purpose of this paper is to explore whether it would be more useful to focus the scope of the planned DP on this particular aspect of rate regulation.

Other aspects of rate regulation

8. There clearly are other aspects of rate regulation that may merit consideration in developing an accounting model for the effects of rate regulation, such as whether the value of the 'right to operate' in a restricted market (ie a monopoly or near-monopoly) should be recognised (and how this right should be measured, particularly if no explicit price is paid for it, and whether the significant

obligations and restrictions placed on a supplier through the rate regulation create obligations that should be recognised (see paragraphs 29-31 of agenda paper 4).

9. As already noted, we are not aware of accounting requirements issued by other standard-setters that specifically address the accounting for these other aspects of rate regulation. The previous IASB discussions started to consider whether the effects of rate regulation (including variance / deferral accounts and the other aspects of rate-regulatory mechanisms) should be analysed in the context of IAS 38 *Intangible Assets* and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* (see IASB Update and associated IASB meeting papers, September 2010). The IASB did not reach conclusions on any technical issues at that meeting but reconfirmed its earlier view that the matter could not be resolved quickly.

10. At this time, we are not asking Consultative Group members to debate the technical issues that relate to whether variance and deferral accounts create assets or liabilities, as defined in the *Conceptual Framework*. Nor are we seeking a debate about whether the other aspects of rate regulation might also create further assets and liabilities. At this stage, we are asking the Consultative Group to consider whether the scope of the planned Rate regulation DP should focus primarily on such variance or deferral accounts.

Questions for the Consultative Group

Defining the scope: Focus on variance and deferral accounts

1. Do you think that the scope of the planned Rate Regulation DP should focus primarily on looking to develop an accounting model for variance or deferral accounts? If so, the planned DP could acknowledge that other aspects of rate regulation may create assets and liabilities but would not look to develop an accounting model for those other aspects?

2. Alternatively, do you think that the scope of the planned DP should be expanded to cover other aspects of rate regulation? If so, what other aspects do you think should be considered?