STAFF PAPER

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Rate-regulated Activities Consultative Group meeting

Project	**Rate-regulated Activities: Research project**		
Paper topic	What types of regulatory deferral account balances are there?		
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Introduction

1. Agenda Paper 4 *What is performance*? considered how we may be able to analyse different types of rate-regulated activities within the context of the revenue recognition principles in IFRS 15 *Revenue from Contracts with Customers*.

2. Some of the responses to the Discussion Paper *Reporting the Financial Effects of Rate Regulation* (the 'Discussion Paper') suggested that we should also further analyse the different types of regulatory deferral account balances and how they arise. The purpose of that analysis would be to identify whether those different types merely reflect the differences in accounting policy between the rate regulation and IFRS requirements (for example, pension costs recognised on a cash vs accruals basis), or whether they instead arise due to timing differences between the 'performance' of activities and when revenue is recognised in accordance with IFRS 15.

3. As noted in paragraphs 75–78, the strongest support is for the recognition of types of regulatory deferral account balances that represent the differences between the time at which the entity satisfies its 'performance obligations' and when it bills customers for the consideration related to that performance. Some respondents also suggest that the recognition of regulatory deferral account balances should be subject to some probability criteria or assessment, which may include the maturity

of the rate regulation and the past experience of its operation as factors to consider.

How do regulatory deferral account balances arise and can they be classified into different types?

4. We would like to explore, with the Consultative Group, whether it is possible to distinguish between types of regulatory deferral account balances. This will help us to better understand the rights and obligations that lead to the creation of those balances. This will also contribute to our wider analysis of the rights and obligations created by defined rate regulation. Some respondents suggest that this will help us to identify a principle-based approach that may be relevant to support (or not) the recognition of at least some regulatory deferral account balances in the financial statements. We appreciate that this analysis is likely to be influenced by the discussion generated by Agenda Paper 4.

5. Within IFRS 14 *Regulatory Deferral Accounts* and the Discussion Paper, there are several examples provided about how regulatory deferral account balances may arise. We summarise many of these examples in the Appendix of this paper. These are for illustrative purposes only. We are also interested in other types of regulatory deferral account balances that the members of the Consultative Group can identify and would like to discuss.

Question for the Consultative Group
Using the following examples, and any other examples that you would like to introduce, can you distinguish between different types of regulatory deferral account balances that you think arise due to different types of rights and obligations created by the rate regulation? Please explain the reasons for your answer. If possible, please indicate the frequency and relative monetary value of the types of regulatory deferral account balances that you have encountered in practice.

Appendix—Illustrative Examples

A1. IFRS 14 defines a regulatory deferral account balance as follows:

> The balance of any expense (or income) account that would not otherwise be recognised as an asset or liability in accordance with other Standards, but that qualifies for deferral because it is included, or is expected to be included, by the rate regulator in establishing the rate(s) that can be charged to customers.

A2. The following illustrative examples provide very simplified information. They are not intended to provide a comprehensive list of examples of regulatory deferral account balances that arise in practice. They are merely designed to provide a basis for a discussion about the nature of the balances and whether they can be categorised into balances with similar features or those that arise from similar rights and obligations. In each example, the monetary amount identified, or the difference between the amounts identified, is to be adjusted for in future rates in accordance with the rate-setting mechanism.

a) During the period, the entity achieves a customer satisfaction score of 87.9 per cent. This is above the target set by the rate regulator and, therefore, the entity is entitled to a bonus.

b) During the period, the entity fails to achieve a pollutant emission reduction target. Consequently, the entity is subject to a penalty.

c) During the period, the entity incurs costs to carry out a restructuring programme that is anticipated to improve efficiency and reduce future fixed and operating costs. The plan for the restructuring programme was previously approved by the rate regulator.

d) The entity constructs items of property, plant and equipment that are used to provide rate-regulated goods and services. The rate regulation does not include any amounts related to the construction of the assets to be included in the revenue requirement until the assets are available for use. However, the regulatory requirements for capitalising construction costs differ from those in IFRS as follows:

i) some non-directly-attributable overhead costs are treated as capital costs for rate regulation purposes but are not permitted to be included in the cost of property, plant and equipment in accordance with IFRS.

ii) actual borrowing costs incurred are not permitted to be included in the cost of property, plant and equipment but, instead, an allowance for the funds used during construction (AFUDC) is capitalised for regulatory purposes. The allowance is calculated using a deemed cost of borrowing plus a deemed cost of equity financing.

e) The entity incurs a gain or loss on the disposal or retirement of an item of property, plant and equipment.

f) The government introduced new legislation requiring the entity to gather and process new information about its customers. As a result, the entity incurs additional costs in the period relating to the resulting changes made to its record-keeping systems.

g) The entity incurs higher costs than anticipated as a result of an event that was not anticipated in the calculation of the revenue requirement for the period; for example, the entity incurs additional repair and maintenance costs to restore network connections as a result of damage caused by an unexpected storm.

h) The entity incurred lower costs than anticipated because an event that was anticipated in the calculation of the revenue requirement for the period did not occur; for example, the entity delayed the start of a new programme to provide ‘free’ loft insulation to particular customers.

i) The rate calculation includes an estimate for the amount of contributions expected to be paid by the entity to provide its employees with post-employment benefits (ie on a cash-paid basis). The entity accounts for the cost of providing post-employee benefits using the projected unit credit method (ie on an accruals basis).

j) The rate calculation includes an estimate for the amount of income tax expected to be paid by the entity during the period. The entity accounts for income tax on an accruals basis, including the recognition of deferred tax amounts.

k) The entity delivers a higher or lower volume of goods or services to customers than estimated in the rate calculation, resulting in an over- or under-recovery of fixed costs in the period.

l) The entity incurs higher or lower fixed or variable costs than estimated in the rate calculation, resulting in an over- or under-recovery of fixed costs in the period.

m) Cumulative depreciation accounted for in accordance with IFRS is lower than the cumulative regulatory depreciation recognised to date in the rate calculations, because:

    i) the amount initially recognised as the cost for regulatory purposes was higher because of the capitalisation of indirect overheads and a deemed AFUDC (see paragraph A6);

    ii) an annual inflation adjustment is added to the regulatory carrying amount of the asset, which is then depreciated;

    iii) the regulatory depreciation rate is designed to depreciate the asset over 15 years, which is shorter than the 25-year useful life determined in accordance with IFRS.