IFRS

STAFF PAPER

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Consultative Group for Rate Regulation Meeting

Project	Rate-regulated Activities		
Paper topic	Rights and obligations		
CONTACT(S)	Jane Pike	jpike@ifrs.org	+44 (0)20 7246 6925
	Mariela Isern	misern@ifrs.org	+44 (0)20 7246 6483

Purpose of the paper

1. We ask Consultative Group members to provide information about how entities identify rate-adjustment amounts and how individual rate-adjustment balances are tracked through to amounts billed to customers. This information will inform the Board's decisions about whether and when to recognise temporary differences as regulatory assets and regulatory liabilities and when to recognise their subsequent reversal.

Summary of the Board's discussions so far

2. In its February 2017 meeting, the Board tentatively decided that the model should focus on the rights and obligations arising from the rate-adjustment mechanism specified in the regulatory agreement. This approach focuses on the component of the rate chargeable to customers that has a direct cause-and-effect relationship between the entity's **past** transactions or other events and the entity's resulting **present** right to charge a higher rate, or obligation to charge a lower rate, for goods or services to be delivered to customers in the **future**.

3. The Board has analysed the rate or price charged to customers as consisting of two components:

   (a) a '**current period**' rate component that comprises the estimated amounts that are intended to compensate the entity for fulfilling regulatory requirements **in the same period** as it supplies the related regulated goods or services; and

   (b) a '**temporary difference**' rate component generated by a **rate-adjustment mechanism**.[1] That mechanism causes temporary differences to arise when the regulated rate in one period includes amounts related to specified activities the entity carries out in a different period.

4. The temporary difference component reflects timing differences that arise when:

   (a) there are differences between actual and estimated amounts used in the calculation of the current period rate component (estimation variances). **As a result,** the rate-adjustment mechanism requires those estimation variances to be 'corrected' by adjusting the regulated rate to be charged in future periods ('allowable estimation variances' and 'chargeable estimation variances');[2]

   (b) the entity fully or partially fulfils a regulatory requirement that has not yet been reflected in the regulatory rate billed to customers. **As a result**, the regulatory agreement gives the entity a **right** to charge an adjusted regulated rate for goods or services to be delivered in the future. That adjusted regulated rate is higher than would have otherwise been determined by the rate regulator; or

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1 The rate-adjustment mechanism is used to enable the rate regulator to achieve the objectives of improving price stability and predictability, and of spreading costs across different classes and generations of existing and future customers (see paragraph 9 of the Board's Agenda Paper 9A *Update of the Board's discussions*, September 2017).

2 Not all variances between estimated amounts and actual amounts will result in adjustments to a future regulated rate. We refer to 'allowable estimation variances' to identify those amounts that the rate-setting mechanism will include in the rate calculation to increase the future regulated rate. Similarly, we refer to 'chargeable estimation variances' to identify those amounts that the rate-setting mechanism will include in the rate calculation to decrease the future regulated rate.

(c) the amount already billed to customers relates to a regulatory requirement that the entity has yet to fulfil. **As a result**, the regulatory agreement **obliges** the entity to charge an adjusted regulated rate for goods or services to be delivered in the future. That adjusted regulated rate is lower than would have otherwise been determined by the rate regulator.

5. Our analysis suggests that the regulatory agreement creates a package of rights and obligations in addition to the rights and obligations arising from the individual contracts between the entity and its customers. However, the model does not account for the combined package of rights and obligations created by the regulatory agreement. Many of those rights and obligations are already accounted for using existing IFRS Standards.

6. It is only the rights and obligations created by the rate-adjustment mechanism that the model aims to account for by recognising regulatory assets and regulatory liabilities. This is because the rate-adjustment mechanism creates a direct cause-and-effect relationship between the entity's **past** transactions or other events and the entity's **present** right to charge a higher rate, or obligation to charge a lower rate, for goods or services to be delivered to customers in the **future**.[3]

7. A right to charge a higher rate could reflect a variety of past events, such as the entity:

(a) incurring costs that the calculation of the regulated rate is intended to recover through amounts billed to customers;

(b) meeting a bonus target; or

(c) having the right to be compensated for the passage of time from the event that triggered an originating rate adjustment to the time when the adjustment is reflected in the regulated rate charged to customers.

8. Similarly, an obligation to charge a lower rate could reflect a variety of past events, such as the entity:

[3] The rights/obligations arising from the rate-adjustment mechanism are consumed/ fulfilled as the entity includes the rate increase/ decrease in a future regulated rate that is charged to customers on the future delivery of goods or services.

(a) receiving amounts from customers in advance of incurring the costs that those amounts are intended to recover;

(b) failing to meet a target so that a penalty is imposed; or

(c) having the obligation to compensate customers for the passage of time from the period in which amounts are included in the rate charged to customers to the event to which those amounts relate.

Questions for Consultative Group members

Rights and obligations and related rate-adjustments
We ask Consultative Group members to provide information about how entities identify rate-adjustment amounts and how individual rate-adjustment balances are tracked through to amounts billed to customers. This information will inform the Board's decisions about whether and when to recognise temporary differences as regulatory assets and regulatory liabilities and when to recognise their subsequent reversal.

9. When gathering and reporting the information we are seeking, Consultative Group members may find it helpful to consider the following questions:

(a) In your experience, is the description in paragraphs 7-8 of the situations that lead to the creation of temporary difference amounts to be captured by the rate-adjustment mechanism accurate and complete?

(b) In your experience, what types of temporary differences and related rate adjustments are specified in the rate regulation sufficiently clearly that there is no doubt that they exist and qualify to be included in the rate-adjustment mechanism?

(c) When determining at what amount any qualifying temporary difference will be included in the rate-adjustment mechanism, do you or the rate regulator typically make the assessment on an overall basis or on an item-by-item basis?

When considering questions (b) and (c), please consider how often (normally, often or occasionally) you are able to determine clearly how specific adjustment amounts arise from identifiable past transactions or events.

(d) If the rate regulator determines the rate-adjustment amount on an overall basis, how is any adjustment above or below the sum of the individual rate adjustments allocated?

(e) When the regulated rate chargeable to customers in a period is adjusted for more than one item, does the regulation require adjustments to be tracked individually? If so, how is the amount billed to customers during a period allocated to the individual adjustments?