IFRS

STAFF PAPER

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Consultative Group for Rate Regulation Meeting

Project	**Rate-regulated Activities**
Paper topic	Identifying the interest rate or return rate

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Purpose of the paper

1. We ask Consultative Group members to provide information about whether, and if so how, rate regulators compensate or charge an entity for the time-lag between the transaction or other event that originates a rate adjustment and the inclusion of that rate adjustment in the amounts billed to customers. This information will inform the Board's decisions about how to measure regulatory assets and regulatory liabilities.

Summary of the Board's discussions so far

2. In its September 2017 meeting, the Board began its discussions about factors to consider when developing requirements in the model about how to measure regulatory assets (or regulatory liabilities). The discussion focused on an illustrative example of a regulatory asset that arose when an entity incurred costs delivering services to customers. In the example, the regulatory agreement specified that the entity has a right to include those costs in the future rate charged to customers over a five-year period; the costs were too high to be fully absorbed by customers in the year in which they were incurred. The Board discussed how the regulatory asset could be measured, depending on whether, and if so how, the

rate regulator were to compensate the entity for the time-lag between incurring the costs and including them in the amounts billed to customers.

3. Some Board members indicated an initial preference for using a discounted cash flow technique to measure the entity's right to include those costs incurred in the rate charged for future services. For such a technique, it would be necessary to determine the cash flows to be discounted, and the discount rate to be used.

4. We are seeking information about how, in practice, rate regulators compensate entities for the time-lag between the event that originates a rate adjustment and the inclusion of the rate adjustment in the amounts billed to customers. This information will help the Board to decide:

   (a) what discount rate to apply, if discounting is appropriate; and

   (b) whether it is appropriate to recognise a 'day one' gain or loss that would be created by measuring a regulatory asset (or regulatory liability) using a discount rate that differs from the interest rate specified by the rate regulator?

Questions for Consultative Group members

Measurement issues
We ask Consultative Group members to provide information about whether, and if so how, rate regulators compensate or charge an entity for the time-lag between the transaction or other event that originates a rate adjustment and the inclusion of that rate adjustment in the amounts billed to customers. This information will inform the Board's decisions about how to measure regulatory assets and regulatory liabilities.

5. 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, does the rate regulator compensate or charge an entity for the time-lag between the transaction or event that originates a rate adjustment and the reversal of that rate adjustment?

(b) If the rate regulator compensates or charges an entity for such a time-lag, what factors does the rate regulator consider when determining the rate to apply to the outstanding rate-adjustment balance (ie the regulatory asset or regulatory liability)? Does the rate typically reflect an interest rate or does is also include a return?

(c) Is the same interest rate or return rate used for all outstanding rate-adjustment balances or do different rates apply to different types of balances? If different interest rates or return rates apply to different rate-adjustment balances, how and why do they differ?

(d) Is the interest rate or return rate applied to a particular rate-adjustment balance typically fixed or variable?

(e) Once a regulatory interest rate or return rate has been applied to a specified rate-adjustment balance, is that regulatory interest rate or return rate subsequently updated to reflect changing conditions, eg changes in market borrowing rates? If so, how often does the rate regulator make these updates?