

Power & Utilities Spotlight

IASB Fosters Discussion on Rate-Regulated Accounting

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The Bottom Line

- On September 17, 2014, the IASB issued a [discussion paper \(DP\)](#)¹ as part of its comprehensive project to develop guidance for rate-regulated entities.
- The DP describes various types of rate regulation schemes, including cost-based, incentive-based, and hybrid schemes. Cost-based schemes allow the entity to recover cost plus a reasonable rate of return, while incentive-based schemes typically have a profit target. Hybrid schemes combine elements of both.
- The objective of the DP is to consult a wide range of stakeholders about what features distinguish the economic environment in which rate-regulated entities operate and whether those features would be best reflected in general-purpose financial statements.
- The DP does not prescribe any specific accounting requirements. Rather, it discusses the characteristics of rate-regulated activities, including the best and most “representationally faithful” way to report these characteristics in IFRS financial statements.
- Key characteristics of rate regulation discussed in the DP include the differences between the amounts billed to customers and the amounts accrued under the revenue requirement, which could be seen as a combination of rights and obligations. These differences are eliminated by a future adjustment of the rates and are considered a distinguishing feature of defined rate regulation.
- Rate regulation creates implicit and explicit rights and obligations. Specific accounting requirements may be needed for the implicit rights and obligations related to rate regulation but not for the explicit rights and obligations; the DP introduces various accounting alternatives² for implicit rights.
- The DP revisits the presentation and disclosure requirements of IFRS 14³ as a potential basis for developing such requirements as part of the IASB’s comprehensive project on rate regulation.
- Comments on the DP are due by January 15, 2015, after which the IASB is expected to consider the feedback received as well as the next steps in the project.

¹ IASB Discussion Paper, *Reporting the Financial Effects of Rate Regulation*.

² The DP introduces several rate-regulated accounting alternatives, including those based on (1) recognition of regulatory deferral accounts as assets or liabilities, (2) recognition of rights and obligations as one intangible asset, (3) application of regulatory accounting requirements, (4) development of specific requirements under IFRSs, or (5) prohibiting the recognition of regulatory deferral account balances.

³ IFRS 14, *Regulatory Deferral Accounts*.

Beyond the Bottom Line

This *Power & Utilities Spotlight* summarizes the IASB's September 17, 2014, DP on rate regulation.

Background

In September 2012, the IASB embarked on a comprehensive [rate-regulated activities project](#), which began with a research phase. After three months, the IASB [decided](#) to expand the project by adding another phase that eventually resulted in the issuance of a limited-scope standard, [IFRS 14](#), on January 30, 2014. IFRS 14 is designed to help rate-regulated entities transition to IFRSs by keeping their local accounting requirements for regulatory account balances. The DP was issued in connection with the IASB's more comprehensive project on rate regulation, which is designed to address the broader issue of whether regulatory deferral accounts meet the definition of an asset or liability under the IASB's conceptual framework.

The DP discusses the characteristics of rate-regulated activities, including the best and most “representationally faithful” way to report these characteristics in IFRS financial statements.

Though many types of rate regulation exist worldwide, the IASB is particularly interested in those forms that can significantly affect the economic performance of rate-regulated entities, including the amount of revenue to be earned and the timing of the cash flows associated with the rate regulation. The objective of the DP is to gain input from constituents on two key questions:

- Are there certain features that distinguish the economic environment of a rate-regulated entity from that of other entities? If so, what are these features?
- Should existing IFRS reporting requirements be modified so that entities reflect the rights and obligations related to those features in general-purpose financial statements?

Although the DP does not propose any specific accounting requirements, it discusses the characteristics of rate-regulated activities, including the best and most “representationally faithful” way to report these characteristics in IFRS financial statements.

Getting to the Core

An Overview of Rate Regulation

The IASB's March 2013 [request for information](#)⁴ defines rate regulation as “the mechanism by which a rate regulator imposes a control over the setting of prices that can be charged to customers for services or products.” The DP focuses on a generic type of rate regulation called “defined rate regulation,” which “applies when customers have little or no choice but to purchase the rate-regulated goods or services from the entity.” Under this approach, the rate-regulated entity is permitted to recover “a determinable amount of consideration (the ‘revenue requirement’) in exchange for the rate-regulated activities that it performs.” Further, the time when customers are billed is also determined by the rate regulation. Defined rate regulation “balances the needs of the customers . . . with the needs of the entity to attract capital and remain financially viable.”

Rate regulation is imposed “when markets do not support effective competition” — for example, when a natural monopoly exists or when a government needs to ensure that the provision of “essential” goods or services “is not discriminatory among various groups of customers.” The DP describes “essential goods or services” as those that are “essential to modern life so that, for moral or social reasons, the government considers that their universal provision should be guaranteed.” The extent of rate regulation for those goods or services is related to the level of supply and the level of competition. If there is sufficient supply and competition, there is usually no need for rate regulation.

According to the DP, the general objectives of rate regulation include:

- Better and more efficient service.
- Greater customer satisfaction.
- Greater reliability and supply capacity.

⁴ IASB Request for Information, *Rate Regulation*.

- Meeting environmental objectives (e.g., reduced emissions).
- Technological innovation (e.g., alternative resources).
- Fostering competition.
- Decreased or increased customer demand or usage.

How Rate Regulation Works

Generally speaking, there are two basic approaches to rate regulation: cost-based and incentive-based.

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Under both schemes, a formula is used to calculate the rate. The formula in the cost-based scheme is based on the entity's actual input costs. These "allowable costs" are restricted to those that "the rate regulator agrees are reasonably incurred." Since the rate is set in advance, the regulator uses forecasts and assumptions of allowable costs. Because the actual costs and volumes will typically differ from those used in setting the rate, an entity will need a "balancing adjustment" mechanism to ensure that actual input costs

are recovered. In excess of cost recovery, the entity receives a "fair and reasonable" rate of return on its capital investment.

Thinking It Through

Terms like "reasonably incurred" and "fair and reasonable" are common in rate regulation. The rate regulator thereby ensures that the rate regulation scheme incorporates enough flexibility for rate setting and allows for renegotiations with the entity. However, as described in the DP, the terms are still narrow enough that the rate regulator's discretion regarding which costs are allowable is somewhat limited. Thus, the entity and potential investors can more easily predict the outcome of regulatory interventions. We expect the project to take into account the degree of discretion the regulator has and how this may affect the existence of rights and obligations within a particular regulatory regime.

The formula used in the incentive-based scheme focuses on targeted outputs, with little or no "true-up" or balancing mechanisms in place. In this scheme, the regulator typically sets a profit target. If the entity exceeds the target, it may "retain any profits above the target level." However, an entity that does not reach the target profit level must suffer "the downside of any inefficiency or under-recovery of costs."

One example of incentive-based regulation is a "price cap" that "applies to all suppliers in a competitive market." (The DP refers to this form of regulation as "market regulation.") The price cap is usually based on benchmark costs and "does not provide assurance to the entities in the market that they will be able to recover their costs or make a reasonable return on the goods or services that are sold." However, under such regulation, there are no restrictions on the total amount of revenue that an entity is able to earn.

The DP notes that pure cost-based or incentive-based rate regulation is rare and that most schemes have features of both categories. One example is a cost-based scheme in which benchmark cost (instead of actual cost) is used as allowable cost.

Features of a Defined Rate Regulation Scheme

The DP indicates that in defined rate regulation, rates are set through a framework with the following features:

- Customers "have little or no choice but to purchase the goods or services from the rate-regulated entity because" (1) "there is no effective competition to supply" and (2) "the rate-regulated goods or services are essential to customers."
- There are "parameters to maintain the availability and quality of the supply of the rate-regulated goods or services and other rate-regulated activities of the entity."
- There are parameters for rates that support "greater stability of prices for customers" as well as "the financial viability of the rate-regulated entity."

- A “revenue requirement” is established that encompasses “the total consideration to which the entity is entitled in exchange for carrying out specified rate-regulated activities over a period of time” (i.e., the regulatory period).
- The entity charges customers a regulated rate or rates per unit “for delivering the rate-regulated goods or services during the regulatory period.”

Further, in a defined rate regulation scheme, a rate-adjustment mechanism is installed to reverse differences between the amounts billed to customers and the amounts accrued under the revenue requirement. These differences are sometimes considered a combination of rights and obligations. The

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DP suggests that this adjustment mechanism “is a distinguishing feature of defined rate regulation.”

To calculate the rate or rates per unit charged to the customer, an entity first uses the rate-adjustment mechanism to determine the revenue requirement. This “allowable revenue” is generally linked “to an amount of allowable profit or a specified rate of return on capital invested.” Next, “[t]he estimated amount of the revenue requirement is divided by the estimated quantity of the rate-regulated goods or services expected to be delivered.” The result is the rate per unit. This rate, in effect, is provisional, since the rate-adjustment mechanism is used to adjust any difference between the amount invoiced to customers and the amount of the revenue requirement.

However, the DP indicates that defined rate regulation is a hybrid scheme that combines incentives with cost-recovery principles. Accordingly, not all differences are reversed by the mechanism, in which case the entity’s profit or loss will be permanently affected. To keep those unadjusted differences at an acceptable level, longer regulatory periods may include a rate-review “trigger” that becomes effective “when events or transactions deviate significantly from those used to estimate the revenue requirement.” In such cases, the entity or rate regulator (or customers) can request a review of the rate.

The DP states that “[t]he most common method used to recover or reverse the amount of a difference is to adjust the price for future sales to seek to eliminate the difference over a period of time.” Such a method is possible in defined rate regulation since the demand is “relatively inelastic” and the timing and probability of future sales are highly predictable.

If the volume of demand becomes unpredictable, the rate regulator needs to use an alternative mechanism that results in cash flow between the entity and the regulator. In rare cases, the entity issues the customer additional bills or credit notes to reverse the differences. However, in many countries, this practice is prohibited by law. Because such alternative mechanisms result in financial assets and liabilities that are within the scope of IFRS 9,⁵ “no specific accounting problems arise in these cases.” Thus, the DP focuses only on the mechanism that is used to adjust future rates.

Thinking It Through

Defined rate regulation includes a regulatory adjustment mechanism to reverse specified differences between the amount of the revenue requirement accrued to date and the amounts billed to customers, allowing the rate-regulated entity to earn the amount of the revenue requirement (which includes a target profit or rate of return to which the entity is entitled). The DP contains references to earning “no more and no less” than the revenue requirement; however, these references must be read in context and do not suggest that defined rate regulation is a pure cost-recovery scheme. On the contrary, the DP is describing a hybrid form of regulation that not only is based on cost-recovery principles but that also includes incentive mechanisms that may permit an entity to underperform or overperform when compared with the target profit or rate of return. This understanding has been validated through discussions with the IASB staff and, we believe, results in a description of a form of regulation that is commonly found in practice in a number of different countries, including the United States and Canada.

⁵ IFRS 9, *Financial Instruments*.

Creation of Rights and Obligations Under Defined Rate Regulation

In many rate-regulated regimes, competition is limited or nonexistent, which might be an implicit right in natural monopolies. As a result of an implicit right in a natural monopoly, “there may be significant barriers to entry . . . due to, for example, the high level of capital investment required or because of physical constraints that apply to putting the necessary infrastructure in place.” Another example of an implicit right might be an entity’s right to recover the revenue requirement by using the rate-adjusting mechanism.

In other cases, the right may be explicit. For example, there may be (1) “an exclusive licence agreement or contract with the rate regulator or other licensing body” or (2) “legislation or other regulation.” These explicit rights are not contractual rights to receive cash and would therefore be accounted for under IAS 38.⁶ Therefore, it is generally believed that those explicit rights do not create rights or obligations for which special accounting guidance is needed.

Such guidance is also not needed for explicit **obligations** (e.g., meeting specified emissions or other environmental targets). However, some implicit obligations are specific to rate-regulated activities, including the following:

- A requirement under which an entity must “supply the rate-regulated goods or services to customers on a non-discriminatory basis, as directed by the rate regulator.”
- A requirement for an entity “to provide the rate-regulated goods or services in accordance with the minimum service levels and at the regulated price, as established by the rate regulation.”
- The entity’s inability “to cease, suspend, restructure or transfer operations . . . without the approval of the rate regulator.”

The DP states that “in order for there to be a substantive right or obligation, there has to be an enforcement mechanism outside the entity.” Rights and obligations are generally enforced by applying the terms and conditions of such documents as rate regulations, legislation, and licenses. The regulator can enforce the entity’s obligations through fines, lower rates, or withdrawal of any licenses granted. The entity, on the other hand, can “enforce its right to recover the revenue requirement.” Although an entity must obtain regulatory approval before it “can change the rate charged to customers, the rate regulator does not have complete discretion over what is or is not allowable.” The criteria in the regulatory agreement must be applied in a fair and reasonable way; thus, the rate-setting mechanism must be sufficiently transparent.

Accounting for Rights and Obligations

The DP introduces various potential accounting alternatives for implicit rights, including those based on (1) recognition of regulatory deferral accounts as assets or liabilities, (2) recognition of rights and obligations as one intangible asset, (3) application of regulatory accounting requirements, (4) development of specific requirements under IFRSs, or (5) prohibiting the recognition of regulatory deferral account balances. Each of these is discussed in greater detail below.

Recognition of Regulatory Deferral Accounts as Assets or Liabilities

An entity that performs rate-regulated activities charges a rate to its customers. In current practice under IFRSs, the entity only recognizes revenue “for the goods or services that it transfers to individual customers during the period by using the regulated rate per unit multiplied by the quantity of units delivered in the period.” Some believe that this practice is consistent with IFRS 15,⁷ since the delivery of the goods and services “is the entity’s only direct revenue-generating activity.”

The DP examines whether IFRS requirements need to be modified to reflect the specialized nature of a rate-regulated environment.

These modified accounting requirements would “reflect the effects of the transactions and events that have occurred in the period, even if the entity is prevented from billing customers for those effects until future periods.” Earlier discussions have focused on whether deferral account balances arising from this approach could qualify as assets or liabilities under the IASB’s *Conceptual Framework for Financial*

The DP introduces various potential accounting alternatives for implicit rights.

⁶ IAS 38, *Intangible Assets*.

⁷ IFRS 15, *Revenue From Contracts With Customers*.

Reporting. The IASB is currently revising its conceptual framework and redeliberating its related DP.⁸ However, tentative decisions the IASB has made thus far have indicated that the current framework's definitions of assets and liabilities are likely to change. The conceptual framework DP would define an asset as "a present economic resource controlled by the entity as a result of past events" and a liability as "a present obligation of the entity to transfer an economic resource as a result of past events."

To be recognized as a "regulatory asset," a right to increase future rates must create a present resource or right for the entity. Similarly, to be recognized as a "regulatory liability," an obligation to reduce future rates must create a present obligation for the entity. Some have argued that rights or obligations related to the rate-adjusting mechanism are future (rather than present) resources or obligations because they are contingent on future sales. Further, the DP notes that "[i]n defined rate regulation, the entity is not required to refund the [specific] customers who have been over-billed, or to make a payment to the rate regulator or other designated body." Thus, in such cases, regulatory deferral accounts would be "contingent assets" or "contingent liabilities," which would not be recognized under IAS 37.⁹

Thinking It Through

At its July 2014 meeting, the IASB "tentatively decided that an entity has a present obligation to transfer an economic resource as a result of past events if" (1) "the entity has no practical ability to avoid the transfer" and (2) "the amount of the transfer is determined by reference to benefits that the entity has received, or activities that it has conducted, in the past." A regulatory deferral account credit balance would meet both criteria under the above argument.

One of the issues that we believe needs to be further explored in connection with the project is when, if ever, the unit of account for recognizing revenue should be identified as the population or customer base as a group rather than as each individual within that population and whether, if the unit of account is identified as a group, that group should include future as well as current customers. Some believe that the collection or refund of regulatory balances must be to or from the same customer(s) that benefited from the costs incurred — a requirement that would rarely, if ever, be met in real-world regulatory constructs.

The application of IFRS 15 in a regulated environment is likely to garner attention as the IASB staff works on this project. Some have asserted that IFRS 15 may serve as a foundation for recognition of regulatory balances given the standard's approach to the collection of consideration before a performance obligation is satisfied (which could apply to the recognition of regulatory liabilities) as well as its approach to dealing with costs associated with fulfilling a customer contract (which could apply to the recognition of regulatory assets). One of the challenges with such approaches will most likely be the role of regulators and whether that role (or its effects) can be directly attached to the vendor-customer relationship.

Recognition of Rights and Obligations as One Intangible Asset

Some have argued that regulatory licenses are similar to other types of exclusive licenses and thus should be accounted for in accordance with IAS 38. However, others believe the periodic rate-review process is a feature of regulatory licenses that differentiates them from other types of operating licenses. In the latter case, IAS 38 would have to be amended given that "this process modifies or renews the terms and conditions of the licence at intervals throughout its term."

The IASB could amend IAS 38 by introducing a component approach (similar to the approach in IAS 16¹⁰) in which each originating difference is recognized as a separate component of the license. An entity would then amortize the recognized components "over the rate-regulatory adjustment period." However, this approach appears to have several flaws. For example, under IAS 16, an entity must be able to capitalize expenditures that are incurred to replace a component. Although IAS 38 contains similar criteria with respect to expenditures incurred for adding to, replacing, or servicing the original license, regulatory deferral balances "do not, in themselves, represent the costs of acquiring, renewing or modifying the terms of the licence." In addition, although regulatory deferral balances can be both positive and negative, an entity would not be able to recognize negative balances under the component approach.

⁸ IASB Discussion Paper, *A Review of the Conceptual Framework for Financial Reporting*.

⁹ IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*.

¹⁰ IAS 16, *Property, Plant and Equipment*.

An alternative to the component approach might be the revaluation of the regulatory license. Using the revaluation approach, an entity would be able to reflect positive and negative changes in the carrying amount of the license. However, IAS 38 requires that revaluation of an asset be “determined by reference to an active market,” and because there is no active market available for defined rate-regulated activities, IAS 38 would have to be amended before regulatory licenses can be revalued. In addition, because the license is so closely related to the rate-regulated business of the entity, the value of the license may incorporate changes in the value of internally generated goodwill. Revaluation of the license could therefore be complex and could result in recognition of internally generated goodwill. Moreover, under IAS 38, revaluation adjustments must be recognized in other comprehensive income (OCI) even though some items associated with regulatory account balances are recognized in profit or loss. If IAS 38 is amended to permit entities to split the changes in the license’s fair value into OCI and profit or loss, additional complexities may arise.

Thinking It Through

Although the IASB has not dismissed the revaluation approach, the DP acknowledges that the costs and complexity may outweigh the benefits. Specifically, the IASB will need to consider whether the approach provides financial statement users with “sufficiently transparent and understandable information” and whether financial statements prepared under the approach effectively portray the specialized nature of a rate-regulated environment.

Application of Regulatory Accounting Requirements

The DP states that “[a]nother possible approach for reporting the effects of defined rate regulation is to permit (or require) the accounting prescribed by the rate regulator to be used in general purpose IFRS financial statements.”

Under this approach, rate-regulated entities would not have to prepare two separate sets of financial statements (i.e., one under IFRSs and another under rate-regulation requirements), which may prove less burdensome and more cost-efficient for these entities.

However, this approach could result in several potential problems:

- Financial statements of rate-regulated entities would no longer be comparable to those of non-rate-regulated entities and possibly even those of other rate-regulated entities (since every rate-regulated regime has its own specialties).
- Entities operating in several rate-regulated environments would account for their activities under different accounting requirements, creating complexity and reducing transparency.
- The effects of rate regulation could be difficult to distinguish from the effects of general market conditions and management decisions.
- Because the goal of general-purpose financial statements differs from the goal of regulatory accounting requirements, “investors and lenders could lose information that is relevant to their decision-making needs.”

Development of Specific Requirements Under IFRSs

Under this approach, the underlying business activities of rate-regulated entities would be accounted for similarly to those of non-rate-regulated entities. IFRS accounting requirements specific to rate-regulated activities would only be developed to address the financial reporting effects of the rate regulation. The DP identifies two main approaches for modifying IFRS requirements: (1) deferring or accelerating costs and (2) deferring or accelerating revenue.

Under the “deferring or accelerating costs” method, costs incurred for providing the rate-regulated goods or services would be recognized at a different time than under general IFRSs. The timing of the cost recognition would be consistent with the regulatory accounting requirements. For example, while regulatory accounting requirements often allow entities to capitalize certain indirect costs as property, plant, and equipment, such costs would be expensed as incurred under IAS 16. Thus, for rate-regulatory purposes, such costs would be deferred and they would be recognized over time rather than “immediately in profit or loss in accordance with IAS 16.” Proponents of this approach believe that because it takes into account the asset’s regulatory carrying amount, it enables financial statement users to “more easily identify and predict the effect of the regulatory requirements on the amount and timing

of the entity's revenue, profit and related cash flows." However, some have criticized the method for relying too heavily on a "matching" principle, lacking transparency, and failing to reflect incentives (since it purely relies on costs).

In contrast, under the "deferring or accelerating revenue" method, an entity recognizes revenue when it performs its activities, regardless of when the customers are billed. For example, an entity could incur costs from repairing storm damage that will be reimbursed by rate increases in future periods. This approach accelerates revenue recognition to the period when the costs were incurred. Some consider this method to be the most helpful to financial statement users because it allows them to "see how the rate regulation compensates the entity for the activities that it performs in accordance with the rate regulation." Further, the adjustment to future rates would take into account adjustments "that are not directly related to the recovery of incurred costs" and would reward (or penalize) entities for good (or poor) performance. The entity could also provide supplementary disclosures regarding when it "expects the accrued or deferred revenue to be recovered or reversed through future billings."

The DP also explores using a combination of the two approaches described above, which "might alleviate some of the complexities of trying to apply a single model to the different aspects of defined rate regulation."

Thinking It Through

While there may be certain merits to the mixed approach, in certain jurisdictions there may be a bias toward an approach that is familiar (e.g., one that is consistent with the historical accounting for the effects of rate regulation). For example, among jurisdictions that have historically applied the ASC 980 model, there may be a bias toward the cost method.

Prohibiting the Recognition of Regulatory Deferral Account Balances

The IASB may decide that regulatory deferral account balances should not be recognized in financial statements presented in accordance with IFRSs.

Proponents of this approach argue that all entities, regardless of whether they are rate-regulated, use some kind of framework to determine the prices for their goods and services. They note that although there may be "a 'right' to increase future prices or an 'obligation' to decrease future prices, . . . this is economically no different from an unregulated entity's ability to increase, or need to decrease, future prices" because the entity needs to have future sales to recover the right or fulfill the obligation.

In addition, proponents of this approach believe that it is sufficient for rate-regulated entities to use IFRS 15 to account for their transactions, since this standard focuses on "revenue-generating" activities (which, in the case of a rate-regulated entity, are the sales of goods and services to customers). Under IFRS 15, many believe that these entities should use the regulated price per unit to recognize revenue when the goods or services are transferred to customers.

Moreover, proponents highlight that the deferral of costs incurred for repairing damages would lack transparency and could even be misleading. They further argue that the revaluation method in IAS 16 is available for entities that want to report the recoverable amount of an item of property, plant, and equipment instead of its cost. In such cases, no regulatory adjustment of the carrying amount of these items would be required.

If the IASB decides to use this approach, it could require rate-regulated entities to supplement their disclosures with information about the impact of rate regulation on their financial statements.

Thinking It Through

The DP implies that the IASB's conceptual framework currently does not support the recognition of regulatory assets or liabilities. This belief was also reflected in the adoption experience of many IFRS filers, most notably those in Europe. On the other hand, we are aware of foreign registrants that have recorded regulatory assets and liabilities under IFRSs and such accounting has been supported by the registrants' local securities regulators. We do not believe this debate is over and expect the IASB to focus on this issue in connection with its work.

As noted above, we also expect that the application of IFRS 15 in a regulated environment will be further considered (e.g., if and how the role of the regulator should affect the analysis of the vendor-customer relationship).

Presentation and Disclosure Requirements

The DP summarizes the disclosure and presentation requirements in IFRS 14, which may serve as the starting point for developing disclosure requirements as part of its comprehensive project on rate regulation. However, the DP stresses that the IFRS 14 requirements “should not be considered as prejudging decisions about any subsequent requirements that may be developed.”

IFRS 14 requires that regulatory deferral accounts be isolated and distinguished from the rest of the items in the statement of financial position and that they be presented as a separate line item after subtotals for total assets and total liabilities. Similarly, “[i]n the statement(s) of profit or loss and other comprehensive income, the net movements recognised in the amounts of regulatory deferral accounts are presented as separate line items.” These line items are also isolated from the other items of profit and loss and presented after a subtotal of these other items.

Disclosures required by IFRS 14 include the following:

- A “reconciliation of the carrying amount at the beginning and end of the period, with movements segregated between amounts arising in the period, amounts recovered or reversed in the period and other reconciling items.”
- The “rate of return or discount used to reflect the time value of money.”
- The “remaining periods over which the entity expects to recover or reverse the regulatory deferral account balance recognised.”
- A “brief description of the nature and extent of the activities that are subject to rate regulation and the nature of the rate-setting process.”
- “[i]nformation about risks and uncertainty in the future recovery or reversal of each type of regulatory deferral account balance that has been recognised.”

Looking Ahead

Potential Issues in Developing Rate-Regulation Accounting

The discussion so far has focused on rate regulation schemes that are established by either legislation or other formal regulation. Questions have arisen about whether cooperatives¹¹ are “subject to defined rate regulation” or whether they should be considered “self-regulated” and therefore outside the scope of this topic. The DP notes that although “[c]o-operatives are commonly self-regulated when it comes to setting prices for goods or services that they supply,” they are often overseen by regulatory bodies if they provide essential goods or services. The DP requests feedback on whether this oversight provides a sufficient basis for including cooperatives within the scope of a proposed standard.

Another issue related to developing rate-regulated accounting requirements is the potential for unintended interactions with other standards. These interactions may include the following:

- *IFRIC 12*¹² — Rate-regulated accounting requirements could be inconsistent with some of the requirements in IFRIC 12. The interaction between IFRIC 12 and rate regulation accounting is evident in paragraph 23(c) of IFRIC 12, which states that a service concession contract “sets out the initial prices to be levied by the operator and regulates price revisions over the period of the service arrangement.” Although the features of service concession arrangements are often similar to those in rate regulation arrangements (e.g., situations in which an operator “relies solely on sales of the concession service in order to generate sufficient revenue over the period of the arrangement to recover its costs and earn a reasonable rate of return”), there are notable differences. Under IFRIC 12, for instance, property, plant, and equipment are not recognized as assets of the operator while they would be recognized as such under defined rate regulation accounting standards.

¹¹ Defined by the International Co-operative Alliance as “an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise.”

¹² IFRIC Interpretation 12, *Service Concession Arrangements*.

An issue related to developing rate-regulated accounting requirements is the potential for unintended interactions with other standards.

- *IFRS 15* — Rate-regulatory standards may also conflict with the IASB’s recently issued revenue standard, IFRS 15. Under IFRS 15, an entity must recognize revenue “when (or as) the entity satisfies a performance obligation by transferring a promised good or service (ie an asset) to a customer.” However, the consideration in defined rate regulation may involve not only the transfer of goods or services but also “changes to the entity’s property, plant and equipment or infrastructure assets or switching to alternative sources of energy, etc.” It is currently unclear how such differences would affect revenue recognition under IFRS 15 and how the IASB would tailor this standard to take defined rate regulation into account.
- *IAS 12*¹³ and *IAS 20*¹⁴ — In certain defined rate regulation scenarios, the rates that regulators compensate entities for may be so high that they are considered unaffordable for customers. In such situations, regulators may need to develop alternative methods for compensating entities (e.g., government grants, subsidies, taxation), which may affect the current requirements in IAS 12 or IAS 20.
- *IFRS 3*¹⁵ — The IASB will need to consider how regulatory deferral account balances acquired or assumed in a business combination should be measured and recognized under IFRS 3, since there is currently no specific guidance on this topic.

Next Steps

Comments on the DP are due by January 15, 2015. After the comment period ends, the IASB will consider the feedback it receives to determine the appropriate next steps.

Deloitte’s power and utilities industry team will continue to monitor developments in the rate regulation project and will provide updates through various means, including (1) live industry seminars, (2) quarterly accounting update webcasts, and (3) periodic *Power & Utilities Spotlight* publications. In addition, watch for Deloitte’s annual *Power & Utilities — Accounting, Financial Reporting, and Tax Update*, which will be published this winter.

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¹³ IAS 12, *Income Taxes*.

¹⁴ IAS 20, *Accounting for Government Grants and Disclosure of Government Assistance*.

¹⁵ IFRS 3, *Business Combinations*

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