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IFRS® Standard 14 Regulatory Deferral Accounts

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SCOPE AND KEY DEFINITIONS

The accounting impact of regulation by Governments on the supply and pricing of particular types of activity by private entities are addressed in IFRS Standard 14 Regulatory Deferral Accounts. Types of activity include utilities such as gas, electricity and water.

The objective of the IFRS 14 is to specify the financial reporting requirements for regulatory deferral account balances that arise when an entity provides goods or services to customers at a price or rate that is subject to rate regulation (IFRS 14.1).

IFRS 14 is permitted, but not required, to be applied where an entity conducts rate-regulated activities and has recognized amounts that meet the definition of "regulatory deferral account balances" in its previous GAAP financial statements.

To understand this standard correctly, we must know some basic definitions (IFRS14.Appendix A).

Rate Regulation: A framework for establishing the prices that can be charged to customers for goods and services and that framework is subject to oversight and/or approval by a rate regulator.

Rate Regulator: Any authorised body that is empowered by statute or regulation to establish the rate or range of rates that bind an entity.

Regulatory Deferral Account Balance: The balance of any expense (or income) account that would not be recognized as an asset or a 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.

REGULATIONS

Regulations are often designed to:

- Allow the suppliers to recover specified costs and other amounts through the prices they charge the customers with.
- Protect the interests of customers.

Rate regulation is a means of ensuring that specified costs are recovered by the supplier and that prices charged to customers are fair. These twin objectives mean that prices charged to customers at a particular time do not necessarily cover the costs incurred by the supplier at that time. In this case, the recovery of such costs is deferred and they are recognized through future sales.

This leads to a mismatch. IFRS does not have specific requirements in respect of accounting for this mismatch. However, established practice is that amounts are recognized in profit or loss as they arise.

IFRS 14 permits first-time adopters of IFRS to continue to recognize amounts related to rate regulation in accordance with their previous GAAP when they adopt IFRS.

This is affected through an exemption from p.11 of IAS Standard 8 Accounting Policies, Changes in Accounting Estimates and Errors which generally requires an entity to consider the requirements of IFRS dealing with similar matters and the requirements of the Conceptual Framework when setting its accounting policies.

Examples: These are examples of the types of costs that rate regulators might allow in rate-setting decisions and that an entity might, therefore, recognise in regulatory deferral account balances:

- Volume or purchase price variances.
- Costs of approved "green energy" initiatives (in excess of amounts that are capitalised as part of the cost of property, plant and equipment in accordance with IAS Standard 16 Property, Plant and Equipment).
- Non-directly-attributable overhead costs that are treated as capital costs for rate regulation purposes (but are not permitted, in accordance with IAS 16, to be included in the cost of an item of property, plant and equipment).
- Project cancellation costs.
- Storm damage costs.
- Deemed interest (including amounts allowed for funds that are used during construction that provide the entity with a return on the owner's equity capital as well as borrowings).

CHANGES IN ACCOUNTING POLICIES

An entity shall not change its accounting policies in order to start to recognize regulatory deferral account balances. An entity may change its policy for regulatory deferral accounts in accordance with IAS Standard 8 Accounting Policies, Changes in Accounting Estimates and Errors, but only if the change makes the financial statements more relevant and reliable to users.

RECOGNITION AND MEASUREMENT

An entity within the scope of IFRS 14 is able to make a voluntary irrevocable election in its first annual IFRS financial statements whether or not to recognize regulatory deferral balances in accordance with IFRS 14.

An entity that has elected to apply IFRS 14 in its first annual IFRS financial statements, continues to apply the recognition, measurement, impairment, and de-recognition requirements in accordance with its previous GAAP to all its regulatory deferral account balances. Essentially, this means that, in respect of those balances, the provisions of the entity's previous GAAP continue to apply.

Changes are only permitted if they result in the financial statements' being either:

- More relevant and no less reliable
- More reliable and no less relevant

As the regulatory deferral account balances to be recognised are restricted to the incremental amounts from what would otherwise be recognised as assets and liabilities under IFRS and the conceptual framework, the measurement of these balances effectively entails a two-step process:

- An entity would first determine the carrying amount of its assets and liabilities under IFRS, excluding IFRS 14.
- These amounts would then be compared with the assets and liabilities determined under the entity's previous GAAP presentation (i.e., its rate-regulated balances).

The differences would represent the regulatory deferral debit or credit account balances to be recognised by the entity.

Example: Assume Entity A is an electricity company in Country B that reports under Local Accounting Standards. In order to reduce volatility in rates charged to customers, the regulator in Country B requires Entity A to recover the differences between actual and estimated costs over time. Under Local Accounting Standards, the deferred electricity costs meet the asset recognition criteria and are presented as "Other assets and deferred costs" on Entity A's statement of financial position dated December 31, 2019. There are no other assets included in this line item on the statement of financial position aside from these deferred costs.

The rate regulator permitted Entity A to recover its electricity supply costs on the basis of a one-for-one pass through to customers. Under the rate-setting mechanism, it also requires the entity to amortise any net over or under-recovery of electricity costs on a straight-line basis over three years.

Entity A decides to adopt IFRS in its 2021 financial statements. On the date of IFRS adoption (January 1, 2020), Entity A has a carrying amount of CU 300,000 presented as "other assets and deferred costs" on its Local Accounting Standards statement of financial position, which relates to the net under-recovery of electricity costs to be deferred over the next three years.

Entity A has assessed that these deferred costs do not meet the requirements to be recognised as assets under IFRS. Consequently, the "regulatory deferral account" balances to be recognised under IFRS 14 amount to CU 300,000, which is the difference between the deferred costs capitalised and recognised under Local Accounting Standards and what would have been recognised under IFRS without the adoption of IFRS 14. Amortisation expense of CU 100,000 (CU 300,000/3 years) will be recognised annually during the three-year recovery period.

Example: The use of deferral regulatory accounts may result from the request to report the effects of the transactions given in the table below:

Transactions covered by deferral regulatory accounts	**Beginning Balance**	**Increases or Decreases During the Period**	**Ending Balance**
Distribution Expenses	XXX	+/- XXX	XXX
Installation Costs	XXX	+/- XXX	XXX
Storm Damage Expenses	XXX	+/- XXX	XXX
Pension Benefits	XXX	+/- XXX	XXX
Gas Cost Variances	XXX	+/- XXX	XXX
Land Transfer	XXX	+/- XXX	XXX
Corporate Tax	XXX	+/- XXX	XXX
Deactivation	XXX	+/- XXX	XXX
TOTAL	**XXXX**	**+/- XXX**	**XXX**

PRESENTATION

The amounts of regulatory deferral account balances are separately presented in an entity's financial statements.

An entity shall present separate line items in the statement of financial position for:

- The total of all regulatory deferral account debit balances
- The total of all regulatory deferral account credit balances.

The total regulatory deferral account debit balances and regulatory deferral account credit balances are presented separately from, and after, all other items. They are not split into current and non-current portions.

Subtotals for assets and liabilities are calculated before the inclusion of regulatory deferral account balances. Debit and credit balances of regulatory deferral accounts are not offset.

To illustrate, the asset section of the statement of financial position may be presented in the following manner, with a similar presentation for liabilities.

Non-current Assets	XXXX
Current Assets	XXXX
Total Assets	**XXXX**
Regulatory Deferral Account Debit Balances	*XXXX*
Deferred Tax Asset Related to Regulatory Deferral Account Balances	*XXXX*
Total Assets and Regulatory Deferral Account Debit Balances	**XXXX**

Separate line items shall be used for the net movement related to items that, in accordance with other Standards:

- will not be reclassified subsequently to profit or loss
- will be classified subsequently to profit or loss when specific conditions are met.

The net movements in all regulatory deferral account balances that relate to items recognized in other comprehensive income in the reporting period are presented separately. Separate line items are presented depending on whether the net movement relates to items that will subsequently be reclassified to profit or loss.

Remaining net movements are presented as a separate line item in profit or loss. Net movements are distinguished from income and expenses that are presented in accordance with other standards by a subtotal calculated before their inclusion.

To illustrate, the statement of profit or loss and other comprehensive income may be presented in the following manner.

Revenue	XXXX
Cost of Sales	(XXX)
Gross Margin	**XXXX**
Other Income	XXXX
Distribution Costs	(XXX)
Administrative Expenses	(XXX)
Other Expenses	(XXX)
Finance Costs	(XXX)
Profit Before Tax	**XXXX**
Income Tax Expense	(XXX)
Profit for the Year Before Net Movement on Regulatory Deferral Account Balances	**XXXX**
Net Movement in Regulatory Deferral Account Balances Related to Profit or Loss	*XXX*
Net Movement in Deferred Tax Arising from Regulatory Deferral Account Balances Related to Profit or Loss	*(XXX)*
Profit for the Year and Net Movement in Regulatory Deferral Account Balances	**XXXX**

Example: Changes of the type given below may require reporting under the name of "deferral accounts" as they are considered as a type of accounting policy change (IFRS14.B4):

- recognising a regulatory deferral account debit balance where the entity has the opportunity to increase rates in future periods to recoup its authorised costs as a result of the rate regulator's actual or anticipated actions.
- recognising, as a regulatory deferral account debit or credit balance, an amount that is equivalent to any loss or gain on the disposal or retirement of both items of property, plant and equipment and of intangible assets, which is expected to be recovered or reversed through future rates.
- Measuring regulatory deferral account balances on an undiscounted or discounted basis using a rate regulator-specified interest or discount rate.

DISCLOSURES

IFRS 14 contains specific disclosure requirements to enable users to evaluate

- the nature of, and risks associated with, the rate regulation that establishes the price(s) the entity can charge customers for the goods or services it provides
- the effects of rate regulation on the entity's financial statements.

To help a user of the financial statements assess the nature of, the risks associated with, the entity's rate regulated activities, an entity shall, for each type of rate regulated activity, disclose activities subject to rate regulation.

An entity shall disclose the basis on which regulatory deferral account balances are recognized and derecognized, and how they are measured initially and subsequently, including how regulatory deferral account balances are assessed for recoverability and how any impairment loss is allocated.