

Via Email to: [iasb@iasb.org](mailto:iasb@iasb.org)

June 30, 2008

International Accounting Standards Board  
IFRIC Staff Responsible for Project Agenda Request on Rate Regulated Liabilities  
30 Cannon Street  
London EC4M 6XH  
United Kingdom

Dear Sirs and Madams:

RE: Comments on Rate Regulated Assets and Liabilities  
(Agenda Paper 7A)

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## **Introduction**

The Alberta Utilities Commission (AUC) notes that IFRIC staff has requested comments on its “Project plan for agenda request on rate regulated liabilities” (Agenda Paper 7a).

The AUC regulates investor owned utilities in Alberta as well as several municipally owned utilities. The total regulated rate base was approximately \$11 billion at the end of 2007. The AUC regulates 17 relatively larger utilities of varying size (\$13 million to \$4.2 billion in rate base) as well as numerous small water utilities. The industry segments include gas and electricity distribution, gas and electricity transmission, and water purification and distribution. The electricity generation segment is no longer regulated as to prices charged.

The AUC is concerned that a large number of regulatory assets and liabilities may not be allowed to be recognized under IFRS.

While there are a large number of accounting items involved, the most substantive issue is whether or not the regulatory rulings and practices of the AUC, in substance, create economic assets and liabilities which should be recognized in the financial statements of regulated utilities in order to best reflect economic reality.

The AUC notes the statement that “IFRIC thought that an entity should recognize regulatory assets to the extent that they meet the criteria to be recorded as assets in accordance with existing IFRS. Whether the assets are labeled as “regulatory” should not affect their recognition.”<sup>1</sup> The

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<sup>1</sup> International Accounting Standards Board Paper regarding IFRIC Meeting of May 2008, Agenda paper 7A, paragraph 6.

AUC agrees with this statement but only to the extent that the existing criteria to be recorded as an asset is broad enough to capture regulatory assets that are “in substance” assets.

### **Financial Statement Impact of Regulatory Assets**

For some of the AUC regulated utilities the impact of deferral accounts or regulated assets and liabilities is significant. For example, at the end of 2006 one AUC-regulated utility had regulatory assets of \$46.5 million. This figure was slightly larger than its net income in 2006 of \$41.4 million. Total regulatory assets at the end of 2007 had declined to \$11.8 million. If the company had not been allowed to recognize its regulatory assets at the end of 2006, it presumably would have shown a net loss for 2006, followed by an abnormally large profit in 2007, neither of which would have reflected economic reality.

The above example is not unusual as many of the AUC-regulated utilities have had deferral amounts, in one or more of the past five years, that are very large in comparison to their net income.

### **Analysis**

The AUC notes the IFRS definition of a liability:

A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.<sup>2</sup>

The AUC does not claim to be knowledgeable in the interpretation of the above definition. However, on a plain reading, the AUC believes that most or all regulatory liabilities that are created as a result of regulatory rulings and practice would clearly meet this definition of a liability. Regulatory deferral accounts and actions often create an obligation for a utility to make refunds to customers or to mark funds on the balance sheet as effectively belonging to customers. The AUC notes that in some cases a utility will be aware that a refund will be required based on existing deferral account practice. In some cases the AUC will not have made a specific ruling on a specific amount owing. However the utility will be aware that based on the existence of the deferral account and on past practices an obligation exists in substance and therefore should be recognized on the financial statements.

The AUC understands that one view is that a regulatory liability may not meet the criteria of “arising from past events” since the final amount payable to customers is usually subject to future regulatory review. The AUC would disagree with this view. A regulatory liability is typically created by events that have happened prior to the balance sheet date. The requirement to later substantiate that those events did occur and that they meet the criteria of a deferral account does not change the fact that the events occurred in the past.

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<sup>2</sup> Framework for the Preparation and Presentation of Financial Statements  
<http://www.iasb.org/NR/rdonlyres/E29DA762-C0E1-40F8-BDD4-A0C6B5548B81/0/Framework.pdf>

The AUC notes the IFRS definition of an asset:

An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.<sup>3</sup>

The AUC understands that the requirement for an asset to be “controlled by the entity” may prevent regulatory assets from being recognized. (This may depend on how the word control is interpreted and whether absolute control is required). Regulatory assets are financial assets that represent future cash flows to the entity that are highly likely to occur. In the AUC’s view it would not be appropriate to exclude from recognition regulatory assets on the basis that the regulator also exerts considerable control. To do so would prevent these assets that are clearly assets in substance from being recognized. Taken to the extreme no resource could be recognized by any entity where a regulator or any other external party has some control, which would seem to be an absurd result. Such a result would seem to go well beyond conservatism into the realm of absurdity.

The AUC understands that one view is that a regulatory asset may not meet the criteria of “arising from past events” since the final amount collectible from customers is usually subject to future regulatory review. The AUC would disagree with this view. A regulatory asset is typically created by events that have happened prior to the balance sheet date. The requirement to later substantiate that those events did occur and that they meet the criteria of a deferral account does not change the fact that the events occurred in the past.

The AUC believes that the transition to IFRS could create additional new regulatory assets and liabilities that would be recognized for regulatory purposes and that should be recognized in financial statements. Areas affected include for example; existing capitalized equity return during construction, existing capitalized administration and general expenses, existing non-recognition of future income taxes. In the AUC’s view, if there is a general recognition of the principal that regulatory rulings do lead to “real” assets and liabilities, that need to be recognized, then the transition to IFRS can likely be made with no material write-downs of assets and with limited impact on the volatility of earnings. Various regulatory assets could be setup to prevent the need for write-offs on the transition date. Failing this recognition, the AUC fears that write-downs and severe earnings volatility which do not reflect economic reality would be the result.

In summary, the AUC urges IFRIC to take whatever steps are necessary in order to insure that under IFRS regulatory assets and liabilities can be recognized in accordance with economic reality.

### **Additional Information**

#### **Nature of the regulatory assets and liabilities (regulatory items) that are shown on the balance sheets of AUC regulated utilities.**

Please see Appendix 1 attached which summarizes the nature of these assets and liabilities.

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<sup>3</sup> Ibid

In summary most or all regulatory items are amounts that the utilities have deferred on the basis of approved (or historically approved) deferral or reserve account treatment. The deferral of these items (although usually not the particular amounts) has been approved but these items are typically subject to further Commission approval as to the particular amounts and the timing of recovery or payment. In some cases the deferral has been approved for previous years and the utility may defer the item in a current year based on the past precedent.

In some cases the amount to be collected or refunded has been given final approval and is in the process of being collected or refunded via a rate rider. In the case of rate riders, the utilities right to collect or pay would be under the control of the utility (meeting the asset definition) although in theory the amount could be revised by a future Commission Decision or by an appeal of the Decision authorizing the rate rider.

**Are these regulatory items assets and liabilities, in substance?**

In the AUC's view, yes, they appear to be. These items in the past have been eventually realized in cash in the great majority of cases. In the AUC's view, this would suggest that they are assets and liabilities, in substance. In the AUC's view, if these regulatory items are in substance assets and liabilities, the defined objectives of financial statements would be best met by recognizing these items.

Yours truly,

*Original Signed by Robert D. Heggie*

Robert D. Heggie  
Chief Executive

Enclosure: Appendix 1

## Appendix 1: Summary of Regulatory Assets and Liabilities of AUC Regulated Utilities

### Definitions:

**Deferral Account** – Typically AUC decisions approve deferral accounts for certain expenditures or variances from forecast expenditures. In essence there is an “approval in principle” of the deferred item, but these items are still subject to a prudence review in a future AUC hearing. There are many examples of items which are placed in deferral accounts or given deferral accounting treatment. These include: pension costs, financing costs, purchased power costs, variances in income tax rates, variances in income tax deductions.

Almost any expense could be subject to deferral account treatment but the deferral account treatment must be approved (usually in advance) by the regulator. Due to regulatory lag, there are many cases where deferral account treatment is approved retroactively when a revenue requirement decision is made after the beginning of a year. (In this case it might be reasonable for a utility to use precedent to defer items which were given deferral account treatment in its last rate hearing.)

In rare cases a utility may apply to the regulator for recovery of an unusual expense or revenue loss that had **not** been approved for deferral account treatment.

Deferred amounts may be realized by rolling the amount forward to be included in future base rates or may be realized via a specific rate rider, as defined below.

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**Transmission Deferral Amount** – Electrical Distribution utilities in Alberta pay Transmission charges to the Alberta Electric System Operator (AESO), an independent, statutory entity that pays the costs of the various Transmission utilities and then charges a standard rate to the Distribution utilities. The Distribution utilities charge this amount to their customers on a forecast basis. However a deferral account records changes in transmission access costs due to changes in AESO rates only, followed by a “true-up” process to insure that the Distribution utility collects the appropriate amount. The utility is responsible for the risk of volume related transmission cost variances (and would not book the volume related variance to the deferral account).

**Reserve Account** – AUC decisions allow certain types of forecast expenses to be collected in rates with the amount credited to a reserve account. Actual expenses are then charged (debited) against the reserve account. Any outstanding balance is brought forward to the next rate hearing. The balance is subject to AUC scrutiny but ordinarily would be rejected only if it is not reasonable and legitimate. The amount to be reflected in rates is adjusted to zero out any existing balance over a reasonable period of time. Reserve accounts are routinely used for hearing costs and for uninsured injuries and damages (mostly used to recover unusual expenses related to damages to utility facilities such as due to storms and fires that the utility self insures or are uninsurable and insurance deductibles).

**Rate Rider** – This is a mechanism to realize a specific deferred amount. This is a temporary surcharge or refund to be applied to all customers in a given rate class for a defined period of time. This is designed to collect or refund a specific amount over a period of time. In cases where there the amount collected or refunded is materially different than the forecast amount, a “true-up” rider may be used to insure that the appropriate deferred amount is ultimately collected or refunded.

Description	Utilities	Basis for Utility to Defer	Right to Collect / Obligation to Pay
Deferred hearing costs	All	Reserve account treatment has been approved	Prudent costs incurred may be collected Subject to an AUC hearing as to exact amount and timing.
Fuel Cost Deferral	Gas Utilities	Deferral treatment approved	Subject only to an accuracy and reasonableness check by the AUC.
Transmission AESO Rate Deferrals	All Electric Distribution Utilities	Deferral account treatment has been approved	Prudent costs incurred may be collected Subject to an AUC hearing as to exact amount and timing.
Transmission Unforecast Capital Project Deferrals	All Electric Distribution Utilities	Deferral account treatment has been approved	Prudent costs incurred may be collected Subject to an AUC hearing as to exact amount and timing.
Other Deferrals	All	Deferrals approved in revenue requirement hearing for the current year or at the last approved year	Subject to AUC approval but generally past regulatory practice would apply.
Reserve for Damages and Self Insurance	All	Reserve account treatment has been approved	All costs are subject to AUC approval and in some cases the utility uses judgment in deciding which costs to defer and claim in this account (example - a storm cost).
Rate Riders	All, from time to time	The utility has approval to apply a surcharge or refund item to customer bills for a specific period of time	It would be very unusual for the AUC to reverse a decision on a rider, once approved.