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# IFRS® Standard 14 Regulatory Deferral Accounts



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## CASE STUDY – IFRS 14 REGULATORY DEFERRAL ACCOUNTS

### Introduction

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.

### The Case Information

Hamburg Water Business (HSI) is operating in Germany, where the corporate tax is 15%. HSI is preparing its financial statements according to German Generally Accepted Accounting Principles (GERMAN GAAP). In order to reduce the volatility in the prices charged to customers, the regulator in Germany requires HSI to compensate for the differences between the actual and estimated costs over time. Under GERMAN GAAP, deferred water costs meet the asset recognition criteria and are presented as "Other assets and deferred costs" in HSI's statement of financial position as of December 31, 2021. Apart from these deferred costs, there are no other assets included in this item in the statement of financial position. The agency that regulates the tariffs allows HSI to recoup water supply costs to customers on a one-to-one pass-through basis. Under the price setting mechanism, the entity is required to depreciate the net over- or under-collection of water costs on a straight-line basis over three years.

HSI has decided to apply International Financial Reporting Standards (IFRS) in its 2023 financial statements. At the date of adoption of IFRS (January 1, 2022), HSI's GERMAN GAAP statement of financial position has a carrying amount of CU120,000, which is shown as other assets and deferred costs related to the net under-collection of water costs to be deferred over the next three years. HSI has assessed that these deferred costs do not meet the requirements to be recognized as assets under IFRS.

The table below presents the effects of variations in the cost of water on HSI's rate-regulated activities over a three-year period, as of 31 December:

(In CU)	2021	2022	2023
Amount charged to customers based on regulated rates	950,000	1,250,000	1,090,000
Part of rate that recovers deficit/surplus in prior years	-	(40,000)	(30,000)
<b>Net amount charged to customers in respect of current year</b>	<b>950,000</b>	<b>1,210,000</b>	<b>1,060,000</b>
Actual water supply costs of current year	<u>1,050,000</u>	<u>1,180,000</u>	<u>980,000</u>
<b>Net amount of (under)/over recovery of costs (i.e., regulatory deferral account (debit)/credit balance)</b>	<b>(100,000)</b>	<b>30,000</b>	<b>80,000</b>

### **Discussion Questions**

- What should be the accounts and amounts to be presented regarding deferred costs in the statement of financial position as of December 1, 2022, to be prepared in accordance with IFRS?
- Show the movements in the net regulatory deferral account balances over the three-year period, as of December 31.

## SOLUTION OF CASE STUDY – IFRS 14 REGULATORY DEFERRAL ACCOUNTS

### Presentation in the Statement of Financial Position as of January 1, 2022

Current Assets	XXX
Long Term Assets	XXX
<b>Total Assets</b>	<b>XXX</b>
Regulatory Deferral Accounts	120.000
Regulatory Deferral Accounts Deferred Tax Effect	18.000
<b>Total Assets Including Regulatory Deferral Accounts</b>	<b>XXX</b>

Consequently, the regulatory deferral account balances to be recognised under IFRS 14 amount to CU120,000, which is the difference between the deferred costs capitalised and recognised under GERMAN GAAP and what would have been recognised under IFRS without the adoption of IFRS 14 (i.e., CUNil). Amortisation expense of CU40,000 (CU120,000/3 years) will be recognised annually during the three-year recovery period.

Due to the under-recovery of water costs, a debit regulatory deferral balance of CU120,000 was recognised as of 1 January 2022 on application of IFRS 14. This regulatory deferral account debit balance will be amortised over three years, with an annual charge of CU40,000.

In the year 2022, the over-recovery of water costs of CU (30,000) results in a regulatory deferral credit balance which will also be amortised over three years, with an annual credit of CU (10,000).

The table below shows the movements in the net regulatory deferral account balances over the three-year period, as of 31 December:

Regulatory Deferral Account Balances, net (in CU)	2021	2022	2023
<b>Beginning balance</b>	-	<b>100,000</b>	<b>30,000</b>
Net under-recovery of water costs during the year	100,000	-	-
Net over-recovery of water costs during the year	-	<b>(30,000)</b>	<b>(80,000)</b>
Amortization of:			
• Under-recovery of water costs incurred in Year 20x1	-	(40,000)	(40,000)
• Over-recovery of water costs incurred in Year 20x2	-	-	<u>10,000</u>
Net movement	<b>100,000</b>	<b>(70,000)</b>	<b>(110,000)</b>
<b>Ending balance</b>	<b>100,000</b>	<b>30,000</b>	<b>(80,000)</b>

Under IFRS 14, the net movement in the debit and credit balances will flow to the statement of profit or loss and other comprehensive income. A similar process would be applied when accounting for the activity in the regulatory deferral account balances for the subsequent years.