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# UNIFORM SYSTEM OF ACCOUNTING

ACCOUNTING GUIDELINES FOR GEORGIAN REGULATED  
GAS MARKET COMPANIES

LEASE

USAID ENERGY PROGRAM

21 May 2019

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CONTRACT NUMBER: AID-OAA-I-13-00018

DELOITTE CONSULTING LLP

USAID | GEORGIA

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21 MAY 2019

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# DATA

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**Practice Area:** Uniform System of Accounting

**Key Words:** Regulatory Chart of Accounting, Uniform System of Accounting, Unified Accounting, Accounting System

## ACRONYMS

<b>CoA</b>	Chart of Accounts
<b>DLL</b>	Discounted Lease Liability
<b>GEL</b>	Georgian Lari
<b>GNERC</b>	Georgian National Energy and Water Supply Regulatory Commission
<b>HGEP</b>	Hydro Gas and Energy Planning Project
<b>HPEP</b>	Hydro Power and Energy Planning Project
<b>IAS</b>	International Accounting Standards
<b>IFRS</b>	International Financial Reporting Standards
<b>MPa</b>	Megapascal Pressure Unit
<b>PV</b>	Present Value
<b>USAID</b>	United States Agency for International Development
<b>USoA</b>	Unified System of Accounting

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## 1.0 BACKGROUND

According to the international best practice, regulatory financial information must be relevant, reliable, comparable, verifiable, transparent and comprehensive. To ensure the coherence of data, to avoid double counting and to detect anti-competitive effects its common practice in United States of America, Canada, Asia and some European Union countries to develop and implement the regulatory accounting – unified accounting system for rate regulated entities so called Unified System of Accounting (USoA).

USAID through its Hydropower Investment Promotion Project (HPEP March 2010 – August 2013) and its Hydro Power and Energy Planning Project (HIPP starting September 2013) provided guidance to GNERC in reforming the regulatory framework including development of the USoA for the electricity sector of Georgia. It was developed Regulatory Chart of Accounts (CoA) for the electricity sector, instructions to the CoA and performed capacity building of GNERC and the electricity sector generation, transmission, dispatch and distribution licensees. Later in December 2016 USoA and its constituent parts were approved by GNERC through its administrative procedures. USoA for rate regulated electric utilities would become mandatory from January 2019. The period between the approval of USoA and its mandatory application were allocated for the preparatory works for the transition to the regulatory accounting mandatory rules.

Considering the success in the past, in 2018 GNERC has applied USAID Energy Program with the request to support development of USoA for rate regulated utilities performing licensed activities in gas sector of Georgia.

As for electricity sector, Gas USoA proposed to provide a sound basis for recording of expenses and facilities of rate regulated gas utilities. Similarly, to the Electric USoA It includes a Regulatory CoA, Instructions to Regulatory CoA, General and Special Guidelines, Reports and Instructions to Reports that financial information can be properly recorded and traced for the purpose of sector regulation. This document was developed as the unbundled part of USoA for Georgian Gas Regulation with the purpose to be approved by the end of 2019 and applied for next year.

The USoA has proven to be a good tool for financial management of the utilities and without exception, the increased level of information provided by the USoA to utility management allows for better cost control and insights on the efficiency of their companies. It is a win-win success story as both consumers and investors reap benefits from this proven approach to regulatory oversight.

## **2.0 INTRODUCTION**

These Accounting Guidelines regulate the accounting of lease of asset of companies operating in Georgian regulated gas market. Gas market regulated companies shall follow the rules and procedures, use the same approaches stated in this document. These Accounting Guidelines are an essential part of USoA for Georgian regulated gas market that supports tariff development, monitoring, benchmarking and other regulatory information needs.

These Accounting Guidelines shall be applied for recording, maintaining and reporting of financial data using Unified Regulatory CoA set by Georgian National Energy Regulatory Commission.

## 3.0 GENERAL REGULATION

The *Lease* under Unified System of Accounting for Gas Sector Regulated Companies shall be treated in accordance with the IFRS 16 'Lease'.

Assets property (land or a building—or part of a building— or both) held (by the owner or by the lessee as a right-of-use asset) to earn rentals or for capital appreciation or both regulated by IAS 40 "Investment Property" are considered as Non-Regulated Assets.

### 3.1 GENERAL REGULATORY TREATMENT

The *Regulated Lease* under USoA shall be consistent with the Tariff Methodology and other rules adopted by GNERC.

Company shall treat the Non-Regulated positions and performances in accordance with the IFRS/IAS standards out of this Guideline.

Gas Sector Regulator may issue special guidelines for the cases requiring the *accordance with the regulation set by Gas Sector Regulator*. Where such guideline is not specifically issued, Company shall apply to Gas Sector Regulator for recognition of each case and get the acceptance for the approach developed by the Company.

### 3.2 REGULATORY DEFINITIONS

The definitions stated in this article are regulatory treatments of terms used in IFRS 16 "Lease". It not stated below Company shall follow the full regulation described in IFRS 16 "Lease".

*Regulatory Lease* for Gas Market Company is a contract, or part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration in accordance with the regulation set by Gas Sector Regulator.

*Regulatory Value* is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing Gas Market parties in accordance with the regulation set by Gas Sector Regulator.

*Underlying Regulatory Asset* is an asset that is the subject of a lease, for which the right to use that asset has been provided by a lessor to a lessee in accordance with the regulation set by Gas Sector Regulator.

*Regulatory Short-Term Lease* is a lease that, at the commencement date, has a lease term of 12 months or less in accordance with the regulation set by Gas Sector Regulator. A lease that contains a purchase option is not a short-term lease.

*Regulatory Right-of-use Asset* is an asset that represents a lessee's right to use an regulatory underlining asset for the lease term in accordance with the regulation set by Gas Sector Regulator.

*Regulatory Underlining Asset* is an asset that is the subject of a lease, for which the right to use that asset has been provided by a lessor to a lessee in accordance with the regulation set by Gas Sector Regulator.

*Regulatory Commencement Date of the Lease (Regulatory Commencement Date)* is the date on which a lessor makes a regulatory underlying asset available for use by a lessee in accordance with the regulation set by Gas Sector Regulator.

*Regulatory Lease Incentives* are payments made by a lessor to a lessee associated with a Regulatory Lease, or the reimbursement or assumption by a lessor of costs of a lessee in accordance with the regulation set by Gas Sector Regulator.

*Regulatory Lease Liability* is present value of the Regulatory Lease Payments that are not paid at that date.

*Regulatory Lease Payments* are payments made by a lessee to lessor relating to the right of use a Regulatory Underlying Asset during the lease term, comprising the regulation set by Gas Sector Regulator.



## 4.0 IDENTIFICATION

At inception of a contract, an entity shall assess whether the contract is, or contains, a Regulatory Lease. A contract is, or contains, a Regulatory Lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration in accordance with the regulation set by Gas Sector Regulator.

For a Regulatory Lease, an entity shall account for each Regulatory Lease component within the contract as a regulatory lease from non-regulated and non-lease components of the contract.

Sale and leaseback transactions are identified as Non-Regulated activity.

### 4.1 LESSEE

The lease activity of the lessee is a Gas Regulated Activity when the lease contract contains a regulatory lease component.

For a contract that contains a regulatory lease component and one or more additional non-regulated or non-lease components, a lessee shall allocate the consideration in the contract to each lease component on the basis of the (a) relative stand-alone price of the regulatory lease component, (b) relative stand-alone price of non-regulatory lease component and (c) the aggregate stand-alone price of the non-lease components.

Lessee shall not apply this guideline to:

- a) Regulatory Short-Term Leases; and
- b) Leases for which the Regulatory underlining asset is of low value.

When lessee does not apply this guideline, then lessee shall recognize the Regulatory Lease Payments associated with those leases as a Regulatory Cost of Rent and then passed to regulatory expenses of gas services.

### 4.2 LESSOR

The lease activity of the lessor is not a Gas Regulated Activity.

## **5.0 RECOGNITION**

At the Regulatory Commencement Date, a lessee shall recognize a Regulatory Right-of-use Asset and a lease liability.

## 6.0 MEASUREMENT

### 6.1 INITIAL MEASUREMENT

At the Regulatory Commencement Date, a lessee shall measure the Regulatory Right-of-Use Asset at Regulatory Cost.

The Regulatory Cost of the Regulatory Right-of-Use Asset shall comprise, *in accordance with the regulation set by Gas Sector Regulator*:

- (a) the amount of the initial measurement of the lease liability,
- (b) any lease payment made at or before the commencement date, less any lease incentives received;
- (c) any initial direct cost incurred by the lessee; and

an estimate of costs to be incurred by the lessee in dismantling and removing the underlying asset, restoring the site on which it is located or restoring the underlying asset to the condition required by the terms and conditions of the lease, unless those costs are incurred to produce inventories. The lessee incurs the obligation for those costs either at the commencement date or as a consequence of having used the underlying asset during a particular period.

### 6.2 SUBSEQUENT MEASUREMENT OF THE REGULATORY RIGHT-OF-USE ASSET

After the commencement date, a lessee shall measure the Regulatory Right-of-use Asset applying a cost model only.

To apply a cost model, a lessee shall measure the Regulatory Right-of-Use asset at cost:

- (a) less any Regulatory Accumulated Depreciation and any Regulatory Accumulated Impairment; and
- (b) adjusted for any remeasurement of the lease liability specified in paragraph 36(c) IFRS 16 *in accordance with the regulation set by Gas Sector Regulator*.

*If in accordance with the regulation set by Gas Sector Regulator* the lease transfers ownership of the underlying asset to the lessee by the end of the lease term, the lessee shall depreciate the Regulatory Right-of-use Asset from the commencement date to the end of the Regulatory Useful Life of the Regulatory Underlining Asset. Otherwise, the lessee shall depreciate the Regulatory Right-of-Use Asset from the commencement date to the earlier of the end of the Regulatory Useful Life or the Regulatory Right-of-use Asset or the end of the lease term.

A lessee shall apply the depreciation requirements in IAS 16 “Property, Plant and Equipment” and special Guideline of Gas Sector Regulator relating to “Property, Plant and Equipment” in depreciating the Regulatory Right-of-Use Asset.

A lessee shall recognize other measurement models as Non-Regulated activity. If a regulated company for any reason chooses to use other model, it shall recognize the cost model part of measurement in regulatory accounts and the difference in non-regulated accounts of correspondent regulatory activity.

### 6.3 LEASE MODIFICATION

Lessee shall apply the approaches stated in this Guideline for Regulatory Right-of-use Assets to the cases described in IFRS 16 for Lease modification.

## 7.0 PRESENTATION IN USOA

### 7.1 STATEMENT OF FINANCIAL POSITION

A lessee shall:

- (a) include Regulatory Right-of-Use Asset within the same line item as that within which the corresponding underlying assets would be presented if they were owned; and
- (b) disclose which line item in the statement of financial position include those Regulatory Right-of-use Assets.

A lessee shall use Account Class 2100 with following structure:

Class	Account	Regulatory	Activity
2100	10 Land	2 Gas Regulated Activity	[Reserve] Transmission / Transportation Distribution Supply Storage 9 Other
	20 Construction in progress		
	30 Buildings		
	40 Construction		
	50 Machinery and Equipment		
	55 Transferring Asset		
	57 Contribution and Grants		
	60 Office Equipment		
	70 Furniture and fixtures		
	80 Vehicles		
	85 Instruments and Other Long-Term Tangible Assets in Operation		
	95 Long-Term Tangible Assets Not in Operation (in warehouse)		

**A lessee shall disclose which line item in the statement of financial position include the liabilities of Regulatory Lease.**

A lessee shall register Lease Liability using following accounts:

Class	Account	Regulatory	Activity
4100	30 Obligations under finance leases	2 Gas Regulated Activity	1 [Reserve] 2 Transmission / Transportation 3 Distribution 4 Supply 5 Storage 9 Other

### 7.2 STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

In the statement of Profit or Loss and other comprehensive income, a lessee shall present interest expense on the lease liability separately from the Regulatory depreciation charge for the Regulatory Right-of-use Asset as a component of finance cost.

Class	Account	Regulatory	Activity
8200	12 Interest Expense: Lease	2 Gas Regulated Activity	1 [Reserve] 2 Transmission / Transportation 3 Distribution 4 Supply 5 Storage 9 Other

8212.2	INTEREST EXPENSE, LEASE: GAS REGULATED ACTIVITY
8212.21	INTEREST EXPENSE, LEASE, GAS REGULATED ACTIVITY: [RESERVE]
8212.22	INTEREST EXPENSE, LEASE, GAS REGULATED ACTIVITY: TRANSMISSION / TRANSPORTATION
8212.221	INTEREST EXPENSE, LEASE, GAS REGULATED ACTIVITY, TRANSMISSION / TRANSPORTATION: MORE THAN 2.5 MPA
8212.222	INTEREST EXPENSE, LEASE, GAS REGULATED ACTIVITY, TRANSMISSION /

	TRANSPORTATION, 1.2 – 2.5 MPA
8212.223	INTEREST EXPENSE, LEASE, GAS REGULATED ACTIVITY, TRANSMISSION / TRANSPORTATION: LESS THAN 1.2 MPA
8212.228	INTEREST EXPENSE, LEASE, GAS REGULATED ACTIVITY, TRANSMISSION / TRANSPORTATION: TECHNICAL SERVICES
8212.229	INTEREST EXPENSE, LEASE, GAS REGULATED ACTIVITY, TRANSMISSION / TRANSPORTATION: OTHER
8212.23	INTEREST EXPENSE, LEASE, GAS REGULATED ACTIVITY: DISTRIBUTION
8212.231	INTEREST EXPENSE, LEASE, GAS REGULATED ACTIVITY, DISTRIBUTION: 0,3 – 1.2 MPA
8212.232	INTEREST EXPENSE, LEASE, GAS REGULATED ACTIVITY, DISTRIBUTION: 0.005 – 0.3 MPA
8212.233	INTEREST EXPENSE, LEASE, GAS REGULATED ACTIVITY, DISTRIBUTION: LESS THAN 0.005 MPA
8212.238	INTEREST EXPENSE, LEASE, GAS REGULATED ACTIVITY, DISTRIBUTION: TECHNICAL SERVICES
8212.239	INTEREST EXPENSE, LEASE, GAS REGULATED ACTIVITY, DISTRIBUTION: OTHER
8212.24	INTEREST EXPENSE, LEASE, GAS REGULATED ACTIVITY: SUPPLY
8212.25	INTEREST EXPENSE, LEASE, GAS REGULATED ACTIVITY: STORAGE
8212.29	INTEREST EXPENSE, LEASE, GAS REGULATED ACTIVITY: OTHER
8212.9	INTEREST EXPENSE, LEASE: NON-REGULATED ACTIVITY

### 7.3 STATEMENT OF CASH FLOW

There is no special regulatory treatment on presentation in the Statement of Cash Flow other than described in IFRS 16.

## 8.0 DISCLOSURE

A Regulated Gas Market Company shall report in accordance with the reporting forms adopted by the Regulator.

A Regulated Gas Market Company shall disclose:

- (a) The accounting policies adopted for the recognition of Regulated Lease, including the methods adopted for metering and billing if it is not set by the Regulator;
- (b) The depreciation charge for Regulatory Right-of-use Assets by class of Regulatory Underlying Asset if it is not set by the Regulator.
- (c) Regulatory Interest expense on Regulatory Lease liabilities.

## 9.0 CASE STUDY

### 9.1 INITIATION

#### 9.1.1 SITUATION

*Company A* and *Company B* are operating in Gas Regulated Sector. *Company A* takes a transmission / transportation asset for the 10 years rent from *Company B* for operation. The rent contract states that *Company A* shall pay to *Company B* GEL 60,000,000 per year. There is no interest rate stated in the lease contract. Lessee's incremental borrowing rate is 18%.

There is no special assignments of Regulator.

#### 9.1.2 TESTS: RECOGNITIONS AND MEASUREMENTS

##### Test 1. Is it a lease contract?

Yes, the **contract conveys the right to control the use of an identified asset for a period of time**, IFRS 16:9, 16:B9-B33.

##### Test 2. Is it a short term or low value lease?

No, lease contract is for 9 years.

##### Test 3. Parties of lease agreement as Regulatory parties of the contract.

*Company A* is a Lessee. Leasing activity of *Company A* is under Regulation and shall use the Regulatory Accounts set by Regulator.

*Company B* is a Lessor. Leasing activity of *Company B* is not under regulation and, thus, company shall use Non-Regulatory Accounts. (*Company B* for our case is operating under Regulation, thus it shall use the Regulatory Accounts for other activity, but not for financial events as lessor.)

##### Test 4. Components of underlying assets

Lessee shall be able to break-down the underlying assets by classes and groups to be compliant with the break-down of Fixed Assets in USoA. (Lessee shall be able to breakdown to provide evidence of contract fairness.)

For our case we simplified the case to one financial position item: TRANSFERRING ASSETS, GAS REGULATED ACTIVITY, TRANSMISSION / TRANSPORTATION, MORE THAN 2.5 MPA: GAS MAINS

##### Test 5. Value of the Right-of-use Asset.

Right-of-use Asset equals to Discounted Lease liability.

Step 1: GEL 60,000,000/year for 10 years = GEL 600,000,000.

Step 2: Discount Rate can be either *interest rate implicit in the lease* if that rate can be readily determined or *lessee's incremental borrowing rate* if interest rate cannot be determined readily in the contract. There is no interest rate For our case let's have: Lessee's incremental borrowing rate as 18%

Step 3: Discounted Lease Liability is GEL 269,645,178.

$$DLL = Rent \times \left[ \frac{1 - (1 + r)^{-n}}{r} \right]$$

Where DLL = Discounted Lease Liability;  
Rent = Rent payment for a period;  
r = discount rate = interest rate implicit in the lease or incremental borrowing rate for a period;  
n = number of payment periods

PV	A	r	n
\$ 269,645,178	\$ 60,000,000	18%	10

Step 4: Right-of-use Asset equals GEL 269,645,178.

### 9.1.3 INITIAL ENTRIES: PRESENTATION OF FINANCIAL POSITIONS

Initial Entries Description of event	Debit Account	Credit Account	Debit Amount	Credit Amount
Initial Presentation of Regulatory Right-of-use Asset	2155.2211		269,645,178	
Initial Presentation of Discounted Lease Liability		4130.221		269,645,178
Transaction Balance			269,645,178	269,645,178

## 9.2 FURTHER IMPROVEMENTS: YEAR 1

### 9.2.1 SITUATION

*Company A* operates leased asset. Additional expenditures were made on leased asset for GEL 200,000, where GEL 80,000 paid to workers making repair of that asset and GEL 120,000 used for materials for that repair.

### 9.2.2 TESTS: RECOGNITIONS AND MEASUREMENTS

#### Test 1. Lease improvement vs. Operation and Maintenance Cost?

*Company A* shall test the expenditures on leased asset whether it is a cost of an additional asset (lease improvement) or current operation and maintenance. The test shall be based on criteria described in IAS 16 "Property, Plant and Equipment" and Regulatory guideline "Property, Plant & Equipment".

For our case, we take that GEL 200,000 was spend for maintenance of leased asset.

#### Test 2. Regulatory treatment of Operation and Maintenance Cost

There is no special restriction of regulation on measurement of this maintenance cost of leased asset.

Thus, the whole amount will be presented as Regulatory Maintenance Cost.

#### Test 3. Depreciation of the Right-of-use Asset

*Company A* shall depreciate the Right-of-use asset using the least of periods: term of lease and useful life of underlying asset.

The Cost of Right-of-use Asset is 269,645,178.

Lease term is 10 years.

Thus, Depreciation of Right-of-use Asset is GEL 269,645,178 / 10 years = GELL 26,964,517.8 / year.

#### Test 4. Financing Expense

*Company A* shall recognize the financing expense as part of rent payment.

Financing Expense is the discounting rate applied to carrying amount of Discounted Lease Liability.

For the year 1:

Discounted Lease Liability is GEL 269,645,178

Discounted Rate is equal to *incremental borrowing rate* 18%.

Financing cost (expense) is GEL 269,645,178 x 18% = GEL 48,536,132



### 9.2.3 PRESENTATION OF FINANCIAL PERFORMANCE

Maintenance Cost Description of event	Debit Account	Credit Account	Debit Amount	Credit Amount
Accrued cost for payroll	7100.22121		80,000	
Accrued cost for materials	7100.22122		120,000	
Accrued liability for payroll		3130		80,000
Accrued liability for materials		3110		120,000
Transaction Balance			200,000	200,000

Depreciation Cost Description of event	Debit Account	Credit Account	Debit Amount	Credit Amount
Regulated Depreciation of asset in operation	7100.22118		26,964,518	
Regulated Right-of-use Asset		2155.2211		26,964,518
Transaction Balance			26,964,518	26,964,518

Financing Cost Description of event	Debit Account	Credit Account	Debit Amount	Credit Amount
Regulatory Financial expense	8212.22		48,536,132	
Accrued liability to pay for interest		3410		48,536,132
Transaction Balance			48,536,132	48,536,132

### 9.2.4 PRESENTATION OF FINANCIAL POSITIONS

Lease Payment Description of event	Debit Account	Credit Account	Debit Amount	Credit Amount
Decrease of Lease Liability	4130.221		11,463,868	
Accrued liability to pay for interest	3410		48,536,132	
Cash Payment for Lease		1200		60,000,000
Transaction Balance			60,000,000	60,000,000

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