IFRS Accounting

Staff paper

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IASB® meeting

Date	**April 2024**
Project	**Rate-regulated Activities**
Topic	**Discounting of future cash flows—Minimum interest rate**
Contacts	Siok Mun Leong (smleong@ifrs.org) Mariela Isern (misern@ifrs.org)

Objective

1. This paper sets out staff analysis and recommendations on the proposals dealing with minimum interest rate in paragraphs 50–53 of the Exposure Draft *Regulatory Assets and Regulatory Liabilities* (Exposure Draft).

Staff recommendations

2. The staff recommend that the final Accounting Standard:

   (a) retain the proposals in paragraphs 50–52 of the Exposure Draft that require an entity to assess whether there is any indication that the regulatory interest rate for a regulatory asset may be insufficient and to use the minimum interest rate as the discount rate if it is higher than that regulatory interest rate.

   (b) clarify in the application guidance that an entity performing the assessment in paragraph (a) need not calculate the minimum interest rate for that regulatory asset or undertake an exhaustive search for indications.

   (c) retain the proposal in paragraph 53 of the Exposure Draft that requires an entity to use the regulatory interest rate as the discount rate for a regulatory liability in all circumstances.

(d) provide guidance on the estimation of the minimum interest rate that incorporates the principles used in other IFRS Accounting Standards.

(e) exempt an entity from applying the proposed requirements on minimum interest rate to a regulatory asset that arises from variances between estimated and actual costs or volume. The entity would apply the proposals once the regulator determines the final variance balance to be included in future regulated rates.

(f) require an entity that elects to apply the exemption in paragraph (e) to disclose this fact and the carrying amount of regulatory assets at the end of the reporting period to which the entity has applied this exemption.

Structure of the paper

3. This paper is structured as follows:

   (a) proposals in the Exposure Draft (paragraphs 5–9);

   (b) feedback (paragraphs 10–14); and

   (c) staff analysis (paragraphs 15–69).

4. The appendix to this paper contains feedback on the topics analysed in this paper from:

   (a) the Consultative Group for Rate Regulation (the Consultative Group); and

   (b) European stakeholders primarily at a meeting of a European standard-setter.

Proposals in the Exposure Draft

5. Paragraphs 50–51 of the Exposure Draft propose that on initial recognition of a regulatory asset:

   (a) an entity assesses whether there is any indication that the regulatory interest rate for the regulatory asset may be insufficient to compensate the entity for the time value of money and for uncertainty in the amount and timing of the future cash flows arising from the regulatory asset.

(b) if there are indications that the regulatory interest rate may be insufficient, the entity:

  (i) estimates the minimum interest rate sufficient to provide that compensation; and

  (ii) uses, as the discount rate, the higher of the regulatory interest rate and that minimum interest rate.

6. Paragraph 52 of the Exposure Draft provides examples of situations in which there may be such indications.

7. The Exposure Draft also proposes that if the regulatory agreement changes the regulatory interest rate subsequently, the entity applies the requirements in paragraphs 50–52 at the date of that subsequent change. The entity determines the minimum interest rate to reflect conditions existing at the date of the change in the regulatory interest rate.[1]

8. The Basis for Conclusions accompanying the Exposure Draft explains that if the regulatory agreement does not provide sufficient compensation for the time lag until recovery of a regulatory asset, the regulatory agreement is, in effect, disallowing part of the related allowable expense. When an entity uses the minimum interest rate as the discount rate, the entity reduces the carrying amount of the regulatory asset. The difference between that reduced carrying amount and the amount of the related allowable expense reflects, in effect, the disallowance of part of that expense. However, the IASB concluded that situations in which the regulatory interest rate for a regulatory asset is insufficient are expected to occur infrequently. This is because regulated rates are typically designed to support entities' financial viability.[2]

9. To avoid unnecessary cost and complexity, the Exposure Draft does not propose requiring an entity to assess whether the regulatory interest rate for a regulatory liability is sufficient.[3] Instead, paragraph 53 of the Exposure Draft proposes that an

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[1] Paragraph 58 of the Exposure Draft.

[2] Paragraphs BC167–BC168 of the Basis for Conclusions accompanying the Exposure Draft.

[3] Paragraphs BC169–BC170 of the Basis for Conclusions accompanying the Exposure Draft.

entity uses the regulatory interest rate as the discount rate for a regulatory liability in all circumstances.

Feedback

10. This section is structured as follows:

    (a) the minimum interest rate proposals (paragraphs 11–13); and

    (b) suggested alternatives (paragraph 14).

The minimum interest rate proposals

11. Some respondents agreed with the proposals on minimum interest rate for regulatory assets. A few of these respondents said that this proposal strikes a balance between reflecting the terms of the regulatory agreement and providing relevant information when the regulatory interest rate is insufficient.

12. However, most respondents—including most users of financial statements—did not support the proposals. They said the complexity and costs of applying the proposals would outweigh any benefits. They explained the proposals would:

    (a) lead to implementation costs because:

        (i) in some cases, the regulatory interest rate is revised frequently—an entity would be required to reassess frequently whether the new regulatory interest rate is sufficient, and if not, determine the new minimum interest rate.

        (ii) the minimum interest rate determination may be difficult and may require significant judgements—an entity may be unable to find interest rates that it could use as a reference to determine the minimum interest rate. A few respondents asked for additional guidance on determining the minimum interest rate, including what factors should be considered.

(b) not provide useful information because:

(i) the minimum interest rate does not reflect the regulatory interest for which an entity will be compensated in accordance with the regulatory agreement.

(ii) the minimum interest rate determination can involve significant estimation uncertainty that may reduce comparability. Respondents who are users of financial statements said the information provided by applying the proposals would reduce comparability amongst entities and would be confusing for users.

(iii) an entity would reflect a loss in profit or loss even if the regulatory agreement provides the entity with an overall adequate compensation. This is because the entity would use the minimum interest rate as the discount rate to measure a regulatory asset at a lower amount than the related item of expense.

(iv) the proposal would result in an asymmetric treatment of regulatory assets and regulatory liabilities, producing outcomes that could undermine the understandability and neutrality of the resulting information.

13. A few respondents said some differences in timing may give rise to a regulatory asset in some periods and a regulatory liability in other periods. For each regulatory asset, an entity would be required to assess whether the regulatory interest rate is sufficient, and if not, determine the minimum interest rate. Moreover, the use of different discount rates for regulatory assets and regulatory liabilities would result in gains or losses that do not reflect a change in economics. Those respondents said that an entity should be exempted from discounting the future cash flows that arise from differences in timing that give rise to a regulatory asset in some periods and a regulatory liability in other periods.

Suggested alternatives

14. Respondents suggested alternatives to the minimum interest rate proposals:

    (a) many respondents suggested using the regulatory interest rate as the discount rate for all regulatory assets and regulatory liabilities in all circumstances.

    (b) a few respondents in Europe suggested using a rate similar to or closely aligned with the incremental borrowing rate in IFRS 16 *Leases* as the discount rate if the regulatory interest rate for a regulatory asset is insufficient.

    (c) a few respondents said similar requirements should be applied to regulatory liabilities, if the IASB decided to retain the minimum interest rate proposals. An accountancy body in Africa preferred using the minimum interest rate as the discount rate for all regulatory assets and regulatory liabilities, if the regulatory agreement does not update the regulatory interest rates with sufficient regularity to reflect prevailing economic conditions.

    (d) an accounting firm suggested assessing the sufficiency of regulatory interest rates at the regulatory agreement level, similar to the approach in IFRS 15 *Revenue from Contracts with Customers* to assess onerous contracts with customers in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

Staff analysis

15. This section is structured as follows:

    (a) the minimum interest rate proposals (paragraphs 16–52);

    (b) additional guidance (paragraphs 53–60); and

    (c) specific relief (paragraphs 61–69).

The minimum interest rate proposals

16. Most respondents—including most users of financial statements—did not support the proposals (paragraphs 12–13). Many respondents suggested using the regulatory interest rate as the discount rate for all regulatory assets and regulatory liabilities (paragraph 14(a)).

17. To help us understand the feedback on the Exposure Draft, we obtained input from members of the Consultative Group.[4] Most members of the Consultative Group who commented suggested removing the proposals on minimum interest rate. These members supported using the regulatory interest rate as specified in the regulatory agreement. The appendix contains feedback on these proposals from the Consultative Group.

18. Our analysis is structured as follows:

    (a) benefits and costs of applying the minimum interest rate proposals (paragraphs 19–27);

    (b) clarifying how the minimum interest rate proposals would be applied (paragraphs 28–34);

    (c) asymmetric treatment of regulatory liabilities (paragraphs 35–50); and

    (d) conclusion (paragraphs 51–52).

Benefits and costs of applying the minimum interest rate proposals

19. When developing the discount rate proposals, the IASB could have required entities to use a discount rate that reflects the characteristics of the future cash flows. However, the IASB concluded that the objective of the Exposure Draft could be met without requiring the usual level of precision required by IFRS Accounting Standards.[5] Consequently, the IASB proposed that an entity use the regulatory interest rate as the discount rate.

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4 Agenda Paper 2 discussed at the Consultative Group meeting in October 2023 and the meeting summary.

5 Paragraphs BC163–BC164 of the Basis for Conclusions accompanying the Exposure Draft.

20. However, the IASB concluded that using the regulatory interest rate as the discount rate would not always be appropriate. When developing the minimum interest rate proposals, the IASB:

    (a) considered that if a regulatory agreement does not provide sufficient compensation for the time value of money and for uncertainty in the future cash flows arising from a regulatory asset, the regulatory agreement is, in effect, disallowing part of the related allowable expense (paragraph 8).

    (b) expected situations in which the regulatory interest rate for a regulatory asset is insufficient to occur infrequently (paragraph 8). This is because regulated rates are typically designed to support entities' financial viability.

21. We think the minimum interest rate proposals would be consistent with the discount rates that entities are required to use in cash-flow-based measurement techniques when applying other IFRS Accounting Standards (paragraph 19). We also think the IASB's rationale behind the minimum interest rate proposals in paragraph 20(a) still holds. If the minimum interest rate is higher than the regulatory interest rate for a regulatory asset, the regulator is, in effect, disallowing the recovery of part of the related allowable expense. Reducing the carrying amount of the regulatory asset to reflect this partial disallowance would result in useful information.

22. A few users of financial statements said significant uncertainty in the estimation of the minimum interest rate would result in information that would reduce comparability (paragraph 12(b)(ii)). We acknowledge that entities would need to apply judgment to estimate the minimum interest rate. However, other IFRS Accounting Standards require an entity to estimate the discount rate used in the measurement of an asset or a liability (paragraph 56). The level of judgement required to estimate the minimum interest rate is similar to that required in those other Accounting Standards. Consequently, we think the minimum interest rate would not result in less comparable information than other discount rates required in IFRS Accounting Standards.

23. Respondents who disagreed with the minimum interest rate proposals raised significant concerns about the costs of applying those proposals. Since the Exposure Draft was issued, we learnt that regulatory agreements typically provide regulatory

returns on the regulatory capital base but do not specify a regulatory interest rate for individual regulatory assets and regulatory liabilities in many jurisdictions. Therefore, we think the proposals may affect a larger population of regulatory assets than initially expected (paragraph 20(b)).

24. We think the costs of applying the minimum interest rate proposals could be partially relieved by:

(a) specific exemptions from discounting that the IASB tentatively decided in March 2024 (paragraphs 25–27).

(b) a specific relief from the minimum interest rate proposals (paragraphs 61–69).

25. In March 2024, the IASB tentatively decided to exempt an entity from discounting the cash flows that arise from a regulatory asset or regulatory liability:

(a) if the entity expects the period between recognition of that regulatory asset or regulatory liability and its recovery or fulfilment to be 12 months or less; or

(b) for the period between recognition of that regulatory asset or regulatory liability and when regulatory interest starts to accrue, if the entity expects that period to be 12 months or less.[6]

26. If an entity elects to apply any of the exemptions in paragraph 25 to a regulatory asset, then the entity would not apply the proposals on minimum interest rate to that regulatory asset during the period the exemption is applied. This is because the minimum interest rate proposals would be irrelevant for a measurement that does not involve discounting of future cash flows.

27. In the case of a regulatory asset that has a time lag between recognition and when regulatory interest starts to accrue, the entity would apply the minimum interest rate proposals to that regulatory asset only once regulatory interest starts to accrue.

[6] Agenda Paper 9A discussed at the March 2024 IASB meeting.

How the minimum interest rate proposals would be applied

28. Paragraph 50 of the Exposure Draft proposes that on initial recognition of a regulatory asset an entity assesses whether there is *any indication* that the regulatory interest rate for a regulatory asset may be insufficient. Paragraph 52 provides examples of such indications.

29. A few respondents suggested introducing a rebuttable presumption that the regulatory interest rate is sufficient, unless indications to the contrary are present. Based on the concerns raised by respondents, they might have read the proposal in paragraph 50 of the Exposure Draft to require entities to undertake an exhaustive search for indicators or a quantitative assessment of whether the regulatory interest rate may be insufficient using comparable interest rates.

30. This was not the IASB's intention when it developed the minimum interest rate proposals. When developing the minimum interest rate proposals, the IASB expected that in most cases the regulatory interest rate for a regulator asset would be sufficient to provide compensation at least for the time value of money and for the uncertainty in future cash flows arising from that regulatory asset. That expectation was underpinned by an understanding that regulated rates are typically designed to support entities' financial viability.[7] We think respondents might not have read the proposals in paragraphs 50 and 52 of the Exposure Draft together with the IASB's expectations explained in the Basis for Conclusions.

31. Considering the matters in paragraph 30, we think the IASB intended that an entity need not:

    (a) calculate the minimum interest rate for a regulatory asset in all circumstances but rather only needs to assess whether there is *any indication* that the regulatory interest rate may be insufficient. In some cases, it will be straight forward to conclude there is no indication. For example, if the regulatory interest rate is revised frequently to reflect changes in market interest rates, we

[7] Paragraphs BC163(d) and BC167 of the Basis for Conclusions accompanying the Exposure Draft.

expect that an entity would be able to conclude there is no indication that the regulatory interest rate may be insufficient without a detailed assessment (paragraph 12(a)(i)).

(b) undertake an exhaustive search for indications that the regulatory interest rate may be insufficient. This is consistent with how entities apply other principles-based requirements in IFRS Accounting Standards.[8]

32. We also think there is little practical difference between the proposals and the rebuttable presumption that regulatory interest rates are sufficient suggested by respondents in paragraph 29. Applying the proposals, an entity would be able to conclude in most cases that there was no indication that the regulatory interest rates might be insufficient (paragraph 30). If there was a rebuttable presumption, an entity would still need to consider whether there is evidence the presumption should be rebutted.

33. In response to the concerns raised by respondents, we think the understanding of the proposals in paragraphs 50 and 52 of the Exposure Draft would be enhanced if the IASB's intention underlying those proposals was clarified in the application guidance of the final Standard.

34. We recommend the final Accounting Standard clarify in the application guidance that, in assessing whether there is any indication that the regulatory interest rate for a regulatory asset may be insufficient, an entity need not calculate the minimum interest rate for that regulatory asset or undertake an exhaustive search for indications.

Asymmetric treatment of regulatory liabilities

35. Table 1 shows the economic effects of a regulatory interest rate. It illustrates that:

(a) an economic loss arises if the regulatory interest rate is:

[8] For example, paragraph 17 of IFRS 13 *Fair Value Measurement* states 'An entity need not undertake an exhaustive search of all possible markets to identify the principal market or, in the absence of a principal market, the most advantageous market, but it shall take into account all information that is reasonably available'.

(i) insufficient for a regulatory asset—that is, lower than a rate that compensates an entity for the time value of money and for the uncertainty in the future cash flows; or

(ii) excessive for a regulatory liability—that is, higher than a rate that charges an entity for the time value of money and for the uncertainty in the future cash flows; and

(b) an economic gain arises if the regulatory interest rate is:

(i) excessive for a regulatory asset; or

(ii) insufficient for a regulatory liability.

Table 1—Economic effects of regulatory interest

	Regulatory interest rate < time value of money and uncertainties in the cash flows (insufficient regulatory interest rate)	**Regulatory interest rate > time value of money and uncertainties in the cash flows** (excessive regulatory interest rate)
Regulatory assets	*Loss*	Gain
Regulatory liabilities	Gain	Loss

36. The proposals deal with only economic losses arising from regulatory assets with an *insufficient* regulatory interest rate (circled in red in Table 1). Applying the minimum interest rate proposals, an entity would reflect those economic losses *immediately* by recognising lower amounts of regulatory assets and regulatory income than the entity would have recognised using the regulatory interest rate as the discount rate. In the case of regulatory assets with an *excessive* regulatory interest rate and all regulatory liabilities (grey cells in Table 1), the entity would measure them using the regulatory interest rate as the discount rate. The entity would reflect:

(a) the economic gains arising from an excessive regulatory interest rate on a regulatory asset by recognising higher regulatory interest income *over time*—that is, over the life of the regulatory asset.

(b) the economic gains (losses) arising from an insufficient (excessive) regulatory interest rate on a regulatory liability by recognising lower (higher) regulatory interest expense *over time*—that is, over the life of the regulatory liability.

37. Many respondents who disagreed with the minimum interest rate proposals noted that, applying the proposals, an entity would reflect a loss on recognition of regulatory assets with an insufficient regulatory interest rate:

(a) even if the regulatory agreement provides the entity with an overall adequate compensation (paragraph 12(b)(iii)); and

(b) even though the entity would not reflect any gain on recognition of regulatory liabilities with an insufficient regulatory interest rate (paragraph 36(b)).[9]

38. Some respondents were concerned about the asymmetric treatment of regulatory assets and regulatory liabilities proposed in the Exposure Draft (paragraph 12(b)(iv)). A few respondents suggested the final Standard require symmetric treatment for regulatory liabilities if the IASB decided to retain the minimum interest rate proposals (paragraph 14(c)). An accounting firm suggested assessing the sufficiency of regulatory interest rates at the regulatory agreement level (paragraph 14(d)).

39. We acknowledge that applying the minimum interest rate proposals may not always provide more useful information than using the regulatory interest rate as the discount rate. For example, regulators typically determine regulated rates so that an entity is sufficiently compensated even if individual regulatory assets do not attract a regulatory interest rate that is sufficient. In addition, an entity applying the proposals would not recognise any offsetting gains arising from regulatory assets with an excessive regulatory interest rate or regulatory liabilities with an insufficient regulatory interest rate (paragraphs 36(a)–(b)).

[9] Agenda Paper 9F discussed at the October 2021 IASB meeting.

40. We consider approaches suggested by respondents in paragraph 38, namely:

    (a) symmetric treatment for regulatory liabilities (paragraphs 41–46); and

    (b) assessing sufficiency of regulatory interest rates at the regulatory agreement level (paragraphs 47–49).

Symmetric treatment

41. Respondents were unclear what they meant when they referred to symmetric treatment for regulatory liabilities. Table 1 illustrates the economic effects of regulatory interest rates charged on regulatory liabilities. A few respondents commented explicitly that an entity should be required to assess whether the regulatory interest rate charged on a regulatory liability is *excessive*. In that case, an entity would reflect the economic loss immediately by recognising higher amounts of regulatory liability and regulatory expense than the entity would have recognised using the regulatory interest rate. However, some respondents provided comments implying that when a regulatory interest rate charged to a regulatory liability is *insufficient*, an entity should be required to reflect the economic gain immediately by recognising lower amounts of regulatory liability and regulatory expense to offset the lower regulatory income recognised on regulatory assets that attract an insufficient regulatory interest rate.

42. The IASB did not propose that an entity assess whether the regulatory interest rate for a regulatory liability is excessive. This is because the IASB expected an entity would be unlikely to be subject to an excessive regulatory interest rate on a large overall net regulatory liability position. Instead, the IASB considered that an excessive regulatory interest rate on a regulatory liability may merely offset an excessive regulatory interest rate on a larger regulatory asset, so that the regulatory interest rate sufficiently compensates the entity for an overall net regulatory asset position.[10]

[10] Paragraph BC169 of the Basis for Conclusions accompanying the Exposure Draft.

43. We think the IASB's considerations still hold. Based on feedback on the minimum interest rate proposals and from the survey on the direct (no direct) relationship concept, we expect only a limited population of regulatory liabilities would have an excessive regulatory interest rate. Such regulatory liabilities would mainly arise from regulatory compensation for capitalised borrowing costs a regulator provides during the construction of an asset, if an entity's regulatory capital base has a direct relationship with its property, plant and equipment.[11, 12] This situation, however, was only identified in very few surveys. We think introducing specific requirements for a limited population of regulatory liabilities with an excessive regulatory interest rate would add complexity to the model.

44. The IASB also did not propose to require an entity to estimate an interest rate that is sufficient to charge the entity for the time value of money and uncertainty if the regulatory interest rate for a regulatory liability is lower than that rate. Such a treatment would lead to lower amounts of regulatory liability and regulatory expense on *initial recognition* of that regulatory liability. Consequently, the treatment of such regulatory liabilities would give rise to an asymmetry with regulatory assets that receive an excessive regulatory interest rate, even though their regulatory interest rates have similar economic effects (circled in blue in Table 1). For those regulatory assets, the entity would recognise higher regulatory interest income *over time* rather than higher regulatory income at initial recognition.

45. In conclusion, we think that a requirement for entities to assess whether the regulatory interest rate for a regulatory liability is excessive or insufficient would add complexity to the model for little benefit.

46. Consequently, we recommend the final Accounting Standard retain the proposal that requires an entity to use the regulatory interest rate as the discount rate for a regulatory liability in all circumstances.

[11] Agenda Paper 9A discussed at the October 2023 IASB meeting.

[12] In cases of direct relationship, the recovery period of the regulatory capital base is often closely aligned with the assets' useful lives. Consequently, regulatory assets or regulatory liabilities might not arise.

Assessing sufficiency at the regulatory agreement level

47. An accounting firm suggested using an approach similar to the requirements in IFRS 15. IFRS 15 requires an entity to assess whether contracts with customers are onerous in accordance with IAS 37, rather than to assess whether performance obligations in contracts with customers are onerous.

48. IAS 37 requires an entity to recognise a provision for an onerous contract. An onerous contract is a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. IAS 37 also requires the entity to recognise any impairment loss that has occurred on assets used in fulfilling the contract before a separate provision for an onerous contract is established.

49. An entity is required to apply IAS 37 to assess whether a regulatory agreement is onerous. A regulatory agreement creates rights and obligations beyond regulatory assets and regulatory liabilities. In many cases, a regulatory agreement would not be onerous even if an entity does not receive sufficient regulatory interest rates on its regulatory assets (paragraph 20(b)). Therefore, we think the requirements for onerous contracts in IAS 37 cannot be a substitute for the minimum interest rate proposals. We think this would be consistent with the requirements in IFRS Accounting Standards to recognise impairment losses for assets related to a contract before the entity establishes any provision if that contract is onerous.[13]

50. Based on our analysis in paragraphs 41–49, we think the approaches suggested by respondents are likely to add complexity to the model and to involve more estimation uncertainty than the minimum interest rate proposals. Those approaches may also provide less useful information than the proposals.

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[13] For example, paragraph 103 of IFRS 15 and paragraph 69 of IAS 37.

Conclusion

51. On balance, we recommend that the final Accounting Standard:

(a) retain the proposals in paragraphs 50–52 of the Exposure Draft that require an entity to assess whether there is any indication that the regulatory interest rate for a regulatory asset may be insufficient and to use the minimum interest rate as the discount rate if it is higher than that the regulatory interest rate (paragraphs 19–27 and 47–50).

(b) clarify in the application guidance that an entity performing the assessment in paragraph (a) need not calculate the minimum interest rate for that regulatory asset or undertake an exhaustive search for indications (paragraphs 28–34).

(c) retain the proposal in paragraph 53 of the Exposure Draft that requires an entity to use the regulatory interest rate as the discount rate for a regulatory liability in all circumstances (paragraphs 41–46).

52. Paragraphs 61–69 of this paper discuss a relief to address a specific situation in which applying the minimum interest rate proposals may not result in benefits that outweigh the costs.

Question for the IASB
1. Does the IASB agree with the staff recommendation in paragraph 51?

Additional guidance

53. A few respondents asked for additional guidance on determining the minimum interest rate, including what factors should be considered (paragraph 12(a)(ii)). These respondents did not provide a suggestion on what those factors might be.

54. The Exposure Draft describes the minimum interest rate as the rate sufficient to provide compensation for the time value of money and for uncertainty in the amount and timing of the future cash flows arising from a regulatory asset.

55. The Exposure Draft does not contain specific guidance on how an entity would determine the minimum interest rate for a regulatory asset. Instead, paragraph 52 of the Exposure Draft provides examples of situations in which there may be indications that the regulatory interest rate for a regulatory asset may be insufficient.

56. IFRS Accounting Standards generally:

(a) require discount rates used in cash-flow-based measurement techniques to reflect the characteristics of estimated cash flows. Based on the description of the minimum interest rate, we think the key features of the future cash flows that an entity would consider in determining the minimum interest rate for a regulatory asset would be the currency in which the regulatory asset is denominated, the maturity profile and the uncertainties in the future cash flows.

(b) explain the need for internal consistency between inputs used in cash-flow-based measurement techniques. To avoid double-counting the effects of assumptions, the minimum interest rate should not reflect risks for which the future cash flows have been adjusted, for example an estimate of the uncollectible amounts in the case of the entity bearing credit risk.[14]

57. A few respondents suggested a closer alignment of the minimum interest rate with the incremental borrowing rate in IFRS 16 (paragraph 14(b)). IFRS 16 defines a lessee's incremental borrowing rate as:

> The rate of interest that a lessee would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment.

58. We think the principles used in other IFRS Accounting Standards would help an entity to estimate the minimum interest rate for a regulatory asset. For example, the IASB noted that a lessee may be able to refer to a readily observable rate as a starting point and to adjust such an observable rate as the lessee deems needed to determine its

[14] Agenda Paper 9A discussed at the September 2023 IASB meeting.

incremental borrowing rate for a lease as defined in IFRS 16.[15] Similarly, if a regulatory agreement does not specify a regulatory interest rate for a regulatory asset, an entity may estimate the minimum interest rate by using the interest rates for other assets as a starting point and adjusting that initial reference rate to reflect only the characteristics of future cash flows arising from the regulatory asset.

59. In conclusion, we think entities would benefit from guidance on the estimation of the minimum interest rate that incorporates the principles used in other IFRS Accounting Standards as described in paragraphs 56 and 58.

60. Therefore, we recommend that the final Accounting Standard provide guidance on the estimation of the minimum interest rate that incorporates the principles used in other IFRS Accounting Standards.

Question for the IASB
2. Does the IASB agree with the staff recommendation in paragraph 60?

Specific relief

61. Some differences in timing give rise to regulatory assets in some periods and regulatory liabilities in other periods until the regulator determines the amount to be added to or deducted from future regulated rates. As mentioned in paragraph 13, a few respondents said applying the minimum interest rate proposals to such regulatory assets would be costly and would not provide useful information.

62. A few respondents and members of the Consultative Group said differences in timing of the type described in paragraph 61 may arise from, for example:

    (a) variances between estimated and actual costs or volume that arise during a specified period, which is generally short. The final variance balance for that period would be included in regulated rates in a future period. In relation to

[15] Paragraph BC162 of the Basis for Conclusions on IFRS 16.

cost variances, these costs are generally non-controllable in nature and can be very volatile. An example of such costs are fuel costs. These items—costs or volume—give rise to frequent changes between positive variances and negative variances and can be significant.

(b) performance incentives that assess an entity's performance over several reporting periods. The entity's performance would give rise to either a bonus or a penalty for a performance period. In some cases, the entity's performance may be subject to significant uncertainty and may result in changes between a bonus and a penalty over the performance period. In other cases, however, the entity's performance may be more certain and may result in a bonus or a penalty for several reporting periods within the performance period. The significance of performance incentives can vary.

63. We agree with the concerns raised by the respondents about applying the minimum interest rate proposals in the case of differences in timing that often fluctuate between being a regulatory asset and being a regulatory liability (paragraph 13). Regulatory assets and regulatory liabilities that arise from these differences in timing typically do not attract regulatory interest until the regulator determines the final amount to be included in future regulated rates. Therefore:

(a) each time a regulatory asset arises, an entity would be required to estimate the minimum interest rate and perform detailed discounting computations. Consequently, the entity would need to perform recurring calculations and continued tracking to unwind the discount.

(b) the entity would determine the discount rate for regulatory assets to be the minimum interest rate and for regulatory liabilities to be zero interest rate. The use of different discount rates for regulatory assets and regulatory liabilities would result in recurring gains or losses that do not reflect a change in economics.

64. We think the IASB could consider exempting an entity from applying the proposed requirements on minimum interest rate to a regulatory asset that arises from variances between estimated and actual costs or volume. The entity would apply the proposals

once the regulator determines the final variance balance to be included in future regulated rates.

65. Applying the exemption in paragraph 64, an entity would use the regulatory interest rate as the discount rate for regulatory assets that may arise from those differences in timing even if the regulatory interest rate is zero, until the regulator determines the final variance balance to be included in future regulated rates. This would result in symmetric treatment for regulatory assets and regulatory liabilities that arise from fluctuations between positive variances and negative variances.

66. We think this targeted exemption would alleviate concerns raised by respondents while providing useful information. In the case of differences in timing related to cost and volume variances (paragraph 62(a)), the frequent fluctuations mean the effects of the time value of money are unlikely to be significant relative to future cash flows in most cases. Moreover, the regulator typically determines the final variance balance for these items within a short period of time and this limits the timeframe for applying the exemption.

67. However, we think the exemption should not be extended to differences in timing related to incentives that assess an entity's performance over several reporting periods (paragraph 62(b)). This is because only some performance incentives are subject to significant uncertainty and may change between a bonus and a penalty. In some other cases, an entity has a degree of certainty about its performance and may expect a bonus or a penalty for several reporting periods within a performance period. For this type of performance incentives, we expect fewer concerns about the minimum interest rate proposals being costly to apply and not providing useful information.

68. If an entity applies the exemption, the entity needs to provide disclosures to help users of financial statements to understand the effects of applying the exemption. We think the following disclosures would be useful:

    (a) the fact that the entity has elected to apply the exemption; and

    (b) the amount of regulatory assets at the end of the reporting period to which the entity has applied this exemption.

69. Therefore, we recommend that the final Accounting Standard:

   (a) exempt an entity from applying the proposed requirements on minimum interest rate to a regulatory asset that arises from variances between estimated and actual costs or volume. The entity would apply the proposals once the regulator determines the final balance to be included in future regulated rates.

   (b) require an entity that elects to apply the exemption in paragraph (a) to disclose this fact and the carrying amount of regulatory assets at the end of the reporting period to which the entity has applied this exemption.

Question for the IASB
3. Does the IASB agree with the staff recommendation in paragraph 69?

Appendix—Feedback from the Consultative Group and other stakeholders

A1. This appendix contains:

(a) extracts from the summary of the meeting of the Consultative Group held on 13 October 2023 relating to the matters analysed in this paper.[16]

(b) inputs on those matters from European stakeholders at a meeting of a European standard-setter and from subsequent outreach with specific stakeholders.

A2. Paragraphs 8–12 of the summary of the Consultative Group meeting follow.

Minimum interest rate

8. CGRR members discussed:

(a) circumstances in which the regulatory interest rate for a regulatory asset may be insufficient to compensate an entity for the time value of money and uncertainty in the amount and timing of future cash flows;

(b) circumstances in which differences in timing give rise to a regulatory asset in some periods and a regulatory liability in others; and

(c) possible alternatives to the minimum interest rate proposals.

9. A member said in Canada, there are few regulatory assets with regulatory interest rates that may be insufficient. However, another member from an accounting firm said there is a lack of information about how common and significant regulatory assets with insufficient regulatory interest rates may be because entities do not currently collect the information. Such regulatory assets may arise, for example, if the regulatory interest rate is not reset in response to changes in market interest rates. This member said in determining whether a regulatory interest rate is sufficient, an entity could consider the market interest rates or the frequency with which the

[16] The meeting summary and the material discussed with the Consultative Group can be found on the IFRS Foundation website.

regulatory interest rate is reset. This would, however, require entities to put in place processes to track these changes.

10. A member said in Canada, differences in timing that give rise to a regulatory asset in some periods and a regulatory liability in others often arise from costs recovered on a pass-through basis. These passthrough balances may be significant and can regularly change between regulatory assets and regulatory liabilities, often within months.

11. A member, a user of financial statements, said applying the minimum interest rate proposals would result in less understandable information than using the regulatory interest rate as the discount rate. Such information would not reflect regulatory interest rates specified by regulatory agreements and comparable outcomes for regulatory assets and regulatory liabilities.

12. All members who commented supported removing the minimum interest rate proposals. A few members said they would not rule out an alternative of restricting the proposals to some long-term regulatory assets. These members acknowledged that the effects of time value of money could be significant for those regulatory assets, however, it would be difficult to define the regulatory assets to which the proposals should apply.

A3. The feedback from European stakeholders is largely similar to the feedback from the Consultative Group. However, a few stakeholders acknowledged that using a regulatory interest rate that is insufficient as the discount rate might be inappropriate especially for long-life regulatory assets. The stakeholders also said:

(a) it is uncommon that regulatory assets attract a regulatory interest rate that is insufficient.

(b) in France, there are differences in timing that give rise to regulatory assets in some periods and regulatory liabilities in other periods. The regulatory agreements specify a regulatory interest rate for those regulatory assets and regulatory liabilities but do not specify a timeframe for their recovery or fulfilment.