Staff paper

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IASB® meeting

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Project	**Rate-regulated Activities**
Topic	**Sweep issues**
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Objective

1. This paper sets out staff analysis and recommendations on sweep issues identified during the drafting of the Accounting Standard *Regulatory Assets and Regulatory Liabilities* (the prospective Accounting Standard).

Staff recommendations

2. The staff recommend that the prospective Accounting Standard:

   (a) include no requirements for a minimum interest rate;

   (b) include a requirement for an entity to disaggregate the quantitative information, using time bands, about when it expects to recover regulatory assets and fulfil regulatory liabilities between regulatory assets and regulatory liabilities for which the regulatory agreement:

      (i) provides or charges a regulatory interest rate; and

      (ii) does not provide or charge a regulatory interest rate;

   (c) include a requirement for an entity to disaggregate the quantitative information in (b) using reasonable and consistent assumptions; and

(d) clarify that assumptions about market variables used in the estimates of future cash flows:

(i) should be consistent with observable market prices at the measurement date; and

(ii) should not include any effects of possible changes in market variables in the future.

3. The staff also recommend that the prospective Accounting Standard:

(a) include no requirement for an entity to disclose whether it receives regulatory returns on an asset not yet available for use;

(b) include a requirement for the quantitative information about when an entity expects to recover regulatory assets and fulfil regulatory liabilities to be provided using undiscounted amounts; and

(c) include transitional requirements for interim financial statements as set out in paragraph C14.

Structure of the paper

4. The main body of the paper addresses questions about an exemption from discounting that applies in specific circumstances, and is structured as follows:

(a) the exemption from discounting in specified circumstances and questions raised on its drafting (paragraphs 7–10);

(b) overview of possible approaches and staff recommendations (paragraphs 11–21);

(c) detailed information about the minimum interest rate requirements (paragraphs 22–30); and

(d) detailed information about the possible approaches considered (paragraphs 31–54).

5. Appendix A and Appendix B set out examples that are used to illustrate the difficulties for estimating future cash flows.

6. Appendix C sets out other minor sweep issues and a question for the IASB on those issues.

The exemption from discounting in specified circumstances and questions raised on its drafting

7. In July 2024, the IASB tentatively decided to exempt an entity from discounting the estimates of future cash flows arising from a regulatory asset or regulatory liability in specified circumstances.[1] The circumstances are when:

   (a) the regulatory asset or regulatory liability arises from an item of expense or income that (i) is related to liabilities or assets measured on a present value basis and (ii) affects regulated rates on an accrual basis (so does not qualify for the alternative measurement approach available when an item of expense or income is included in regulated rates only when an entity pays or receives the related cash); and

   (b) the entity is unable to estimate the amount and timing of the future cash flows having considered all reasonable and supportable information that is available without undue cost or effort.

8. The staff developed the following drafting for the exemption:

> An entity need not discount the estimated future cash flows arising from a regulatory asset or regulatory liability if the regulatory asset or regulatory liability arises from an item of expense or income that relates to a liability or an asset that is measured on a present value basis applying IFRS Accounting Standards and:

[1] Agenda Paper 9A discussed at the IASB meeting in July 2024. IASB Update July 2024.

(a) a regulatory agreement treats the item of expense or income as allowable or chargeable in determining the regulated rates for a period based on the related expense or income the entity would have recognised in that period by applying either IFRS Accounting Standards or another accounting framework used to prepare financial statements; and

(b) the entity is unable to estimate the amount and timing of the future cash flows, having considered all reasonable and supportable information that is available without undue cost or effort.

9. Some IASB members said the drafting of the exemption was difficult to understand and raised questions about the intended scope of the exemption, in particular:

(a) when an entity might be unable to estimate the amount and timing of the future cash flows based on all reasonable and supportable information that is available without undue cost or effort; and

(b) how these difficulties in estimating future cash flows compare with the difficulties entities might encounter when measuring assets and liabilities applying other IFRS Accounting Standards.

10. The IASB members observed that, based on the IASB discussion in July 2024, the scope was intended to be limited, but that is not necessarily clear from the drafting in paragraph 8.

Overview of possible approaches and staff recommendations

11. The examples the IASB considered in Agenda Paper 9A discussed in July 2024 related to regulatory assets or regulatory liabilities arising from compensation for pension costs. The estimates of future cash flows in such examples depend on assumptions about:

(a) the variables that affect the future cash flows, which comprise market variables (for example interest rates) and non-market variables (for example the future size of the workforce)[2]; and

(b) which future cash flows recover the regulatory asset or fulfil the regulatory liability that exists at the measurement date, rather than arise from expected future changes in the regulatory asset or regulatory liability existing at the measurement date.

12. The staff have identified a clarification about the assumptions relating to market variables that would significantly reduce the difficulty in estimating the future cash flows (see paragraphs 35–36). Nonetheless, challenges would remain relating to assumptions about non-market variables and assumptions about which future cash flows recover the regulatory asset or fulfil the regulatory liability that exists at the measurement date. This would mean that either additional guidance would be required to enable an entity to estimate the amount and timing of future cash flows or an exemption from discounting would continue to be required. Such additional guidance or such an exemption would be complex and difficult for the IASB to develop and for entities to apply.

13. Given the complexity of addressing the questions about the exemption from discounting, the staff have explored other ways of approaching the need to do something about the situations the exemption was intended to address. These other approaches relate to the minimum interest rate requirements.

14. The minimum interest rate requirements apply to regulatory assets that attract a regulatory interest rate that provides insufficient compensation for the time value of money and for uncertainty in the future cash flows. The requirements and feedback on these requirements are discussed in paragraphs 22–28.

[2] The examples were simplified so that the only difference between local GAAP and IFRS Accounting Standards was the discount rate used to measure the pension liability (market variable). However, there may be multiple differences in the requirements between local GAAP and IFRS Accounting Standards (including differences related to non-market variables), resulting in measurements of the pension liability that are significantly different.

15. The minimum interest rate requirements would typically apply to the regulatory assets to which the IASB intended the exemption from discounting set out in paragraph 8 to apply. This is because the regulatory interest rate that regulatory agreements specify for these regulatory assets is typically 0%. If the minimum interest rate requirements did not apply, no exemption would be necessary because an entity would be required to use the regulatory interest rate specified in the regulatory agreement as the discount rate. The entity would use the regulatory interest rate to discount the estimated future cash flows including the cash flows for the regulatory interest (which in this case are typically nil). Such discounting has the same outcome as not discounting the estimated future cash flows excluding the cash flows for the regulatory interest that has not yet accrued (which in this case are typically nil). Accordingly, when the discount rate is the regulatory interest rate specified in the regulatory agreement, an entity does not need to estimate the timing of the non-interest future cash flows, and does not need an exemption from discounting them.

16. Given this, the staff considered whether the questions about the exemption from discounting in paragraph 8 could be addressed by amending the minimum interest rate requirements. The staff considered three approaches (in addition to developing a replacement for the existing exemption):

    (a) extending the exemption relating to the minimum interest rate requirements that the IASB tentatively decided in April 2024;[3]

    (b) removing the minimum interest rate requirements except in a few specified circumstances; or

    (c) removing the minimum interest rate requirements completely.

17. In considering these approaches to amending the minimum interest rate requirements, the staff bore in mind:

[3] IASB Update April 2024.

(a) the minimum interest rate requirements have been part of the package of requirements for a long time. They were in the Exposure Draft *Regulatory Assets and Regulatory Liabilities* (Exposure Draft). The reasons for them are discussed in paragraphs 22–26.

(b) most stakeholders (including users of financial statements) are opposed to the requirements. The reasons for that opposition are discussed in paragraph 27.

(c) the minimum interest rate requirements add substantial complexity to the prospective Accounting Standard (see paragraph 29).

18. The following table sets out the advantages and disadvantages of the approaches considered by the staff.

Approach		**Advantages**	**Disadvantages**
1	Retain the minimum interest rate requirements unchanged, and develop a replacement for the existing exemption from discounting or add guidance on estimating future cash flows (see paragraphs 31–40).	Least change to the IASB's tentative decisions to date.	Additional guidance would add further complexity to the requirements.
2	Remove the exemption from discounting and instead extend the existing exemption from the minimum interest rate requirements (see paragraphs 41–43).	Retaining the minimum interest rate requirements would be perceived as less of a change at this stage in the project.	Extending the scope of the exemption from the minimum interest rate requirements may add complexity to those requirements. It might also raise a question about the costs and benefits of the requirements.

Approach		Advantages	Disadvantages
3	Remove the minimum interest rate requirements, except in a few specified circumstances (see paragraphs 44–48).	Removes substantial complexity of applying the prospective Accounting Standard, except in the few specified circumstances.	Retains complexity of the minimum interest rate requirements in the prospective Accounting Standard. Involves development of new requirements to specify the circumstances in which the minimum interest rate requirements apply, which might also be complex. There is also the risk of missing circumstances in which the minimum interest rate requirements should apply. Further, as with approach 2, it might raise a question about the costs and benefits of the minimum interest rate requirements.

Approach		Advantages	Disadvantages
4	Remove the minimum interest rate requirements completely (see paragraphs 49–54).	Removes substantial complexity from the prospective Accounting Standard. The change would be supported by the many stakeholders (including users of financial statements) who disagree with the minimum interest rate requirements.	Creates a risk of overstatement of regulatory assets. However, additional disclosures could mitigate the effect of loss of information resulting from any such overstatement. It would be a significant change at a late stage in the project.

19. Given the reduction in complexity that would result from the removal of the minimum interest rate requirements, and given we think we can mitigate the effect of loss of information resulting from their removal by including additional disclosure requirements, the staff recommend Approach 4 to the IASB (paragraphs 49–54). This approach will mean that the prospective Accounting Standard:

(a) includes no requirements for a minimum interest rate;

(b) includes a requirement for an entity to disaggregate the quantitative information, using time bands, about when it expects to recover regulatory assets and fulfil regulatory liabilities between regulatory assets and regulatory liabilities for which the regulatory agreement:

(i) provides or charges a regulatory interest rate; and

(ii) does not provide or charge a regulatory interest rate; and

(c) includes a requirement for an entity to disaggregate the quantitative information in (b) using reasonable and consistent assumptions.

20. As discussed in paragraphs 35–36, the staff also recommend the Standard clarify that assumptions about market variables used in the estimates of future cash flows:

(a) should be consistent with observable market prices at the measurement date; and

(b) should not include any effects of possible changes in market variables in the future.

Question for the IASB
1. Does the IASB agree with the staff recommendations in paragraphs 19–20?

21. The following sections provide:

(a) detailed information about the minimum interest rate requirements (see paragraphs 22–29);

(b) analysis of the possible approaches to addressing the questions on the exemption from discounting described in paragraph 8:

(i) Approach 1—retain the minimum interest rate requirements unchanged, and develop a replacement for the exemption from discounting or add guidance on estimating future cash flows (see paragraphs 31–40);

(ii) Approach 2—remove the exemption from discounting and instead extend the existing exemption from the minimum interest rate requirements (see paragraphs 41–43);

(iii) Approach 3—remove the minimum interest rate requirements, except in a few specified circumstances (see paragraphs 44–48); or

(iv) Approach 4—remove the minimum interest rate requirements completely (see paragraphs 49–54).

Detailed information about the minimum interest rate requirements

22. The minimum interest rate requirements apply only to discounting the estimates of future cash flows arising from regulatory assets. According to these requirements:

    (a) an entity should assess whether there is any indication that the regulatory interest rate for a regulatory asset might 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; and

    (b) if there is any indication that the regulatory interest rate may be insufficient, the entity should estimate the minimum interest rate sufficient to provide that compensation and use as the discount rate the higher of that rate and the regulatory interest rate.

23. When the IASB published the Exposure Draft, it expected that generally the regulatory interest rate provided on regulatory assets would be sufficient to compensate the entity for the time value of money and for uncertainty in the amount and timing of the estimated future cash flows.

24. Since the Exposure Draft was issued, we have learned that regulatory agreements in many jurisdictions provide regulatory returns on the regulatory capital base but do not specify a regulatory interest rate for individual regulatory assets and regulatory liabilities. In these cases, the regulatory returns on the regulatory capital base and other components of the regulated rates might provide an entity with an overall adequate compensation across the total population of regulatory assets. However, the model regards the individual regulatory assets as separate units of account, and hence the minimum interest rate requirements might affect a larger population of regulatory assets than initially expected. The exemption from discounting described in paragraph 8 would have affected regulatory assets in this larger population.

25. In addition, we identified limited circumstances in which the regulatory interest rate might be insufficient and the effect of not using the minimum interest rate might be significant. Those circumstances include, for example, if:

(a) an entity operates in a developing regulatory environment where regulated rates might not fully support the entity's financial viability, regulatory assets do not attract regulatory interest and there is significant uncertainty about their recovery time frame; or

(b) the regulator takes a deliberate decision to provide no regulatory interest rate or an insufficient regulatory interest rate for specific regulatory assets that might be recovered over many years—for example, regulatory assets relating to assets that have been written off.

26. In the cases described in paragraph 25, the use of the minimum interest rate prevents the overstatement of the compensation provided by the regulatory agreement and the overstatement of regulatory assets.

27. Feedback from most stakeholders (including users of financial statements and members of the Consultative Group for Rate Regulation (Consultative Group) who commented on this topic) is that the complexity and costs of applying the minimum interest rate requirements would outweigh any benefits.[4] They said these requirements 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 stakeholders asked for additional guidance on

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

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. Stakeholders 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. In this case, the entity would use the minimum interest rate as the discount rate to measure an individual regulatory asset and will recognise a loss on initial recognition of that asset, even if the agreement provides an overall adequate compensation (see paragraph 24).

(iv) the requirements 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. In particular, for differences in timing that give rise to a regulatory asset in some periods and a regulatory liability in other periods, the use of different discount rates for regulatory assets and regulatory liabilities would result in gains and losses in the period of change between asset and liability that do not reflect an economic event.

28. At the April 2024 meeting, the IASB acknowledged the concerns raised by stakeholders but tentatively decided to retain the minimum interest rate requirements.

The IASB's tentative decision was motivated by the expectation that the requirements could affect a larger population of regulatory assets than initially expected and that retaining the requirements could avoid regulatory assets from being significantly overstated. IASB members were divided on this decision, requiring the Chair to use his additional casting vote. The IASB also tentatively decided to add guidance to clarify the application of the requirements and to introduce an exemption from the requirements to alleviate some of the concerns.

29. The minimum interest rate requirements make the prospective Accounting Standard complex, both in terms of how it is drafted and how it will be applied. Removal of the minimum interest rate requirements would have the following consequences:

(a) there would be no need for an entity to assess whether the regulatory interest rate is sufficient to compensate for the time value of money and for uncertainty in the amount and timing of the estimated future cash flows.

(b) there would be no need for any guidance on how to determine the minimum interest rate, including guidance on whether adjustments for the risk that the ultimate amount or timing of future cash flows may differ from that estimate.

(c) the asymmetric treatment of regulatory assets and regulatory liabilities would be removed, thereby avoiding the recognition of a gain or loss that does not depict any economic event when a regulatory asset becomes a regulatory liability or vice versa.

(d) only one of the three exemptions from discounting tentatively decided by the IASB would be needed. The exemption described in paragraph 8 of this paper and the exemption for regulatory assets or regulatory liabilities expected to be recovered or fulfilled within one year or less would be removed (for the reason set out in paragraph 15). The prospective Accounting Standard would retain the exemption from discounting relating to uneven regulatory interest rates, which applies during the period in which regulatory interest does not start to accrue if that period is one year or less.

(e) there would be no need for any exemptions from the minimum interest rate requirements themselves.

30. Possible approaches as to whether the prospective Accounting Standard should continue to include the minimum interest rate requirements, and if so the extent to which these requirements should apply, are explored in paragraphs 31–54 of this paper. Ultimately, it is a question of whether the benefits of the information produced by retaining the minimum interest rate requirements (with exemptions, or by applying them in limited circumstances) outweighs the associated costs in terms of the complexity of the prospective Accounting Standard and its application. The staff have also considered how to mitigate the effect of removing or reducing the application of the minimum interest rate requirements by additional disclosures (see paragraphs 51–54).

Detailed information about the possible approaches considered

Approach 1: retain the minimum interest rate requirements unchanged, and develop a replacement for the exemption from discounting or add guidance on estimating future cash flows

31. The staff started by considering how to provide clarity on the scope of the exemption from discounting as described in paragraph 8. The staff considered three examples:

(a) example 1: compensation for pension expenses based on local generally accepted accounting principles (GAAP) with a two-year time lag (set out in Appendix B of AP9A July 2024);

(b) example 2: compensation for actuarial gains and losses only when they exceed a specified amount (a 'corridor') (set out in Appendix C of AP9A July 2024); and

(c) example 3: compensation for expenses relating to a decommissioning liability based on local GAAP (set out in Appendix A of this paper).

32. In each example, compensation is provided for allowable expenses an entity recognises by applying IFRS Accounting Standards. The amount the regulator includes in the regulated rate for a period is based on the amount of the expense the entity would have recognised in that period by applying local GAAP. Over the life of the pension or decommissioning liability (and related capitalised asset), the total IFRS measured expense will equal the total compensation provided through the regulated rates. Both will equal the total cash outflow for the expense. However, for individual reporting periods, the expense recognised applying local GAAP will differ from the expense recognised applying IFRS Accounting Standards. As a result, a difference in timing arises that will reverse over time.

33. To measure the regulatory asset or regulatory liability arising from the difference in timing, an entity is required to estimate the future cash flows and discount them. The future cash flows are the amounts that will be included in the regulated rates charged in future periods and those amounts comprise the reversal of the difference in timing. It is therefore necessary for an entity to estimate the pattern of the reversal of the difference in timing.

34. In the examples, there is uncertainty over the pattern of the reversal of the difference in timing. The difference in timing does not have an agreed contractual pattern of reversal. Instead, the evolution of the difference in timing will depend on the differences between the compensation (based on local GAAP) and the related expenses (based on IFRS Accounting Standards) in each individual future period (see Appendix B). In the July 2024 paper, the staff suggested that in some cases the uncertainty was such that an entity would be unable to estimate the pattern of the reversal of the difference in timing.

35. The pattern of the reversal of the difference in timing depends on assumptions about:

(a) the variables that affect the future cash flows, which comprise market variables (for example interest rates) and non-market variables (for example the future size of the workforce); and

(b) which future cash flows recover the regulatory asset or fulfil the regulatory liability that exists at the measurement date, rather than arise from expected future changes in the regulatory asset or regulatory liability existing at the measurement date.

36. When measuring assets or liabilities using discounted cash flows, other IFRS Accounting Standards (for example, IFRS 16 *Leases* and IFRS 17 *Insurance Contracts*) do not require an entity to include any effects of possible changes in market variables in the future. For example, IFRS 17 requires assumptions about market variables to be consistent with market prices at the measurement date. For consistency and clarity, the staff recommend that the prospective Accounting Standard includes the same requirement (see paragraph 20).

37. The staff considered the effect of such a requirement on the examples listed in paragraph 31. In those specific examples, the staff concluded that such a requirement would remove much of the uncertainty over the pattern of the reversal of the difference in timing. However, there could still be uncertainty about the future cash flows because of possible future changes in non-market variables. In addition, it would also be necessary to make assumptions about which future cash flows relate to the difference in timing that exists at the measurement date and which future cash flows relate to expected future changes in the difference in timing.

38. Appendix B analyses the difficulties that arise in the examples listed in paragraph 31 in making assumptions about which future cash flows relate to the difference in timing that exists at the measurement date. Across these examples, different assumptions seem to be the most appropriate. Without guidance on what assumptions to make, an entity would find it difficult to identify which future cash flows relate to the difference in timing that exists at the measurement date, and there could be a resulting lack of comparability between entities that made different assumptions.

39. The staff concluded that, even if the prospective Accounting Standard were to require assumptions about market variables to be consistent with market prices at the measurement date, there would be a need to either provide:

(a) additional requirements on which assumptions an entity should consider for identifying which future cash flows relate to the difference in timing that exists at the measurement date. The staff think that the need for these assumptions is what makes estimating the future cash flows arising from some differences in timing more difficult than estimating future cash flows as required by other IFRS Accounting Standards; or

(b) an exemption from discounting for situations in which an entity could not identify which future cash flows to discount because of the lack of the requirements described in (a).

40. Developing the additional requirements described in paragraph 39(a) is likely to be difficult and will add further complexity to the application of the prospective Accounting Standard. It might be possible to identify the most appropriate assumptions to make in any specific situation. However, it would be difficult to draft requirements that would apply consistently across all situations. Developing a well-defined and robust scope for the exemption described in paragraph 39(b) is also difficult. The scope would need to be robust to achieve the intended limited scope because entities are likely to want to be able to apply it broadly (see paragraph 27).

Approach 2: remove the exemption from discounting and instead extend the existing exemption from the minimum interest rate requirements

41. The IASB has tentatively decided to include an exemption from the minimum interest rate requirements in the prospective Accounting Standard. This exemption applies when a regulatory asset arises from variances between estimated and actual costs or volume before a regulator determines the final amount of the variance. Until the regulator determines the final amount of the variance, the cost or volume variances might change frequently between positive variances and negative variances, resulting in regulatory assets changing frequently to regulatory liabilities and vice versa. These regulatory assets or regulatory liabilities do not attract regulatory interest, so without an exemption the minimum interest rate requirements would apply.

42. The IASB could extend the exemption from the minimum interest rate requirements based on the principle of avoiding a gain or loss that does not represent any economic event. Such a principle-based approach would provide a clearer scope and make the prospective Accounting Standard less complex. An exemption from the minimum interest rate requirements would have the same outcome as an exemption from discounting (see paragraph 15). The extended scope of the minimum interest rate requirements exemption would likely cover the examples we have considered in relation to the exemption from discounting described in paragraph 8. However, the extended scope of the minimum interest rate requirements exemption might not be quite the same as the scope the IASB intended for the exemption from discounting described in paragraph 8. For example, the extended scope of the minimum interest rate requirements exemption might cover regulatory assets arising from some long-term performance incentives. Those long-term performance incentives give rise to estimated amounts that might vary significantly over the performance period, which might result in bonuses reversing and becoming penalties. Regulatory assets arising from such long-term performance incentives were not covered by the exemption from discounting described in paragraph 8.

43. Further, reducing the application of the minimum interest rate requirements calls into question the balance between the substantial complexity these requirements create and the benefits of the resulting information in potentially only limited circumstances.

Approach 3: remove the minimum interest rate requirements, except in a few specified circumstances

44. The IASB introduced the minimum interest rate requirements in the Exposure Draft to avoid an entity overstating compensation provided by a regulatory agreement and overstating regulatory assets. At that time, the IASB expected the circumstances in which the minimum interest rate requirements would apply would be limited (see paragraph 24). We have since learned that the requirements might apply to a wider set of circumstances (see paragraph 24). In those wider circumstances the regulatory interest rate applied to an individual regulatory asset might be zero, but the regulatory

rate of return on the regulatory capital base and other components of the regulated rates are likely to provide an entity with an overall adequate compensation across the total population of regulatory assets. Requiring an entity to recognise a loss for an individual regulatory asset might not be a faithful representation of the effect of the overall compensation.

45. Accordingly, the application of the minimum interest rate requirements might be better targeted at the limited circumstances identified in paragraph 25, that is when:

  (a) an entity operates in a developing regulatory environment where regulated rates might not fully support the entity's financial viability, regulatory assets do not attract regulatory interest and there is significant uncertainty about their recovery time frame; or

  (b) the regulator takes a deliberate decision to provide no regulatory interest rate or an insufficient regulatory interest rate for specific regulatory assets that might be recovered over many years—for example, regulatory assets relating to assets that have been written off.

46. Specifying limited circumstances in which the minimum interest rate requirements would apply would also make the prospective Accounting Standard easier to apply for entities that do not have such circumstances.

47. The challenge for such an approach would be to draft clearly the circumstances in which the minimum interest rate requirements would apply. For example, we would need to define or describe what is a 'developing regulatory environment', when 'regulated rates might not fully support an entity's financial viability' and what qualifies as regulatory assets that are 'recovered over many years'. The scope would need to be robust, because entities would likely want to exclude items from the minimum interest rate requirements.

48. Such an approach would also retain the complexity of the minimum interest rate requirements for those entities that have items that fell within the scope. Accordingly, as with approach 2, it calls into question the balance between the substantial

complexity these requirements create and the benefits of the resulting information in only limited circumstances.

Approach 4: remove the minimum interest rate requirements completely

49. Approaches 2 and 3 discuss resolving the questions about the exemption from discounting set out in paragraph 8 by limiting the scope of the minimum interest rate requirements. As noted in paragraphs 43 and 48, such scope limitations call into question the balance between the substantial complexity the minimum interest rate requirements create and the benefits of the resulting information in only limited circumstances.

50. The staff therefore considered whether a simpler approach, removing the minimum interest rate requirements completely, would achieve a better balance. Paragraph 29 lists the benefits of removing the requirements in terms of reduction in complexity of applying the prospective Accounting Standard. The staff have considered whether additional disclosures could mitigate the effect of removing of the minimum interest rate requirements on the information provided in the financial statements.

51. The prospective Accounting Standard could require an entity to provide information about regulatory assets and regulatory liabilities for which the regulatory agreement does not provide or charge a regulatory interest rate. For example, the IASB has already tentatively decided that the prospective Accounting Standard should require an entity to disclose quantitative information, using time bands, about when it expects to recover regulatory assets and fulfil regulatory liabilities.[5] The prospective Accounting Standard could further require that information to be disaggregated for regulatory assets and regulatory liabilities for which the regulatory agreement does not provide or charge a regulatory interest rate. Such information would help users of financial statements to understand the effects of not discounting such regulatory assets and regulatory liabilities.

[5] Paragraphs C8–C12 of Appendix C recommend that the information should be provided for undiscounted amounts.

52. The staff acknowledge that this disclosure would not capture situations in which the regulatory interest rate is more than zero but is nevertheless insufficient. However, there is no way to extend the scope of the disclosure without retaining the requirement for an entity to assess whether the regulatory interest rate is sufficient, which would bring back some of the complexity of the minimum interest rate requirements.

53. The staff would recommend including regulatory liabilities rather than just regulatory assets in this disaggregated disclosure requirement, despite the removal of the minimum interest rate requirements affecting only the measurement of regulatory assets. The effect of not discounting regulatory assets using a minimum interest rate might be offset to some extent by the effect of not discounting regulatory liabilities using such a rate. Providing information about both regulatory assets and regulatory liabilities that attract a regulatory interest rate of 0% will allow users of financial statements to understand the effect of not discounting on the net regulatory asset or regulatory liability position.

54. Paragraphs 34–38 of this paper discuss difficulties an entity might have in determining the timing of future cash flows for some regulatory assets or regulatory liabilities. The staff think those difficulties could be overcome when requiring that an entity disclose quantitative information using time bands because the precision needed is less. The prospective Accounting Standard could specify that the quantitative information should be disaggregated using reasonable and consistent assumptions.

Appendix A—Example dealing with decommissioning costs affecting regulated rates on an accrual basis based on local GAAP (Example 3 of paragraph 31)

A1. Entity A has an asset that becomes available for use on the last day of Year 1. The asset has a five-year useful life and is depreciated on a straight-line basis. The asset is measured using the cost model. Entity A has an obligation to decommission the asset at the end of Year 6. Entity A estimates it will settle the provision at the end of Year 6 for an amount of CU10,000. Entity A's regulatory capital base has a direct relationship with its property, plant and equipment.

A2. Applying IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, Entity A recognises a decommissioning provision at the end of Year 1. It measures the provision by discounting the estimated decommissioning costs of CU10,000 to its present value using a discount rate of 5% (determined by applying IAS 37). The present value of the estimated decommissioning costs is CU7,835. Applying IAS 16, Entity A recognises the present value of the decommissioning costs as part of the cost of the asset.

A3. The regulatory agreement specifies that decommissioning costs are an allowable expense. The regulatory agreement provides Entity A compensation for the decommissioning expense for a reporting period on the basis of the depreciation expense and the financing expense (unwinding of the discount) that the entity recognises in that period by applying local GAAP. At initial recognition of the decommissioning provision there are no differences between the measurement of the provision applying local GAAP and IFRS Accounting Standards. The compensation for the decommissioning expense determined for a reporting period on the basis of local GAAP is included in regulated rates charged and hence in revenue from contracts with customers (IFRS 15 revenue) in the same period.

A4. Table 1 shows the regulatory compensation for Years 2–6.

Table 1 Regulatory compensation

In CU	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Year 6**	**Total**
Present value of provision at 5%	7,835	8,227	8,638	9,070	9,524	10,000	
Unwind of the discount	-	392	411	432	454	476	**2,165**
Property, plant and equipment	7,835						
Depreciation expense	-	1,567	1,567	1,567	1,567	1,567	**7,835**
Regulatory compensation[(a)]	-	**1,959**	**1,978**	**1,999**	**2,021**	**2,043**	**10,000**

(a) Comprises both the depreciation expense and the financing expense (unwinding of the discount).

A5. Applying IFRS Accounting Standards, Entity A remeasures the provision at the end of Year 2 to reflect a change in the current market-based discount rate from 5% to 2%. The estimated decommissioning costs at the end of Year 2 remain the same. The present value of the provision at the end of Year 2 using a discount rate of 2% is CU9,238—that is CU1,011 higher than it would be using a discount rate of 5%. Consequently, applying IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities*, Entity A also increases the carrying amount of the asset by CU1,011.

A6. The remeasurement of the provision at the end of Year 2 affects the depreciation expense and the unwinding of the discount recognised in Years 3–6. For simplicity, this example assumes that the estimated decommissioning costs remain the same during Years 3–6.

A7. Local GAAP requires an entity to apply the discount rate determined at initial recognition throughout the life of the provision. Consequently, a difference in timing (a regulatory asset) arises from the compensation for decommissioning costs, as shown in Table 2, based on the assumption that interest rates remain the same during Years 3–6.

Table 2 Difference in timing (regulatory asset)						
In CU	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Year 6**	**Total**
Present value of provision at 5% [A]	8,227					
Present value of provision at 2% [B]	9,238	9,423	9,612	9,804	10,000	
Unwind of the discount	-	185	189	192	196	**762**
Difference [B] – [A]	1,011					
Regulatory compensation (IFRS 15 revenue) (see Table 1) [C]	**1,959**	**1,978**	**1,999**	**2,021**	**2,043**	**10,000**
Depreciation expense IFRS Accounting Standards	1,567	1,820	1,820	1,820	1,819	**8,846**
Unwind of the discount IFRS Accounting Standards	392	185	189	192	196	**1,154**
Total decommissioning expense IFRS Accounting Standards [D]	**1,959**	**2,005**	**2,009**	**2,012**	**2,015**	**10,000**
Difference [D] – [C]	**-**	**27**	**10**	**(9)**	**(28)**	**-**
Regulatory asset (based on undiscounted cash flows)	**-**	**27**	**37**	**28**	**-**	**-**

A8. The total amount of decommissioning expense (comprising depreciation expense and financing expense) that Entity A recognises for Years 2–6 using IFRS Accounting Standards is the same as the total IFRS 15 revenue (comprising the regulatory compensation determined using local GAAP). In other words, any differences between the regulatory compensation included in IFRS 15 revenue and the decommissioning expense recognised by applying IFRS Accounting Standards give rise to differences in timing that will reverse over time.

A9. The regulatory agreement does not specify a regulatory interest rate for regulatory assets or regulatory liabilities arising from these differences. Accordingly, the minimum interest rate requirements apply, and the entity would need to determine the pattern of the reversal of the difference in timing (the future cash flows) in order to discount those future cash flows.

A10. In this example, the only uncertainty at the end of Year 2 about the future cash flows arises from future interest rates. If interest rates are assumed to be consistent with market interest rates at the end of Year 2, the future cash flows (the reversal of the regulatory asset) will be as shown in Table 2.

A11. However, it is still necessary to decide whether the cash flows arising from the regulatory asset of CU27 in Year 3 are assumed to be:

(a) all the changes in the difference in timing—that is, CU10 in Year 4, CU(9) in Year 5 and CU(28) in Year 6; or

(b) only the changes in the difference in timing that are reversals—that is, CU(9) in Year 5 and CU(18) (consisting of 27 - 9) in Year 6.

A12. That question is discussed further in paragraphs B7–B8.

Appendix B—which future cash flows relate to the difference in timing that exists at the measurement date

B1. Paragraph 37 refers to the need for an entity to make assumptions about which future cash flows relate to the difference in timing that exists at the measurement date and which future cash flows relate to expected future changes in the difference in timing. This appendix considers such assumptions for each of the examples listed in paragraph 31.

B2. For example 1 (compensation for pension expenses based on local GAAP with a two-year time lag), the regulatory asset (based on market variables as at the measurement date) is expected to develop as shown highlighted in yellow in the following table (reproduced from Table 4 of Appendix A of AP9A July 2024):

Table 4—Difference in timing								
In CU / Years	1	2	3	4	5	6	7	Total
Amount recognised in local GAAP (Table 1)	857	924	1,008	136	75	-	-	3,000
Amount recognised in IFRS (Table 3)	901	936	992	107	64	-	-	3,000
Differences in GAAP (a)	***44***	***12***	***(16)***	***(29)***	***(11)***	***-***	***-***	***-***
Amounts included in rates charged (Table 2)	-	-	857	924	1,008	136	75	3,000
Amounts recognised in local GAAP (Table 1)	857	924	1,008	136	75	-	-	3,000
Time lag (b)	***857***	***924***	***151***	***(788)***	***(933)***	***(136)***	***(75)***	***-***
Difference in timing (a) + (b)	901	936	135	(817)	(944)	(136)	(75)	-
Regulatory asset (undiscounted)	**901**	**1,837**	**1,972**	**1,155**	**211**	**75**	**-**	**-**

B3. In the analysis of this example in AP9A July 2024, the staff suggested that an entity could assume that the regulatory asset of CU901 in Year 1 is recovered from CU857 of the regulatory compensation in Year 3 and CU44 (consisting of 901 - 857) in Year 4, that is on a first-in first-out method. This seems sensible given that the regulatory agreement specifies that the compensation for the allowable expense measured under local GAAP for Year 1 will be included in regulated rates with a two-year time lag (in Year 3). In this example, the differences arising from differences between local GAAP and IFRS Accounting Standards (that is, the row 'Differences in GAAP' in Table 4) has a pattern of reversal that is similar to the pattern of reversal of the regulatory asset illustrated in Appendix A.

B4. In example 2 (compensation for actuarial gains and losses only when they exceed a specified amount (a 'corridor')), the estimated future cash flows that relate to the regulatory asset or regulatory liability that exists at the measurement date could be based on, for example:

(a) only service to date, in which case the corridor will decrease as the benefits for service to date are paid.

(b) expectations of the effect of future service on the size of the corridor but considering only the difference in timing that exists at the measurement date, in which case the corridor could grow or remain at its current size for as long as the pension plan remains open to future service.

(c) expectations of the effect of future service on the size of the corridor and expectations of how the current difference in timing for the actuarial gains and losses might change in the future because of future changes in non-market variables.

B5. The approaches described in paragraphs B4(a) and B4(b) would require an entity to track separately the actuarial gains and losses that arise in each period, which the entity is not required to do to apply IAS 19 or the local GAAP in question.

B6. In example 3 (compensation for expenses relating to a decommissioning liability based on local GAAP), the regulatory asset (based on market variables as at the measurement date) is expected to develop as shown in the following table (see Table 2 of Appendix A):

Difference in timing						
In CU	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Year 6**	**Total**
Regulatory compensation [A]	1,959	1,978	1,999	2,021	2,043	10,000
Total decommissioning expense IFRS Accounting Standards [B]	1,959	2,005	2,009	2,012	2,015	10,000
Difference [B] – [A]	-	27	10	(9)	(28)	-
Regulatory asset	**-**	**27**	**37**	**28**	**-**	**-**

B7. In this example, if we applied a first-in first out method, the regulatory asset of CU27 in Year 3 would be regarded as recovered in full in Year 4, out of the regulatory compensation of CU1,999. However, that does not seem an appropriate assumption here. Rather, it would seem more sensible to assume that the regulatory asset of CU27 is recovered by either:

(a) cash inflows of CU9 in Year 5 and CU18 (that is, 27 - 9) in Year 6; or

(b) a cash outflow of CU10 in Year 4, and cash inflows of CU9 and CU28 in Years 5 and 6.

B8. Of the approaches described in paragraph B7, the staff think that approach (b) would probably be more appropriate. However, it might raise questions whether this approach includes as future cash flows future differences in timing (for example, CU10 in Year 4). Approach (a) identifies as future cash flows, cash flows that 'recover' the initial regulatory asset of CU27 in Year 1. However, in this example, the regulatory agreement does not specify how this regulatory asset would be recovered in regulated rates charged because differences in timing arising from differences between local GAAP and IFRS Accounting Standards are not tracked by regulators. Therefore, these differences in timing do not have an agreed contractual pattern of reversal but rather their evolution (in some periods they will increase, in others will decrease) will depend on the differences between compensation and related expenses in each individual future period.

B9. These examples illustrate that it might be possible in any specific situation to identify the most appropriate assumptions to make about which future cash flows arise from the regulatory asset that exists at the measurement date. However, it would be difficult to draft requirements that would apply consistently across all situations. And without such guidance, an entity might find it difficult to identify which future cash flows relate to the difference in timing that exists at the measurement date.

Appendix C—other sweep issues

C1. This appendix discusses three minor sweep issues identified during the drafting of the prospective Accounting Standard. It is structured as follows:

(a) disclosure of whether an entity receives regulatory returns on an asset not yet available for use (paragraphs C2–C7);

(b) disclosure of quantitative information, using time bands, about when an entity expects to recover regulatory assets or fulfil regulatory liabilities (paragraphs C8–C12); and

(c) transition requirements for interim financial statements (paragraphs C13–C14).

Disclosure of whether an entity receives regulatory returns on an asset not yet available for use

C2. Differences in timing can arise when a regulatory agreement entitles an entity to regulatory returns on an asset not yet available for use, if the entity's regulatory capital base has a direct relationship with its property, plant and equipment and the entity capitalises borrowing costs.

C3. When the IASB discussed the requirements relating to such differences in timing, IASB members asked whether additional disclosures might be necessary to help users of financial statements analyse information about regulatory returns in such circumstances.

C4. In February 2024, the staff recommended that the IASB require an entity whose regulatory capital base has a direct relationship with its property, plant and equipment and capitalises borrowing costs to disclose qualitative information about:

(a) whether it receives regulatory returns on an asset not yet available for use;

(b) whether those regulatory returns comprise both a debt and an equity return or only a debt return and whether those regulatory returns are included in regulated rates charged during the construction period or operational period of the asset; and

(c) the effect of those regulatory returns on changes in the related regulatory assets or regulatory liabilities.

C5. The IASB however thought these requirements were excessive and tentatively decided to require an entity whose regulatory capital base has a direct relationship with its property, plant and equipment and capitalises borrowing costs to disclose whether it receives regulatory returns on an asset not yet available for use but not to require the disclosures set out in paragraph C4(b)–(c).[6]

C6. When drafting the disclosure requirement set out in paragraph C4(a), the staff were unclear how a user of financial statements would use the information about regulatory returns on assets not yet available without the information described in paragraphs C4(b)–(c).

C7. Considering the reasons for the IASB's tentative decision in February 2024, on balance the staff conclude the disclosure in paragraph C4(a) is unnecessary and recommend not requiring it.

Disclosure of quantitative information, using time bands, about when an entity expects to recover regulatory assets or fulfil regulatory liabilities

C8. In February 2024, the IASB decided to retain paragraphs 80(a) and 81 of the Exposure Draft *Regulatory Assets and Regulatory Liabilities* (Exposure Draft).[7] Paragraphs 80 and 81 of the Exposure Draft state:

> 80 To achieve the objective in paragraph 79, an entity shall disclose in the notes:

[6] IASB Update February 2024.

[7] Agenda Paper 9C discussed at the IASB meeting in February 2024.

(a) quantitative information, using time bands, about when it expects to recover the regulatory assets and fulfil the regulatory liabilities.

…

81 In disclosing the information required by paragraph 80(a), an entity shall:

(a) specify whether the amounts disclosed in the notes are undiscounted or discounted.

…

C9. Considering these two paragraphs together, the Exposure Draft appears to permit an entity to provide the information required in paragraph 80(a) on either a discounted or undiscounted basis.

C10. Requiring a maturity analysis to be prepared using the same basis for all cash flows — that is, either on a discounted or undiscounted basis—provides useful information because it increases comparability between entities.

C11. The staff note that IFRS 7 *Financial Instruments: Disclosures* requires an entity to disclose maturity analyses for non-derivative financial liabilities and for derivative financial liabilities using contractual undiscounted cash flows. IFRS 7 also requires maturity analyses of the undiscounted cash outflows to repurchase transferred assets.

C12. To avoid confusion and to enhance comparability between the amounts provided by an entity and between entities, the staff recommend that the prospective Accounting Standard include a requirement for the quantitative information about when an entity expects to recover regulatory assets and fulfil regulatory liabilities to be provided using undiscounted amounts.

Transition requirements for interim financial statements

C13. In July 2024, the IASB discussed transition requirements, including whether to require the presentation or disclosure of comparative information on transition in interim financial statements. The IASB asked the staff to consider transition requirements for interim financial statements.

C14. The staff has drafted these requirements:

> C13 If an entity applies IAS 34 *Interim Financial Reporting* in preparing condensed interim financial statements in the first year of applying this Standard, the entity shall present in the condensed interim financial statements each heading and subtotal it expects to use in applying the Standard in its annual financial statements, despite the requirements in paragraph 10 of IAS 34. An entity shall apply the requirements in paragraph 10 of IAS 34 for headings and subtotals in condensed interim financial statements after it has issued its first set of annual financial statements prepared in accordance with this Standard.
>
> C14 If an entity applies IAS 34 in preparing interim financial statements in the first year of applying this Standard, the entity shall:
>
> (a) present adjusted comparative information for the comparative interim period and the cumulative comparative interim period of the immediately preceding financial year; and
>
> (b) disclose in the notes, as part of the information required by paragraph 16A(a) of IAS 34, the amounts previously presented for each line item in the financial statements for the comparative interim period and cumulative comparative interim period of the immediately preceding financial year.
>
> C15 An entity is permitted, but not required:
>
> (a) to present adjusted comparative information for any earlier comparative interim periods presented; and

(b) to disclose the information described in paragraph C14(b) for the current interim period or any earlier comparative interim periods presented.

Question for the IASB
2. Does the IASB agree with the staff recommendations in Appendix C, that the prospective Accounting Standard: a. includes no requirement for an entity to disclose whether it receives regulatory returns on an asset not yet available for use; b. includes a requirement for the quantitative information, using time bands, about when an entity expects to recover regulatory assets and fulfil regulatory liabilities to be provided using undiscounted amounts; and c. includes transitional requirements for interim financial statements as set out in paragraph C14?