
IASB[®] meeting

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Project **Rate-regulated Activities**
Topic **Inflation adjustments to the regulatory capital base**
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Objective

1. An external editorial review draft of the prospective IFRS Accounting Standard *Regulatory Assets and Regulatory Liabilities* (external review draft) was made available in June 2025 to selected stakeholders for their comment.
2. This paper analyses comments received on the treatment of inflation adjustments to an entity's regulatory capital base in the external review draft.
3. At this meeting, we will ask the IASB to redeliberate the treatment of inflation adjustments to an entity's regulatory capital base in the light of the comments received.
4. This paper does not consider the treatment of compensation for inflation unrelated to the regulatory capital base. The analysis or staff recommendation in this paper do not affect the requirements for such compensation (paragraph B61 of the external review draft in Appendix D of this paper).

Staff recommendations

5. We recommend that the final Standard:

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- (a) reflect the view that the inflation adjustment to the regulatory capital base is a mechanism to adjust the measurement of the regulatory capital base so that it holds its value over time. Applying this recommendation, entities subject to the real approach would recognise the inflation adjustment as part of the measurement of any recognised regulatory assets or regulatory liabilities arising from regulatory depreciation; and
 - (b) retain the treatment in the external review draft for the compensation for inflation, when that compensation forms part of the nominal regulatory return.

Structure of this paper

- 6. This paper sets out:
 - (a) background information (paragraphs 8–16);
 - (b) recent comments (paragraphs 17–21); and
 - (c) staff analysis (paragraphs 22–57).
- 7. This paper contains four appendices:
 - (a) Appendix A summarises the proposals in the Exposure Draft *Regulatory Assets and Regulatory Liabilities* (Exposure Draft);
 - (b) Appendix B illustrates the revenue profiles of different regulatory approaches to compensation for inflation on the regulatory capital base; and
 - (c) Appendix C is only relevant if the IASB disagrees with the staff recommendation in paragraph 47. It discusses recognition of and disclosures about regulatory assets arising from inflation adjustments to the regulatory capital base.
 - (d) Appendix D contains extracts from the external review drafts of the prospective Standard and the Basis for Conclusions that will accompany the Standard.

Background information

Proposals in the Exposure Draft and feedback received

8. The Exposure Draft proposed to treat the inflation adjustment to the regulatory capital base as a form of ‘target profit’ provided by the regulatory agreement.¹ According to the Exposure Draft, the right to add an inflation adjustment in the regulated rates to be charged to customers in future periods is not a right to recover total allowed compensation for goods or services already supplied to customers. Consequently, the Exposure Draft proposed that that adjustment did not result in a regulatory asset. Appendix A includes further details on the proposals in the Exposure Draft.
9. A few respondents to the Exposure Draft—mainly a few standard-setters in Asia-Oceania and Europe, a few accounting firms and a few preparers—disagreed with the proposals in the Exposure Draft. These respondents thought the final Standard should treat an inflation adjustment to the regulatory capital base as a regulatory asset.
10. During 2022 inflation rates rose globally. During that time some stakeholders raised concerns about the proposals in the Exposure Draft. These stakeholders also supported treating an inflation adjustment to the regulatory capital base as a regulatory asset.

Redeliberations and tentative decision

11. The IASB redeliberated the treatment of the inflation adjustment to the regulatory capital base in December 2022.² At that meeting the IASB discussed the two regulatory approaches that are typically used to compensate entities for inflation on the regulatory capital base:

¹ The Exposure Draft defined ‘target profit’ as the profit that an entity is entitled to add in determining a regulated rate.

² See [Agenda Paper 9A](#) discussed at the IASB December 2022. [Agenda Paper 9B](#) discussed at the same IASB meeting includes the summary notes from, and the material prepared for, the Consultative Group meeting on this topic.

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- (a) nominal approach—under this approach entities receive a regulatory return that is computed by multiplying a nominal regulatory capital base by a return rate that includes inflation (that is, a nominal return rate).
 - (b) real approach—under this approach entities receive a regulatory return that is computed by multiplying a regulatory capital base that is adjusted by inflation by a return rate that does not include inflation (that is, a real return rate).
12. During its redeliberations the IASB discussed two views:
- (a) View 1—The inflation adjustment to the regulatory capital base represents compensation for regulatory goods or services already supplied and, consequently, might give rise to a regulatory asset.
 - (b) View 2—The inflation adjustment to the regulatory capital base represents compensation for regulatory goods or services to be supplied in the future and, consequently, does not give rise to a regulatory asset.
13. At the December 2022 meeting, the IASB supported View 1. Following View 1:
- (a) the IASB concluded that if an entity subject to the real approach had an enforceable present right to add the inflation adjustment on the regulatory capital base to the regulated rates to be charged to customers in the future, that right met the definition of a regulatory asset.
 - (b) entities subject to the real approach would reflect compensation for inflation in profit or loss in the period inflation arises through the recognition of a regulatory asset.
14. Applying View 1, the accounting outcome would be the same for entities subject to the nominal approach and those subject to the real approach—both would reflect the compensation for inflation in the period inflation arises.³ However, the IASB concluded that the costs for entities subject to the real approach of recognising a

³ Even though View 1 would result in both entities reflecting the compensation for inflation in the period inflation arises, total allowed compensation for these entities would only coincide on initial recognition of the inflation-related regulatory asset. This is because entities subject to the real approach receive a higher amount of total revenues (see Appendix B).

regulatory asset would outweigh the benefits of recognition. Consequently, the IASB tentatively decided that the final Standard should specify that an entity is neither required nor permitted to recognise as a regulatory asset inflation adjustments to the regulatory capital base. This tentative decision applied regardless of the relationship between an entity's regulatory capital base and its property, plant and equipment.⁴

15. In practice, the IASB's tentative decision to prohibit recognition of the inflation adjustment to the regulatory capital base as a regulatory asset *would lead to different outcomes* under the two approaches:
 - (a) under the nominal approach the effect of inflation would continue to be reflected through the nominal regulatory return in profit or loss *in the period inflation arises*; and
 - (b) under the real approach the effect of inflation would be recognised in profit or loss *over time* (as and when the inflation adjustment is included in regulatory depreciation and in regulated rates charged).
16. The external review draft of the prospective Standard and the external review draft of the Basis for Conclusions incorporate the IASB's tentative decision. Appendix D includes the draft requirements and draft Basis for Conclusions.

Recent comments

17. Although no IASB members expressed support for recognising a regulatory asset for inflation adjustments to the regulatory capital base, a few IASB members commenting on the external review draft disagreed with the rationale for non-recognition provided in the draft Basis for Conclusions—they disagree that inflation adjustments to the regulatory capital base give rise to a regulatory asset.

⁴ See [IASB Update December 2022](#).

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18. These IASB members:
- (a) view the inflation adjustment to the regulatory capital base as a mechanism to adjust the measurement of the regulatory capital base so that it holds its value over time, rather than an item that gives rise to a difference in timing (a regulatory asset). In other words, the inflation adjustment should be seen as a higher amount of compensation for the items included in the regulatory capital base, that is, as a measurement difference. The model aims to account for differences in timing; it does not aim to account for the regulatory capital base or for changes in the value of the regulatory capital base.
 - (b) do not view the inflation adjustment to the regulatory capital base as compensation for regulatory goods or services already supplied; the inflation adjustment to the regulatory capital base will result in a higher amount of regulatory depreciation that the regulator will include when determining the allowed revenue to which an entity is entitled for a specified period. According to these IASB members, accounting for the inflation adjustment as a regulatory asset in the period the inflation arises would be equivalent to accounting for future revenues, to which the entity is not yet entitled.
19. The views of these IASB members would, in some circumstances, lead to different accounting outcomes to the ones an entity subject to the real approach would obtain if it applied the requirements in the external review draft (see paragraphs 24–26). These IASB members are of the view these different accounting outcomes better reflect the economics of the inflation adjustment.
20. One of these IASB members also views the compensation for inflation included in the nominal regulatory return for entities subject to the nominal approach as a measurement difference rather than as compensation for regulatory goods or services the entity has supplied in the period inflation arises (see paragraphs 51–57).
21. A European national standard-setter agrees with the conclusion in the external review draft that the inflation adjustment to the regulatory capital base is a difference in timing (regulatory asset) but is of the view that the regulatory asset should be

recognised. They argue that it is possible to track the recovery of the inflation adjustment and that the regulatory asset would not be subject to significant measurement uncertainty. Consequently, this stakeholder does not support the IASB's conclusion that the costs for entities subject to the real approach of recognising a regulatory asset would outweigh the benefits of recognition (paragraph 14). This stakeholder is of the view that if the recognition prohibition of this regulatory asset is retained, the final Standard should require additional disclosures about the inflation adjustment to the regulatory capital base (Appendix C).

Staff analysis

22. In response to IASB members' comments the staff have reconsidered which view results in accounting outcomes that best reflect the substance of an entity's rights under the regulatory agreements:
- (a) View 1 would view the inflation adjustment to the regulatory capital base as a difference in timing that gives rise to a right for compensation for regulatory goods or services supplied in the period inflation arises—that is, the inflation adjustment is part of the regulatory return for the period in which inflation arises; and
 - (b) View 2 would view the inflation adjustment as a mechanism to change the measurement of the regulatory capital base—that is, a right for higher compensation (a measurement difference) when supplying regulatory goods or services in the future.
23. We have structured the staff analysis as follows:
- (a) accounting outcomes of View 1 and View 2 (paragraphs 24–26);
 - (b) inflation adjustment to the regulatory capital base as a measurement difference (paragraphs 27–50); and
 - (c) applying View 2 to entities subject to the nominal approach (paragraphs 51–57).

Accounting outcomes of View 1 and View 2

24. Table 1 outlines View 1 and View 2 and describes the accounting outcomes under each view for entities subject to the real approach.

Table 1—Accounting outcomes
View 1—Inflation adjustment to the regulatory capital base as a difference in timing Rationale—The inflation adjustment to the regulatory capital base relates to compensation for inflation arising in a period, and is therefore deemed to be compensation for regulatory goods or services that the entity has already supplied in the period. Consequently, it is compensation to which the entity is already entitled but that the entity will receive over time. Accounting outcome—The inflation adjustment to the regulatory capital base gives rise to a regulatory asset if the entity has an enforceable present right to add the amount of the inflation adjustment in future regulated rates. The IASB's tentative decision on this topic in December 2022 supports View 1. However, the IASB's cost-benefit considerations mean the final Standard would not permit recognition of an inflation-related regulatory asset. The tentative decision applies regardless of the relationship between an entity's regulatory capital base and its property, plant and equipment (see paragraph 14).⁵
View 2—Inflation adjustment to the regulatory capital base as a measurement difference Rationale—The inflation adjustment to the regulatory capital base should be seen as a mechanism to adjust the measurement of the regulatory capital base so that it holds its value over time rather than giving rise to a separate regulatory asset. That is, the inflation adjustment will impact the compensation that an entity will receive on the items included in the regulatory capital base through the regulatory depreciation. As a result, it can be seen as a measurement difference. Accounting outcome No differences in timing arise from regulatory depreciation If there are no differences in timing arising from the regulatory depreciation, the inflation adjustment to the regulatory capital base will 'add' to the compensation the entity receives on the different items included in the regulatory capital base. In this case, the inflation adjustment would be reflected in profit or loss over time—as part of the regulatory depreciation. Differences in timing arise from regulatory depreciation If there are differences in timing arising from regulatory depreciation (for example, because the regulatory recovery period differs from the assets' useful lives), the inflation adjustment to the

⁵ The external review draft required an entity to recognise some regulatory assets and regulatory liabilities only if the entity's regulatory capital base has a direct relationship with its property, plant and equipment. Such regulatory assets and regulatory liabilities will be subject to the recognition requirements discussed in Agenda Paper 9B of this IASB meeting. Those recognition requirements are described in terms of a direct relationship between an entity's regulatory capital base and an underlying item that gives rise to amounts for which the regulatory depreciation provides or charges compensation.

Table 1—Accounting outcomes

regulatory capital base would form part of the measurement of any recognised regulatory asset or regulatory liability.

This means that:

- If there is **direct relationship** between an entity's regulatory capital base and its property, plant and equipment—the measurement of any regulatory assets and regulatory liabilities arising from regulatory depreciation would be affected by the inflation adjustment.
- If there is **no direct relationship** between an entity's regulatory capital base and its property, plant and equipment—the entity would not recognise regulatory assets and regulatory liabilities arising from regulatory depreciation. Consequently, the inflation adjustment would not be included in the measurement of recognised regulatory assets and regulatory liabilities. Instead, an entity would reflect the inflation adjustment in profit or loss over time—as and when the inflation adjustment forms part of the regulatory depreciation and regulatory depreciation is included in regulated rates charged.
- If there is **no direct relationship** but an entity **is able to track the recovery of specified items** through the regulatory depreciation of the regulatory capital base—the measurement of any regulatory assets and regulatory liabilities arising from regulatory depreciation would be affected by the inflation adjustment.

25. The following numerical example illustrates the difference between View 1 and View 2 for an entity subject to the real approach. The example assumes:
- (a) the entity's regulatory capital base has a direct relationship with its property, plant and equipment. The entity has a single item of property, plant and equipment in its regulatory capital base.
 - (b) the carrying amount of the item of property, plant and equipment at the beginning of Year 1—and the opening balance of the regulatory capital base in Year 1—is CU100.
 - (c) inflation is 0% for all years, except for Year 2 where inflation is 5%. The opening balance of the regulatory capital base in Year 2 is CU80.
 - (d) applying View 1, the entity recognises the regulatory asset arising from the inflation adjustment to the regulatory capital base in Year 2. The inflation adjustment in Year 2 is CU4 (5% × CU80). The requirements in the external review draft prohibit recognition of such a regulatory asset, this example assumes recognition of that asset for the purposes of illustrating the different accounting outcomes of View 1 and View 2.

26. We have considered two scenarios:

- (a) Scenario 1—The entity recovers the asset in 5 years, coinciding with the asset's useful life. No difference in timing arises between the allowable expense (depreciation expense) recognised and the compensation for that expense (regulatory depreciation). See Table 2.
- (b) Scenario 2—The entity recovers the asset in 5 years. However, the asset's useful life is 4 years. A difference in timing—a regulatory asset—arises between the allowable expense (depreciation expense) recognised and the compensation for that expense (regulatory depreciation). See Table 3.

Table 2—Scenario 1—Asset being recovered over 5 years, useful life 5 years						
View 1—Inflation adjustment as a regulatory asset						
	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Regulatory depreciation (cost)	20	20	20	20	20	100
Regulatory depreciation (inflation)	—	1	1	1	1	4
IFRS 15 revenue	20	21	21	21	21	104
Regulatory income (regulatory expense)	—	3	(1)	(1)	(1)	—
Revenue	20	24	20	20	20	104
Depreciation expense	(20)	(20)	(20)	(20)	(20)	(100)
Profit	—	4	—	—	—	4
Regulatory asset (inflation)	—	3	2	1	—	
View 2—Inflation adjustment as a measurement difference						
	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Regulatory depreciation (cost)	20	20	20	20	20	100
Regulatory depreciation (inflation)	—	1	1	1	1	4
IFRS 15 revenue	20	21	21	21	21	104
Depreciation expense	(20)	(20)	(20)	(20)	(20)	(100)
Profit	—	1	1	1	1	4
Inflation adjustment is treated as a measurement difference and reflected in profit or loss over time.						

Table 3—Scenario 2—Asset being recovered over 5 years, useful life 4 years

View 1—Inflation adjustment as a regulatory asset

	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Regulatory depreciation (cost)	20	20	20	20	20	100
Regulatory depreciation (inflation)	—	1	1	1	1	4
IFRS 15 revenue	20	21	21	21	21	104
Regulatory income (regulatory expense)	5	8	4	4	(21)	—
Revenue	25	29	25	25	—	104
Depreciation expense	(25)	(25)	(25)	(25)	—	(100)
Profit	—	4	—	—	—	4
Regulatory asset (depreciation expense)	5	10	15	20	—	
Regulatory asset (inflation)	—	3	2	1	—	

View 2—Inflation adjustment as a measurement difference

	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Regulatory depreciation (cost)	20	20	20	20	20	100
Regulatory depreciation (inflation)	—	1	1	1	1	4
IFRS 15 revenue	20	21	21	21	21	104
Regulatory income (regulatory expense)	5	5.3	5.3	5.3	(21)	—
Revenue	25	26.3	26.3	26.3	—	104
Depreciation expense	(25)	(25)	(25)	(25)	—	(100)
Profit	—	1.3	1.3	1.3	—	4
Regulatory asset^(a)	5	10.3	15.7	21	—	

(a) During Year 1, the entity recognised a regulatory asset of CU5, which represents part of the total allowed compensation for regulatory goods or services supplied in Year 1 that the entity will recover in Year 5. The entity will recover the inflation adjustment of CU4 arising in Year 2 through regulated rates charged over Years 2 to 5 (CU1 per year). The measurement of the regulatory asset during Years 2 to 4 increases by CU5.3. That amount includes part (one third) of the inflation adjustment that the entity will recover in Year 5 (that is, $1/3 \times \text{CU}1 = 0.3$).

Inflation adjustment to the regulatory capital base as a measurement difference

27. This section discusses whether the inflation adjustment could be considered a measurement difference (View 2). It discusses:

- (a) the appropriateness of the outcomes of View 1 (paragraphs 28–40);

- (b) operational costs of View 2 (paragraphs 41–43); and
- (c) conclusions (paragraphs 44–50).

Appropriateness of the outcomes of View 1

28. As noted in paragraph 9 and paragraph 21, a few stakeholders view the inflation adjustment to the regulatory capital base as part of the regulatory return (income) for the period—that is, as compensation for the regulatory goods or services supplied in the period inflation arises (View 1). View 1 was the view supported by the IASB in December 2022 (paragraph 13). A few IASB members however view the inflation adjustment to the regulatory capital base as a mechanism that changes the measurement of the regulatory capital base—that is, an adjustment to capital or compensation for regulatory goods or services to be supplied in the future (View 2).
29. If we leave the recognition prohibition aside, View 1 would lead to the same accounting outcomes for the real and the nominal approaches. The following paragraphs discuss whether this outcome is appropriate by considering:
- (a) the main features of the real and the nominal approaches (paragraphs 30–31);
 - (b) the recovery period of the inflation adjustments compared to the recovery period of other items (inflation adjustments to allowed revenue, performance incentives and investments in assets)—(paragraphs 32–34);
 - (c) other ways in which regulatory agreements might compensate entities for inflation (paragraph 35–36(b)); and
 - (d) the effects of the accounting for the inflation adjustment as a regulatory asset in the revenue profile of entities subject to the real approach (paragraphs 37–40).

Main features of the real and the nominal approaches

30. Table 4 describes the main features of each approach.

Table 4—Main features	
Real approach	Nominal approach
Protects entities from inflation risk ensuring entities <i>maintain the real purchasing power of their invested capital</i> . An inflation adjustment to the regulatory capital base helps create <i>higher revenue potential—that is, higher IFRS 15 revenue in the future</i> .	Ensures adequacy of the current period compensation to investors through a <i>higher regulatory return</i> . The nominal approach helps ensure investors are compensated for both the opportunity cost of capital and for <i>increases in the general price level</i> in the period these increases occur.
<i>Revenue profile over time</i>. The real approach results in smoother regulated rates for customers over time (see Appendix B). It also reduces the increase in revenues that occurs when assets are replaced at the end of their useful lives.	Investor's ability to understand the return. A nominal regulatory return is directly comparable with other financial benchmarks, particularly the nominal rate of return on other investments. Financial markets are familiar with such benchmarks.

31. Table 4 demonstrates that the features of the real approach and the nominal approach are different. Regulators seek to achieve different economic objectives when they choose between the two approaches. This would seem to support the idea that the accounting outcomes for the two approaches should reflect these differences. Under the real approach the inflation adjustment appears to be a mechanism to change the measurement of the regulatory capital base so that it holds its value over time (View 2). Under the nominal approach the inflation component of the nominal return appears to compensate the entity for the inflation arising in the period (View 1).

Recovery periods

32. The pace for recovering the investments and the added inflation adjustments to the regulatory capital base through regulatory depreciation varies amongst industries and jurisdictions—we have observed periods ranging from 15 to 45 years or longer.
33. View 1 sees the inflation adjustment of the regulatory capital base for a period as part of the regulatory return for the period. Regulatory returns for a period contribute to an entity's profitability for the period. We note the recovery periods of items that contribute to the profitability of entities for a period such as performance incentives are generally much shorter than the recovery periods of the inflation adjustments.

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34. The recovery of the inflation adjustments at a pace that is aligned with the recovery pace of the investments in the regulatory capital base provides support for View 2—that is, these adjustments provide additional compensation for investments (measurement difference) and compensate the entity for future regulatory goods or services, rather than providing compensation for regulatory goods or services already supplied.

Other ways of providing compensation for inflation

35. Regulatory agreements might also provide compensation for inflation for the current reporting period based on the expected inflation rate for that period applied to, for example, the entity's allowed revenue or specific costs for the period. Regulatory agreements might also require differences between the estimated and actual inflation rates for the current reporting period to be added or deducted in determining the regulated rates to be charged to customers in future periods. The external review draft requires differences between the estimated and actual inflation rates to be accounted for as regulatory assets and regulatory liabilities (see paragraph B61 in Appendix D).
36. We think that the nature of compensation for inflation is aligned to the nature of the underlying item to which an inflation rate is applied. For example:
- (a) compensation for inflation applied to the allowed revenue or to an expense for a period is compensation for the regulatory goods or services supplied in that period. This is aligned with how allowed revenue for a period or compensation for an allowable expense recognised in a period are treated—both are compensation for regulatory goods or services supplied in the period.
 - (b) an inflation adjustment is applied to a regulatory capital base that includes investments that will be used to supply regulatory goods or services in the future and that will be recovered over time through the regulatory depreciation. For this case, it would be appropriate to conclude that the inflation adjustment is compensation for regulatory goods or services to be supplied in the future. That conclusion is aligned with viewing the

investments in the regulatory capital base as items for which the entity will receive compensation as it supplies regulatory goods or services in the future.

Effects of the inflation-related regulatory asset on the revenue profile of entities subject to the real approach

37. Both the real approach and the nominal approach provide entities with the same amount of cash flows on a present value basis—that is, the approaches are present value neutral (see Appendix B). However, the revenue profiles of the two approaches are different. An entity subject to the real approach receives higher total amount of revenue than an entity subject to the nominal approach due to higher amounts of regulatory depreciation. An entity subject to the real approach receives higher revenues in later years compared to an entity subject to the nominal approach.
38. Present value neutrality is achieved by distributing the amounts of revenue for each approach differently, compensating entities subject to the real approach for receiving higher revenues in later years with a higher total amount of revenue.
39. Accounting for a regulatory asset related to the inflation adjustment changes the revenue profile of an entity subject to the real approach, making it similar to the revenue profile of an entity subject to the nominal approach (Figure 2 in Appendix B)—that is, earlier period revenues will be higher.
40. In other words, accounting for the inflation-related regulatory asset makes the real approach appear economically similar to the nominal approach (see Figure 2 in Appendix B).

Operational costs of View 2

41. As described in Table 1, View 2 would require an entity subject to the real approach to include the inflation adjustment as part of the measurement of regulatory assets or regulatory liabilities arising from regulatory depreciation. This would affect:
 - (a) entities whose regulatory capital base has a direct relationship with their property, plant and equipment (paragraph 42); and

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- (b) entities whose regulatory capital base does not have a direct relationship with their property, plant and equipment but for specified items, they are able to track an amount of the regulatory depreciation that provides compensation for these items (paragraph 43).
42. View 2 would mean that entities with direct relationship that have regulatory assets and regulatory liabilities arising from regulatory depreciation would be required to include the inflation adjustment as part of the measurement of these regulatory assets and regulatory liabilities. We think the operational costs of applying View 2 will vary depending on how entities currently track the inflation adjustment. However, we think the following factors mitigate these costs—based on the evidence gathered throughout the project for entities with direct relationship:
- (a) often the recovery periods and assets' useful lives are closely aligned, which means differences in timing might arise from a limited population of assets. In the case of service concession arrangements, in most cases, the recovery period of the items in the regulatory capital base related to the intangible asset coincides with the useful life of the intangible asset—that is, no differences in timing would arise.
- (b) we have observed more cases of entities subject to the nominal approach than to the real approach.
43. As described in Table 1, View 2 would also affect entities whose regulatory capital base does not have a direct relationship with their property, plant and equipment but for specified items, they are able to track an amount of the regulatory depreciation that provides compensation for these items. That would be the case, for example, if recovery of specified items in the regulatory capital base is being monitored by the regulator separately. We have encountered only a few cases of entities in this situation. We have asked one of these entities whether they would be able to allocate the inflation adjustment to regulatory assets or regulatory liabilities arising from these specified items and a preliminary assessment indicates they would be able to do so.

Conclusions

44. Overall, the analysis in paragraphs 28–40 provides support for viewing the inflation adjustment to the regulatory capital base as a mechanism to adjust the measurement of the regulatory capital base so that it holds its value over time (View 2). The inflation adjustment provides compensation for future regulatory goods or services (View 2) rather than for regulatory goods or services already supplied (View 1). Consequently, the analysis supports the accounting outcomes for entities subject to the nominal approach to be different from the accounting outcomes for entities subject to the real approach:
- (a) the main features of the real approach and the nominal approach are different.
 - (b) the long recovery periods of the inflation adjustments are aligned to the recovery periods of the investments included in the regulatory capital base. This supports the view that compensation for inflation is for future regulatory goods or services, similar to the amounts of regulatory depreciation that compensate for depreciation expense.
 - (c) the nature of the compensation for inflation provided through an adjustment to the regulatory capital base that includes long-term investments is different from the nature of the compensation for inflation that is applied to an entity's allowed revenue or allowable expenses for a period. This supports viewing the inflation adjustment as compensation for future regulatory goods or services.
45. The analysis also shows that recognising the inflation adjustment as a regulatory asset makes the real approach *appear* economically similar to the nominal approach. However, the differences in the main features of the two approaches indicate their economics are different.
46. We acknowledge View 2 might give rise to some operational costs (see paragraphs 41–43). However, we think these costs are moderate, would arise only in limited number of situations and would not outweigh the benefits.

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47. Consequently, we recommend that the final Standard reflect the view that the inflation adjustment to the regulatory capital base is a mechanism to adjust the measurement of the regulatory capital base so that it holds its value over time.
48. If the IASB agrees with this recommendation, for entities subject to the real approach the inflation adjustment to the regulatory capital base would be recognised:
- (a) over time as part of the regulatory depreciation of the regulatory capital base (see Table 1) when:
 - (i) there are no differences in timing arising from regulatory depreciation, regardless of the type of relationship between an entity's regulatory capital base and its property, plant and equipment—there would be no difference between this outcome and the outcome the entity would obtain applying the requirements in the external review draft; or
 - (ii) there are differences in timing arising from regulatory depreciation but an entity's regulatory capital base does not have a direct relationship with its property, plant and equipment—there would be no difference between this outcome and the outcome the entity would obtain applying the requirements in the external review draft.
 - (b) as part of the measurement of regulatory assets or regulatory liabilities arising from regulatory depreciation (see Table 1), when an entity's regulatory capital base:
 - (i) has a direct relationship with its property, plant and equipment. Applying the requirements in the external review draft, the measurement of any regulatory assets or regulatory liabilities arising from regulatory depreciation would not be affected by the inflation adjustment; or
 - (ii) does not have a direct relationship with its property, plant and equipment but for specified items, the entity is able to track an amount of the regulatory depreciation that provides compensation for these

items. The outcome that would be obtained by applying the requirements in the external review draft is described in (i).

49. Table 5 summarises the accounting outcome resulting from the staff recommendation in paragraph 47 for the inflation adjustment to the regulatory capital base under the real approach.

Table 5—Summary of accounting treatment of inflation adjustment to the regulatory capital base	
Over time as part of regulatory depreciation	There are no differences in timing arising from regulatory depreciation, regardless of the type of relationship.
	There are differences in timing arising from regulatory depreciation but there is no direct relationship.
Part of the measurement of a regulatory asset/ regulatory liability (arising from regulatory depreciation)	Direct relationship.
	No direct relationship but an entity is able to track the recovery of specified items through the regulatory depreciation of the regulatory capital base.

50. If the IASB does not agree with this recommendation, Appendix C discusses whether the IASB wishes to retain the recognition prohibition for regulatory assets arising from the inflation adjustment.

Question 1 for the IASB

Does the IASB agree with the staff recommendation in paragraph 47?

Applying View 2 to entities subject to the nominal approach

51. Under the nominal approach, compensation for inflation would be included in the nominal regulatory return. Applying the requirements in the external review draft, an entity subject to the nominal approach would account for the compensation for inflation as part of regulatory returns—that is, regulatory returns would form part of the total allowed compensation for the period in which the regulatory agreement entitles an entity to apply a rate of return to the regulatory capital base. Consequently,

- an entity subject to the nominal approach would reflect the compensation for inflation in the nominal return in profit or loss in the period in which the regulatory agreement entitles the entity to apply the nominal return to the regulatory capital base.
52. Under View 2, the inflation adjustment to the regulatory capital base is regarded as a measurement difference—that is, an additional amount of compensation for the items included in the regulatory capital base that will be included in regulated rates as part of the regulatory depreciation and reflected in profit or loss over time.
53. As mentioned in paragraph 20, an IASB member supports View 2 being applied to entities subject to the nominal approach.
54. Our recommendation in paragraph 47 is based on the premise that the real approach and the nominal approach have different economic features that warrant different accounting outcomes. Applying View 2 to entities subject to the nominal approach would result in similar accounting outcomes under the two approaches, triggering similar concerns to those discussed in paragraphs 28–40.
55. In addition, we think applying View 2 to entities subject to the nominal approach would be costly. It would require entities to:
- (a) strip out the basis points within the nominal regulatory return that relate to inflation; and
 - (b) allocate the resulting regulatory liability to the different items in the regulatory capital base so that the regulatory liability is fulfilled over time.
56. Apart from the cost of applying View 2 to entities subject to the nominal approach, we think treating inflation as part of the regulatory return when entities are subject to the nominal approach is appropriate and aligned with the main features of that approach (see Table 4). In the nominal approach the regulator deliberately defines the return after inflation—that is, on a nominal basis. Therefore the requirement of the external review draft to treat the inflation component of the nominal return using the same requirements for regulatory returns appears appropriate.

-
57. Consequently, we recommend the final Standard retain the treatment in the external review draft for the compensation for inflation when that compensation forms part of the nominal regulatory return.

Question 2 for the IASB

Does the IASB agree with the staff recommendation in paragraph 57?

Appendix A—Proposals in the Exposure Draft

- A1. This Appendix outlines the proposals in the Exposure Draft.
- A2. The Exposure Draft explains that an entity's regulatory capital base can include items that are not necessarily recognised applying IFRS Accounting Standards and assets that are measured on a basis that is different from the basis required by IFRS Accounting Standards. For example, the regulatory capital base may include an inflation adjustment (paragraph B13). The Exposure Draft treats the inflation adjustment to the regulatory capital base as a form of target profit provided by the regulatory agreement (paragraphs B10 and B14).
- A3. The definition of target profit and paragraphs B10, B13 and B14 in the Exposure Draft are shown below.

target profit The profit that an entity is entitled to add in determining a regulated rate.

...

Target profit

- B10 Target profit that a regulatory agreement entitles an entity to add in determining a regulated rate for goods or services supplied in a period forms part of the total allowed compensation for goods or services supplied in the same period, unless this section specifies a different treatment (see paragraphs B12, B15 and B17).

...

Regulatory returns

- B13 A significant component of an entity's target profit often consists of regulatory returns. Regulatory agreements typically determine the regulatory return for a period by specifying a return rate and a base to which that return rate applies. Common terms for such a base are 'regulatory capital base' or 'regulatory asset base', although other terms are also used. Some regulatory agreements specify more than one base, each with its own return rate. The items for which amounts are included in such a base are not necessarily recognised as assets or liabilities applying IFRS Standards, and a regulatory agreement does not necessarily measure assets or liabilities on the same basis as IFRS Standards. For example, the regulatory capital base might measure property, plant and equipment on a basis including an allocation of administrative overheads recognised as an

expense by applying IAS 16, or including an inflation adjustment not reflected in an entity's financial statements prepared by applying IFRS Standards.

B14 Applying the guidance for target profit set out in paragraph B10, if the regulatory agreement entitles an entity to add regulatory returns in determining a regulated rate for goods or services supplied in a period, those regulatory returns form part of the total allowed compensation for goods or services supplied in the same period, except as specified in paragraph B15.

A4. Illustrative example 7C.2 in the Illustrative Examples accompanying the Exposure Draft is shown below. According to this example, an entity's right to add an inflation adjustment in the regulated rates to be charged to customers in future periods does not meet the definition of a regulatory asset. The footnote to Illustrative example 7C.2 explains that two approaches are typically used to compensate entities for inflation. It says that neither approach results in a regulatory asset.

Example 7C Examples of circumstances that give rise to neither regulatory assets nor regulatory liabilities		
	Fact pattern	Analysis
7C.2	A regulatory agreement adjusts the regulatory capital base in the current period for inflation, giving an entity the right to add an inflation adjustment in determining the regulated rates to be charged to customers in future periods.	The inflation adjustment is a form of target profit provided by the regulatory agreement. Applying the requirements of paragraph B10 of the [draft] Standard, target profit forms part of total allowed compensation for goods or services to be supplied in the periods when the regulatory agreement entitles the entity to add that amount of target profit in determining the regulated rates to be charged to customers — which in this example will be only in future periods. The right to add an amount reflecting the inflation adjustment in determining the regulated rates to be charged to customers in a future period is not a right to recover total allowed compensation for goods or services already supplied to customers. Consequently, that right does not meet the definition of a regulatory asset.⁶

⁶ Two broadly equivalent approaches are typically used to compensate entities for inflation. Some regulatory agreements include inflation in a nominal return rate and apply it to a nominal base (such as the regulatory capital base). Others adjust a base such as the regulatory capital base for inflation and apply to it a real return rate excluding inflation. Neither approach results in a regulatory asset.

Appendix B—Revenue profiles of nominal and real approaches

- B1. [Agenda Paper 9A](#) discussed in December 2022 used an example to illustrate the revenue profiles of an entity subject to the nominal approach and an entity subject to the real approach. Tables 1 and 2 and Figure 1 in this Appendix have been extracted from that paper.
- B2. The numerical example showed that:
- (a) the present value of the revenue arising from both nominal and real approaches is the same (that is, CU100 in this example—Tables 1 and 2).
 - (b) the revenue profiles of the nominal and real approaches differ:
 - (i) under the nominal approach revenues are higher in earlier years and lower in later years.
 - (ii) the real approach leads to smoother revenue recovery and generally to smoother prices.
 - (iii) the real approach provides the entity with higher revenues from Year 5 onwards and with higher total amount of revenue (see Tables 1 and 2 below).

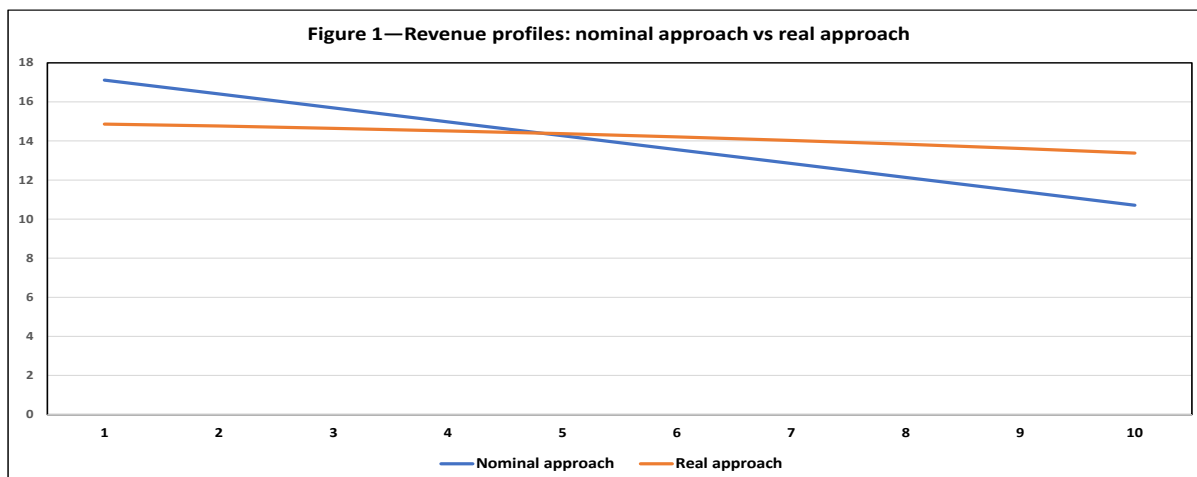


Table 1 Nominal approach

7.11%											
Nominal return											
In CU	1	2	3	4	5	6	7	8	9	10	Total
Opening RCB	100	90	80	70	60	50	40	30	20	10	
Regulatory depreciation (A)	10	10	10	10	10	10	10	10	10	10	100
Closing RCB	90	80	70	60	50	40	30	20	10	0	
Nominal return (B)	7.11	6.40	5.69	4.98	4.27	3.56	2.85	2.13	1.42	0.71	39.12
Revenue (A) + (B)	17.11	16.40	15.69	14.98	14.27	13.56	12.85	12.13	11.42	10.71	139.12
Discount factor (7.11%)	0.93	0.87	0.81	0.76	0.71	0.66	0.62	0.58	0.54	0.50	
Present value	100.00	15.98	14.30	12.77	11.38	10.12	8.98	7.94	7.00	6.15	5.39

Table 2 Real approach

2.50%											
Inflation											
Real return											
4.50%											
In CU	1	2	3	4	5	6	7	8	9	10	Total
Opening RCB	100.00	92.25	84.05	75.38	66.23	56.57	46.39	35.66	24.37	12.49	
Inflation adjustment	2.50	2.31	2.10	1.88	1.66	1.41	1.16	0.89	0.61	0.31	14.83
Regulatory depreciation (A)	10.25	10.51	10.77	11.04	11.31	11.60	11.89	12.18	12.49	12.80	114.83
Closing RCB	92.25	84.05	75.38	66.23	56.57	46.39	35.66	24.37	12.49	0.00	
Real return (B)	4.61	4.26	3.88	3.48	3.05	2.61	2.14	1.64	1.12	0.58	27.37
Revenue (A) + (B)	14.86	14.76	14.65	14.52	14.37	14.21	14.03	13.83	13.61	13.38	142.20
Discount factor (7.11%)	0.93	0.87	0.81	0.76	0.71	0.66	0.62	0.58	0.54	0.50	
Present value	100.00	13.88	12.87	11.92	11.03	10.19	9.41	8.67	7.98	7.33	6.73

B3. Tables 3 and 4 show the statements of financial performance for Years 1–10 and the profitability measured as profit over revenue for each approach.

Table 3 Profit or loss—Nominal approach	1	2	3	4	5	6	7	8	9	10	Total
Revenue	17.11	16.40	15.69	14.98	14.27	13.56	12.85	12.13	11.42	10.71	139.12
Depreciation expense	-10	-10	-10	-10	-10	-10	-10	-10	-10	-10	-100.00
Profit	7.11	6.40	5.69	4.98	4.27	3.56	2.85	2.13	1.42	0.71	39.12
Profit / Revenue (%)	41.56%	39.03%	36.27%	33.24%	29.91%	26.23%	22.15%	17.59%	12.45%	6.64%	28.12%

Table 4 Profit or loss—Real approach	1	2	3	4	5	6	7	8	9	10	Total
Revenue	14.86	14.76	14.65	14.52	14.37	14.21	14.03	13.83	13.61	13.38	142.20
Depreciation expense	-10	-10	-10	-10	-10	-10	-10	-10	-10	-10	-100.00
Profit	4.86	4.76	4.65	4.52	4.37	4.21	4.03	3.83	3.61	3.38	42.20
Profit / Revenue (%)	32.72%	32.26%	31.72%	31.11%	30.41%	29.61%	28.71%	27.69%	26.54%	25.24%	29.68%

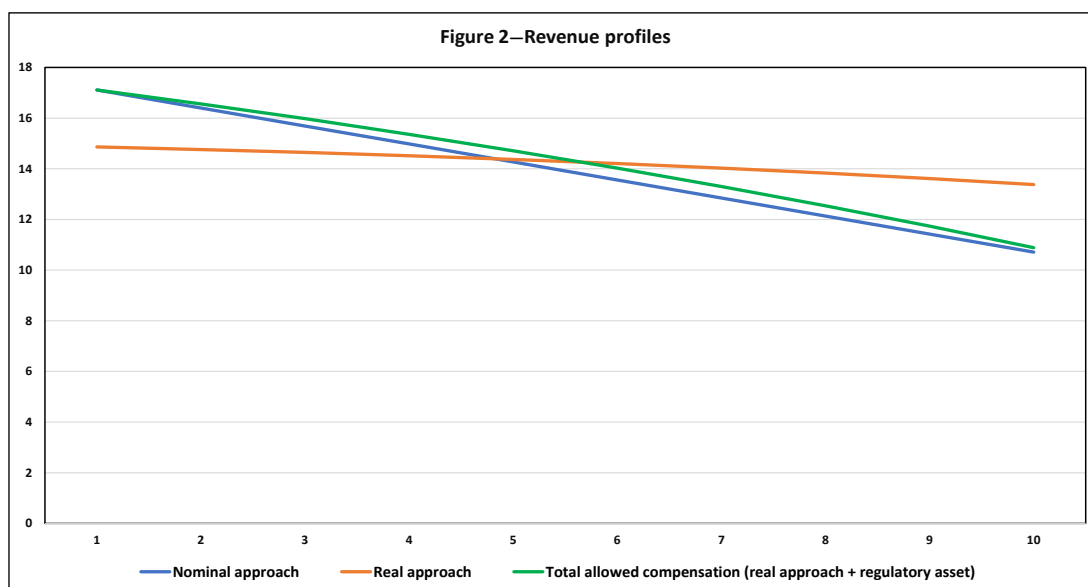
B4. View 1 views the inflation adjustment to the regulatory capital base as a difference in timing (a regulatory asset). Assuming an entity was required to recognise such a regulatory asset, Table 5 shows the reconciliation of the regulatory asset.

In CU	1	2	3	4	5	6	7	8	9	10	Total
Opening balance	0.00	2.25	4.05	5.38	6.23	6.57	6.39	5.66	4.37	2.49	
Addition (Table 2)	2.50	2.31	2.10	1.88	1.66	1.41	1.16	0.89	0.61	0.31	14.83
Regulatory interest income	0.11	0.21	0.28	0.33	0.35	0.36	0.34	0.29	0.22	0.13	2.62
Recovery	-0.36	-0.71	-1.05	-1.37	-1.67	-1.96	-2.23	-2.48	-2.71	-2.93	-17.45
Closing balance	2.25	4.05	5.38	6.23	6.57	6.39	5.66	4.37	2.49	0.00	

B5. Table 6 shows the total allowed compensation of the entity subject to the real approach that has accounted for the regulatory asset in Table 5.

In CU	1	2	3	4	5	6	7	8	9	10	Total
IFRS 15 revenue (real approach) (Table 2)	14.86	14.76	14.65	14.52	14.37	14.21	14.03	13.83	13.61	13.38	142.20
Reg income / (Reg expense) (Table 5)	2.25	1.80	1.33	0.85	0.34	-0.18	-0.73	-1.29	-1.88	-2.49	0.00
TAC (Total revenue)	17.11	16.56	15.98	15.36	14.71	14.02	13.30	12.54	11.73	10.89	142.20
Discount factor 7.11%		0.93	0.87	0.81	0.76	0.71	0.66	0.62	0.58	0.54	0.50
Discounted TAC (Total revenue)	102.06	15.98	14.43	13.00	11.67	10.43	9.29	8.22	7.24	6.32	5.48

B6. Figure 2 shows the new revenue profile of an entity subject to the real approach that accounts for a regulatory asset (green profile).



B7. Table 7 shows the statement of financial performance for an entity subject to the real approach that accounts for the inflation adjustment to the regulatory capital base as a regulatory asset.

Table 7 Profit or loss—Real approach + reg asset	1	2	3	4	5	6	7	8	9	10	Total
IFRS 15 Revenue	14.86	14.76	14.65	14.52	14.37	14.21	14.03	13.83	13.61	13.38	142.20
Regulatory income (regulatory expense)	2.25	1.80	1.33	0.85	0.34	-0.18	-0.73	-1.29	-1.88	-2.49	0.00
TAC (Revenue)—(Table 6)	17.11	16.56	15.98	15.36	14.71	14.02	13.30	12.54	11.73	10.89	142.20
Depreciation expense	-10	-10	-10	-10	-10	-10	-10	-10	-10	-10	-100.00
Profit	7.11	6.56	5.98	5.36	4.71	4.02	3.30	2.54	1.73	0.89	42.20
Profit / TAC (Revenue) (%)	41.56%	39.62%	37.41%	34.90%	32.02%	28.69%	24.81%	20.23%	14.77%	8.16%	29.68%

Appendix C—Recognition of the inflation adjustment to the regulatory capital base as a regulatory asset

- C1. This section is only relevant if the IASB disagrees with the staff recommendation in paragraph 47 and instead supports View 1—that is, the inflation adjustment gives rise to a regulatory asset.
- C2. The requirements in the external review draft reflect View 1 but prohibit an entity from recognising the inflation adjustment to the regulatory capital base as a regulatory asset. This section discusses whether the IASB wishes to retain this recognition prohibition.
- C3. The IASB discussed the recognition of the inflation adjustment as a regulatory asset in December 2022.⁶ The IASB learned that for entities whose regulatory capital base does not have a direct relationship with their property, plant and equipment, it would be costly to track the movement of the inflation adjustment to the regulatory capital base. This is because in many cases these entities would not be able to disaggregate the regulatory depreciation for a period into the individual items that are being recovered. Consequently, it might be difficult for these entities to estimate the future cash flows arising from such regulatory assets—which might mean the measurement uncertainty of inflation-related regulatory assets could be significant.
- C4. As noted in paragraph 21, we have since heard from a European national standard-setter that it is possible in some circumstances to identify and track the recovery of a regulatory asset arising from the inflation adjustment to the regulatory capital base for a specific period. This stakeholder notes that for some entities in their jurisdiction the regulatory asset arising from the inflation adjustment to the regulatory capital base can be material. In their view, prohibiting the recognition of a material regulatory asset would not faithfully represent the assets of such entities.

⁶ [Agenda Paper 9A](#) discussed at the December 2022 IASB meeting.

- C5. However, we still think that tracking the recoverability of such inflation adjustments might be difficult for many entities—we have not heard concerns from other stakeholders about this recognition prohibition. On the contrary, a few preparers from the same jurisdiction as the national standard-setter have expressed support for the IASB's tentative decision, noting that the regulatory asset would be complex to account for and that recognition would not provide useful information.
- C6. We also note that recognition of an inflation-related regulatory asset would require additional transition requirements. Fully retrospective recognition of an inflation-related regulatory asset is likely to be difficult if not impracticable.
- C7. In addition to the costs associated with recognition, feedback from users about the usefulness of the information arising from the recognition of such regulatory assets has been mixed. While some users have told us that information about inflation-related regulatory assets might be useful, others have acknowledged the operational challenges of recognising and measuring such assets and expressed concerns about the level of measurement uncertainty.
- C8. Consequently, the staff continue to think that the costs of recognising a regulatory asset related to the inflation adjustment to the regulatory capital base outweigh the benefits. We therefore continue to recommend that the final Standard prohibit the recognition of a regulatory asset related to the inflation adjustment to the regulatory capital base.

Question 3 for the IASB

Does the IASB agree with the staff recommendation in paragraph C8?

Disclosure about unrecognised regulatory assets related to the inflation adjustment to the regulatory capital base

- C9. As noted in paragraph 21, a stakeholder has suggested that, if the IASB continue to prohibit the recognition of regulatory assets related to inflation, it should consider requiring additional disclosures about these unrecognised regulatory assets.
- C10. According to the external review draft, an entity would be required to disclose:
- (a) information about unrecognised regulatory assets and unrecognised regulatory liabilities, including the type of compensation or charge they relate to and the reason they have not been recognised.⁷
 - (b) the regulatory approach (nominal or real) used by the regulator to compensate the entity for inflation on its regulatory capital base.
- C11. Although the draft requirements do not specifically mention unrecognised regulatory assets related to inflation adjustments to the regulatory capital base, the disaggregation requirements in IFRS 18 *Presentation and Disclosure in Financial Statements* would require entities to provide information about such regulatory assets separately if that information is material.⁸
- C12. The staff have considered whether it would be possible to require additional disclosures beyond those described in paragraph C10. However, when the IASB discussed possible disclosure requirements for unrecognised regulatory assets or regulatory liabilities it learned that for some stakeholders it would be very difficult to provide quantitative information about these items, for the same reasons the IASB decided an entity should not recognise these items as regulatory assets or regulatory

⁷ If the IASB supports the staff recommendation in paragraph 47, then the inflation adjustment to the regulatory capital base would not give rise to unrecognised regulatory assets. Consequently, the disclosure requirements for unrecognised regulatory assets would not apply. Indeed any such disclosures would arguably go beyond the objective of financial statements in paragraph 3.2 of the *Conceptual Framework for Financial Reporting*.

⁸ Paragraphs 20 and 41(d) of IFRS 18.

liabilities. Having said that, the external review draft does not preclude an entity from providing quantitative information if the entity could do so.

- C13. Consequently, the staff do not recommend adding any additional disclosure requirements for unrecognised regulatory assets related to inflation adjustments.

Question 4 for the IASB

Does the IASB agree with the staff recommendation in paragraph C13?

Appendix D—Extracts from external review draft of the prospective Standard and Basis for Conclusions

- D1. Paragraphs B59–B61 in the external review draft deal with the treatment of differences in timing relating to inflation.

Differences in timing relating to inflation

- B59. Compensation for inflation arising in a reporting period might be:

- (a) related to the regulatory capital base; or
- (b) unrelated to the regulatory capital base.

Compensation for inflation related to the regulatory capital base

- B60. A regulatory agreement might provide compensation for inflation arising in a period relating to the regulatory capital base by:

- (a) providing a nominal rate of return on a nominal regulatory capital base. An entity shall account for the compensation for inflation as part of regulatory returns by applying paragraphs B48–B58; or
- (b) providing a real rate of return on a regulatory capital base that is adjusted each period by the inflation arising in that period. Compensation provided by such inflation adjustments forms part of the total allowed compensation in the period the inflation arises. Inflation adjustments for a period create differences in timing because those adjustments are recovered through regulatory depreciation included in regulated rates to be charged in future periods. However, an entity shall not recognise a regulatory asset for inflation adjustments to the regulatory capital base.

Compensation for inflation unrelated to the regulatory capital base

- B61. A regulatory agreement might provide compensation for inflation that is unrelated to the regulatory capital base in the form of an inflation adjustment. Such compensation forms part of the total allowed compensation in the period the inflation arises. For example, a regulatory agreement might provide an entity compensation for inflation for the current reporting period based on the expected inflation rate for that period applied to specified costs. The regulatory agreement also requires differences between the estimated and actual inflation rates for the current reporting period to be added or deducted in determining the regulated rates to be charged to customers in future periods. Differences between the estimated and actual inflation rates give rise to a difference in timing in the current reporting period.

- D2. Paragraphs BC103–BC110 in the external review draft of the Basis for Conclusions accompanying the prospective Standard deal with differences in timing relating to inflation.

Differences in timing relating to inflation

- BC103 A regulatory agreement might determine the compensation for inflation arising in a period in various ways. For example, compensation for inflation might be:
- (a) related to the regulatory capital base (see paragraphs BC104–BC109) or
 - (b) unrelated to the regulatory capital base (see paragraph BC110)

Compensation for inflation related to the regulatory capital base

- BC104 A regulatory agreement might provide compensation for inflation related to an entity's regulatory capital using either of these two approaches:
- (a) a nominal approach—in this case, the regulatory agreement provides a nominal rate of return on a nominal regulatory capital base. A regulatory capital base that stays constant in nominal terms loses its underlying value through inflation each year. The nominal rate of return aims to compensate entities for that loss of value.
 - (b) a real approach—in this case, the regulatory agreement provides a real rate of return on a regulatory capital base that is adjusted for inflation so that the regulatory capital base holds its value over time.
- BC105 Under the nominal approach, a regulatory agreement includes compensation for inflation in the regulatory returns on the regulatory capital base. Paragraph B60(a) of IFRS 20 requires an entity to account for the compensation for inflation as part of regulatory returns (see paragraphs BC87–BC102).
- BC106 Under the real approach, a regulatory agreement provides compensation for inflation for a period by adjusting the regulatory capital base for inflation in that period. The regulatory agreement includes the inflation adjustment in regulated rates over time as part of regulatory depreciation. Paragraph B60(b) of IFRS 20 requires such compensation for inflation to form part of the total allowed compensation in the period the inflation arises. Therefore, a difference in timing arises if the entity has an enforceable present right to add an inflation adjustment arising in a period in determining future regulated rates.
- BC107 In developing IFRS 20, the IASB learned that an entity might find it difficult—and sometimes impracticable—to track differences in timing arising from an inflation adjustment if the entity's regulatory capital base does not have a direct relationship with its property, plant and equipment. Consequently, significant measurement uncertainty is likely to be associated with recognising a regulatory asset related to an inflation adjustment. This measurement uncertainty reduces

the usefulness to users of financial statements of the information provided by recognition. Even if an entity's regulatory capital base has a direct relationship with its property, plant and equipment, the accounting could be costly because it would require the entity to track differences in timing related to an inflation adjustment by asset class.

BC108 Some users of financial statements told the IASB that accounting for inflation adjustments to the regulatory capital base as a regulatory asset would provide useful information. For example, an entity recognising such regulatory assets would provide information about the effect of inflation on future regulated rates. However, a few of those users acknowledged the difficulties associated with accounting for such regulatory assets and agreed that the resulting measurement uncertainty would reduce the usefulness of the resulting information.

BC109 The IASB concluded that the costs associated with recognising a regulatory asset related to inflation adjustments to the regulatory capital base would outweigh the benefits of the information provided to users. Consequently, the IASB decided to prohibit an entity from recognising such regulatory assets. This decision applies regardless of the relationship between an entity's regulatory capital base and its property, plant and equipment. As a result, an entity would recognise inflation adjustments to its regulatory capital base in profit or loss when the entity includes them in the regulated rates charged to customers.

Compensation for inflation unrelated to the regulatory capital base

BC110 A regulatory agreement might provide compensation for inflation that is unrelated to the regulatory capital base in the form of an inflation adjustment. Paragraph B61 of IFRS 20 requires such compensation for inflation arising in a period to form part of the total allowed compensation in the period the inflation arises. A difference in timing arises if compensation for inflation arising in a period is included in regulated rates for a different period. In this case, any difference in timing that arises from such compensation might result in the recognition of a regulatory asset or regulatory liability.