IFRS Accounting

Staff paper

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Project	**Rate-regulated Activities**
Topic	**Discounting estimated future cash flows**
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Objective

1. This paper sets out staff analysis and recommendations on the proposals in the Exposure Draft *Regulatory Assets and Regulatory Liabilities* (Exposure Draft) dealing with discounting of estimated future cash flows arising from a regulatory asset or regulatory liability.

2. This paper does not discuss the proposals dealing with minimum interest rate set out in paragraphs 50–52 of the Exposure Draft. We will discuss these proposals at a future meeting.

Staff recommendations

3. The staff recommend that the final Accounting Standard:

   (a) retain the proposal to discount estimates of future cash flows.

   (b) retain the proposal to use the regulatory interest rate for a regulatory asset or regulatory liability as the discount rate for that regulatory asset or regulatory liability.

   (c) retain the proposed definition of regulatory interest rate.

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(d) permit an entity not to discount the estimates of future cash flows that arise from a regulatory asset or regulatory liability, if the entity expects that the period between the recognition of that regulatory asset or regulatory liability and its recovery or fulfilment will be 12 months or less.

(e) require an entity that has elected to apply the exemption from discounting in paragraph (d) to disclose this fact and the amount of regulatory assets and regulatory liabilities at the end of the reporting period to which the entity has applied the exemption.

(f) not provide an exemption from discounting for a regulatory asset or regulatory liability for which the regulatory agreement does not specify a recovery or fulfilment timeframe.

(g) retain the proposal in paragraph 54 of the Exposure Draft to compute a single discount rate when a regulatory agreement specifies at initial recognition different regulatory interest rates over the life of a regulatory asset or regulatory liability. The final Accounting Standard would:

  (i) not provide further guidance on the computation of the single discount rate.

  (ii) permit an entity not to discount the estimates of future cash flows that arise from a regulatory asset or regulatory liability, if the entity expects that the period between recognition of that regulatory asset or regulatory liability and when regulatory interest starts to accrue will be 12 months or less. This exemption would cease to apply once regulatory interest starts to accrue.

  (iii) require an entity that has elected to apply the exemption from discounting in paragraph (g)(ii) to disclose this fact and the amount of regulatory assets and regulatory liabilities at the end of the reporting period to which the entity has applied the exemption.

  (iv) clarify that the proposal does not apply to a regulatory asset or regulatory liability that attracts regulatory interest rates that depend on

an interest rate benchmark. The final Accounting Standard would not provide further guidance on the measurement of such a regulatory asset or regulatory liability.

Structure of the paper

4. This paper is structured as follows:
   (a) use of the regulatory interest rate as the discount rate (paragraphs 6–32);
   (b) exemption from discounting (paragraphs 33–50); and
   (c) uneven regulatory interest rate (paragraphs 51–78).
5. There are two appendices:
   (a) Appendix A contains the notes of the Consultative Group for Rate Regulation (Consultative Group) meeting dealing with the topics analysed in this paper; and
   (b) Appendix B illustrates how an entity applies an exemption from discounting to a specific fact pattern.

Use of the regulatory interest rate as the discount rate

6. This section is structured as follows:
   (a) proposals in the Exposure Draft (paragraphs 7–11);
   (b) feedback (paragraphs 12–18); and
   (c) staff analysis (paragraphs 19–32).

Proposals in the Exposure Draft

7. The Exposure Draft proposes that an entity measures a regulatory asset or regulatory liability using a cash-flow-based measurement technique that:[1]

   (a) includes an estimate of all future cash flows—including future cash flows arising from regulatory interest—and updates those estimates at the end of each reporting period to reflect conditions existing at that date; and

   (b) discounts those estimated future cash flows to their present value. Consequently, the entity recognises regulatory interest income or regulatory interest expense over the life of the related regulatory asset or regulatory liability.[2]

8. Paragraphs 48 and 49 of the Exposure Draft state (**emphasis added**):

> 48 An entity shall use the ***regulatory interest rate*** **for a regulatory asset or regulatory liability as the discount rate for that regulatory asset or regulatory liability**, unless the regulatory interest rate for a regulatory asset is insufficient. Paragraphs 50–52 prescribe how to determine whether that rate is sufficient and what discount rate to use if it is insufficient.
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> 49 At initial recognition of a regulatory asset or regulatory liability, if the regulatory interest rate is also the discount rate, the present value of the estimated future cash flows equals the sum of the estimated future cash flows excluding the cash flows from regulatory interest. This result also holds in the case of subsequent measurement if the regulatory interest rate is also the discount rate and, in addition, the regulatory interest is recovered or fulfilled in the same period in which it accrues.

9. The Exposure Draft defines *regulatory interest rate* as:

> The interest rate provided by a regulatory agreement to compensate an entity for the time lag until recovery of a regulatory asset or to charge the entity for the time lag until fulfilment of a regulatory liability.

[1] Paragraphs 30, 36 and 55 of the Exposure Draft.

[2] Paragraphs 46 and 47 of the Exposure Draft.

10. Paragraph B24 of the Exposure Draft proposes that if a regulatory asset or regulatory liability forms part of a larger base and the regulatory agreement applies a return rate to the whole of that larger base, that rate is the regulatory interest rate applied to that regulatory asset or regulatory liability.

11. When developing the discount rate proposals, the IASB considered that for a measurement based on estimated future cash flows, IFRS Accounting Standards generally specify a discount rate that reflects the characteristics of those cash flows. The IASB acknowledged that regulatory interest rates may not be designed to compensate or charge an entity precisely for the time value of money and for the uncertainty in the amount or timing of the future cash flows arising from a regulatory asset or a regulatory liability. However, the IASB expected that in most cases the regulatory interest rate would be sufficient to provide at least that level of compensation or charge. Consequently, the IASB concluded that the objective of the Exposure Draft could be met without requiring the usual level of precision required by IFRS Accounting Standards, and that any benefit of incremental information provided by that level of precision would be unlikely to outweigh the costs and complexity.[3]

Feedback

12. The feedback is structured as follows:

    (a) discounting estimated future cash flows (paragraphs 13–14); and

    (b) use of the regulatory interest rate as the discount rate (paragraphs 15–18).

Discounting estimated future cash flows

13. Most respondents who commented on the proposed cash-flow-based measurement technique agreed with the proposal for the reasons explained in the Basis for Conclusions.[4]

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[3] Paragraphs BC163–BC164 of the Basis for Conclusions accompanying the Exposure Draft.

[4] Agenda Paper 9A discussed at the June 2023 IASB meeting.

14. A few respondents disagreed with discounting estimates of future cash flows if the regulatory assets and regulatory liabilities attract regulatory interest. These respondents said the measurements would be similar whether or not the estimates of future cash flows are discounted.

Use of the regulatory interest rate as the discount rate

15. Most respondents agreed with the proposed requirement to use the regulatory interest rate for a regulatory asset or regulatory liability as the discount rate for that regulatory asset or regulatory liability. Some of these respondents said:

    (a) the regulatory interest rate is an objective rate that reflects the regulatory interest that the entity will be compensated or charged under the regulatory agreement; and

    (b) the proposal would simplify the application of the cash-flow-based measurement technique.

16. A few respondents did not support using the regulatory interest rate as the discount rate. They said the regulatory interest rate often provides compensation beyond the time value of money and the uncertainty in the future cash flows to fulfil broader regulatory objectives, such as to ensure the financial viability of the entity. Many of these respondents supported a discount rate that is determined using principles similar to those in other IFRS Accounting Standards—for example, a rate that reflects only the time value of money and the risks inherent in the asset or liability.

17. Some respondents suggested using other discount rates, for example:

    (a) a discount rate that would be either:

        (i) the entity's weighted average cost of capital; or

        (ii) consistent with the discount rate used to derive the significant financing component in IFRS 15 *Revenue from Contracts with Customers*.

    (b) a current interest rate, the cost of debt, the regulatory return rate, or a long-term risk-free interest rate.

(c) a preparer suggested using a single average regulatory interest rate to discount all regulatory assets and regulatory liabilities that may be subject to different regulatory interest rates and different recovery or fulfilment periods.

18. A few respondents questioned the term ‘time lag’ included in the proposed definition of regulatory interest rate. Some of these respondents were confused. They said the term ‘time lag’ is vague because the definition does not specify the components that the regulatory interest rate may include.

Staff analysis

19. The section analyses:

(a) discounting estimated future cash flows (paragraphs 20–23); and

(b) use of the regulatory interest rate as the discount rate (paragraphs 24–32).

Discounting estimated future cash flows

20. As mentioned in paragraph 13, most respondents that commented, including users of financial statements, agreed with the cash-flow-based measurement technique.[5] A few respondents disagreed with discounting estimates of future cash flows arising from regulatory assets and regulatory liabilities that attract regulatory interest (paragraph 14). These respondents said the measurement of those regulatory assets and regulatory liabilities would be similar regardless of discounting. Those respondents also cited difficulty in determining the period in which cash flows will arise in some situations.

21. We agree that if an entity used the regulatory interest rate as the discount rate, discounting would not significantly affect the measurement of regulatory assets and regulatory liabilities in many cases. In addition, when the regulatory interest rate is used as the discount rate, the entity would not need to determine the timing of future cash flows because discounting computations would not be necessary. This is

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

because the present value of the estimated future cash flows equals the sum of the estimated future cash flows excluding the cash flows from regulatory interest that has not yet accrued.[6]

22. However, discounting computations would be necessary when the discount rate differs from the regulatory interest rate. An example would be when the regulatory interest for a regulatory asset is insufficient. In such cases, discounting could significantly affect the measurement of regulatory assets. When developing the proposal to use the regulatory interest rate as the discount rate, the IASB concluded that a consistent principle that requires explicit estimates and explicit discounting provides useful information in all cases.[7] We think the IASB's conclusion still holds.

23. Consequently, we recommend the final Accounting Standard retain the proposal to discount estimates of future cash flows. However, we think the IASB could alleviate some of the concerns raised by respondents by providing specific exemptions from discounting (paragraphs 33–50).

Question for the IASB
1. Does the IASB agree with the staff recommendation in paragraph 23?

Use of the regulatory interest rate as the discount rate

24. As mentioned in paragraph 15, most respondents, including most users who commented on the measurement proposals, agreed with the proposal to use the regulatory interest rate for a regulatory asset or regulatory liability as the discount rate for that regulatory asset or regulatory liability. This feedback is consistent with that received from members of the Consultative Group—see Appendix A.

[6] Paragraphs 49 of the Exposure Draft and paragraphs BC162(a) and BC162(c) of the Basis for Conclusions accompanying the Exposure Draft.

[7] Paragraphs BC161 of the Basis for Conclusions accompanying the Exposure Draft.

25. However, a few respondents suggested using a discount rate that reflects only the time value of money and the risks inherent in a regulatory asset or regulatory liability (paragraph 16). Some respondents also suggested using other discount rates or a single average regulatory interest rate to discount all regulatory assets and regulatory liabilities (paragraph 17).

26. When developing the proposal to use the regulatory interest rate as the discount rate, the IASB considered that:

    (a) implementing the proposal is often straightforward (paragraph 21).

    (b) in most cases, the regulatory interest rate would be sufficient to provide at least the amount of compensation or charge for the time value of money and for the uncertainty in the amount or timing of future cash flows. The IASB concluded that requiring a level of precision that reflects the characteristics of those cash flows would provide benefits that would be unlikely to outweigh the costs and complexity (paragraph 11).

27. We think the matters considered by the IASB during the development of the proposal for using the regulatory interest rate as the discount rate still hold. In most cases, we agree with respondents who said that applying the proposal would:

    (a) provide useful information because the regulatory interest rate reflects the regulatory interest that an entity is compensated or charged under the regulatory agreement (paragraph 15(a)).

    (b) be less costly to apply than using a discount rate other than the regulatory interest rate (paragraph 15(b)). This is because the use of any other discount rates would always require discounting computations, both on initial recognition and subsequently (paragraphs 21–22). Moreover, it can be difficult to determine a discount rate that reflects the characteristics of the future cash flows.

28. Because of the reasons explained in paragraphs 26–27, we have considered but rejected the other discount rates suggested by some respondents (paragraph 17).

29. As mentioned in paragraph 18, a few respondents questioned the proposed definition of regulatory interest rate. That definition says that the regulatory interest rate provides an entity compensation or charge for the time lag until recovery of a regulatory asset or fulfilment of a regulatory liability. These respondents said the term 'time lag' is vague and sought for more precision about the components the regulatory interest rate may include.

30. When developing the proposals on discount rate, the IASB acknowledged that regulatory interest rates may not be designed to compensate or charge an entity *precisely* for the time value of money and for the uncertainty in the amount or timing of the future cash flows arising from a regulatory asset or a regulatory liability (paragraph 11).

31. Therefore, we think it is appropriate that the definition of regulatory interest rate does not specify explicitly the components that the regulatory interest rate may include. We think the proposed definition is sufficiently general to contemplate the diversity in how regulatory agreements determine regulatory interest rates without adding complexity to the model.

32. Therefore, we recommend the final Accounting Standard retain:

    (a) the proposal to use the regulatory interest rate for a regulatory asset or regulatory liability as the discount rate for that regulatory asset or regulatory liability (paragraph 27); and

    (b) the proposed definition of regulatory interest rate (paragraph 31).

Question for the IASB
2. Does the IASB agree with the staff recommendation in paragraph 32?

Exemption from discounting

33. This section is structured as follows:

    (a) proposals in the Exposure Draft (paragraph 34);

    (b) feedback (paragraphs 35–37); and

    (c) staff analysis (paragraphs 38–50).

Proposals in the Exposure Draft

34. The Basis for Conclusions accompanying the Exposure Draft explains why the IASB considered, but decided not to provide, an exemption from discounting if:

    (a) the effects of the time value of money and uncertainty in the amount and timing of the estimated future cash flows is not significant—the IASB rejected such an exemption because it would still, in effect, require an entity to assess whether the time value of money and uncertainty inherent in the cash flows are significant. The IASB viewed this exemption as introducing unnecessary complexity that may outweigh any incremental benefit.

    (b) the regulatory asset or regulatory liability is recovered or fulfilled within a specified time period—the IASB rejected such an exemption because it would be difficult to define a 'bright line' time period within which the effects of the time and uncertainty would not be expected to be material.[8]

Feedback

35. Many respondents said that the final Standard should provide an exemption from discounting the estimates of future cash flows arising from a regulatory asset or regulatory liability in specific circumstances:

[8] Paragraph BC165 of the Basis for Conclusions accompanying the Exposure Draft.

(a) if the effect of discounting is not significant, similar to the practical expedient in IFRS 15; or

(b) if the regulatory asset or regulatory liability is expected to be recovered or fulfilled within a specified period, for example one year.

36. Some respondents mentioned that a measurement using undiscounted cash flows would be similar to the exemption from the recognition and measurement requirements in IFRS 16 *Leases* for short-term leases. An entity applying that exemption would recognise short-term leases expense using undiscounted cash flows.

37. A few respondents said that an entity should be exempted from discounting if the regulatory agreement does not specify a timeframe over which the estimated future cash flows arising from a regulatory asset or regulatory liability would be included in determining future regulated rates.

Staff analysis

38. This section analyses:

(a) regulatory assets and regulatory liabilities with short recovery or fulfilment period (paragraphs 39–46); and

(b) regulatory assets and regulatory liabilities with unspecified timeframe for recovery or fulfilment (paragraphs 47–50).

Regulatory assets or regulatory liabilities with short recovery or fulfilment period

39. Many respondents suggested an exemption from discounting for regulatory assets and regulatory liabilities that are expected to be recovered or fulfilled within a specified period, similar to the practical expedient in IFRS 15 or the exemption in IFRS 16 (paragraphs 35 and 36). Some respondents said for those regulatory assets and regulatory liabilities, discounting would provide little benefits and an exemption from

discounting would reduce the burden of applying the proposals. Members of the Consultative Group supported this exemption (Appendix A).

40. IFRS 15 permits an entity not to adjust the promised amount of consideration for the effects of a significant financing component if the entity expects, at contract inception, that the period between when the entity transfers a promised good or service to a customer and when the customer pays for that good or service will be one year or less.[9]

41. IFRS 16 permits a lessee not to apply the recognition and measurement requirements to short-term leases—that is, leases that, at the commencement date, have a lease term of 12 months or less and do not contain a purchase option—or to leases for which the underlying asset is of low value.[10] Instead, the lessee would recognise the lease payments associated with those leases as an expense using undiscounted cash flows.

42. We think the IASB could permit an entity not to discount the cash flows that arise from a regulatory asset or regulatory liability that the entity expects will be recovered or fulfilled within 12 months of recognition. This exemption could result in benefits that outweigh the costs because:

    (a) the measurement of short-term regulatory assets or regulatory liabilities would be simplified. Feedback indicated that in many jurisdictions, the regulatory agreement typically does not provide regulatory interest for regulatory assets and regulatory liabilities. The exemption would provide relief especially to entities that have many short-term regulatory assets or regulatory liabilities that do not attract regulatory interest.

    (b) the effects of the time value of money over a 12-month period are unlikely to be significant relative to an undiscounted measurement of a regulatory asset or regulatory liability in most cases. In some cases, those effects may be significant, for example, because of high inflation. If an entity elected to apply the exemption, we expect that the entity would provide additional disclosures to enable users of financial statements to understand the impact of the time

[9] Paragraph 63 of IFRS 15.
[10] Paragraphs 5–6 of IFRS 16.

value of money on its financial position and financial performance applying IAS 1 *Presentation of Financial Statements*.[11]

43. In supporting the exemption in paragraph 42, we considered other IFRS Accounting Standards that use the 'bright-line' 12-month period as a basis for providing an exemption from discounting (paragraphs 40–41). We also considered the IASB's reasons for supporting the practical expedient in IFRS 15. When developing IFRS 15, the IASB acknowledged that the practical expedient could produce arbitrary outcomes in some cases because the financing component could be material for short-term contracts with high implicit interest rates and, conversely, could be immaterial for long-term contracts with low implicit interest rates. However, the IASB concluded that the effect on the pattern of profit recognition should be limited because the exemption would apply only to financing arrangements that are expected to expire within 12 months.[12]

44. In February 2024, the IASB tentatively decided to retain the specific disclosure objective relating to financial position proposed in paragraph 79 of the Exposure Draft:[13]

> 79 An entity shall disclose information that enables users of financial statements to understand the entity's regulatory assets and regulatory liabilities at the end of the reporting period. That understanding will provide insights into how regulatory assets and regulatory liabilities will affect the amount, timing and uncertainty of the entity's future cash flows.

45. If an entity applies the exemption in paragraph 42, we think the entity should be required to provide disclosures to help users of financial statements to understand the effects of the exemption on its regulatory assets and regulatory liabilities at the end of the reporting period. We think the following disclosures would be useful:

[11] Paragraph 122 of IAS 1 *Presentation of Financial Statements*. The prospective [draft] IFRS 18 *Presentation and Disclosure in Financial Statements*, which will replace IAS 1, will amend IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to include these requirements.

[12] Paragraph BC236 of the Basis for Conclusions accompanying IFRS 15.

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

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

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

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

(a) permit an entity not to discount the estimates of future cash flows that arise from a regulatory asset or regulatory liability, if the entity expects that the period between the recognition of that regulatory asset or regulatory liability and its recovery or fulfilment will be 12 months or less.

(b) require an entity that has elected to apply the exemption from discounting to disclose this fact and the amount of regulatory assets and regulatory liabilities at the end of the reporting period to which the entity has applied the exemption.

Question for the IASB
3. Does the IASB agree with the staff recommendation in paragraph 46?

Regulatory assets and regulatory liabilities with unspecified timeframe for recovery or fulfilment

47. A few respondents suggested an exemption from discounting if a regulatory agreement does not specify a timeframe over which a regulatory asset or regulatory liability will be recovered or fulfilled as this could make discounting operationally difficult (paragraph 37).

48. Feedback from members of the Consultative Group in Appendix A shows that regulatory agreements typically specify a timeframe over which a regulatory asset or regulatory liability will be recovered or fulfilled. Considering this feedback and the small number of respondents who mentioned the scenario of a regulatory agreement not specifying a timeframe, we expect that entities would be able to estimate the

timeframe for recovery or fulfilment for most of their regulatory assets and regulatory liabilities.

49. We acknowledge, however, that the lack of clear timeframes for recovery or fulfilment of regulatory assets and regulatory liabilities could be common for entities subject to developing regulatory frameworks. We think providing an exemption from discounting for those regulatory assets and regulatory liabilities would add complexity to the model and lead to costs outweighing the benefits. Because those regulatory assets and regulatory liabilities are subject to a high level of uncertainty in regulatory decisions, there may be a substantial time lag between their recognition and recovery or fulfilment. Therefore, the effects of time value of money can be significant relative to the cash flows that arise from those regulatory assets and regulatory liabilities. Hence, discounting these cash flows would provide useful information to users. For those regulatory assets and regulatory liabilities, entities would need to consider the requirements of IAS 1 and disclose significant judgements made in applying the proposed discounting requirements.

50. Consequently, we recommend the final Accounting Standard not provide an exemption from discounting for a regulatory asset or regulatory liability for which the regulatory agreement does not specify a recovery or fulfilment timeframe.

Question for the IASB
4. Does the IASB agree with the staff recommendation in paragraph 50?

Uneven regulatory interest rate

51. This section is structured as follows:

    (a) proposals in the Exposure Draft (paragraphs 52–54);

    (b) feedback (paragraphs 55–59); and

    (c) staff analysis (paragraphs 60–78).

Proposals in the Exposure Draft

52. Paragraph 54 of the Exposure Draft states:

> 54 Sometimes a regulatory agreement provides or charges regulatory interest unevenly by specifying at initial recognition of a regulatory asset or regulatory liability a series of different regulatory interest rates for successive periods over the life of that regulatory asset or regulatory liability. At initial recognition of the regulatory asset or regulatory liability, an entity shall translate those uneven regulatory interest rates into a single discount rate that it shall use throughout the life of the regulatory asset or regulatory liability. In determining that single discount rate, an entity shall not consider possible future changes in the regulatory interest rate.

53. Paragraphs 55 and 58 of the Exposure Draft propose that:

    (a) an entity continues to use the discount rate determined at initial recognition at the end of each reporting period; and

    (b) if a regulatory agreement changes the regulatory interest rate, the entity determines the new discount rate as the new regulatory interest rate provided by the regulatory agreement (if necessary, translated into a single discount rate).

54. The Basis for Conclusions accompanying the Exposure Draft does not provide the IASB's rationale for the proposal in paragraph 54 of the Exposure Draft.

Feedback

55. Fewer respondents commented on the proposal on uneven regulatory interest rate than on other aspects of the discount rate proposals. Many respondents who commented agreed with the proposal. A few respondents said the proposal reflects the effect of uneven regulatory interest rates in a way similar to the effective interest method in IFRS 9 *Financial Instruments* and simplifies the proposed measurement requirements.

56. However, some respondents who commented disagreed with the proposal. These respondents said the proposal adds complexity to the proposed measurement requirements with no obvious benefits. For example:

    (a) the regulatory agreement may provide or charge a regulatory interest rate only when an entity starts recovering a regulatory asset or fulfilling a regulatory liability through the regulated rates charged or once the regulator approves the related item of expense or income. This situation is common in North America. A respondent said the time lag could range from six months to two years. A few respondents asked whether the proposal should be applied only once the regulatory agreement starts providing or charging regulatory interest. However, a few respondents had not considered the proposals would apply to this situation.

    (b) the proposal would create an additional difference between the regulatory assets and regulatory liabilities reported in financial statements and the regulatory balances determined in accordance with the regulatory agreement.

57. Respondents expressed mixed views about whether uneven regulatory interest rates are expected to be common:

    (a) a few preparers in North America and a European national standard-setter said that they have not encountered any situation in which a regulatory agreement at initial recognition provides for uneven regulatory interest rates in their jurisdictions.

    (b) a European preparer and national standard-setter said that the proposal would be applied more frequently than initially thought, such as the situations described in paragraph 56(a).

58. Feedback from a few members of the Consultative Group was aligned with the feedback from respondents described in paragraphs 56 and 57(a) (Appendix A).

59. A few respondents asked for clarification and additional guidance, for example:

    (a) whether an entity would calculate the single discount rate using *only* the method illustrated in Example 5 of the Illustrative Examples accompanying

the Exposure Draft, which according to them is similar to the effective interest method. These respondents asked whether the entity would be allowed to use other calculation techniques that are aligned with the proposal in paragraph 54 of the Exposure Draft.

(b) whether and how the proposal would be applied to regulatory interest rates that depend on an interest rate benchmark, and therefore, change periodically over the life of a regulatory asset or regulatory liability. For example, an accounting firm asked whether the single discount rate would be determined based on a series of different rates in the benchmark or on the current rate in the benchmark as at the date of measurement.

Staff analysis

60. This section is structured as follows:

(a) uneven regulatory interest rate proposal (paragraphs 61–66);

(b) regulatory assets and regulatory liabilities with short time lag between recognition and accrual of regulatory interest (paragraphs 67–73); and

(c) regulatory interest rates that depend on an interest rate benchmark (paragraphs 74–78).

Uneven regulatory interest rate proposal

61. Many respondents agreed with the proposal in paragraph 54 of the Exposure Draft (paragraph 55). However, some respondents said the proposal adds complexity to the proposed measurement requirements with no obvious benefits (paragraph 56).

62. Paragraph 54 of the Exposure Draft says that 'Sometimes a regulatory agreement provides or charges regulatory interest unevenly by specifying at initial recognition a regulatory asset or regulatory liability a series of different regulatory interest rates for successive periods over the life of that regulatory asset or regulatory liability'.

63. We think applying the proposal to use a single discount rate over the life of a regulatory asset (regulatory liability) would provide useful information. This is

because the proposal would, regardless of the amount and timing of the cash flows relating to regulatory interest, result in:

(a) initial and subsequent measurements of the regulatory asset (regulatory liability) that would reflect the effects of time value of money; and

(b) an allocation of regulatory interest income (regulatory interest expense) on the carrying amount of the regulatory asset (regulatory liability) using the single discount rate over its life. This would be consistent with recognition of regulatory interest income (regulatory interest expense) on an accrual rather than regulatory basis.

64. As discussed in paragraph 56(a), a few respondents had assumed that the proposal in paragraph 54 of the Exposure Draft would not apply to the 'time lag' situation described paragraph 56(a). Example 5 of the Illustrative Examples accompanying the Exposure Draft illustrates the 'time lag' situation. This Example clearly shows that the proposal would apply to that situation. We think, however, the understanding of the proposal could be enhanced through drafting of the final Standard and by providing the rationale in the Basis for Conclusions.

65. A few respondents asked for guidance on the calculation of the single discount rate, for example, whether an entity would calculate that rate using *only* a method similar to the effective interest method in IFRS 9 (paragraph 59(a)). We think additional guidance on the calculation of the single discount rate is unnecessary—Example 5 of the Illustrative Examples accompanying the Exposure Draft illustrates how an entity would determine the single discount rate, both at initial recognition of a regulatory asset or regulatory liability and subsequently when the regulatory agreement changes the regulatory interest rate.

66. In conclusion, we recommend the final Accounting Standard:

(a) retain the proposal in paragraph 54 of the Exposure Draft to compute a single discount rate when a regulatory agreement specifies at initial recognition different regulatory interest rates over the life of a regulatory asset or regulatory liability; and

(b) not provide further guidance on the computation of the single discount rate.

Question for the IASB
5. Does the IASB agree with the staff recommendation in paragraph 66?

Regulatory assets and regulatory liabilities with short time lag between recognition and accrual of regulatory interest

67. In some cases there is a time lag between the period in which a regulatory asset or regulatory liability is recognised and the period when regulatory interest starts to accrue (paragraph 56(a)).

68. If the time lag is short, we think the proposal in paragraph 54 of the Exposure Draft to apply a single discount rate over the life of a regulatory asset or regulatory liability might not provide benefits that outweigh the costs. This is because in most cases the effect of time value of money related to the short time lag is unlikely to be significant. The proposal may be operationally difficult to apply if an entity has a large pool of such regulatory assets and regulatory liabilities.

69. Because of this, we think the IASB could exempt an entity from discounting the cash flows that arise from a regulatory asset or regulatory liability if the entity expects that the period between recognition of that regulatory asset or regulatory liability and when regulatory interest starts to accrue will be 12 months or less. This exemption would cease to apply once regulatory interest starts to accrue.

70. Appendix B illustrates how an entity would apply this exemption. Applying this exemption, the entity would measure the regulatory asset or regulatory liability:

    (a) at initial recognition and subsequently until regulatory interest starts to accrue, at an amount that equals the sum of the estimated future cash flows excluding the cash flows from regulatory interest.

(b) once regulatory interest starts to accrue, by discounting the estimated future cash flows (including cash flows from regulatory interest) using the regulatory interest rate as the discount rate.

71. The exemption in paragraph 69 would be an extension of the staff recommendation to permit an entity not to discount the cash flows of regulatory assets and regulatory liabilities that are expected to be recovered or fulfilled within 12 months of their recognition (paragraph 42). In most cases, the effects of the time value of money over a 12-month period are unlikely to be significant relative to an undiscounted measurement of a regulatory asset or regulatory liability. Therefore, we think this exemption could reduce the cost of applying the proposal on uneven regulatory interest rate without a loss of useful information.

72. If an entity has elected to apply the exemption in paragraph 69, we think disclosures similar to those described in paragraph 46(b) would help users to understand the effects on the entity's regulatory assets and regulatory liabilities at the end of the reporting period.

73. We recommend that the final Accounting Standard:

(a) permit an entity not to discount the estimates of future cash flows that arise from a regulatory asset or regulatory liability, if the entity expects that the period between recognition of that regulatory asset or regulatory liability and when regulatory interest starts to accrue will be 12 months or less. This exemption would cease to apply once regulatory interest starts to accrue.

(b) require an entity that has elected to apply the exemption from discounting to disclose this fact and the amount of regulatory assets and regulatory liabilities at the end of the reporting period to which the entity has applied the exemption.

Question for the IASB
6. Does the IASB agree with the staff recommendation in paragraph 73?

Regulatory interest rates that depend on an interest rate benchmark

74. As mentioned in paragraph 59(b), a few respondents asked whether and how the proposal on uneven regulatory interest rate would be applied to regulatory interest rates that depend on an interest rate benchmark. According to feedback on the Exposure Draft, regulatory interest rates that depend on such a benchmark are used in some regulatory schemes in Brazil and Hong Kong.

75. Paragraph 54 of the Exposure Draft states that the proposal on uneven regulatory interest rate applies if 'a regulatory agreement provides or charges regulatory interest unevenly by *specifying at initial recognition* of a regulatory asset or regulatory liability *a series of different regulatory interest rates for successive periods* over the life of that regulatory asset or regulatory liability'. However, that proposal was not developed for the case of interest rate benchmark that includes a series of different interest rates for successive time bands.

76. We think a regulatory asset or regulatory liability with regulatory interest rates that depend on an interest rate benchmark would be analogous to floating-rate financial assets and floating-rate financial liabilities. IFRS 9 states that if a floating-rate financial asset or a floating-rate financial liability is recognised initially at an amount equal to the principal receivable or payable on maturity, re-estimating the future interest payments normally has no significant effect on the carrying amount of the asset or the liability.[14]

77. Similarly, we think a measurement of the regulatory asset or regulatory liability in paragraph 76 would in most cases equal the sum of the estimated future cash flows, excluding the cash flows arising from regulatory interest that has not yet accrued. Those cash flows would include the amount of regulatory interest that has accrued since the previous measurement and has not yet been recovered or fulfilled. This measurement would be consistent with the principle underpinning the proposal to use the regulatory interest rate as the discount rate (paragraph 21). Therefore, we think an

[14] Paragraph B5.4.5 of IFRS 9.

entity would be able to apply the discount rate proposals to determine the measurement of such a regulatory asset or regulatory liability.

78. We therefore recommend that the final Accounting Standard clarify that the proposal in paragraph 54 of the Exposure Draft does not apply to a regulatory asset or regulatory liability that attracts regulatory interest rates that depend on an interest rate benchmark.

Question for the IASB
7. Does the IASB agree with the staff recommendation in paragraph 78?

Appendix A—Extracts from the Consultative Group's meeting summary

A1. This appendix contains extracts from the summary of the meeting of the Consultative Group held on 13 October 2023 relating to the matters analysed in this paper.[15]

Regulatory interest rate as the discount rate

2. CGRR members discussed:

   (a) circumstances in which a regulatory agreement:

      (i) does not provide or charge a regulatory interest rate for a regulatory asset or regulatory liability;

      (ii) does not specify a time frame over which a regulatory asset or regulatory liability would be recovered or fulfilled; or

      (iii) provides regulatory compensation for both the present value of the cash flows arising from a provision and the unwinding of the related discount with a two-year time lag.

   (b) a possible exemption from discounting regulatory assets and regulatory liabilities.

3. CGRR members reported diversity in whether regulatory agreements in their jurisdictions specify a regulatory interest rate for regulatory assets and regulatory liabilities. Members said that:

   (a) in Canada, regulators in the electricity and gas industries typically provide or charge a regulatory interest rate on regulatory assets and regulatory liabilities, except for specified categories of regulatory assets and regulatory liabilities. However, regulators do not provide a regulatory interest rate between when an entity incurs an expense—and hence, recognises a regulatory asset—and when the regulator approves that expense. The time lag between when the expense is incurred and approved is typically a few months but the time lag between when the expense is approved and recovered may be a few years.

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

(b) in Germany, the regulatory agreements provide or charge a regulatory interest rate on regulatory balances and those balances are not recognised as an asset or a liability applying IFRS Accounting Standards.

(c) in other jurisdictions, regulatory agreements provide a return on an entity's regulatory capital base but may not specify a regulatory interest rate separately for regulatory assets and regulatory liabilities. For example, regulators do not provide or charge a regulatory interest rate for:

(i) most or all regulatory assets and regulatory liabilities in India and South Africa; or

(ii) specified regulatory assets and regulatory liabilities—for example, those arising from items of expense or income that had not resulted in cash outflows or inflows in the United States, or those that are recovered or fulfilled within the next few years in the United Kingdom.

(d) a member from an accounting firm said there is insufficient information from other jurisdictions about whether regulatory agreements provide or charge a regulatory interest rate on regulatory assets or regulatory liabilities. This may be because entities do not currently collect the information when applying IFRS Accounting Standards.

4. A member from an accounting firm said the proposals are unclear if a regulatory agreement provides a return on an entity's regulatory capital base but does not specify a regulatory interest rate separately for regulatory assets and regulatory liabilities. This member said it is unclear for these regulatory assets and regulatory liabilities, whether an entity is required to discount future cash flows and to determine the discount rate by applying the minimum interest rate proposals.

5. A member said that in India, regulatory assets and regulatory liabilities for which the regulatory agreement does not specify a time frame for recovery or fulfilment are common. These regulatory assets and regulatory liabilities arise from items of expense or income that the regulator approves on a case-by-case basis following a prudence review.

6. [...]

7. All members who commented supported introducing an exemption from discounting regulatory assets and regulatory liabilities, recovered or fulfilled within 12 months of recognition.

[…]

Uneven regulatory interest rate

13. CGRR members discussed:

    (a) circumstances in which a regulatory agreement does not provide (charge) a regulatory interest rate for a regulatory asset (regulatory liability) between when an entity recognises the regulatory asset (regulatory liability) and when the regulator allows the entity to start recovering (fulfilling) the regulatory asset (regulatory liability); and

    (b) how an entity should discount the estimates of future cash flows arising from such a regulatory asset (regulatory liability).

14. A few members provided examples of circumstances in which there is a time lag between the recognition of a regulatory asset or regulatory liability and the accrual of regulatory interest:

    (a) a member said there are no apparent examples in Canada in which the regulatory agreement specifies uneven regulatory interest rate for a regulatory asset or regulatory liability. It is common, however, for the regulator to provide or charge a regulatory interest rate only once an item of expense or income is approved, rather than for the full life of the regulatory asset or regulatory liability (see paragraph 3(a)).

    (b) a member from an accounting firm said feedback from the network firms did not identify any examples of such circumstances.

15. A few members provided their views on how an entity should discount the estimates of future cash flows arising from such a regulatory asset or regulatory liability. Almost all members who commented did not support applying the proposals on uneven regulatory interest rate and said the accounting should reflect the regulatory interest rates as specified by the regulatory agreement. However, one member expressed support for the proposals, acknowledging that in India regulatory agreements generally do not provide or charge a regulatory interest rate on regulatory assets and regulatory liabilities and that regulatory assets and regulatory liabilities are generally recovered or fulfilled within two years.

16. A few members provided additional comments on the proposals on uneven regulatory interest rate:

    (a) a member said a regulatory agreement could have specified increasing regulatory interest rates over the life of a regulatory asset or regulatory liability to reflect increasing level of risks over time. If this were the case, it would be

unclear why an entity would be prohibited from discounting the estimates of future cash flows in a way that reflected the regulatory interest rates as specified by the regulatory agreement.

(b) a member, a user of financial statements, said in some cases the regulator determines performance incentives based on an entity's performance over multiple reporting periods. The regulator provides or charges a regulatory interest rate on the performance incentives only after the end of the performance period. The member said that it is also unclear how the proposals would apply in such cases.

Appendix B—Regulatory assets and regulatory liabilities with short time lag between recognition and accrual of regulatory interest

B1. Paragraph 73 sets out the staff recommendation to provide an exemption from discounting to a regulatory asset or regulatory liability for which the entity expects that the period between recognition and when regulatory interest starts to accrue will be 12 months or less. This appendix illustrates how an entity applies this exemption with an example.

B2. Assume an entity incurs an allowable expense of CU60 at the end of Year 0. The regulatory agreement allows the entity to recover an amount of CU30, together with regulatory interest at 5% on the unrecovered regulatory balance at the beginning of Years 2 and 3. Table 1 shows the regulatory balances:

Table 1—Regulatory balances

In CU / Years	0	1	2	3	Total
Opening balance	-	60	60	30	-
Addition	60	-	-	-	60
Regulatory interest	-	-	3	2	5
Recovery	-	-	(33)	(32)	(65)
Closing balance	**60**	**60**	**30**	**-**	-

B3. Applying the proposals in paragraph 54 of the Exposure Draft, an entity would need to compute the discount rate that discounts the estimated future cash flows in Year 2 and Year 3 back to CU60 in Year 0. That rate is 2.95%. Table 2 shows the reconciliation of the carrying amount of the regulatory asset measured applying the proposals:

Table 2—Reconciliation of the regulatory asset applying the proposals

In CU / Years	0	1	2	3
Opening balance	-	60	62	31
Amount recognised	60	-	-	-
Regulatory interest income	-	2	2	1
Recovery	-	-	(33)	(32)
Closing balance	**60**	**62**	**31**	**-**

B4. Applying the exemption in paragraph 73, the entity would measure the regulatory asset at CU60 at the end of Year 0, based on total cash flows of CU65 less regulatory interest of CU5 (paragraph 70(a)). At the end of Year 1, the entity would measure the regulatory asset at the present value of CU60 by discounting the cash flows in Year 2 and Year 3 back to that date using the regulatory interest rate of 5% as the discount rate (paragraph 70(b)). Table 3 shows the reconciliation of the carrying amount of the regulatory asset measured applying the exemption.

Table 3—Reconciliation of the regulatory asset applying the exemption

In CU / Years	**0**	**1**	**2**	**3**
Opening balance	-	60	60	30
Amount recognised	60	-	-	-
Regulatory interest income	-	-	3	2
Recovery	-	-	(33)	(32)
Closing balance	**60**	**60**	**30**	**-**