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Rate-regulated Activities

Issues Paper

Objective

- 1 The purpose of the session is twofold:
 - (a) to discuss and obtain EFRAG FR TEG-CFSS views on the IASB's May tentative decisions relating to a sweep issue identified during the drafting of the prospective IFRS Accounting Standard *Regulatory Assets and Regulatory Liabilities* ("prospective Standard"); and
 - (b) to provide an assessment of the likely effects (benefits and costs) of the prospective Standard.
- 2 The input received from EFRAG FR TEG-CFSS will be presented at the Accounting Standards Advisory Forum meeting on 7-8 July 2025. The [IASB agenda paper AP2](#) for this session is provided for background information only.
- 3 This issues paper is structured as follows:
 - (a) Sweep issue
 - (b) IASB tentative decisions related to the sweep issue
 - (c) Likely effects (benefits and costs) of the prospective Standard
 - (d) EFRAG Secretariat analysis

Sweep issue

- 4 In July 2024, the IASB tentatively decided to exempt an entity from discounting regulatory assets and regulatory liabilities in some specified circumstances, such as:
 - (a) the regulatory asset or regulatory liability arises from an item of expense or income that (i) is related to liabilities or assets measured on a present value basis and (ii) affects regulated rates on an accrual basis (i.e. pension costs); and

- (b) the entity is unable to estimate the amount and timing of the future cash flows having considered all reasonable and supportable information that is available without undue cost or effort.
- 5 Given the complexity of applying the exemption from discounting, the IASB considered whether the exemption from discounting in paragraph 4 could be addressed by amending the minimum interest rate requirements.
- 6 The minimum interest rate requirements apply to regulatory assets that attract a regulatory interest rate that provides insufficient compensation for the time value of money and uncertainty in future cash flows. These requirements would typically apply to the regulatory assets to which the IASB intended the exemption from discounting as set out in paragraph 4.
- 7 During the drafting of the prospective Standard, the IASB considered four approaches:
- (a) develop a replacement for the exemption from discounting or add guidance on estimating future cash flows;
 - (b) remove the exemption from discounting and instead extend the existing exemption from the minimum interest rate requirements;
 - (c) remove the minimum interest rate requirements, except in a few specified circumstances; or
 - (d) remove the minimum interest rate requirements completely and include enhanced disclosure requirements to help users understand the time value effects on regulatory assets and regulatory liabilities for which the regulatory agreement does not specify a regulatory interest rate.

IASB tentative decisions related to the sweep issue

- 8 In May 2025, the IASB tentatively decided that the prospective Standard would:
- (a) include no requirements for a minimum interest rate.
 - (b) include a requirement for an entity to disclose quantitative information, using time bands, about when it expects to recover regulatory assets and fulfil regulatory liabilities. The entity would be required to disaggregate the quantitative information between regulatory assets and regulatory liabilities for which the regulatory agreement:
 - (i) provides or charges a regulatory interest rate; and
 - (ii) does not provide or charge a regulatory interest rate.

- (c) include a requirement for an entity to provide the quantitative information described in (b) using:
 - (i) undiscounted cash flows; and
 - (ii) reasonable and supportable assumptions about the timing of future cash flows that are consistent between periods.
 - (d) clarify that assumptions about market variables used in the estimates of future cash flows:
 - (i) should be consistent with observable market prices at the measurement date; and
 - (ii) should not take into account the effects of possible future changes in market variables;
- 9 Additionally, the IASB tentatively decided to include in the prospective Standard transitional requirements for interim financial statements. If an entity applies IAS 34 *Interim Financial Reporting* in the first year of applying the prospective Standard, the entity shall present in its condensed interim financial statements each heading and subtotal it expects to use in its annual financial statements, despite the requirements in paragraph 10 of IAS 34. The entity shall apply the requirements in paragraph 10 of IAS 34 for headings and subtotals after it has issued its first set of annual financial statements.

Likely effects (benefits and costs) of the prospective Standard

- 10 With every major IFRS Accounting Standard, the IASB publishes an effects analysis describing the likely costs and benefits of the new or amended standard.
- 11 Similarly, throughout the development of the prospective Standard on rate-regulated activities, the IASB collected information through comment letters, meetings with advisory bodies and fieldwork. Based on this information, the IASB's observations on the likely effects on reported information, benefits and costs are laid out in the following paragraphs.

Effects on reported information

- 12 Statement(s) of financial performance will include information about:
- (a) regulatory income minus regulatory expense which will be presented as a separate line item classified as revenue in the statement of profit or loss or other comprehensive income in limited cases;
 - (b) total allowed compensation for regulatory goods or services supplied in a reporting period which will complement information from other IFRS Accounting Standards.

- 13 Statement of financial position will include current and non-current regulatory assets, and current and non-current regulatory liabilities.
- 14 Notes to the financial statements will disclose information about regulatory assets, regulatory liabilities, regulatory income and regulatory expenses. The disclosed information will include a reconciliation, a maturity analysis of regulatory assets and regulatory liabilities and the risks and uncertainties affecting the recovery or fulfilment of those regulatory assets and regulatory liabilities.
- 15 The effects for entities that do not currently recognise regulatory balances are expected to be greater than the effects for entities that currently recognise regulatory balances in their reporting. Based on preliminary fieldwork results, the impact of regulatory assets / total assets and regulatory liabilities / total liabilities could range between 5% to up to 30%/ 40%. Similar is the impact of regulatory income or regulatory expense/revenue from regulated activities – ranging between 5% to up to 40%.
- 16 Some entities whose regulatory capital base is not related to their property, plant and equipment expect to have significant unrecognised regulatory assets and unrecognised regulatory liabilities.
- 17 The prospective Standard is also expected:
 - (a) to affect some financial metrics such as EBITDA, operating profit, working capital, liquidity and leverage ratios;
 - (b) might impact financial-related items such as debt covenants, distributable reserves and remuneration policies to the extent that these are calculated using information resulting from applying IFRS Accounting Standards;
 - (c) might affect non-GAAP measures – by either reducing their use as some of the effects would be already captured by applying the prospective Standard or increasing their use due to effects of rate regulation not captured by it.

Benefits

- 18 In general, the requirements in the prospective Standard will result in:
 - (a) more complete information about an entity's total allowed compensation and its prospects for future cash flows;
 - (b) improved users' understanding of how differences in timing affect an entity's financial performance and financial position which will allow them to better assess the amount, timing and uncertainty of the entity's future cash flows;

- (c) improved comparability across entities based on the usage of a single set of requirements.

And the above will lead to better economic decision-making for users.

- 19 Most of the participants in the IASB fieldwork indicated that the prospective Standard will at least 'somewhat likely' provide useful information and improve comparability (see paragraph 1 of Appendix 1).
- 20 The prospective Standard is expected to improve the quality of digital reporting through presentation and classification as well as structured disclosure requirements.

Costs

Costs for preparers

- 21 The implementation of the prospective Standard is likely to result in reduced costs for entities that currently recognise regulatory balances and higher costs for entities that do not currently recognise regulatory balances.
- 22 The expected implementation costs relate to costs to implement or make changes to existing systems and processes, external and internal education and increased audit costs.
- 23 Based on the IASB fieldwork, some entities consider some of these costs to be only one-time implementation costs, while other entities might consider the same costs to be also ongoing. Ongoing costs are generally expected to gradually decrease over time.
- 24 The expected implementation costs are expected to be mitigated by:
 - (a) scope clarifications made by the IASB - clear interaction with other IFRS Accounting Standards;
 - (b) recognition prohibitions – recognition of specific regulatory assets and regulatory liabilities is prohibited when tracking differences between the entity's regulatory capital base and its property, plant and equipment would be costly, highly judgemental or even impracticable;
 - (c) Measurement simplification and relief – entities are required to use the regulatory interest rate to discount future cash flows; entities are exempt from discounting in the period between recognition and the date when the regulatory interest starts to accrue if that period is expected to be one year or less;
 - (d) Transition reliefs – the prospective Standard provides a modified retrospective transition approach in addition to a full retrospective approach.

25 Based on the IASB fieldwork, the majority of fieldwork participants expect implementation costs to be low or medium. However, some fieldwork participants ranked costs related to systems and processes (i.e. costs related to developing new systems and processes to accommodate the requirements of the prospective Standard) and audit costs (i.e. audit costs related to estimating future cash flows would involve significant estimates and judgements) to be high (see paragraph 2 of Appendix 1).

Costs for users

26 The expected costs that users will incur are associated with adjusting their valuation models to capture the information provided in the new line items of the statement of financial position and financial performance, and in the notes. However, these costs are expected to be mitigated by the reduced costs of users having to source information outside the financial statements.

27 Clarifications, simplifications and reliefs provided in the prospective Standard are expected to help entities reduce some implementation costs while maintaining the usefulness of information provided to users.

28 Users will also incur costs in understanding how the entity's financial results differ from those reported in previous reporting periods.

EFRAG Secretariat analysis

Sweep issue

29 Consistent with the position of EFRAG's comment letter¹ to the IASB 2021 exposure draft *Regulatory Assets and Regulatory Liabilities* and the subsequent discussions held by EFRAG RRAWG, the EFRAG Secretariat supports the IASB's tentative decision to remove the

¹ EFRAG disagreed with the proposed application of a minimum interest rate as the discount rate for regulatory assets when the regulatory interest rate provided for a regulatory asset was insufficient. Users considered that the regulatory interest rate was objective and should be used to discount regulatory assets and regulatory liabilities in all circumstances. Users informed EFRAG that using a different WACC determined by each individual company when determining a minimum discount rate will not facilitate comparability and will be confusing.

EFRAG also disagreed with the proposal for different discounting approaches for regulatory assets and regulatory liabilities. In EFRAG's view, the regulatory agreement does not use the concept of a minimum interest rate and introducing such a rate in the accounting model might be a subjective and complex exercise for preparers which would not result in relevant information for users. It would also involve a lot of discussion with auditors given the level of judgement necessary to make the assessment.

proposals related to minimum interest rate. This will reduce the complexity of the model for rate-regulated entities and result in a better depiction of economic circumstances.

- 30 The EFRAG Secretariat is generally in agreement with the proposed additional disclosure requirements as a result of removing the minimum interest rate requirement.

Likely effects of the prospective Standard

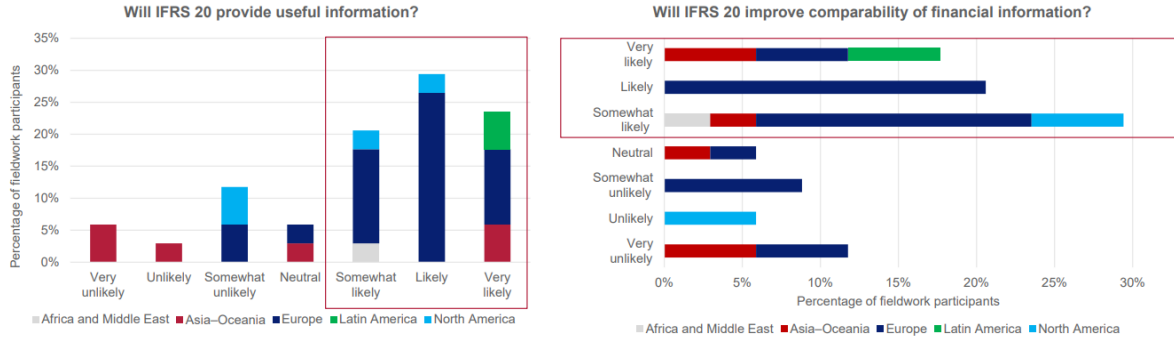
- 31 The EFRAG Secretariat acknowledges that the overall picture from the preliminary findings of the IASB's fieldwork on likely effects of the prospective Standard is consistent with the findings from the EFRAG survey to preparers on the practicability and likely costs and benefits of the prospective Standard. This is hardly surprising as a significant number of respondents to the IASB field test were from Europe.
- 32 However, the EFRAG Secretariat considers that, given the complexity of the Standard and the number of significant decisions made after the exposure draft, rather than being deemed conclusive, the IASB field test findings should only be seen as a positive initial step that ought to be followed by a more detailed field test involving preparers, auditors, enforcers, and users. Moreover, there are some differences in the respective aggregate findings of the IASB and EFRAG surveys. For instance, unlike the IASB survey, EFRAG's survey highlighted that there is a need to further assess the direct (no direct) relationship constraint towards recognition of regulatory assets (liabilities) and unit of account challenges. Also, some respondents to the EFRAG survey to preparers considered that internal education costs will be high in addition to systems and processes and audit costs. Finally, it is challenging to fully reconcile the results of the EFRAG survey to preparers with the presented high-level findings of the IASB fieldwork.

Questions for EFRAG FR TEG/CFSS

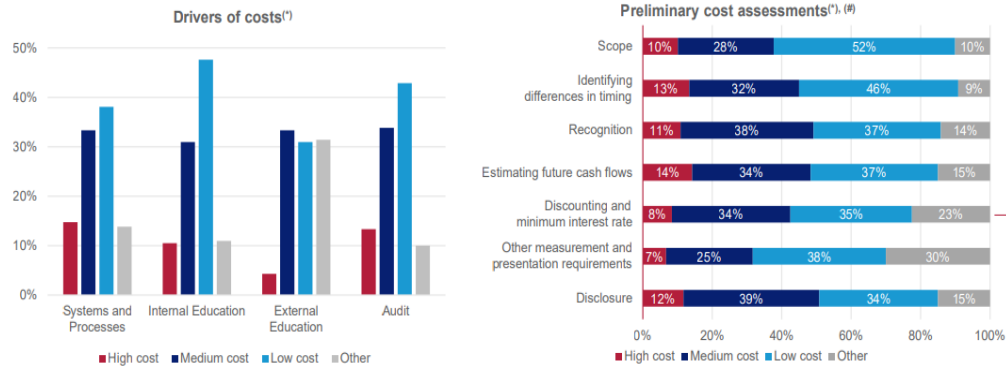
- 33 Does EFRAG FR TEG/CFSS have any comments or questions on:
- (a) the sweep issue (paragraphs 4-7) and related tentative decisions in paragraph 8?
 - (b) the assessment of the expected benefits and costs of the prospective Standard (paragraphs 10 - 28)?
 - (c) the EFRAG Secretariat's analysis of the sweep issue and likely costs and benefits of the prospective Standard (paragraphs 29 - 32)?

Appendix 1: Preliminary fieldwork results based on the IASB survey

1 Expected benefits of the prospective Standard



2 Expected costs of the prospective Standard



★ The IASB's recent decision to remove the minimum interest rate requirements should make the prospective Standard simpler to apply, reducing costs for entities.