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IASB Rate-regulated Activities project

Issues Paper

Measurement of regulatory assets and regulatory liabilities

Objective

- 1 The objective of this session and agenda paper is to discuss the IASB's tentative decisions on the measurement requirements that will be reflected in the prospective IFRS Accounting Standard related to Regulatory Assets and Regulatory Liabilities (prospective IFRS RARL Standard).

Structure of this paper

- 2 This paper covers the following aspects:
 - (a) Overview of the measurement requirements
 - (b) General measurement principles
 - (c) Discounting – general principles
 - (d) Discounting – minimum discount rate
 - (e) Appendix 1 – ED proposals and feedback to the ED
 - (f) Appendix 2 - Illustrative example-uneven discount rates
 - (g) Appendix 3 - Illustrative example-minimum interest rate
- 3 This paper also provides an overview of the feedback received on the IASB's tentative decisions during EFRAG RRAWG, EFRAG CFSS-TEG and ASAF meetings. Also, at the end of this paper is an EFRAG Secretariat analysis of the overall measurement requirements.

Overview of the measurement requirements

4 The table below provides an overview of the proposed measurement requirements.

Future cash flows	Discount rate
<i>Initial measurement</i>	
Include all future cash flows (including regulatory interest)	Discount estimated future cash flows
<ul style="list-style-type: none"> estimated using the ‘most likely amount’ method or ‘expected value’ method, whichever better predicts uncertain future cash flows 	<ul style="list-style-type: none"> using the regulatory interest rate unless the regulatory interest rate for a regulatory asset is insufficient in which case an entity applies a minimum interest rate to discount regulatory assets
<i>Subsequent measurement</i>	
Update estimates of future cash flows	Continue to use discount rate determined at initial recognition
<ul style="list-style-type: none"> to reflect conditions existing at the end of the reporting period 	<ul style="list-style-type: none"> unless the regulatory agreement changes the regulatory interest rate
Reassess the method of estimating uncertain cash flows	
<ul style="list-style-type: none"> only if there is a significant change in facts and circumstances 	
Minimum interest rate—regulatory assets only	
<p>Assess for <u>any indication</u> that the regulatory interest rate <u>may be insufficient</u> to compensate for the time value of money and uncertainty in future cash flows.</p> <p>Not required to carry out an exhaustive search for indications.</p> <p>If there is such an indication:</p> <ul style="list-style-type: none"> calculate the minimum interest rate. use, as the discount rate, the minimum interest rate if it is higher than the regulatory interest rate. <p>The minimum interest rate:</p> <ul style="list-style-type: none"> reflects the key features of future cash flows—the currency, maturity profile and uncertainty. does not reflect risks for which future cash flows have been adjusted 	
Measurement exemptions will be holistically discussed at a later date.	

5 The remaining parts of this paper discuss in more detail the following aspects of the measurement requirements as tentatively decided by the IASB: a) general measurement principles; b) discounting general principles; and c) discounting- minimum interest rate. Measurement exemptions will be presented to EFRAG FR TEG for discussion at a later date.

General measurement principles

IASB tentative decisions (June 2023) ([agenda paper 9B](#)).

- 6 The IASB tentatively decided the following:
- (a) *Initial measurement - Estimating uncertain cash flows* - retain the requirement proposed in the ED (see Appendix 1) that an entity estimate uncertain future cash flows using whichever of the two methods - the 'most likely amount' method or the 'expected value' method - the entity expects would better predict the cash flows;
 - (b) *Subsequent measurement - Reassessment* - require an entity to reassess the method of estimating uncertain future cash flows only if there is a significant change in facts and circumstances such that the entity no longer expects the method to better predict the cash flows;
 - (c) *Use of the 'expected value method'* - clarify that when an entity uses the 'expected value' method to estimate uncertain future cash flows the entity should consider the entire range of outcomes, including those outcomes in which a regulatory asset or a regulatory liability would not exist, or would exist but produce no future cash flows; and
 - (d) *No separate impairment test* - retain the proposal in the ED not to require a separate impairment test for regulatory assets.
- 7 The IASB also tentatively decided that the prospective IFRS RARL Standard would not provide additional guidance on circumstances in which the 'most likely amount' method might better predict uncertain future cash flows.

Feedback from EFRAG RRAWG

- 8 Consistent with EFRAG's final comment letter on the ED (FCL), EFRAG RRAWG members agreed with estimating uncertain future cash flows with the IASB's tentative decision to use either the most likely amount or the expected value method, depending on which approach provides more relevant information.

Feedback from EFRAG TEG-CFSS (September 2023)

- 9 Consistent with EFRAG's FCL, EFRAG TEG-CFSS members generally supported the general measurement proposals. Members noted that :
- (a) requiring the use of either the most likely amount method or the expected value method for estimating uncertain future cash flows is consistent with the requirements of IFRS 15 *Revenue from Contracts with Customers* and IFRIC 23 *Uncertainty over Income Tax Treatments*

- (b) “reassessment of estimation method only if there is a significant change in only if there is a significant change in facts and circumstances such that the entity no longer expects the method to better predict the cash flows” - was in response to concerns about paragraph 42 of the ED which stated that “an entity apply the chosen method for estimating uncertain future cash flows consistently from initial recognition to recovery or fulfilment”
- (c) the tentative decision also clarified the interaction between estimation methods and existence uncertainty- the IASB clarified that all possible outcomes are considered when estimating future cash flows. Some stakeholders had questioned whether the measurement of regulatory assets and regulatory liabilities should only encompass their certain future cash flows. The tentative decision clarified that once it is “more likely than not” certain that regulatory assets and regulatory liabilities exist, an entity should consider all the related cash flows in the measurement including those cash flows that are uncertain.
- (d) No need for a separate impairment test, affirms the ED’s proposals. In its FCL, EFRAG suggested the IASB provides further guidance on how the interaction with a CGU that included regulatory assets would work in practice, in respect of separating the cash flows from regulatory assets from the total cash flows generated by a CGU for impairment test purposes. In its re-deliberations, the IASB considered that such clarification was not necessary as IAS 36 was sufficiently clear.

Feedback from ASAF (September 2023)

- 10 ASAF members generally supported the IASB’s tentative decisions related to estimating uncertain future cash flows.

Discounting – general principles

IASB tentative decisions (March 2024) ([agenda paper 9A](#))

- 11 The IASB tentatively decided to:
 - (a) *General discounting principle* - retain the ED proposal (see Appendix 1) that an entity be required to discount estimates of future cash flows that arise from a regulatory asset or regulatory liability;
 - (b) *Regulatory interest rate* - retain the proposal that an entity be required 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) *Exemption from discounting* - exempt an entity from applying the proposed requirement described in (a) to discount estimates of future cash flows from a regulatory asset or regulatory liability, if the entity expects the period between recognition of that regulatory asset or regulatory liability and its recovery or fulfilment to be 12 months or less. If an entity elects to apply this exception, it will be required to disclose that fact and disclose the carrying amount of regulatory assets and regulatory liabilities at the end of the reporting period to which the entity has applied that exemption;
- (d) *Unspecified regulatory timeframe* - not to exempt an entity from applying the proposed requirement described in (a) to discount estimates of future cash flows from a regulatory asset or regulatory liability for which the regulatory agreement does not specify a time frame for recovery or fulfilment; and
- (e) *Single discount rate* - retain the proposal that an entity be required 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 IASB also tentatively decided not to provide guidance on the computation of the single discount rate. Furthermore, the IASB clarified that this proposal does not apply to a regulatory asset or regulatory liability that attracts regulatory interest rates that depend on an interest rate benchmark.

Feedback from EFRAG RRAWG (December 2023 and May 2024)

12 Consistent with EFRAG's FCL which supported discounting but called for the exemption when the discounting effects were not significant, EFRAG RRAWG members generally agreed with the IASB's tentative decisions. **The more controversial tentative decision (where disagreement was expressed) related to applying a single discount rate** when the regulatory agreement specifies, at initial recognition, different regulatory interest rates over the life of a regulatory asset (liability). However, the IASB staff representative present at the meeting noted that such situations are rare in European jurisdictions. Below are more detailed comments made on the discounting proposals.

- (a) *Regulatory interest rate* - One member informed that some regulatory agreements might not provide a rate and referred to WACC and in those cases, it was not clear which rate an entity should use. Another member responded that an entity should always use the rate the regulatory agreement would allow an entity to recover in the rates it charges to customers. This member explained that in some regulations the rate would allow more than only the time value of money.

- (b) *Exemption from discounting* - Members generally agreed with having an exemption when an entity expects the period between recognition of that regulatory asset or regulatory liability and its recovery or fulfilment to be 12 months or less. One member noted the 12-month exemption was welcomed but would have preferred a materiality exemption. The IASB representative explained that the exemption was developed considering that the effects of the time value of money over a 12-month period are unlikely to be significant, so to some extent materiality had been considered when designing the exemption. In addition to that, the overall materiality concept would apply to discounting.
- (c) *Uneven interest rates – determining a single rate* - members continued to prefer using the regulatory interest rate (rather than determining a single discount rate). This is because the IASB's proposal would add complexity and create an additional difference between the amounts based on IFRS Accounting Standards and the regulatory balances. One member asked for clarification on the circumstances which would require an entity to determine a single interest rate. There could be different situations when the regulatory interest rates could be different -- in some cases for different regulatory assets and regulatory liabilities and other cases for the same regulatory assets (regulatory liabilities).
- (d) In response, the IASB representative explained that the **proposal on determining a single rate would apply in specific circumstances** - when there was a time lag between the initial recognition of a regulatory or regulatory liability and when the regulatory asset or regulatory liability starts to accrue interest. This is illustrated in **example 5 of the Illustrative examples accompanying the ED (see Appendix 2)**. The circumstances for uneven interest rates were common in North America but according to the IASB staff representative, these cases were not common in European regulations.

Feedback from EFRAG TEG-CFSS (September 2024)

- 13 Consistent with EFRAG's FCL support for the general discounting principle, EFRAG FR TEG-CFSS members agreed with the IASB's tentative decisions on the discount rate and welcomed the IASB's tentative decision to provide an exemption to discounting in certain circumstances (recovery (fulfilment) of a regulatory asset (liability) occurs in 12 or less months).

Feedback from ASAF (September 2024)

- 14 ASAF members generally agreed with the IASB's tentative decisions on the general principles of discounting.

Discounting – minimum interest rate

IASB tentative decisions (April 2024)

- 15 The IASB tentatively decided to:
- (a) *Applying a minimum interest rate* - retain the proposals in paragraphs 50-52 of the ED that would require an entity to assess whether there is any indication that the regulatory interest rate for a regulatory asset might be insufficient to compensate the entity for the time value of money and uncertainty in the future cash flows arising from the regulatory asset, and to use the minimum interest rate as the discount rate if it is higher than the regulatory interest rate. The IASB also decided to provide guidance on the estimation of the minimum interest rate;
 - (b) *Regulatory interest rate* - retain the proposal in paragraph 53 of the ED that would require an entity to use the regulatory interest rate as the discount rate for a regulatory liability in all circumstances; and
 - (c) *Exemption to using the minimum interest rate*- exempt an entity from applying the proposals on the minimum interest rate to a regulatory asset that arises from variances between estimated and actual costs or volume, and to require an entity to apply the requirements once the regulator determines the final balance to be included in future regulated rates. An entity that chooses to apply this exemption, must disclose that fact and the carrying amount of regulatory assets at the end of the reporting period to which the entity has applied that exemption.
- 16 Seven of 14 IASB members agreed with decisions 15(a) and 15(b) above. The IASB Chair used his additional casting vote, making the vote in favour of these decisions.
- 17 Some members agreed with applying a minimum interest rate as it would align with the conceptual approach used in most IFRS Accounting Standards to discount cash flows. If there was a long-term rate regulated activity, there would be a large difference. In addition, If the regulatory interest rate did not provide sufficient compensation, then regulatory assets and income would be overstated.
- 18 Those who disagreed with applying a minimum interest rate noted that it would be complex for preparers and not useful for users according to the feedback received. They noted that the assessment would be judgemental and preparers would spend large

amounts of time with auditors and regulators. They also pointed out the asymmetry related to the regulatory asset and the regulatory liability having different discount rates.

Feedback from EFRAG RRAWG (December 2023 and July 2024)

December 2023 (meeting held to provide input to IASB staff before IASB tentative decision)

- 19 **Members generally disagreed with the proposal to apply a minimum interest rate** and suggested removing the proposal as it added complexity, it was asymmetrical and there were no clear benefits from applying the proposal.
- 20 Some members said that they were not aware of cases where the regulatory interest rate could be insufficient. These members provide the following comments:
- (a) An example of a regulatory agreement that did not allow for an inflation indexation and instead changed the revenue profile and allowed the entity to recover more revenue through increased rates in the earlier years. In this case, the regulatory rate could be considered as “insufficient”, however, the allowed revenue could be considered sufficient. The proposal in the ED looked at the regulatory rate in isolation, but what was important was the bigger picture and whether the overall allowed revenue an entity was entitled to was sufficient.
 - (b) If the regulatory return was insufficient this could be an indication of impairment of the regulatory asset.
 - (c) Some members suggested that similar to IAS 12, there should be no discounting because of the complexity involved.

July 2024 RRAWG meeting (post IASB tentative decision)

- 21 **Some members noted that it would be helpful if the IASB would provide guidance on how to estimate the minimum interest rate.** It has been clarified in the IASB tentative decisions that such guidance would be provided. This member added that in some cases the entity was applying a weighted average cost of capital (WACC) and it was unclear whether this could be used when determining the rate to be used for discounting purposes. Some members suggested that the minimum interest rate requirement be considered during EFRAG’s preparatory work for endorsement advice- outreach to preparers.

Clarifications provided by the IASB representative

- 22 There is a distinction between regulatory returns on RCB (generally a weighted average cost of capital, that factors more than just the time value of money and uncertainty in the future cash flows) and regulatory interest that a regulatory agreement provides (charges) for a regulatory asset (regulatory liability). Entities would have to refer to their regulatory

agreements to identify the regulatory interest rate that is relevant to a regulatory asset when applying the minimum interest rate requirement. In general, there were two possibilities with regard to the information in the regulatory agreement:

- (a) the regulator gives regulatory returns on RCB (i.e., WACC) and gives no interest rate for regulatory assets and regulatory liabilities. In this case, the regulatory interest rate is zero and an entity would need to assess whether that rate provides sufficient compensation for the time value of money and uncertainty in the future cash flows arising from the regulatory asset.
- (b) the regulator gives regulatory returns on RCB (WACC) and for some or all regulatory assets and regulatory liabilities provides (charges) a regulatory interest rate. In this case, the explicit regulatory interest rate should be the discount rate to be used.

23 The **minimum interest rate assessment is expected to be applied when the regulatory agreement provides a zero interest rate for regulatory assets**. Some examples of such situations are:

- (a) Entities from developing countries might have material regulatory assets, however, they might not be receiving interest on those assets
- (b) Regulatory assets might be connected to abandoned projects for which the regulator might allow the entity to recover those assets, however, the regulator does not provide an interest rate on the regulatory assets and regulatory liabilities.

24 An entity's WACC is expected to provide compensation beyond the time value of money and uncertainties in cash flows on any regulatory assets. Therefore, minimum interest rate proposals were not developed to assess the sufficiency of regulatory return on assets based on WACC. Some examples of instances where the entity would use WACC as the discount rate are:

- (a) The WACC is not a rate that is expected to be used for discounting regulatory assets and regulatory liabilities which are not related to the RCB. This is either because these regulatory assets or regulatory liabilities may be attracting a regulatory interest rate that is different from WACC or may not be attracting any regulatory interest rate.
- (b) WACC would be used as the discount rate when the entity has a direct relationship between its RCB and PPE if there are differences between the regulatory recovery period and useful lives of assets.

Feedback from EFRAG TEG-CFSS (September 2024)

- 25 In its FCL, EFRAG disagreed with the proposed concept of a minimum adequate interest rate as the discount rate for regulatory assets, when the regulatory interest rate provided is insufficient. Should the IASB decide to maintain this concept, EFRAG recommends that the IASB develop a rebuttable presumption. EFRAG also disagreed with having different discounting approaches for regulatory assets and regulatory liabilities.
- 26 In subsequent discussions, TEG FR and CFSS members continued to express concerns with the IASB's tentative decision to retain the use of the minimum interest rate concept for regulatory assets (for which the exemptions would not apply).
- 27 Members also continued to express concern about the asymmetrical treatment of regulatory assets and regulatory liabilities that would result from these proposals. Members supported the use of the regulatory interest rate as the discount rate as this is the rate an entity would be 'compensated for'.

Feedback from ASAF (September 2024)

- 28 ASAF members generally agreed with the IASB's tentative decisions on the proposed requirements to use the minimum interest rate. However:
- (a) One ASAF member disagreed with the tentative decisions:
 - (i) to retain the minimum interest rate proposals as set out in the Exposure Draft—because these proposals would result in asymmetrical treatment of regulatory assets and regulatory liabilities; and
 - (ii) to require the use of the regulatory interest rate as the discount rate when the regulatory interest rate for a regulatory asset is excessive.
 - (b) some members from Asia reported that their stakeholders have said the regulatory interest rate is more objective than the minimum interest rate. These stakeholders have expressed concerns that the minimum interest rate requirements are complex, will be costly to apply, will reduce comparability among entities in the same jurisdiction and will not result in useful information.
 - (c) Some members also expressed concerns about comparability. It was also noted that the minimum interest rate requirements might be difficult to implement in developing country regulatory environments.
- 29 In response, the IASB staff representative stressed that an entity would be required to apply the minimum interest rate requirements only if the regulatory interest rate for a regulatory asset were deemed to be insufficient, which is unlikely to occur often. The

decisions to provide some exemptions from discounting should also reduce the instances in which an entity would have to estimate the minimum interest rate and use that rate as the discount rate.

EFRAG Secretariat analysis

- 30 Based on feedback received particularly from the discussions with the EFRAG RRAWG, the EFRAG Secretariat considers that the most controversial aspect of the measurement proposals is the requirement to determine a minimum interest rate in those cases where the regulatory rate is deemed to be zero or so-called insufficient. In our view, this proposed requirement remains unclear and subject to potentially significant judgement when and how it should be applied. EFRAG's survey to preparers examined different aspects of discount rates including the regulatory return on the RCB. From the survey responses, we expect to have a better understanding of the composition of the regulatory return on the RCB and if the regulatory agreements provide interest rates on other regulatory assets and liabilities. We also expect that the survey shed light on whether entities expect to have to calculate a minimum interest rate and the difficulties they may face in doing so.
- 31 Despite the IASB staff's explanation and the helpful distinction made between regulatory returns (WACC) and regulatory interest rate (see paragraphs 22 - 24), we consider that this aspect of measurement will need to be further examined to ensure it can be consistently understood and applied in practice.

Questions for EFRAG FR TEG

- 32 Does EFRAG FR TEG have any additional comments on the IASB tentative decisions on the measurement of regulatory assets and regulatory liabilities?
- 33 Does EFRAG FR TEG agree with the EFRAG Secretariat analysis in paragraphs 30 and 31)?

Appendix 1 – ED proposals and feedback to the ED

ED proposals

General measurement principles

- 34 Paragraph 31 of the ED proposed that in measuring a regulatory asset or regulatory liability, an entity is required to include all estimated future cash flows arising from the regulatory asset or regulatory liability, and only those cash flows.
- 35 Paragraph 39 of the ED proposed to require that an entity estimates uncertain future cash flows using whichever of the following two methods the entity expects to better predict the cash flows:
- (a) the ‘most likely amount’ method—this method provides an estimate of the single most likely amount in a range of possible outcomes (that is, possible cash flow amounts). This method may better predict the uncertain cash flows if the possible outcomes are clustered around one outcome or if there are only two possible outcomes and they differ widely.
 - (b) the ‘expected value’ method—this method provides an estimate of the sum of probability-weighted amounts in a range of possible outcomes. This method may better predict the uncertain cash flows if there is a wide range of more than two possible outcomes.
- 36 Paragraph 42 of the ED proposed that an entity apply the chosen method for estimating uncertain future cash flows consistently from initial recognition to recovery or fulfilment.
- 37 The ED did not propose a separate impairment test for regulatory assets given that measurement is updated on an ongoing basis.

Discounting – general principles

- 38 The ED proposes that an entity measures a regulatory asset or regulatory liability using a cash-flow-based measurement technique that:
- (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.

- 39 The ED defines regulatory interest rate as the interest rate provided by a regulatory agreement to compensate an entity for the time lag until the recovery of a regulatory asset or to charge the entity for the time lag until the fulfilment of a regulatory liability.
- 40 Paragraph 54 of the ED states that a regulatory agreement may specify 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. In such cases, the ED proposed that an entity:
- (a) translates those uneven regulatory interest rates into a single discount rate at initial recognition and uses that rate throughout the life of the regulatory asset or regulatory liability.
 - (b) continues to use the discount rate determined at initial recognition, unless the regulatory agreement changes the regulatory interest rate

Discounting - minimum interest rate

- 41 The ED (paragraphs 50-51) proposed that on the initial recognition of a regulatory asset and then subsequently if the regulatory agreement changes the regulatory interest rate:
- (a) an entity assesses whether there is any indication that the regulatory interest rate for a regulatory asset may be insufficient to compensate the entity for the time value of money and uncertainty in the amount and timing of the future cash flows arising from the regulatory asset; and
 - (b) if such an indication exists, the entity estimates the minimum interest rate that is sufficient to provide that compensation. In such cases, the entity would use, as the discount rate, the higher of the regulatory interest rate and the minimum interest rate.
- 42 The ED (paragraph 53) proposed that for a regulatory liability, an entity uses the regulatory interest rate as the discount rate in all circumstances.

Feedback to ED

General measurement principles

- 43 Most respondents to the ED, including EFRAG, agreed with the proposals on estimating uncertain future cash flows.
- 44 Most respondents, including EFRAG, also supported the proposal to require an entity to estimate future cash flows arising from each regulatory asset and regulatory liability recognised, using either the most likely amount or the expected value method, depending on which approach provides more relevant information.

- 45 A few respondents raised the following concerns and made suggestions regarding the proposals for estimating uncertain cash flows:
- (a) raised concerns about using the expected value method when the probability of particular outcomes is low.
 - (b) suggested the IASB requires the use of the expected value method for all regulatory assets and regulatory liabilities that have uncertain cash flows.
 - (c) suggested the IASB provides more guidance on factors to consider in assessing which method of estimating uncertain future cash flows better predicts the cash flows.
 - (d) suggested the IASB requires an entity to change the method selected at initial recognition when facts and circumstances change such that the method may not better predict the cash flows.
 - (e) asked questions about the interaction between the existence uncertainty and the methods for estimating uncertain future cash flows in specific circumstances. These respondents said it is unclear whether an entity, when applying the methods for estimating uncertain future cash flows, should consider only those outcomes in which a regulatory asset or regulatory liability exists.
- 46 All respondents, except for one¹, that commented on this question to the IASB agreed with not requiring an impairment test for regulatory assets.

Discounting – general principles

- 47 Most respondents, including EFRAG, to the IASB who commented on the proposed cash-flow-based measurement technique agreed with the proposal and 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.
- 48 EFRAG's understanding was that under some regulatory regimes, the regulatory interest rate compensates an entity for time lag (i.e., time value of money) as well as for business risk. However, the definition of regulatory interest rate in Appendix A (Defined Terms) of the ED stated that it compensates only for the time lag. Therefore, EFRAG recommended that the IASB amend the definition to reflect what is commonly applied in regulatory regimes (i.e., compensation for both business risks and time value of money).

¹ National standard-setter in Africa

- 49 Many respondents to the IASB, including EFRAG, 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:
- (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.
- 50 Many respondents, including EFRAG, that commented agreed with the proposal and noted that it 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.
- 51 EFRAG also agreed with including Example 5 which illustrates how an entity would compute a single interest rate when multiple rates apply throughout the regulatory period. However, EFRAG asked for some clarifications regarding the possible ways to comply with the proposals and additional illustrative examples, or application guidance, to cover more complex scenarios of determining a single interest rate when rates are uneven.
- 52 However, some disagreed with the proposal on the basis that it 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.

Discounting - minimum interest rate

- 53 Some respondents agreed with the proposals in the ED for cases when the regulatory interest rate provided for a regulatory asset is insufficient. However, most respondents including EFRAG, did not support the proposals. Their concerns were mainly:

- (a) the complexity and costs of applying the proposals would outweigh any benefits; and
- (b) the asymmetric treatment of regulatory assets and regulatory liabilities.

- 54 Many respondents, including EFRAG, said that the asymmetric treatment of regulatory assets and regulatory liabilities produces outcomes that can undermine the understandability and neutrality of the resulting information. It also makes the requirements more complex to apply. Many of these respondents suggested using the regulatory interest rate as the discount rate for all regulatory assets and regulatory liabilities.
- 55 EFRAG recommended that if the IASB retained the concept of a minimum interest rate, it should be as a rebuttable presumption whereby an entity applies the regulatory interest rate for discounting unless there is evidence that the latter rate does meet the objective of the ED to provide relevant information to users.
- 56 Most of the users of financial statements that provided feedback said that the proposals would reduce comparability among entities and would be confusing for users.

Appendix 2 – Illustrative example- uneven discount rates

Fact pattern

- 57 Entity E supplies goods or services to customers under a regulatory agreement. At the end of Year 1, Entity E recognised allowable expenses of CU100. The regulated rate charged to customers in Year 1 did not include these expenses. The amount of CU100 forms part of the total allowed compensation for goods or services already supplied in Year 1 and will be added in determining the regulated rate to be charged to customers in future periods, and hence will be included in revenue in the future. This gives rise to a regulatory asset measured initially at CU100.
- 58 The regulatory agreement allows the entity to recover this amount through the regulated rates charged to customers evenly over Years 3 and 4, together with regulatory interest at 10% on the unrecovered regulatory balance at the beginning of Years 3 and 4. Accordingly, at the end of Year 1 Entity E estimates it will recover the regulatory asset by including CU60 in the regulated rates charged in Year 3 and CU55 in Year 4—no recovery takes place in Year 2. Table 5.1 shows the estimated changes in the unrecovered regulatory balance.

<i>In CU</i>	Year 1	Year 2	Year 3	Year 4
Opening balance	-	100	100	50
Addition	100	-	-	-
Regulatory interest added	-	-	10	5
Recovery	-	-	(60)	(55)
Closing balance	100	100	50	-

- 59 Applying paragraph 54 of the ED, Entity E is required to translate the different regulatory interest rates into a single discount rate to be used throughout the life of the regulatory asset. In this example, that discount rate is the one that discounts the estimated future cash flows, expected to occur in Years 3 and 4, back to CU100 in Year 1—that rate is calculated to be 5.82%. Table 5.2 shows a reconciliation of the carrying amount of this regulatory asset, using a rate of 5.82% as the discount rate. Entity E discloses such a reconciliation, as required by paragraph 83 of the ED.

Table 5.2 Reconciliation of carrying amount of regulatory asset				
<i>In CU</i>	Year 1	Year 2	Year 3	Year 4
Opening carrying amount	-	100	106	52
Amount recognised	100	-	-	-
Regulatory interest income (rounded)	-	6	6	3
Recovery	-	-	(60)	(55)
Closing carrying amount	100	106	52	-

- 60 If the regulatory agreement were to subsequently change the regulatory interest rate, the new regulatory interest rate would be the single discount rate that discounts all the updated estimated future cash flows back to the carrying amount of the regulatory asset or regulatory liability immediately before the new regulatory interest rate is applied.
- 61 To illustrate, assume the same fact pattern as in paragraphs 57 - 58, except that at the end of Year 3 a change in the benchmark rate used in determining the regulatory interest rate results in the regulatory agreement changing the regulatory interest rate applicable to the opening balance in Year 4 from 10% to 8% (see Table 5.3).

Table 5.3 Regulatory balance		
<i>In CU</i>	Year 3	Year 4
Opening balance	100	50
Addition	-	-
Regulatory interest added	10	4
Recovery	(60)	(54)
Closing balance	50	-

- 62 Table 5.4 shows the changes in the carrying amount of this regulatory asset, using the original rate of 5.82% as the discount rate for Year 3, and using the updated regulatory interest rate of 3.89% as the discount rate for Year 4. Entity E discloses a reconciliation of the carrying amount of the regulatory asset, as required by paragraph 83 of the ED. A possible format of this reconciliation for Years 3–4 is shown in Table 5.4.

Table 5.4 Reconciliation of carrying amount of regulatory asset		
<i>In CU</i>	Year 3	Year 4
Opening carrying amount	106	52
Amount recognised	-	-
Regulatory interest income	6	2
Recovery	(60)	(54)
Closing carrying amount	52	-

Appendix 3 - Illustrative example – minimum interest rate

Fact pattern

- 63 Entity B incurs an expense of CU100 in Year 0. The regulatory agreement allows the entity to recover the expense evenly over Years 1–4. The regulatory agreement does not provide a regulatory interest rate for the regulatory asset. The entity determines that a minimum interest rate of 3% would be sufficient to compensate it for the time value of money and for uncertainty in the amount and timing of the future cash flows arising from that regulatory asset. In Year 0, the entity recognises a regulatory asset at CU92.93, representing the present value of the future cash flows measured using the minimum interest rate.

In CU	Year 0	Year 1	Year 2	Year 3	Year 4
Cash flows	100	(25.00)	(25.00)	(25.00)	(25.00)
Net present value at 3%	(92.93)				
Partial disallowance	7.07				

- 64 During Years 1–4, the entity recognises regulatory interest income at an aggregated amount of CU7.07, determined by applying the minimum interest rate to the outstanding amount of the regulatory asset. Table 2 shows a reconciliation of the regulatory asset.

In CU	Year 0	Year 1	Year 2	Year 3	Year 4
Opening balance		92.93	70.72	47.84	24.27
Amount recognised	92.93				
Regulatory interest income		2.79	2.12	1.44	0.73
Recovery		(25.00)	(25.00)	(25.00)	(25.00)
Closing balance	92.93	70.72	47.84	24.27	0.00

- 65 Table 3 illustrates the effects of the proposals on the statement of financial performance:

In CU	Year 0	Year 1	Year 2	Year 3	Year 4	TOTAL
Revenue		25.00	25.00	25.00	25.00	100.00
Regulatory income / (regulatory expense)	92.93	(22.21)	(22.88)	(23.56)	(24.27)	0.00
Expenses	(100.00)					(100.00)
Profit or loss	(7.07)	2.79	2.12	1.44	0.73	(0.00)