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Analysis of the impact of the issuance of the standard Rate Regulated Activities (IFRS 14 Regulatory Deferral Accounts):

A study of the differences between the IASB's proposal and current Spanish standards.

GOBIERNO DE ESPAÑA
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ANALYSIS OF THE IMPACT OF THE ISSUANCE OF THE RATE-REGULATED ACTIVITIES STANDARD (IFRS 14 REGULATORY DEFERRAL ACCOUNTS): A STUDY OF THE DIFFERENCES BETWEEN THE IASB'S PROPOSAL AND CURRENT SPANISH STANDARDS.

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This Study meets the specific relevance criteria for the disclosure of matters affecting the application of accounting and auditing standards and the exercise of the powers assigned to the ICAC, as well as the timeliness of its objectives, both in terms of their nature and scope.

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Executive Summary

Rate-regulated activities, involving a regulator, are particularly relevant in key economic sectors related to essential services, such as gas, electricity or transport. The fact that these are regulated rates means that income from these activities may be recognised on a deferred basis, making it difficult for International Financial Reporting Standard 15 - Revenue from Contracts with Customers (IFRS 15) to adequately reflect this.

Since 2008, the IASB has been working on the development of a standard to better address these situations for accounting purposes. In 2014, this process resulted in the issuance of an interim standard (IFRS 14), and subsequently, in 2021, in the ***Regulatory Assets and Regulatory Liabilities*" exposure draft in 2021**which is the focus of this study. This draft represents a complete and definitive regulatory proposal that comprehensively addresses the accounting aspects of activities subject to regulated rates.

It is, therefore, a comprehensive standard, albeit with **aspects that have given rise to much debate**especially the following:

- The **scope** of the standard, in relation to the limits of the agreements on rate-regulated activities.
- The treatment of certain components of the **total allowed compensation**, such as the return on assets not available for use and the differences between the regulatory capital base and the assets used in these activities (the so-called direct versus non-direct relationship)..
- The **cash flow based measurement** especially with regard to the **discount rate** applicable.
- The interaction of the Draft with **other IFRS, in particular IFRIC 12 - Service Concession Arrangements**.

In any case, despite the extensive deliberation process conducted by the IASB, it has become clear that the **proposals contained in the draft, which were broadly supported** during the commenting process, will not be substantially modified. Instead, the regulatory content will be simplified, illustrative examples will be expanded, and more precise guidance will be developed in the standard to facilitate the identification of the direct or non-direct relationship between the regulatory capital base and accounting assets.

In Spain there is currently no specific accounting regulation for the recognition of assets and liabilities arising from rate-regulated activities. Given that the future IASB standard has a supplementary approach to the standard on revenue, it would be appropriate that an accounting regulation should be introduced through a **specific resolution** to incorporate this new framework within the national context. This regulation should complement both the Spanish accounting standards (PGC) and the Resolution of the Spanish Accounting and Auditing Institute (RICAC) on revenues, as well as the sectoral adaptation of the PGC applicable to concessionaires.

To this end, we propose the **creation of an advisory group** within the ICAC, bringing together preparers, auditors and users, with the aim of facilitating technical interpretation, promoting uniformity in application and anticipating possible sectoral impacts.

The absence of specific regulation on the accounting treatment of rate-regulated activities could lead to disparities in accounting practice and negatively affect comparability between entities, especially in sectors where regulated rate frameworks have a significant weight.

1 Introduction

This study, entitled *"Analysis of the impact of the issuance of the Rate-Regulated Activities standard (IFRS 14 - Regulatory Deferral Accounts): Study of the differences between the IASB proposal and current Spanish regulations"* is part of the Public Call for studies under the agreement between the Spanish Accounting and Auditing Institute (ICAC) and the Spanish Association of University Accounting Lecturers (ASEPUC) for the year 2025.

As outlined in the submitted work plan, this study comprises two main sections. The first of these consists of an analysis of the Exposure Draft Regulatory Assets and Liabilities (IASB, 2021a). This section presents the history of the draft, discusses its main aspects and illustrates it with practical examples. It also includes an assessment of the most controversial aspects, including the opinions of Spanish participants who submitted comment letters on the exposure draft, among them the *European Financial Reporting Advisory Group* (EFRAG), the Spanish Accounting and Auditing Institute (ICAC), Iberdrola and Universidad Loyola Andalucía.

The second section includes a review of the meetings held by the bodies responsible for issuing International Financial Reporting Standards (IFRS) within the IASB. This analysis covers the period from the date of publication of the draft to the start of the fieldwork, including all meetings held up to May 2025. A summary of the topics discussed at these sessions has been prepared by reviewing the documentation available on the IFRS website for each meeting. The summary is presented as an annex.

Rate regulation is a mechanism whereby the prices charged by an entity to its customers are determined under specific regulatory arrangements. This type of regulation is common in strategic sectors where goods or services considered essential to society are provided, such as electricity, gas, water or transport. In these contexts, regulatory authorities play a key role in setting criteria that ensure both the economic sustainability of the operators and the protection of consumer rights.

The main objective of rate regulation is to ensure that companies can recover, through rates, the costs incurred in the provision of the service, including a reasonable return, without unduly burdening users. For this purpose, the regulator sets the total amount that it considers appropriate for the entity to bill in a given period. This amount may not match the amount of sales revenue recognised for accounting purposes in that period, resulting in timing differences that should be appropriately reflected in the financial statements.

This possibility of deferring the accounting recognition of income or expenses has led to significant differences between IFRS and certain national regulations, which have chosen to reflect these balances as regulatory assets or regulatory liabilities. In this context, the IASB's approach with the new standard-setting proposal is focused on entities providing relevant information that fairly represents how regulatory income and expenses affect financial performance, and how regulatory assets and liabilities affect the entity's financial position. To this end, the key proposal in the Exposure Draft Regulatory Assets and Regulatory Liabilities (IASB, 2021a) states that an entity subject to rate regulation should reflect in its financial statements the total allowed compensation that it is authorised by the regulator to charge for goods and services provided during the period.

This standard is expected to have an impact on companies in the *utilities* and transport sector, although other entities could also be affected, as the scope of the standard is not limited to specific sectors. The proposals in the 2021 draft will apply to those entities that are subject to a regulatory agreement. Under such an agreement, an entity must apply the requirements of the exposure draft to all of its assets and liabilities of rate-regulated activities as defined in the exposure draft.

It follows from the proposed definitions that a regulatory asset or liability can only exist if three conditions are met:

(a) the entity is a party to a regulatory agreement, defined as a set of enforceable rights and obligations that determine a regulated rate to be applied in contracts with customers;

(b) that agreement determines the regulated rate, defined as the price for the goods or services, set by the regulatory agreement, charged by the entity to its customers in the period in which it provides those goods or services; and

(c) part of the total allowed compensation, that is, the total amount of compensation for those goods or services that a regulatory agreement entitles an entity to charge customers through regulated rates, is passed through to customers through charges for goods or services provided in a different period, either past or future.

Finally, although the final standard was expected to be issued in the second half of 2025, it is finally estimated that it will be published in the second quarter of 2026. This makes it especially important to analyse its content in advance and its possible implications for Spanish institutions.

2 The Exposure Draft: Regulatory Assets and Regulatory Liabilities

2.1. History of the project until the issuance of the Draft

Since the initial adoption of the IFRS by many countries in 2005, the IASB and the IFRS Interpretations Committee have received several requests to clarify whether financial statements prepared under IFRS could or should recognise balances arising from rate regulation.

Rate regulation is a system whereby the prices (rates) charged by a company to its customers are set according to a regulatory agreement. In many jurisdictions, governments regulate the supply and pricing of certain activities by entities, especially when it involves the provision of goods or services that are deemed essential to consumers, such as transport, gas, electricity or water.

In these cases, the regulator seeks not only to ensure that suppliers earn sufficient revenue through the prices they charge to maintain continuity and quality of supply, but also to protect the interests of consumers. It does this by determining the total amount it considers appropriate for the company to charge for goods and services supplied within a given period, which may differ from the amount of sales revenue recognised.

The regulations may allow the recovery of these differences in a period other than that in which the service is provided, so that, unlike IFRS, some national accounting standards have allowed or required these deferred balances to be recognised as assets or liabilities, thereby changing the timing of their reflection in profit or loss for the financial year. For example, in the United States, SFAS 71 - *Accounting for the Effects of Certain Types of Regulation*[1] (FASB, 1982), issued in 1982, set specific criteria for this treatment.

However, the Interpretations Committee concluded that the recognition criteria set out in national accounting standards were not fully consistent with those defined by IFRS. Therefore, any recognition had to be made in accordance with the Conceptual Framework and current accounting standards under IFRS. This resulted in many institutions ceasing to recognise assets and liabilities of rate-regulated activities, which, in 2008, led the Board to initiate the development of a specific exposure draft for these activities.

In 2009, the first draft was published, entitled *Exposure Draft:. Rate-Regulated Activities* (IASB, 2009), which proposed the recognition of balances arising from a type of rate regulation commonly referred to as cost-of-service regulation (IASB, 2009). Following the public consultation period and subsequent Board discussions, it was concluded that there was a significant disparity of views and that important conceptual gaps remained, especially on whether these balances met the definitions of assets and liabilities in the IFRS Conceptual Framework. Therefore, in December 2010, it was decided to temporarily suspend the project.

1 Currently, the accounting treatment of rate-regulated activities is set out in *Topic 980 Rate Regulated Operations*.

It was only in 2012, following the 2011 agenda consultation, that the Board decided to reinstate the project on its regulatory agenda, together with the review of the Conceptual Framework, the outcome of which could have a significant influence on the development of a standard on rate-regulated activities.

During this period, the Board was lobbied by certain jurisdictions that had not yet adopted IFRS to continue to apply on a temporary basis the accounting practices they had been using for the recognition of balances arising from rate-regulated activities. In response, the Board issued in January 2014 IFRS 14 - *Regulatory Deferral Accounts* (IASB, 2014a) as an interim standard, applicable only to first-time adopters that met certain requirements. This standard allowed for the continued recognition of deferral balances from rate-regulated activities (*Deferral Regulatory Account Balance*[2]) under certain conditions.

In September that year, and in connection with the development of the complete draft, the *Discussion Paper: Reporting the Financial Effects of Rate Regulation* (IASB, 2014b), which described the common features of different types of rate regulation, resulting from the responses to the *Request for Information: Rate Regulation* (IASB, 2013) conducted in March 2013, was published.

Specifically, the Discussion Paper (IASB, 2014b: 3.21-3.37) classifies types of rate regulation into two broad categories, representing the two extremes of a wide spectrum of regulatory schemes:

1) Cost-based regulation

Also known as "cost-of-service" or "return-on-base-rate", this type of agreement seeks to ensure that the regulated entity recovers all allowed costs plus a return on its capital investment.

- The fee is calculated on the basis of the actual costs incurred.
- A balancing adjustment mechanism is used to correct differences between estimated and actual costs.
- The initial rate is considered provisional and may be revised.

2) Incentive-based regulation

It includes schemes such as "price-cap" or "revenue-cap" and focuses on objective results rather than actual costs.

- The rate is based on estimated costs and performance targets, adjusted for inflation and other targets.
- No subsequent adjustments are made for differences between estimated and actual costs.
- Efficiency is incentivised: if the entity exceeds its targets, it retains the profits; if it falls short, it takes the losses.

The paper also presented four possible approaches to what was called "defined rate regulation"in the draft, which is understood to apply when customers have little or no choice and must purchase essential goods or services from a regulated entity. This type of regulation seeks to ensure that the entity recovers a certain amount of consideration (called *revenue requirement*) in exchange for the rate-regulated activities it performs, and establishes, through the unit rate, the time at which this consideration may be invoiced.

The 2014 *Discussion paper* further explored whether the combination of rights and obligations arising from regulatory agreements justified the development of specific accounting requirements, and set out four approaches to reflect their impacts in financial statements under IFRS. These approaches were:

2 IFRS 14 defines deferral balances from rate-regulated activities as *"The balance of any expense (or revenue) account that would not be recognised as an asset or liability under other standards, but qualifies for deferral because it is included, or is expected to be included, by the rate regulator in setting the rates that may be charged to customers."* (IASB, 2014a).

1. Prohibit the recognition of balances for rate-regulated activities, with or without the implementation of disclosure requirements.
2. Recognise the set of rights and obligations established by the regulatory agreement as an intangible asset, i.e. a licence.
3. Permit or require the accounting stipulated by the regulatory agreement to be used in financial statements prepared according to IFRS, which would mean, for example, applying the same depreciation criteria used to calculate regulated rates, even if they differ from the criteria that would normally be applied under IFRS.
4. Develop specific requirements for deferring or anticipating the recognition of revenue, expenses or a combination of both to better reflect the financial effects of rate regulation in financial statements drawn up under IFRS.

Ultimately, the objective of the paper was to gather views on the usefulness of financial information related to rate-regulated activities and to outline the next steps of the draft.

The feedback to the Council's agenda consultation received in 2015 made it clear that work on this draft must continue. When preparing the *Exposure Draft*, the Council took into consideration the replies received to the 2009 *Exposure Draft*, to the 2013 *Request for Information*, and the 2014 *Discussion Paper*, as well as the Conceptual Framework. It also considered the input received from different advisory groups, including the *Consultative Group for Rate Regulation* set up for this purpose.

Additionally, during the drafting process, the Council received suggestions from participants at the 2017 *World Standard-Setters Conference*, which helped to refine several key aspects of the draft. Some of the most prominent suggestions are:

- Clarifying the concept of a regulatory agreement: A request was made to clearly distinguish between regulatory agreements and other similar contracts. The Council responded by defining the term "regulatory agreement" and explaining how assets and liabilities arise from rate-regulated activities, which was described in paragraphs 3-19 of the draft and the basis for conclusions (BC) in paragraphs BC36-BC57.
- Link to IFRS 15: Some participants requested clarification on why IFRS 15 (*Revenue from Contracts with Customers*) did not apply to regulatory agreements. The Board explained that these arrangements do not constitute contracts with customers as defined in IFRS 15, and that the proposals in the Exposure Draft supplement, but do not change, the information provided under that standard (BC73-BC77).
- Definition of regulatory assets and regulatory liabilities: Further clarification was sought on these elements. The Board addressed this issue by concluding in paragraphs BC36-BC57 that they meet the definitions of assets and liabilities in the Conceptual Framework.
- Conceptual foundation:. Some comments expressed concern about a possible perception that the Council was starting from a desired outcome and then justifying it. In response, the Council reaffirmed that its analysis started with the definition of the problem, guided by the definitions of assets and liabilities in the Conceptual Framework, and that accounting separately for these items would provide useful information.
- Separate presentation in the financial statements:. It was proposed that regulatory assets and regulatory liabilities, as well as regulatory income and regulatory expenses, should be presented as separate line items. The Board included this suggestion in paragraphs BC179-FBC186.
- Project scope:. It was recommended that the scope of the proposed standard be carefully reviewed. The Board justified its decisions in paragraphs BC78-BC86.
- Conceptual Framework revised in 2018: It was suggested to highlight the impact of the changes introduced in the revision of the Conceptual Framework. The Board noted that analysing regula-

tory assets and regulatory liabilities under the previous framework would not help to understand its current proposal.

Finally, in January 2021 the *Exposure Draft:. Regulatory Assets and Regulatory Liabilities* was published , hereinafter, ED 2021) (IASB, 2021a). The following section describes the main aspects of this exposure draft.

2.2. Most significant aspects of the Draft and illustrative examples

The objective of the principles set out in the Exposure Draft (hereinafter referred to as "ED"): Regulatory Assets and Regulatory Liabilities 2021 for the recognition, measurement, presentation and disclosure of regulatory assets and regulatory liabilities and, consequently, related income and expenses, is for entities to provide relevant information that faithfully represents how regulatory income and regulatory expenses affect the entity's financial performance, and how regulatory assets and regulatory liabilities affect its financial position.

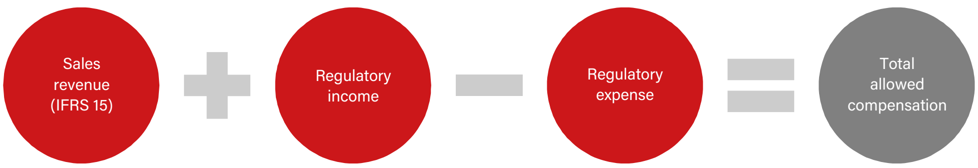
To this end, the key proposal of the draft is that an entity subject to rate regulation must reflect in its financial statements the **total allowed compensation** that it is authorised by the regulator to charge for goods and services provided during the period.

It proposes an overlay approach, whereby an entity first continues to apply the requirements of existing IFRS Standards (e.g. the recognition and measurement of revenue from contracts with customers in accordance with IFRS 15) and then recognises:

- **a regulatory asset**, where it has an enforceable present right, created by a regulatory agreement, to add an amount in determining the regulated rate to be charged to customers in future periods because part of the total allowed compensation for goods or services already provided will be included in revenue in the future; and
- **a regulatory liability**when such an arrangement has created an enforceable present obligation to deduct an amount in determining the regulated rate to be charged to customers in future periods because the revenue already recognised includes an amount that will provide part of the total allowed compensation for goods or services to be provided in the future.

Thus, the total revenue recognised in the statement of financial performance will correspond to the total allowed compensation authorised by the regulator for that year.

//// FIGURE 1 Total allowed compensation in the statement of financial performance



↑ Source: Authors' own.

ED 2021 proposes an accounting model that recognises regulatory rights and regulatory obligations as specific assets and liabilities. The structure of the standard includes, in addition to the general principles of recognition, measurement, presentation and disclosure, the unit of account, which defines the level of aggregation or disaggregation at which regulatory assets and liabilities are identified and accounted for, and the regulatory appendices, which complement the main body of the standard. These appendices include:

A. Defined terms,

B. Application guidance,

C. Effective date and transition, and

D. Draft amendments to other IFRS.

Additionally, the rationale for the conclusions and illustrative examples, which help to interpret and apply the standard in practical contexts, are published separately.

The most significant aspects of the standard are analysed below, following the structure it establishes.

Scope

The proposals set out in ED 2021 will apply to those entities that are subject to a regulatory agreement. Under such an agreement, an entity must apply the requirements of the exposure draft to all its regulatory assets and regulatory liabilities (ED.3), as defined in the exposure draft. It follows from the proposed definitions that a regulatory asset or liability can only exist if three conditions are met (ED.6):

(a) the entity is a party to a *regulatory agreement* which is understood as a set of enforceable rights and obligations that determine a regulated rate to be applied in contracts with customers (ED.7);

(b) the agreement establishes the *regulated rate,* defined as the price for goods or services, determined by a regulatory agreement, that an entity charges its customers in the period when it supplies those goods or services (ED.10); and.

(c) part of the *total allowed compensation* that is, the total amount of compensation for those goods or services that a regulatory agreement entitles an entity to charge customers through regulated rates, in either the period when the entity supplies those goods or services or a different period (ED.11) for goods or services supplied in one period, is passed on to customers through regulated rates for goods or services supplied in a different period, either past or future.

The Council decided not to limit the scope of the proposal exclusively to agreements that have the features of what the 2014 draft called "defined rate regulation" (BC79). Although these features, such as the absence of effective competition, essential nature of the service, price stability and financial viability, are common to many regulatory schemes, the Council found that they were not decisive in determining the existence of a regulatory asset or regulatory liability (BC82-83). Therefore, ED 2021 does not use the term "defined rate regulation" and states that such assets and liabilities only exist if the three essential conditions described above are met.

ED 2021 does not specify the legal form of the **regulatory agreement**, which may be derived from a contractual licensing agreement, a service concession agreement, or be imposed directly by law, legislation or regulation[3] (ED.8). Nor does it set out requirements for the characteristics of the body responsible for enforcing such an agreement. The Board considered it unnecessary to define specific characteristics of the regulator, since what is relevant is that the rights and obligations created by the agreement are enforceable, regardless of the regulator's form or nature. Consequently, restricting the scope of the project only to agreements supervised by regulators with certain characteristics would not provide more useful information on the effects of regulatory assets and regulatory liabilities (BC85-86).

3 The rights and obligations arising from the agreement must be enforceable. Where enforceability is a matter of law, regulatory decisions or court rulings can provide evidence regarding the existence and enforceability of such rights and obligations (ED.9).

Should the draft define certain specific attributes of the regulator?

Opinion of the European Financial Reporting Advisory Group (EFRAG, 2021):

EFRAG considers that it would be useful **to describe the characteristics of a regulator** in order to avoid unintended consequences, including situations where, through certain structures, agreements between companies in the same group or self-regulation would fall within the scope of the Proposed Standard.

Opinion of the Accounting and Auditing Institute (ICAC, 2021)

It would be useful to provide more specific guidance and examples on what constitutes a regulatory agreement, as well as a description of the characteristics of a regulator **description of the characteristics of a regulatory agreement**. Furthermore, we support the notion that the regulatory body should be **independent from the regulated entity**to improve the understanding of the scope of the future standard, e.g. by clarifying possible doubts as to whether it could apply to co-operatives.

Opinion of academics at Universidad Loyola Andalucía (Universidad Loyola Andalucía, 2021)

Incorporating the **independence of the regulator** into the scope could be relevant. The form of the agreement could be considered irrelevant, as long as it creates enforceable rights and obligations. However, it should be noted that the **regulatory body should maintain independence from the regulated entity and from the customer of the regulated entity**. In the absence of this independence between the three parties, it might be difficult to argue that this is not a customer contract, where one of the parties, the one imposing the rate regulation, would have greater bargaining power.

For example, this independence requirement could lead to questions as to whether, in the context of a co-operative production company, an agreement to compensate members for activities carried out in the current fiscal year through future settlements is within the scope of this Proposal. In this case, the members of the cooperative would act as the regulated entities, the cooperative as the customer and, simultaneously, as the rate regulator. Such an agreement could be excluded, given that the regulator is the same as the figure of the customer, which would be evidence of the need to maintain independence between the parties involved.

An entity subject to a regulatory arrangement shall recognise revenue as it fulfils the obligations to transfer goods or services in accordance with IFRS 15 - **Revenue from contracts with customers**. The amount charged to customers shall reflect the **regulated rate**, i.e. the price set by the regulatory agreement for the goods or services supplied in the period in which those goods or services are provided.

However, revenue recognised in a period in accordance with IFRS 15 often differs from the amount that an entity is entitled to charge its customers for goods or services supplied in that same period, i.e, the **total allowed compensation**. This difference may be due, for example, to timing differences when the regulatory agreement includes part of that compensation in the rates for goods or services provided in a different (past or future) period (ED 12(a)), or when the entity provides the goods or services in one period but, applying IFRS 15, recognises some or all of the revenue in a later period (ED 12(b)).

To enable users of financial statements to understand the link between revenue and the total allowed compensation as completely as if the latter were fully reflected in revenue for the period in which the goods or services are provided (ED.2(a)), ED 2021 proposes, on a supplementary basis, to recognise a regulatory asset or regulatory liability, or both, and the related income and expenses. Thus, the revenues for the year will reflect the total allowed compensation authorised by the regulatory agreement.

Therefore, an entity shall recognise a **regulatory asset** (and the related revenue) when it has the right to add an amount when determining the regulated rate to be charged to customers in a future period. This occurs, for example, when the amount of revenue recognised in a period in accordance with IFRS 15 is less than the amount that the entity is entitled to charge its customers for goods or services supplied in the same period. Regulatory income shall reflect that portion of the total allowed compensation for goods or services provided in the current period that was included in revenue in past periods, or will be included in revenue in future periods (ED.16(a)).

Examples of circumstances that could give rise to regulatory assets include the following:

- When the rate charged by a company to customers during the current period includes an estimate of the input cost, but actual costs turn out to be higher than the estimate. The regulatory agreement allows the company to recover this deficit through future rates.
- If the company incurs environmental clean-up costs during the current period, but the rates charged do not include them. The regulatory agreement allows for the recovery of these costs once the corresponding payment has been made in the future.
- When the regulatory agreement grants a bonus to the company for meeting certain performance criteria during the current period, but this bonus was not included in the current rates. The agreement allows for the recovery of this bonus through future rates (IASB, 2021e).

Example 1: Regulatory assets

Entity A is a party to a regulatory agreement that sets the rate that it must apply to its customers. This agreement gives the entity the right to include in the next fiscal year's rate any difference between the estimated cost and the actual cost incurred in providing the services during the current fiscal year.

In fiscal year 1, the estimated costs amounted to EUR 400,000. However, at year-end, the actual cost was EUR 560,000. Consequently, entity A is entitled to include the unrecovered difference, EUR 160,000, when setting the regulated rate to be applied to customers in the following fiscal year.

This entitlement gives rise to the recognition of regulatory asset, together with the corresponding revenue. This revenue reflects the portion of the total allowed compensation for services provided in the current period, which will be included in the next year's rates.

In fiscal year 1, the amount of revenue from contracts with customers recognised in accordance with the price set in the regulated rate for that year, for goods or services supplied in the period, amounted to EUR 800,000.

The accounting record for fiscal year 1 would be as follows:

Account	Debit	Credit
Regulatory assets	160,000	
Regulatory income		160,000

Therefore, the statement of financial performance for fiscal year 1 shall reflect the total allowed compensation, as shown below:

	Year 1
Revenue	800,000
Regulatory income	160,000
Total	960,000

In fiscal year 2, there are no deviations between the estimated cost and the actual cost for the provision of services. The total amount of revenue from contracts with customers amounts to EUR 1,300,000, in accordance with the regulated rates for that fiscal year. This rate includes the portion of the total allowed compensation for fiscal year 1 that was not recognised as revenue in that fiscal year and is now part of revenue in fiscal year 2. The accounting record in fiscal year 2 would be as follows:

Account	Debit	Credit
Regulatory expense	160,000	
Regulatory assets		160,000

The statement of financial performance for fiscal years 1 and 2 shall reflect the following:

	Year 1	Year 2
Revenue	800,000	1,300,000
Regulatory income (expense)	160,000	(160,000)
Total	960,000	1,140,000

↑ Source: Authors' own based on KPMG (2021)

An entity shall also recognise a **regulatory liability** when it has an obligation to deduct an amount when determining the regulated rate to be charged to customers in a future period.. In this case, a regulatory expense is recognised, reflecting the part of the total allowed compensation that has been recognised in revenue in the current period in accordance with IFRS 15, but relates to goods or services that were provided in past periods, or will be provided in the future (ED 16(b)).

Examples of circumstances that may give rise to regulatory liabilities include the following:

- When the rate includes an estimate of input costs, but the actual costs were lower. The regulatory agreement requires the company to repay the excess in future rates.
- Where the regulatory agreement allows part of the construction costs to be recovered upfront through rates, but the asset is not yet available for use. The company must deduct these amounts from future rates until the asset is operational.
- Where the agreement imposes penalties if certain performance criteria are not met, but these penalties were not reflected in the rates for the period. The company must deduct them from future rates until they are paid. (IASB, 2021e).

Example 2: Regulatory liabilities

Entity A is a party to a regulatory agreement that sets the rate that it must apply to its customers. In fiscal year 1, the amount of revenue from contracts with customers recognised in accordance with the price set in the regulated rate for that year, for goods or services supplied in the period, amounted to EUR 800,000.

It penalises entity A if it does not reach a specific level of customer satisfaction, which is monitored through customer surveys. At the end of fiscal year 1, the results of the surveys show that entity A has not reached the required level of customer satisfaction.

As a result, entity A is required to deduct a specific amount as penalty from its invoices to customers in fiscal year 2. According to the regulatory agreement, the amount of the penalty to be deducted from customers' invoices does not accrue interest.

In preparing its financial statements for the period, entity A estimates that the most likely amount of the penalty will be EUR 140,000, based on penalty amounts applied by the regulator in the past five years when similar performance targets were not met.

At the beginning of fiscal year 2, entity A receives the final rate determination confirming that the penalty amount for fiscal year 1 is EUR 140 000.

The accounting record for fiscal year 1 would be as follows:

Account	Debit	Credit
Regulatory expense	140,000	
Regulatory liabilities		140,000

Therefore, the statement of financial performance for fiscal year 1 shall reflect the total allowed compensation, as shown below:

	Year 1
Revenue	800,000
Regulatory income (expense)	(140,000)
Total	660,000

In fiscal year 2, Entity A deducts the amount of the penalty from revenue, thereby fulfilling the regulatory liability. The accounting record shall therefore be as follows:

Account	Debit	Credit
Regulatory liabilities	140,000	
Regulatory income		140,000

↑ Source: Authors' own based on IASB (2021d)

With regard to the nature of regulatory assets and regulatory liabilities, these **are not considered financial assets or liabilities**. Although they involve cash inflows or outflows, the Board concluded that they do not represent rights or obligations to receive or deliver cash merely due to the passage of time (BC52). Another issue discussed was the possibility of recognising the package of rights and obligations as an intangible asset (e.g. a licence); however, after considering the comments received, the Board decided that this option would entail unnecessary costs without providing significant improvements in the usefulness of the information (BC69-70).

On the other hand, in some cases, an entity may not recognise as revenue the full amount that it is entitled to charge its customers for goods or services supplied in that period. This may occur either because the entity does not account for the contract within the scope of IFRS 15 (AS 18(a)), or because estimates of variable consideration are constrained until the related uncertainty is resolved (ED 18(b)).

In these cases, an entity should not recognise a regulatory asset or regulatory liability because the definitions in the standard are not met. Specifically:

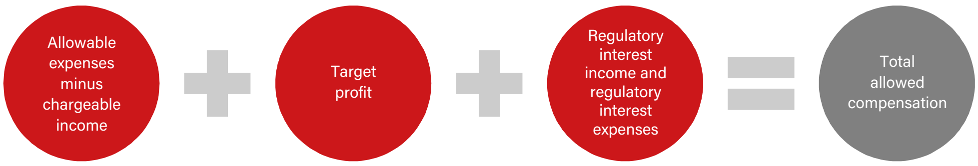
- If the total allowed compensation for the goods or services provided has been fully charged through the rate, but a portion will not be recognised as revenue until a future period, the entity is not entitled to add that amount when determining a future regulated rate, so the definition of a regulatory asset (ED.19(a)) is not met.
- If the amount has been included in setting the rate for goods or services already provided, but has not been recognised as revenue, because it is not included in revenue already recognised, the definition of a regulatory liability (ED.19(b)) is not met..

Finally, there are **rights and obligations that do not constitute regulatory assets or regulatory liabilities**. For example, an entity that is not subject to a regulatory agreement can generally increase the prices of its goods or services at any time. However, this ability does not generate an asset similar to regulatory assets, as it does not imply a present and enforceable right to increase prices. These pricing strategies should therefore be outside the scope of the regulation as they are self-regulations.

Total allowed compensation

Appendix B of the ED 2021 implementation guide identifies the components that make up the total allowed compensation. In particular, it notes that such compensation includes the elements displayed in Figure 2 below.

//// **FIGURE 2** **Components of the total allowed compensation**



↑ Source: Authors' own

Amounts recovering allowable expenses less chargeable income

The regulatory agreement sets out the costs that an entity is entitled to recover by including them in the determination of the regulated rate. This expenditure is referred to as **allowable expense** (ED. B3).

An entity shall treat allowable expenses as related to the supply of goods or services in the period in which they are recognised in accordance with the IFRS. Therefore, the amount that recovers these costs is part of the total allowed compensation for the goods or services supplied in the same period (ED.B4), regardless of when this amount is included in the regulated rate. This timing difference may generate regulatory assets or regulatory liabilities. For example, if an entity recognises an allowable expense as an expense under IFRS, but the amount recovered by that expense will be included in the regulated rate and therefore in revenue in a future period, a regulatory asset (B5(a)) arises.

Similarly, the regulatory agreement may require the deduction of certain revenue recognised under IFRS in determining the regulated rate. This revenue is referred to as **chargeable income** (ED.B9) and also forms part of the total allowed compensation for the period in which it is recognised under IFRS.. An example of this would be an arrangement that requires deducting the profit on the sale of an item of property, plant and equipment from the regulated rate.

Target profit

ED 2021 defines target profit as the profit that an entity is entitled to add when determining the regulated rate for goods or services supplied in a period. This target profit will form part of the total allowed compensation for the same period. The proposal identifies three main components of the target profit as shown below:

//// TABLE 1 Components of target profit

Margins on allowable expenses

- A regulatory agreement may give the right to recover the **amount of an allowable expense incurred plus a profit margin**. For example, a fixed percentage on expenditure (ED.B12).
- This component forms part of the total allowed compensation in the period in which the entity recognises the expense under IFRS (ED.B12)..

Regulatory returns

- Regulated business arrangements typically grant entities the right to earn a **return**, specified in the form of a fee, **on a defined basis** commonly referred to as the "regulatory capital base". The items included in this base do not necessarily match the assets or liabilities recognised under IFRS. For example, such a base may include indirect administrative costs which, according to International Accounting Standard (IAS) 16, are recorded as an expense (ED.B13).
- Generally, this component is part of the total allowed compensation in the period in which the entity has the right to add that return when determining the rate for goods or services provided in that period (ED.B14), except if the asset to which it is related is not yet available for use, in which case it is part of the allowed compensation once the asset is available for use (ED.B15).

Performance incentives

- A regulatory agreement may establish **performance incentives** to reward an entity for meeting certain criteria (e.g. service quality or customer satisfaction levels), or **penalties** if it does not (ED.B16).
- This component incorporates (or reduces) the total allowed compensation for the period in which the entity's performance gives rise to the incentive (or penalty) (ED.B17)..

↑ Source: Authors' own

With regard to regulatory returns, regulatory agreements can adopt two approaches when the capital base includes balances related to an asset that is not yet available for use (BC96):

- First approach: returns accrued while the asset is not available are included in the regulated rates once the asset is available for use.
- Second approach: returns are included in regulated rates during the period when the asset is not yet available for use.

Regardless of the approach adopted, ED 2021 provides that returns on balances related to assets not available for use form part of the total allowed compensation for goods or services provided once the asset is available for use (ED.B15). This proposal is consistent with the underlying principle of the model since, if the asset is under construction, it does not supply goods or services to customers until it becomes operational (BC99)[4].

Consequently, if the second approach is applied, a regulatory liability would arise during the period when the asset is not yet available for use because revenue recognised while the asset is under construction includes an amount that will provide part of the total allowed compensation for goods or services to be provided in the future. Example 3 below illustrates this situation.

Example 3: Regulatory returns when the asset is not yet available for use

Entity A participates in a regulatory agreement that sets the rates to be applied to its customers.

In fiscal year 0, the entity invested EUR 2,000 thousand in the construction of a plant. This agreement gives it the right to recover the invested capital within five years, coinciding with the period in which the plant will be operational.

Additionally, the entity is entitled to an annual return of 5% on the outstanding balance of the capital invested. The regulation states that entity A may include in the regulated rates of the customers of another plant the return accrued during the fiscal year, even if the asset is not yet in operation. The plant was commissioned at the beginning of fiscal year 1.

Therefore, the total allowed compensation for each fiscal year, as well as the amount to be included in the rate, will be as follows for each fiscal year (in thousands of euros):

	0	**1**	**2**	**3**	**4**	**5**
Regulatory capital base	2,000	2,000	1,600	1,200	800	400
Regulatory return (5 %)	100	100	80	60	40	20
Allowable depreciation expense	-	400	400	400	400	400
Amount to be included in the rate	100	500	480	460	440	420
Total allowed compensation (*)	0	520	500	480	460	440
Regulatory income (expense)	**(100)**	**20**	**20**	**20**	**20**	20

(*) The proposal indicates that a reasonable and sustainable base will be used in determining how to allocate the return on that balance (in this case, from fiscal 0) over the remaining periods and will apply that base consistently (ED.B15). For the sake of simplification, the return on fiscal year 0 has been distributed linearly between fiscal years 1 and 5.

In fiscal year 0, entity A records EUR 100 thousand as revenue from contracts with customers, which will form part of the total allowed compensation from the time the plant becomes operational (fiscal years 1-5). Accordingly, an entity shall record a regulatory liability and a regulatory expense, reflecting the portion of the total allowed compensation that has been recognised in revenue in the current period in accordance with IFRS 15 but relates to goods or services to be provided in the future. The accounting record for fiscal year 0 would be as follows:

Account	Debit	Credit
Regulatory expense	100	
Regulatory liabilities		100

From fiscal year 1, an entity shall derecognise the regulatory liability and recognise revenue so that the accounting record in fiscal year 1 to 5 would be as follows:

4 The study of the comment letters showed that the majority of respondents did not agree with paragraph B15 of ED 2021, mainly because the proposed treatment did not reflect the economic substance of the regulation and could entail excessive costs for preparers. For that reason, the Agenda Paper 2 - Regulatory returns on construction work-in-progress (CWIP) of March 2022 addressed possible courses of action to redeliberate the provisions of paragraph B15.

Account	Debit	Credit
Regulatory liabilities	20	
Regulatory income		20

↑ Source: Author's own based on Illustrative Example 3 (IASB, 2021b).

Performance incentives are very common in rate regulation in many jurisdictions. The ED 2021 envisages that this component will be incorporated into (or reduce) the total allowed compensation for the period in which the entity's performance gives rise to the incentive or penalty. This treatment is in line with the underlying principle of the model proposed in the standard when incentives are not related to construction work. For example, if it is an incentive for achieving a certain level of customer satisfaction, it is considered to reward the entity for the quality of the goods or services provided (BC102).

However, where the incentive is intended to reward the entity's performance during the construction phase, including it in the total allowed compensation may not be consistent with the fundamental principle of the model. However, ED 2021 aims to reflect performance incentives as part (or reduction) of the total allowed compensation in the period in which such performance occurs (or ceases to occur, in the case of a penalty), even when they are incentives related to construction work (ED. B18). The Board considered that this proposal would align the treatment of performance incentives for construction work with that of other types of incentives (BC105).

On the other hand, if certain performance criteria assess an entity's performance over a time frame that has not yet been completed, the entity must estimate the amount of the incentive or penalty and determine how much of that amount relates to the period reported. This part shall form part of the total allowed compensation.

Example 4: Performance incentive where performance is assessed over a time frame that has not yet been completed

A regulatory agreement grants an entity a performance incentive of EUR 100,000 if it meets certain specified performance criteria. The period of performance is 12 months: 9 months in the current year (fiscal year 1) and 3 months in the following year (fiscal year 2). If the performance criteria is met, the incentive will be added to the regulated rate immediately after the end of the performance period.

At the end of fiscal year 1, the entity concludes that for the performance period that has not yet been completed:

- The "most likely amount" method predicts incentive cash flows better than the "expected value" method.
- The entity assesses that it is "more likely than not" that the performance criteria are met and it is therefore entitled to the incentive.
- The share of the incentive for fiscal year 1 is EUR 75,000 (9/12 × EUR 100,000), reflecting the relative duration.

At fiscal year-end, the entity recognises as regulatory asset, its right to add the incentive of EUR 75,000 to the regulated rates to be charged to customers in future periods. The accounting entry would be:

Account	Debit	Credit
Regulatory assets	75,000	
Regulatory income		75,000

↑ Source: Illustrative Example 1 (EFRAG, 2025a)

The ED 2021 does not set a probability threshold, although it does state that if the entity uses the "most likely amount" method to estimate the amount of the incentive and considers it more likely than not that it will meet the performance criteria, the estimated portion of the incentive will form part of the total allowed compensation. An entity shall use a reasonable and supportable basis in determining that amount (ED.B19).

Is the approach followed in the proposal for performance incentives consistent with IFRS 15?

Opinion of academics at Universidad Loyola Andalucía (Universidad Loyola Andalucía, 2021)

An example of the application of a probability threshold for revenue recognition is found in IFRS 15, which states that an entity may only include variable consideration in the transaction price if it is highly probable that there will not be a significant reversal of the revenue recognised when the uncertainty is resolved.

ED 2021 does not establish any probability threshold, and its absence implies **less prudent** recognition for performance incentives in rate-regulated activities, compared to performance incentives in contracts with customers under IFRS 15.

Regulatory interest income and regulatory interest expense

Regulatory interest compensates or charges an entity for the time lag until the recovery of a regulatory asset from rate-regulated activities or the fulfilment of a regulatory liability (ED.B21). This is because the present value of the estimated future cash flows included in the measurement of a regulatory asset or regulatory liability varies over time. This effect is sometimes referred to as "unwinding of the discount". As discount unwounds, the entity shall recognise regulatory interest income and regulatory interest expense on a regulatory liability(ED.B22).

Example 5: Regulatory interest income and regulatory interest expense

Entity A participates in a regulatory agreement that sets the rates to be applied to its customers. This arrangement gives entity A the right to recover the actual costs incurred in providing goods or services to customers. The agreement also provides for an annual interest rate of 5% on the amount of unrecovered costs to compensate or charge the entity for the time lag until the recovery or write-off of the regulatory assets or regulatory liabilities. This interest shall be included in the rate charged to customers in the following fiscal year.

Entity A started supplying the goods or services on the first day of fiscal year 1. The regulated rate to be charged to customers in fiscal year 1 was set at EUR 1.8 /unit on the basis of:

- An estimated quantity of 100 units to be supplied in fiscal year 1.
- Variable input costs estimated at EUR 140 (EUR 1.4/unit).
- Fixed input costs estimated at EUR 45.

In fiscal year 1, entity A supplied only 90 units to customers and therefore recognised revenue from contracts with customers of EUR 162 (90 units x EUR 1.8/unit).

The costs incurred and recognised as an expense in the financial statements of fiscal year 1 were higher than estimated;

	Unit cost	Units	Total
Variable input costs	1.6	90	144
Fixed costs			46
Total input costs recognised as expenditure			190

The regulatory agreement entitles the entity to add, in determining the regulated rates to be charged to customers for goods supplied in fiscal 2, an amount to recover the cost and quantity variance experienced in fiscal year 1. The total allowed compensation for goods and services supplied in fiscal year 1 (EUR 190) exceeds the revenue from contracts with customers recognised during that year, which was EUR 162. Entity A shall recover the remaining part of the total allowed compensation, i.e. EUR 28, in fiscal year 2. Additionally, entity A is entitled to regulatory interest of 5 % of this amount (EUR 28 x 5% = EUR 1.4).

In fiscal year 1, entity A must therefore recognise a regulatory asset and regulatory revenue of EUR 28.

In fiscal year 2 the actual costs incurred were also EUR 190 which matched the estimated input costs for that fiscal year and the estimated quantity to be supplied to customers, which was 100 units.

In fiscal year 2, entity A recovers through the rate, the portion of the total allowed compensation not included in revenue in fiscal year 1. Additionally, the entity must recognise in fiscal year 2 the regulatory interest income to which it is entitled for the time lag until it recovers the variance that arose from providing goods or services in fiscal year 1.

The statement of financial performance for fiscal years 1 and 2 shall be as shown below:

	Year 1	Year 2
Revenue	162.0	219.4 (*)
Regulatory income (expense)	28.0	(28.0)
	190	191.4
Input cost	(190)	(190)
Margin	-	1.4

(*) Calculated as the allowable expenses for fiscal year 2 (EUR 190) plus the part not recovered in fiscal year 1 (EUR 28) plus the regulatory interest (EUR 1.4).

Source: Author's own based on Illustrative Example 1 (IASB, 2021c).

Unit of Account

An entity shall account for the right or obligation arising from each individual difference in the recognition period as a separate unit of account (ED.24). The Board decided that these differences should be considered as separate units of account, as entities usually identify each timing difference individually in order to determine future regulated rates and cash flows. These differences often expire at different times and affect cash flows separately, so treating them individually provides more useful and relevant information regarding the timing and expected pattern of recovery or fulfilment of each right or obligation than grouping them together as a single unit of account (BC116-117).

However, ED 2021 indicates that if rights and obligations arising from the same regulatory agreement have similar expiry patterns and are subject to similar risks, an entity may treat them as arising from the same individual difference in the recognition period (ED.24).

Recognition

An entity shall recognise:

(a) all regulatory assets and all regulatory liabilities existing at the end of the reporting period; and

(b) all regulatory income and all regulatory expense arising during the reporting period (ED.25).

The IFRS Conceptual Framework states that an asset or liability shall be recognised if its recognition, together with any related revenue, expense or change in equity, provides users with information that is useful because it is relevant and faithfully represents the economic event (BC122). Regarding relevance, the Framework notes that if there is uncertainty about the existence of the asset or liability, or if it exists but the probability of an inflow or outflow of economic resources is low, this may indicate that its recognition would not provide relevant information (BC123). ED 2021 provides a set of facts and circumstances to determine its existence (ED.27), which are shown in the figure below:

//// TABLE 2. Facts and circumstances relevant to determining the existence of a regulatory asset or regulatory liability

Regulator.-related

- Confirmation from the regulator of the amounts to be added or deducted when determining future regulated rates.
- Preliminary views expressed by the regulator.
- Direct precedents: the entity's experience with the regulator's interpretations under similar circumstances.
- Indirect precedents: experience of other entities regulated by the same regulator, decisions of other regulators, or court rulings in similar circumstances.

Related to the regulatory agreement

- Explicit requirements or guidelines in the regulatory agreement.
- Decisions on rate-regulated activities or court rulings interpreting the agreement.

Entity-related

- Evidence that the entity has incurred allowable expenses.
- Evidence that the entity has (or has not) met the performance criteria that trigger performance incentive bonuses or penalties.

Third-party-related

- Advice by legally qualified and experienced advisors or other experts.

↑ Source: Authors' own based on IASB (2021a), paragraph 27.

ED 2021 proposes that, if it is uncertain whether a regulatory asset or regulatory liability exists, an entity should recognise it when it is **more likely than not** (ED.28).

Should a recognition threshold of being "more likely than not" be applied when the existence of regulatory asset or regulatory liability is uncertain?

Opinion of the European Financial Reporting Advisory Group (EFRAG, 2021):

EFRAG considers that, if there is uncertainty about the existence of a regulatory asset or liability, an entity shall recognise it **when it is more likely than not**.

Opinion of the Accounting and Auditing Institute (ICAC, 2021)

The recognition criterion of "more likely than not" **is appropriate because it is more stringent than simply the absence of a low probability** of occurrence of the economic benefits associated with the asset or liability.

Opinion of Iberdrola (Iberdrola, 2021)

The threshold for recognition should be symmetrical for both assets and liabilities, and we support the use of the **"more likely than not"** criterion.

Opinion of academics at Universidad Loyola Andalucía (Universidad Loyola Andalucía, 2021)

The recognition criterion for regulatory assets and liabilities should be asymmetric, as in the case of IFRS 15 and International Accounting Standard 37 – Provisions (IAS 37). **There should be a strong connection between ED 2021 and IFRS 15**separating only in those particular aspects provided by the regulatory framework. The inclusion of rights and obligations in future rates is subject to demand risk and should be treated as variable consideration, so their recognition should take into account the probability criterion required by IFRS 15 for the variable component of the price (that it is **highly likely that there will not be a significant reversal of revenue**). IFRS 15, in its BC206, argues that "*the majority of the users of financial statements that were consulted indicated that the most relevant measure of revenue in a reporting period would be one that would not result in a significant reversal in a subsequent period*". In the case of revenue recognition, this argument is especially relevant.

When an entity recovers all or part of a regulatory asset or fulfils all or part of a regulatory liability by adding or deducting an amount in determining future regulated rates, it shall **derecognise** that part of the regulatory asset or regulatory liability, and recognise a regulatory expense or regulatory income accordingly (BC129). The Board considered that ED 2021 included sufficient proposals to explain when and how regulatory assets and regulatory liabilities should be derecognised, and therefore decided not to include a separate section on derecognition in ED 2021. However, several respondents suggested including guidance on derecognition of regulatory assets and regulatory liabilities when they no longer qualify for recognition under the proposed Standard, including guidance on when items recognised under this Standard may transition to recognition under other IFRS Standards (e.g.,). EFRAG (2021), Iberdrola (2021), ICAC (2021) and Universidad Loyola Andalucía (2021).

Measurement

Regulatory assets and regulatory liabilities shall be measured at **historical cost**, subsequently modified by using updated estimates of the amount and timing of future cash flows (ED.29). In using this measurement basis, an entity shall use a cash flow-based measurement technique that:

- Include an estimate of all future cash flows arising from a regulatory asset or regulatory liability (ED.30(a)); and
- Discount these future flows to their present value (ED.30(b)).

The Board acknowledges that this measurement basis could have been described as a current value measurement, modified to use a historical discount rate. However, it proposed to define it as a modified historical cost basis because, according to the Framework, historical cost is based on information derived, at least in part, from the price of the transaction that gave rise to the asset or liability. Both the total allowed compensation and the regulated rate may be considered as forms of pricing. Additionally, the discount rate is only updated if the regulatory agreement changes the regulatory interest rate, which affects the cash flows related to regulatory interest (BC133).

Estimating future cash flows

An entity shall include all estimated cash flows arising from regulatory asset or regulatory liability, and only those cash flows (ED.31). In estimating such flows, the entity shall consider (ED.32):

- All reasonable and supportable information available, without incurring disproportionate cost or effort, on past events and conditions existing at the end of the reporting period.
- Current expectations about future conditions other than future changes in the regulatory agreement or in legislation.

Cash flows arising from a regulatory asset or regulatory liability are cash flows that are within the **boundary of a regulatory agreement**[5] (ED.33). This is relevant because the definition of regulatory assets and regulatory liabilities refers to enforceable rights and obligations. The right to add, or the obligation to deduct, an amount in the regulated rates to be charged to customers in future periods shall only be enforceable if such increases or decreases occur within the boundary of the regulatory agreement (BC143).

The current **right** of an entity to increase a regulated rate at a future date, as well as the **obligation** to reduce it, are only considered to be **enforceable** if certain conditions relating to the supply of goods or services and the possibility of terminating the regulatory agreement are met. These conditions are detailed in Table 3, as set out in paragraphs B30 and B32 of the standard (ED.B30, B32).

5 The boundary of a regulatory agreement is the latest future date on which an entity has (ED.B28):
(a) a present enforceable right to recover a regulatory asset by increasing the regulated rate to be charged to customers; or
(b) a present enforceable obligation to fulfil a regulatory liability by decreasing the regulated rate to be charged to customers.

//// TABLE 3. Enforceable rights and obligations

	Supply of goods and services	Cancellation of the agreement
A present enforceable right to increase the regulated rate at a future date.	The regulatory agreement gives the entity the present right to supply goods or services at that future date.	Only the entity may cancel the agreement before that date without compensation.
Present enforceable obligation to decrease the regulated rate at a future date	The regulatory agreement gives the entity a present obligation to supply goods or services at that future date.	The entity cannot cancel the agreement before that date without compensating the other party (e.g. an incoming supplier).

↑ Source: Authors' own based on IASB (2021a), paragraphs B30 and B32.

The boundary of a regulatory agreement may be affected by the **right to renew or cancel it** (ED. B33). For this right to affect the boundary of the agreement, there must be a practical ability to exercise it, which is the case, for example, when: (a) the economic consequences of exercising the right are significantly more adverse than the consequences of not exercising it; (b) exercising the right by the entity would lead to its liquidation or cessation of its activity; or (c) exercising the right by a regulator would lead to major disruption in the provision of an essential public service (ED.B34).

In accordance with the Conceptual Framework, the focus of the definition of assets and liabilities is on whether rights and obligations exist, rather than on the likelihood that they will lead to cash flows. Therefore, when assessing whether the practical ability to exercise a right exists, an entity should not consider the likelihood or intent to exercise the right, but only whether there are circumstances in which the holder actually has the ability to exercise the right (BC146).

In some cases, a regulator or entity may have the right to cancel a regulatory agreement. However, such a right is often conditional on the obligation to provide or agree to provide compensation for regulatory assets not yet recovered or for regulatory liabilities not yet fulfilled (ED.B35). ED 2021 states that the amounts to be received or paid as compensation constitute cash flows within the regulatory agreement boundary, as they depend solely on the monetary amount of unrecovered assets or unfulfilled liabilities (ED.36).

A **change in the boundary of a regulatory agreement** could generate additional cash flows within that boundary (BC154). For this reason,ED 2021 states that, at the end of each period, an entity should reassess the boundary of the arrangement, taking into account all changes in relevant facts and circumstances (ED.39).

Example 6: Change in the boundary of a regulatory agreement

In 20X1, the entity incurs a variance from the estimated cost that it will be able to recover in 20X3, but does not recognise regulatory asset because, under the boundary of the regulatory agreement, it would only be able to recover those flows until the end of 20X2.

However, on reassessing the situation in 20X2 and concluding that the boundary of the agreement extends to 20X3, the entity then recognises the regulatory asset because it now has a present enforceable right to recover those future cash flows that fall within the boundary.

The Board supports this recognition in 20X2 because the recognition of a regulatory asset or regulatory liability accurately reflects the current financial position and makes it possible to show more clearly the impact of those flows in the period in which they will actually be recovered (20X3). Additionally, an entity shall report in the notes to the financial statements, on changes in regulatory assets and regulatory liabilities arising from the boundary change of the agreement and the reasons for the change.

↑ Source: BC155-157 (IASB, 2021b)

If regulated rates are denominated in a **foreign currency**, the entity shall treat regulatory assets and regulatory liabilities as monetary items when applying IAS 21 - *The Effects of Changes in Foreign Exchange Rates* (ED.45).

Cash flows arising from regulatory asset or regulatory liability also include **cash flows arising from interest** related to those activities. These cash flows, which only arise during the period until recovery or fulfilment of the regulatory asset or liability, do not affect the amount of other cash flows that may arise, but do affect their timing and could influence their level of uncertainty (ED.36).

If cash flows are uncertain, an entity shall assess whether the this **uncertainty** is borne by the entity or the customer. In this sense:

- If customers bear the credit risk because the regulatory agreement treats uncollected amounts as allowable in determining the future rate, the entity includes in its estimates of future cash flows the cash it expects to collect in that future period.
- If, on the other hand, the entity bears the credit risk, it must estimate future cash flows by deducting an estimate of the amounts it may not be able to collect. This may entail that estimated cash flows are lower than the amounts the entity will charge to customers and therefore lower than revenue, as IFRS 15 generally requires that uncollected amounts should not reduce revenue recognised (ED.38).

ED 2021 proposes two **methods for estimating uncertain cash flows**, using the method that best predicts them: the "most likely amount method" or the "expected value method" (ED.39). Additionally, if an entity believes that applying one method for certain regulatory assets or regulatory liabilities and another method for other assets or liabilities provides a better prediction of cash flows, it may do so (ED.41). However, once a method has been applied, an entity must continue to use that method until the recovery of the regulatory asset or fulfilment of the regulatory liability (ED.42). The estimate of cash flows should not include the entity's own non-performance risk (ED.43). The Board concluded that the proposal to use these methods is consistent with IFRS 15 for estimating variable consideration in revenue contracts, and with IFRIC 23 on predicting the resolution of uncertainties over tax treatments (BC137).

Is the proposal to estimate future cash flows appropriate?

Opinion of the European Financial Reporting Advisory Group (EFRAG, 2021):

The proposal to estimate future cash flows from regulatory assets and regulatory liabilities using the most likely amount or expected value method, whichever provides more relevant information, is appropriate. It is appreciated that **the own non-performance risk is not included in the estimate,** as it is counter-intuitive and consistent with the treatment of financial liabilities. However, it is noted that there is a need for the IASB to provide additional guidance on how to allocate credit risk to each regulatory asset. Additionally, it is noted that the **requirements on the regulatory agreement boundary can be confusing,**especially if mixed with the concept of an operating licence. It is considered that this boundary should be defined in terms of the enforceable rights and obligations set out in the regulatory agreement, and not as an accounting judgement. In cases where regulatory approval is pending and an enforceable right or obligation does not yet exist, this issue should be addressed in the recognition section, not the measurement section.

Opinion of the Accounting and Auditing Institute (ICAC, 2021)

The discounted cash flow technique is appropriate because the consideration to which an entity is entitled for goods or services already provided is subject to uncertainty, similar to the variable consideration. It is also reasonable for an entity to choose between the most likely amount method and the expected value method, depending on which provides more relevant information. Additionally, the **decision to not include own non-performance risk is correct**, as this would be counter-intuitive and has also been decided for the measurement of financial liabilities. It suggests **revising the requirements and guidelines on the regulatory agreement boundary**, considering that this boundary should be determined on the basis of the entity's enforceable rights and obligations under the regulatory agreement, and not as a mere accounting judgement.

Opinion of Iberdrola (Iberdrola, 2021)

The proposal to estimate uncertain cash flows using the most likely amount or expected value method is appropriate as it is in line with other standards such as IFRS 15 and IFRIC 23 and provides useful information on regulatory assets and regulatory liabilities and enforceable rights or obligations. However, the use of the **discounted cash flow approach is not appropriate** for assets and liabilities that are not financial instruments (FC52), and would create significant operational complexities, especially in US-regulated businesses due to the difficulty of estimating the time of inclusion in rates, the variability of regulatory interest rates and the need to update calculations due to the long useful life of the assets. It is necessary to **clarify the concept of the regulatory agreement boundary**.

Opinion of academics at Universidad Loyola Andalucía (Universidad Loyola Andalucía, 2021)

The **updating of discounted future cash flows is considered useful** for users, as regulatory assets and regulatory liabilities have limited demand risk, and share characteristics with quasi-monetary items, even though they are treated as monetary items for the purpose of exchange rate differences under IAS 21.. A parallel is drawn with deferred tax assets and liabilities, which also require review in the event of changes in tax conditions. It is highlighted that, as **IFRS 15** requires a review of variable consideration at the end of each reporting period, because of their nature of variable consideration, regulatory assets and regulatory liabilities should be reviewed periodically. Uncertainty in the realisation of these assets and liabilities should be incorporated in the measurement, and it is considered relevant that the information avoids significant reversals of revenue, proposing that **expected value should only be used when it is highly probable that such reversals will not occur**. Finally, it is noted that the **definition of the regulatory agreement boundary** affects both the recovery period and the likelihood of recovery of regulatory assets or fulfilment of regulatory liabilities.

Discounting estimated future cash flows

An entity shall measure a regulatory asset or regulatory liability by discounting to their present value the estimated cash flows (ED.46) at the regulatory interest rate, unless this is insufficient (ED.48). Therefore, if the regulatory interest rate is also the **discount rate**, at initial recognition, the present value of the estimated future cash flows is the sum of the estimated future cash flows excluding the cash flows from regulatory interest (ED.49).

On initial recognition of a regulatory asset, an entity shall assess whether there is any indication that the regulatory interest rate may be insufficient to compensate for the time value of money and the uncertainty in the amount and timing of the cash flows associated with that regulatory asset (ED.50). However, ED 2021 does not require this assessment regulatory liabilities; in these cases, the regulatory interest rate will be used as the discount rate in all circumstances (ED.53). When assessing sufficiency, ED 2021 indicates that the regulatory interest rate may be considered insufficient if it is below:

(a) the regulatory interest rate provided for other regulatory assets in the same currency, with a similar maturity profile or subject to similar uncertainties; or

(b) the interest rate on loans in the same currency that have a similar maturity profile, credit risk and terms and conditions similar to those of the regulatory asset, after deducting the part of the interest rate intended to cover the cost of servicing the loans and any credit losses already included in the estimated cash flows.

These could be loans granted by the institution itself or other loans for which the interest rate is readily observable (ED.52).

If there are indications that the regulatory interest rate applicable to an asset may be insufficient, an entity shall estimate the minimum rate that provides sufficient compensation. In these cases, the higher of the regulatory interest rate and the estimated minimum rate shall be used as the discount rate (ED.51). As a result, the carrying amount of the regulatory asset is reduced (BC168).

Sometimes a regulatory agreement may set or change the regulatory interest rate unevenly, for example, by setting different interest rates for different periods over the life of the regulatory asset or regulatory liability. ED 2021 proposes that, in these cases, an entity should determine a single discount rate and not consider possible future changes in the regulatory interest rate (ED.54).

Example 7: Regulatory interest rate

Entity A supplies goods or services to customers under a regulatory agreement. At fiscal year-end 1, it recognised allowable expenses of EUR 100,000 that were not included in the regulated rate for that year. These expenses form part of the total allowed compensation for goods and services supplied in fiscal year 1, and the entity is entitled to add them, with regulatory interest at 10% per annum, to the regulated rate to be charged to customers on a uniform basis for fiscal years 3 and 4. This results in a regulatory asset initially measured at EUR 100,000.

Entity A estimates that it will recover the regulatory asset by including EUR 60,000 in the rates for fiscal year 3 and EUR 55,000 in the rates for fiscal year 4. The following table shows the estimated changes in the balance of unrecovered rate-regulated activities:

	Year 1	Year 2	Year 3	Year 4
Opening balance	-	100,000	100,000	50,000
Addition	100,000	-	-	-
Regulatory interest	-	-	10,000	5,000
Recovery	-	-	(60,000)	(55,000)
Closing balance	100,000	100,000	50,000	-

The discount rate (t) of the estimated cash flows is 5.82%.

$$100.000 + \frac{0}{(1+t)} + \frac{-60.000}{(1+t)^2} + \frac{-55.000}{(1+t)^3} = 0$$

The reconciliation of the carrying amount of regulatory assets will be as shown below:

	Year 1	Year 2	Year 3	Year 4
Initial carrying amount	-	100,000	106,000	52,000
Amount recognised	100,000	-	-	-
Regulatory interest income	-	6,000	6,000	3,000
Recovery	-	-	(60,000)	(55,000)
Final carrying amount	100,000	106,000	52,000	-

Note: The amount of interest, applying the rate of 5.82% per annum, has been rounded off to the nearest whole number.

↑ Source: Illustrative Example 5 (IASB, 2021c)

Subsequent measurement

After initial recognition, at the end of each period, the entity shall update the estimated amounts and timing of future cash flows arising from the regulatory assets or regulatory liabilities to reflect conditions existing at that date. The entity shall continue to use the discount rate determined at initial recognition unless the regulatory interest rate has changed (ED.55).

Example 8: Change in the regulatory interest rate

Continuing with Example 6, let's assume that at the end of fiscal year 3, the regulatory interest rate for fiscal year 4 changes from 10% to 8% per annum.

The following table shows the estimated changes in the balance of unrecovered rate-regulated activities:

	Year 3	Year 4
Opening balance	100,000	50,000
Addition	-	-
Regulatory interest	10,000	4,000
Recovery	(60,000)	(54,000)
Closing balance	50,000	-

The new discount rate (t) will be the updated regulatory interest rate, which is 3.89%.

$$52.000 + \frac{-54.000}{(1+t)} = 0$$

The reconciliation of the carrying amount of regulatory assets will be as shown below:

	Year 3	Year 4
Initial carrying amount	106,000	52,000
Amount recognised	-	-
Regulatory interest income	6,000	2,000
Recovery	(60,000)	(54,000)
Final carrying amount	52,000	-

Note: The amount of interest, applying the rate of 5.82% per annum for fiscal year 3 and 3.89% per annum for fiscal year 4, has been rounded off to the nearest whole number.

↑ Source: Illustrative Example 5 (IASB, 2021c)

Do you agree with the proposals on the discounting of estimated cash flows and the discount rate?

Opinion of the European Financial Reporting Advisory Group (EFRAG, 2021):

The proposal to **discount estimated future cash flows** to their present value when measuring regulatory assets and liabilities, considering that discounting is a fundamental principle in IFRS when the time value of money is material, is **appropriate**. However, the IASB could introduce a **practical exception** similar to that in IFRS 15, permitting **not discounting when the effect is insignificant**.

EFRAG considers the regulatory interest rate to be appropriate for discounting assets and liabilities, and **rejects the use of an alternative minimum rate** for assets. It proposes that, if this minimum rate is maintained, it should be formulated as a rebuttable presumption, allowing the regulatory rate to be used unless there is evidence to the contrary.

It also agrees with determining a single discount rate for the entire life of the asset or liability, but suggests incorporating more illustrative examples for complex cases.

It also notes that in some regulatory agreements the interest rate compensates for both time lag and business risk, and therefore recommends **amending the definition of regulatory interest rate** to reflect this common practice.

Opinion of the Accounting and Auditing Institute (ICAC, 2021)

It supports the discounting of regulatory assets and regulatory liabilities following the general principles of IFRS, as it reflects the time value of money.

However, it recommends that the IASB allow for a **practical exemption** from the start of the agreement if the rate does not differ significantly from the minimum rate.

Opinion of Iberdrola (Iberdrola, 2021)

It would be preferable to measure regulatory assets and liabilities without discounting cash flows, as under Topic 980 *Regulated Operations* of the FASB. This would reduce costs and complexity. However, if the IASB ultimately decides to maintain the discount, it would be consistent with IFRS when the time value of money is significant. It suggests introducing a **practical exception to not discount when the effect is minor** or the flows are realised in the short term. It does not agree with using different discounting approaches for assets and liabilities and supports using the regulatory interest rate for both.

Opinion of academics at Universidad Loyola Andalucía (Universidad Loyola Andalucía, 2021)

With the **current wording**paragraph 53 of the Exposure Draft on the **interest rate to be used for liabilities appears to be inconsistent**. On one hand, it is unclear whether this requirement is voluntary or mandatory, the [draft] Standard stating that it"*does not require an entity to assess whether the regulatory interest rate for a regulatory liability is sufficient*" which seems to open the door to the assessment of its significance by the entity, yet it also states that "*For a regulatory liability, an entity shall use the regulatory interest rate as the discount rate in all circumstances.*"and does not open up that possibility. On the other hand, if the regulatory interest rate is not specified in the agreement, we consider that it should be estimated as the cost of incremental borrowing to the entity.

There are some exceptions to the general criterion for measuring regulatory assets and regulatory liabilities.

On one hand, ED 2021 proposes an alternative when a regulatory asset or regulatory liability arises because the agreement treats an expense or income item as allowable or chargeable in determining regulated rates only when the entity pays or receives the related cash (ED.59).

For example, this could occur when an entity recognises a provision for the cost of environmental clean-up and the related expense in accordance with IAS 37, and the regulatory agreement gives it the right to include those costs in the regulated rate only when the related cash payment has been made.

In these cases, ED 2021 proposes to recognise the regulatory asset at the time the provision is recognised, and to measure it using the same measurement basis applied under IAS 37, adjusted for any uncertainty in the regulatory asset that is not present in the related provision.

Presentation

An entity shall generally present all regulatory income less all regulatory expenses in a **separate line item in the statement of financial performance**, located after revenue (ED.67). Regulatory income and regulatory expenses include regulatory interest income and expenses (ED.68).

This presentation reflects the fact that regulatory assets and regulatory liabilities represent present enforceable rights to increase or present enforceable obligations to decrease, future regulated rates. As these items do not affect the amount of revenue recognised in the current period, regulatory income and regulatory expenses are not presented as part of revenue (BC179).

However, regulatory income and regulatory expenses derived from regulatory assets or regulatory liabilities that have been re-measured through other comprehensive income shall also be recognised in other comprehensive income (ED.69). This could be the case for actuarial gains or losses arising from subsequent measurement of pension benefits in accordance with IAS 19 - *Employee Benefits*.

Regarding the presentation of regulatory assets and liabilities in the **balance sheet**, ED 2021 proposes that they be presented as **separate line items** (ED.70(a)).. Additionally, they shall be classified as current or non-current regulatory assets and regulatory liabilities in accordance with IAS 1 unless an entity elects to present all assets and liabilities in order of liquidity (ED.70(b)).

An entity may offset regulatory assets and regulatory liabilities that form separate units of account only if the entity:

(a) has a legally enforceable right to offset them by including them in the same regulated rate; and (ED.71(a))

(b) expects to include amounts derived from the recovery and fulfilment of those regulatory assets and liabilities in the same regulated rate for goods or services supplied in the same future period (ED.71(b)).

Do you agree with the proposal for the presentation of regulatory income and regulatory expenses?

Opinion of the European Financial Reporting Advisory Group (EFRAG, 2021):

The proposal to present all regulatory income minus all regulatory expenses **in a separate line item** immediately below revenue is **appropriate**. It also supports the inclusion of regulatory interest income and regulatory interest expenses in the same line.

It supports the netting of **regulatory assets and liabilities** in the statement of financial position. However, it expresses concern that the requirements of paragraph 71(b) of the draft standard could make this **compensation** difficult. It also notes that the requirement in paragraph 70(b) to present current and non-current regulatory assets and regulatory liabilities separately **implies significant judgement** on the part of the entity..

Opinion of the Accounting and Auditing Institute (ICAC, 2021)

The inclusion of a **separate line item** to present all regulatory income less regulatory expenses is **appropriate**. However, **regulatory interest income and regulatory interest expenses** should be presented as **financial items**in line with ED/2019/7 on General Presentation and Disclosures.

Opinion of Iberdrola (Iberdrola, 2021)

Iberdrola **agrees** with the proposal to present, in the statement of financial performance, all regulatory income and regulatory expenses in a **a single separate line item** located immediately below revenue, with both regulatory interest income and regulatory interest expense included in that line.

Opinion of academics at Universidad Loyola Andalucía (Universidad Loyola Andalucía, 2021)

Rate regulation generates time lags between the provision of the good or service and the time at which the amount is included in the rate. These mismatches result in adjustments to revenue for the period, either because of the right to recover the amount in future rates or because of the obligation to deduct an anticipated charge. In both cases, these are adjustments to revenue, and therefore it is **not considered appropriate to refer to negative adjustments as "regulatory expenses"**. Even so, it considers it appropriate to present regulatory income and regulatory expenses in a single line item.

It is also noted that, since regulatory assets and liabilities are treated as monetary items (e.g. for exchange rate differences), the **financial component** should be **classified as financial**unless it is considered part of ordinary activity according to ED/2019/7.

Information to be disclosed

An entity shall disclose in the notes, information on regulatory income, regulatory expenses, regulatory assets and regulatory liabilities. This information, together with the other information included in the financial statements, will enable users to:

(a) Understand the relationship between the entity's revenue and expenses as completely as if the total allowed compensation had been reflected directly in revenue. This understanding will provide a better assessment of the entity's cash flow prospects.

(b) Comprehend the regulatory assets and regulatory at the end of the reporting period. This information provides a clearer picture of how these elements will affect the amount, timing and uncertainty of the entity's future cash flows (ED.72).

An entity shall disclose in the notes, information that enables users to understand how financial performance has been affected when part of the total allowed compensation for goods or services provided in one period has been (or will be) included in the determination of regulated rates for goods or services provided in a different period (ED.77).

To fulfil this objective, ED 2021 requires entities to disclose in the notes, the components of the statement of financial performance detailed in the table below.

//// TABLE 4. Disclosure: Components of regulatory income and regulatory expenses.

Description	Information to be disclosed
Origin of regulatory assets	The part of the total allowed compensation for goods or services provided in the current period that will be included in revenue in future periods.
Recovery of regulatory assets	The amount included in revenue in the current period that provides part of the total allowed compensation for goods or services that were provided in past periods.
Origin of regulatory liabilities	The amount included in revenue in the current period that will provide part of the total allowed compensation for goods or services to be provided in future periods.
Fulfilment of regulatory liabilities	The part of the total allowed compensation for goods or services provided in the current period that was included in revenue in past periods.
Regulatory interest income and regulatory interest expenses	Regulatory interest income on regulatory assets and regulatory interest expenses on regulatory liabilities.
Changes to the boundary of a regulatory agreement.	Changes in the carrying amount of a regulatory asset or regulatory liability resulting from a change in the boundary of a regulatory agreement, and the reasons for the change.
Changes in the measurement of regulatory assets and regulatory liabilities.	The re-measurements of regulatory assets and regulatory liabilities, and the reasons for the re-measurements.

↑ Source: IASB (2021a), paragraph 78.

An entity shall disclose information that enables users to understand the regulatory assets and regulatory liabilities existing at the end of the reporting period so they can better understand how they will affect the amount, timing and uncertainty of future cash flows (ED.79).

To meet this objective, they entity shall include in the notes, the information set out in the following table.

//// TABLE 5. Disclosure of regulatory assets and regulatory liabilities

Description	Information to be disclosed
Quantitative information	• Time bands indicating when regulatory assets are expected to be recovered and regulatory liabilities are expected to be fulfilled. When doing so, the entity should apply professional judgement to determine an appropriate number of time bands (e.g. up to one year; more than one year and less than three years; more than three years and not more than five years; and more than five years). • Indication as to whether amounts are presented in discounted or undiscounted terms.
Discount rates used	• The discount rate or discount rate ranges used in measuring regulatory assets and regulatory liabilities.
Minimum interest rate	• The regulatory interest rate provided by the regulatory agreement for a regulatory asset if the entity uses the minimum interest rate as the discount rate for that asset.
Risks and uncertainties	• An explanation of how risks and uncertainties affect the recovery of regulatory assets or the fulfilment of regulatory liabilities.

↑ Source: IASB (2021a), paragraph 80.

ED 2021 does not establish specific disclosure requirements for the cash flow statement. The Board considered that, normally, an entity recovers a regulatory asset by increasing the rate, and fulfils a regulatory liability by decreasing it, but not by directly receiving or paying cash (BC202).

Interaction with other standards

The overall approach of ED 2021 is that an entity:

- Shall apply the requirements of existing IFRS (for example, by recognising revenue under IFRS 15); and then
- Recognise regulatory assets and regulatory liabilities.

However, ED 2021 specifically discusses how the proposal interacts with IAS 12 and IFRIC 12 - Service Concession Arrangements.

Interaction with IAS 12 - Income Taxes

Tax expense is usually an allowable expense and tax income is usually chargeable income. Sometimes the regulated rate for a specified period does not include all current and deferred tax effects of transactions occurring in that period (ED.42).

In such situations, an entity shall recognise a regulatory asset or regulatory liability if some or all of the current or deferred tax effects of transactions in the current period affect regulated rates in future periods, or if they have already affected regulated rates in prior periods (ED.43).

ED 2021 notes that the tax base of a regulatory asset or regulatory liability is generally nil, so the recognition of such an asset or liability generally leads to the recognition of a deferred tax liability or asset, as set out in IAS 12.

Example 9: Interaction between ED 2021 and IAS 12

An entity has a regulatory asset that arises because a performance incentive (bonus) of EUR 60,000 has not yet been included when determining regulated rates. The income tax rate is 40% and the regulatory agreement allows all tax cash flows to be included finally when determining the regulated rate.

The measurement of the regulatory asset (the EUR 60,000 incentive) reflects the pre-tax cash inflow (EUR 100,000) and the income tax cash outflow (EUR 40,000), which will occur when the entity recovers the regulatory asset.

As the entity is entitled to include the tax cash flows in the determination of the future regulated rate, the regulatory asset amounts to EUR 100,000. Additionally, the entity must recognise a deferred tax liability of EUR 40,000.

↑ Source: IASB (2021a), paragraph B46.

Interaction with IFRIC 12 - Service Concession Arrangements

ED 2021 recognises that a regulatory agreement could take the form of a service concession agreement (ED.8(b)).

IFRIC applies to public-to-private service concession agreements if:

- The grantor controls or regulates the services to be provided by the operator with the infrastructure, to whom said services must be provided and their prices; and
- The grantor controls any significant residual interest in the infrastructure at the end of the term of the agreement.

Therefore, certain agreements within the scope of IFRIC 12 may result in the separate recognition of regulatory assets or liabilities that would be within the scope of the exposure draft (ED.B47).

Would all agreements within the scope of IFRIC 12 also be within the scope of ED 2021?

Not all service concession agreements within the scope of IFRIC 12 would be within the scope of ED 2021.

Price regulation is one of the key scope criteria of IFRIC 12: a concession agreement only falls within IFRIC 12 if the grantor controls the prices charged to customers. This includes cases where prices are controlled by an independent regulator acting in the public interest.

However, many service concession agreements will not meet the proposed requirement that part of the total allowed compensation for goods and services supplied in one period be charged to customers through regulated rates for goods or services supplied in a different period.

For example, if we consider a typical service concession agreement where an operator builds and operates a toll road and has the right to collect tolls from users. This could be within the scope of IFRIC 12 if the relevant criteria are met, including the grantor's control over the tolls charged to users.

This service concession agreement would not necessarily be within the scope of ED 2021. For example, if the operator assumes the risks of higher or lower construction and operating costs than expected, and assumes the demand risk, then the operator is not entitled to a specific amount of compensation.

The service concession agreement would only be within the scope of ED 2021, if the concession agreement grants the operator an enforceable right (obligation) to increase (decrease) tolls in future periods to recover (settle) cost and demand variance.

The same is true for renewable energy generation concession assets.

Spanish legislation establishes that the remuneration regime for renewable energies, cogeneration and waste will be based on the necessary market participation of these installations, complementing market revenues, if necessary, with a specific regulated remuneration that allows these technologies to compete on an equal footing with the rest of the technologies in the market. This additional specific remuneration will be sufficient to reach the minimum level required to cover the costs which, unlike conventional technologies, cannot be recovered on the market and will allow them to obtain a reasonable return with regard to the standard installation in each applicable case.

Under this criterion, the specific remuneration shall consist, according to technologies, of:

- A term per unit of installed power to cover the investment costs of a typical installation that cannot be recovered by the sale of energy on the market, and
- An operating term covering the negative difference between operating costs and revenue from participation in the market..

The remuneration shall be calculated on a standard installation over its regulatory useful life, taking into account:

- the standard revenue from the sale of generated energy, valued at the (estimated) output market price,.
- the standard operating costs and the standard value of the initial investment.

For the calculation of the specific remuneration, regulatory periods of 6 years and half-periods of 3 years are established.

In Spain, the first regulatory period began on 14 July 2013 and ended on 31 December 2019. The second regulatory period began on 1 January 2020 and will end on 31 December 2025.

In the review corresponding to each regulatory period, all remuneration parameters may be modified and, among them, the value on which the reasonable profitability will be based for the remaining regulatory useful life of the standard installations, which shall be legally established. In no case, once the regulatory useful life or the standard value of the initial investment of an installation has been recognised, may these values be revised.

Therefore, because the operator bears the risks that construction and operating costs are higher or lower than expected and does not have an enforceable right (obligation) to increase (decrease) remuneration in future periods to recover (settle) cost and demand variance, it would not be within the scope of the proposed standard on regulatory assets and regulatory liabilities.

↑ Source: Interviews conducted by the project heads with professionals.

Effective date and transition

ED 2021 requires entities to apply the standard for annual periods commencing within 18 to 24 months after its date of publication. Earlier application is permitted; if so, the entity must disclose this fact (ED.C1).

The standard shall be applied retrospectively in accordance with IAS 8 - Accounting Policies, Changes in Accounting Estimates and Errors, except in the case of past business combinations, in which case an entity may elect not to apply the standard (ED.C3-C4).

3 Discussion of the exposure draft as of June 2021

All meetings held by the bodies responsible for issuing IFRS within the IASB from the date of publication of the draft until the start of our fieldwork, have been considered. This study covers the period up to the IASB meetings of May 2025.

A summary of the topics discussed at these meetings has been prepared by reviewing the documentation available on the IFRS website for each session, accessible via the following URL.. The summary, which is available as supplementary documentation on request, is organised into columns detailing the following information:

- Body calling the meeting.
- Date of the meeting.
- Topic and most significant comments from said meeting.
- File name used for reference.

3.1. Stages of the standard-setting process

At the IASB meeting in July 2024, all steps followed within the established standard-setting process were reviewed, differentiating between the compulsory and optional phases that have been carried out since the start of the project. The details are as follows:

Compulsory stages

- Public discussion of proposals at 61 IASB meetings.
- Publication of documents for feedback:.
  - Exposure Draft (2021): 128 responses received.
  - Discussion Paper (2014): 113 responses received.
  - Request for Information (2013): 80 responses received.
  - Consideration of feedback received.
  - Evaluation of the need for re-exposure.
  - Consultations with ASAF (20 meetings) and the IFRS Advisory Council.
  - Effects (cost/benefit) analysis included in the ED.
  - Proposed effective date: 1 January 2029.

Optional stages

- Publication of the *Discussion Paper*.

- Creation of the *Consultative Group for Rate Regulation* (9 meetings).
- Public hearings (5 events between 2014 and 2021).
- Fieldwork: surveys on the concept of direct/non-direct relationship.
- Meetings with other advisory groups.
- Extensive outreach programme: 219 meetings with users and stakeholders.

Publication of the draft standard and feedback responses

As indicated at the end of section 2.1 of this document, in January 2021 the Exposure Draft: Regulatory Assets and Regulatory Liabilities (IASB, 2021a) was published. On that date, the feedback period was opened and it concluded in July 2021.

At the October 2021 IASB meeting it was reported that 128 responses had been received by 30 July 2021. Approximately half of them came from preparers, mainly in the water, gas and electricity sectors, while a quarter came from regulators. One third of all responses were from Europe.

In the staff summary of the responses received, the following points are highlighted:

Aspects with broad consensus:

- The majority of respondents were in agreement with:
  - The proposed definitions of regulatory assets and regulatory liabilities, considering that they comply with the definitions set out in the Conceptual Framework for Financial Reporting.
  - The "more-likely-than-not" recognition threshold for regulatory assets and regulatory liabilities.
  - The use of a cash flow-based measurement technique to measure regulatory assets and liabilities that would involve estimating uncertain cash flows using the "most likely amount" or "expected value" method.
  - The use of the regulatory interest rate as the discount rate applicable to the regulatory assets and regulatory liabilities.

Aspects that raised the greatest concern among preparers:

- *Scope*significant uncertainty was identified as to which arrangements, agreements or rate-regulated activities would fall within the scope of the proposals. Concerns focused on the lack of clarity regarding interaction with other Standards (mainly IFRS 9, IFRS 17 and IFRIC 12), the breadth of the definition of "regulatory agreement" and the absence of an explicit definition of "regulator".
- *Return on assets not yet available for use*: most letters expressed disagreement with the proposal to reflect the return on an asset not yet available for use in the period in which that asset is used to provide goods or services. Objections were based on the lack of alignment with the economic substance, the low usefulness of the information, the high cost of implementation and incompatibility with US GAAP.
- *Regulatory assets and regulatory liabilities arising from differences between the regulatory recovery rate of assets and their useful lives*: numerous comments disagreed with the recognition of regulatory assets or regulatory liabilities due to differences between the length of time permitted by regulatory arrangements to an entity to recover an asset (the regulatory recovery rate) and the useful life of the asset; as they would not reflect an entity's rights and obligations arising from its regulatory agreements, would not meet the ED's definitions of assets and liabilities, would not be useful, and their cost of implementation would be high.

- *Minimum interest rate*: the proposal to use a minimum interest rate as a discount rate when the regulatory rate does not adequately compensate for the time value of money and the uncertainty of future flows was criticised for its high complexity.
- *Interaction with IFRIC 12 Service Concession Arrangements*: the majority of letters addressing this issue suggested that the Board provide detailed guidance and illustrative examples on how an entity would account for regulatory assets and regulatory liabilities by applying the financial asset, intangible asset or hybrid model of IFRIC 12.
- Additionally, meetings were held with users, risk and investment analysts, mainly linked to the energy, utilities and infrastructure sectors in Asia-Oceania, Europe and North America. The following is a summary of user responses on different aspects of the proposed model:
  - *Recognition, measurement and discount rate*most users agreed with the cash-flow-based measurement technique and the use of the regulatory interest rate as the discount rate. However, they disagreed on the proposal to use a minimum interest rate in cases where the expected regulatory rate does not adequately compensate for the time value of money and the uncertainty associated with the cash flows of the regulatory asset.
  - *Presentation*: with all users commenting on the presentation proposals agreed to present all regulatory income minus all regulatory expenses, including regulatory interest income and regulatory interest expenses, as a separate line item immediately below revenue; and to present the regulatory income minus regulatory expenses line item as operating revenue.
  - *Disclosure*: they agreed with the proposed general and specific disclosure objectives.
  - *Transition*: all users who commented on the transition proposals agreed with the proposed requirements for retroactive application of the final Standard.
  - *Other comments*: users understood that alignment with US GAAP is essential as it facilitates comparability between companies in the same sector reporting under IFRS or US GAAP.

3.2. Re-deliberation and Tentative Decisions in the IASB

Since that date (October 2021), IASB meetings have been re-deliberating on all sections included in ED 2021, taking into account both the responses received and the analysis conducted by the Board's staff.

At the meeting held in **May 2024**, although there were still some issues to be discussed and which had not been considered highly relevant, a summary of what had been discussed up to that point was presented. The summary was structured thematically, differentiating between initial proposals, comments received and tentative decisions taken by the IASB. The following section provides an outline of this summary:

1) Scope of the standard:
   - Proposal: Application to all regulatory assets and regulatory liabilities, regardless of the legal form of the agreement.
   - Responses received: General endorsement, although concern was expressed regarding the breadth of the scope and its interaction with other IFRSs.
   - Tentative decision: Maintain the proposed scope, clarifying that agreements may include enforceable rights and obligations, without listing specific types of regulatory agreements to which this would apply.

2) Key definitions:

- Proposal: Definition of regulatory assets and regulatory liabilities as an enforceable right/obligation giving rise to timing differences.
- Responses received: General approval, although concerns were raised about the term "customers" and enforceability in weak regulatory environments.
- Tentative decision: Include definition of "regulator", exclude self-regulation, and clarify that agreements can generate either assets or liabilities, even if not both.

3) Total allowed compensation:

- Proposal: Total allowed compensation includes allowable cost recovery, profit margins, incentives and interest components.
- Responses received: Criticism of applicability in schemes other than the cost-based approach, especially with regard to depreciation.
- Tentative decision: Focus guidelines on identifying timing differences, maintain the definition of allowable expenditure and include examples for benchmarks.

4) Recognition and derecognition:

- Proposal: Recognition of whether it is "more likely than not" that the regulatory asset or regulatory liability exists.
- Responses received: Some responses called for higher thresholds ("highly likely") and more clarity on enforceability.
- Tentative decision: Maintain the proposed threshold and clarify that rights and obligations may be enforceable, even if their existence is uncertain.

5) Measurement:

- Proposal: A technique based on discounted cash flows, using the expected value or most likely amount.
- Responses received: Concerns regarding complexity, cost and comparability with US GAAP.
- Tentative decision: Maintain both methods, allow switching if no longer makes predictions better, and not require additional impairment testing.

6) Discount rate:

- Proposal: Use of the regulatory interest rate, with an option to apply a minimum rate if the regulatory rate does not provide sufficient compensation.
- Responses received: General rejection of the minimum rate due to its cost and complexity; preference for always using the regulatory rate.
- Tentative decision: Maintain the proposal, including an exemption for assets recoverable in less than 12 months in terms of discounting. In this case, require disclosure of this circumstance.

7) Presentation

- Proposal: Separate line for regulatory income/regulatory expenses below revenue; possibility of compensation on balance sheet.
- Responses received: General approval, although some suggested including it as ordinary income or in financial performance.

- Tentative decision: Classify all regulatory income minus all regulatory expenses as revenue on a separate line, eliminate the compensation option in the balance sheet and maintain the separate presentation.

8) Disclosure:

- Proposal: Specific objectives on performance, financial position and changes not derived from regulatory income/regulatory expenses.
- Responses received: General approval, although concerns were expressed regarding the cost and level of aggregation.
- Tentative decision: Maintain objectives, include examples, require qualitative explanations of significant changes and expand the requirements for unrecognised assets and their relationship to fixed assets.

(9) Interaction with other IFRS:

- Proposal: Amendments to IAS 1, IAS 36, IFRS 1, IFRS 3, IFRS 5, IFRIC 12, among others.
- Responses received: Request for further guidance, especially on cash flows and business combinations.
- Tentative decision: Maintain the exclusion from IAS 36, create an exception in IFRS 3 and exclude regulatory assets from IFRS 5.

10) Effective date and transition:

- Proposal: Application between 18 and 24 months following publication; full retrospective application is permitted.
- Responses received: Preference for a longer period (24-36 months) and the option of modified retrospective application.
- Tentative decision: Pending final decision in the revised document.

After May 2024, the following meetings were held:

- IASB meeting in July 2024, where issues such as possible extension of measurement and presentation proposals, transition and implementation dates were discussed. Within this context, the possibility of re-exposing the draft of the future standard for a new round of public feedback before its final publication was evaluated, an option that was not considered at the time.
- Meetings of the *Accounting Standards Advisory Forum* (ASAF) in September and December 2024, at which the IASB's tentative decisions on the discount rate, disclosure, limits on regulatory agreements and their interaction with other IFRS were discussed. Concerns were also expressed regarding the applicability of the minimum interest rate and comparability across jurisdictions.
- IASB meeting in March 2025, which discussed whether to develop reduced disclosure requirements for entities applying IFRS 19 - *Subsidiaries without Public Accountability*..
- IASB meeting of **May 2025**, where additional technical issues and disclosure and transition requirements were discussed, the most significant of which was the decision to remove the minimum interest rate requirements, as it prevents artificial accounting losses, eliminates asymmetric treatment between regulatory assets and regulatory liabilities, and significantly reduces the complexity of the standard.

Annex 1 displays the list of meetings reviewed since the publication of ED 2021 together with the topics discussed.

3.3. EFRAG's position on the exposure draft

EFRAG has consistently monitored IASB meetings, actively participating in ASAF sessions on the Exposure Draft and the IASB's deliberations throughout the period in which they have taken place.

At its meeting on 19 September 2025, EFRAG presented the following background information describing its monitoring:

- The IASB completed its re-deliberations on ED 2021: Regulatory Assets and Regulatory Liabilities in July 2024..
- EFRAG issued its final response on the Exposure Draft in September 2021 and, since then, has been actively monitoring the IASB's re-deliberations with regard to the responses received. During this process, regular updates have been provided at meetings of the following technical groups: the *EFRAG Rate-Regulated Activities Working Group* (RRAWG), the *EFRAG Financial Reporting Technical Expert Group* (FR TEG), the *Financial Reporting Board* (FRB) and the *EFRAG Financial Reporting Consultative Forum of Standard Setters* (CFSS).
- In May 2025, the IASB addressed additional issues ("*sweep issues*") that emerged during the drafting phase of the future IFRS Standard.. At this meeting, the IASB decided not to include requirements related to a minimum interest rate. It also took decisions on disclosure requirements (mainly as a result of removing the minimum interest rate requirement) and on transition requirements applicable to interim financial statements.
- The IASB's decisions on the additional issues in May 2025, together with the IASB staff's cost-benefit analysis and the results of the field testing of the future IFRS Standard, were presented at the ASAF meeting in July 2025 and discussed at the EFRAG meeting in the same month.
- The IASB expects to publish the new IFRS Standard in the second quarter of 2026, with an effective date of 1 January 2029 and with early adoption permitted. The new standard will replace IFRS 14.
- EFRAG commenced its preparatory work for endorsement advice in the third quarter of 2024. Within this context, during the meeting of the *EFRAG Financial Reporting Technical Expert Group* (FR TEG) held in May 2025, the EFRAG Secretariat presented the preliminary results of:

    a. EFRAG's survey of preparers from European entities that are likely to fall within the scope of the future IFRS Standard,

    b. the review of regulations in EEA countries.

The steps EFRAG intends to take are as follows:

- Within the framework of the preparatory work for advice on the adoption of the new standard, the EFRAG Secretariat will follow up on the most affected areas identified from the survey of preparers. This follow-up will be carried out via interviews with the preparers who responded to the survey, as well as by a review of their financial statements in order to assess potential impacts.
- The EFRAG Secretariat will also extend the regulatory review beyond the scope of electricity and gas utilities (e.g. to the water sector), thus covering a wider set of EU Member States. This review will focus on regulatory issues that may have implications for the future IFRS Standard. In this regard, an additional survey is envisaged to facilitate the collection of relevant information.

As observed, the **publication of the Standard is scheduled for the second quarter of 2026**, which is a postponement of the initially estimated date (second half of 2025).. This delay is due to the fact that the IASB circulated, on a restricted and confidential basis, the new wording of the Standard (following the re-deliberation process) to various regulators and stakeholders. In this exchange, significant disagreements were identified, especially made by the UK *Endorsement Board* (UKEB). The basis for the main disagreements of the UKEB were the following facts:

- The recognition of certain regulatory assets and regulatory liabilities depends on whether an entity's regulatory capital base bears a direct or non-direct relationship to its property, plant and equipment or intangible assets.
- Regulatory agreements are broadly classified into two types:
  - Cost-based schemes: reflecting a closed relationship between an entity's specific costs and its revenues. They usually include “true-up” mechanisms that guarantee the recovery of costs incurred.
  - Incentive-based schemes: regulators seek cost efficiency rather than cost recovery. They are divided into two types:
    - "*Building blocks*"Regulators determine allowed revenues on the basis of forecasts for different types of expenses ("blocks"), such as operating expenses, depreciation, regulatory return, etc. Only amounts that the regulator considers efficient are part of allowed revenues. There may be true-up mechanisms for costs that are not controllable.
    - TOTEX (*total expenditure*): regulators determine allowed revenues by considering total expenditure, both operating ("opex") and capital ("capex") expenses. It is highly dependent on benchmarking techniques to define appropriate levels of efficiency.

      The regulator defines the TOTEX percentage to be capitalised and recovered through depreciation. The TOTEX ratio defined by the regulator may differ from the accounting ratio.

Based on the above, the UKEB argues that the Exposure Draft is primarily designed for cost-based schemes and for situations where there is a direct relationship between the regulatory capital base and the accounting information. However, in the UK, most regulatory agreements adopt an incentive-based approach and do not present a direct link between the regulatory capital base and financial reporting.

This disagreement has been one of the key factors in the above-mentioned delay. Because of their relevance, these two aspects are discussed in more detail below for illustrative purposes.

Regulatory Capital Base vs. Accounting Information

As discussed above, the recognition of certain regulatory assets and regulatory liabilities depends on whether an entity's regulatory capital base has a direct or non-direct relationship to its property, plant and equipment or intangible assets. Let us look at what is meant by a direct or indirect relationship:

1) **Direct relationship**: typical in cost-recovery-based regulation where the regulatory capital base is a tool to recover the costs of property, plant and equipment. In these cases, items in the regulatory capital base related to property, plant and equipment are similar to items included in property, plant and equipment; and the entity can reconcile the differences between the items in the regulatory capital base and those in property, plant and equipment.

2) **Non-direct relationship**: typical in incentive-based regulation where the regulatory capital base is a tool to determine the allowed revenue. Examples of an absence of a direct relationship may be:

   a. Items in the regulatory capital base related to property, plant, and equipment differ materially from items in property, plant, and equipment; or

   b. The entity is unable to reconcile differences between items in the regulatory capital base and those in property, plant and equipment.

   The regulator uses the regulatory capital base to determine compensation for the recovery (and return) on investment. The regulatory capital base comprises investments in assets and other items for which a regulatory agreement gives the entity the right to add an amount when determining a regulated rate, such as items related to:

   ✓ Property, plant and equipment

   ✓ Intangible assets

   ✓ Inventories, etc.

Compensation related to the regulatory capital base may include:

✓ Regulatory depreciation: the recovery of amounts included in the regulatory capital base; and

✓ Regulatory return: a return on the amounts included in the regulatory capital base.

In determining whether or not an entity's regulatory capital base bears a direct relationship to its tangible assets (property, plant and equipment) or intangible assets, an entity should apply professional judgement and consider all reasonable and verifiable information available, without incurring undue cost or effort.

Example 10: Direct relationship between regulatory capital base and property, plant and equipment

Entity A is entitled to receive compensation for the depreciation of its regulatory capital base.

Entity A's regulatory capital base and its property, plant and equipment are substantially similar; in fact:

- Most items and classes of regulatory capital base items related to property, plant and equipment coincide with those of property, plant and equipment and are measured using the same measurement basis (IAS 16).
- Most items and classes of regulatory capital base items related to property, plant and equipment have the same useful lives as the items of property, plant and equipment in the balance sheet.

Entity A's regulatory capital base includes specific adjustments determined by the regulator to reflect the efficiency of the total investment in property, plant and equipment. Therefore, Entity A can track differences by asset class (or at a more detailed level) between the regulatory capital base and its property, plant and equipment.

Entity A concludes that there is a direct relationship between the regulatory capital base and its property, plant and equipment.

↑ Source: Illustrative Example 1 (EFRAG, 2025c)

Example 11: No direct relationship between regulatory capital base and property, plant and equipment

Entity A is entitled to receive compensation for the depreciation of its regulatory capital base.

The regulatory capital base is determined using a TOTEX approach, which involves applying a capitalisation rate defined by the regulator to Entity A's total expenses (opex + capex). Total expenses include efficiency adjustments and other items not reflected in the accounting, such as inflation. The capitalisation rate is not linked to the accounting ratio (capex/totex) and may change from year to year. As a result, the regulatory capital base is a cumulative balance that cannot be broken down into classes of items.

The regulator defines a single depreciation rate for the entire regulatory capital base, regardless of the useful lives of the individual components.

As the regulatory capital base is disconnected from property, plant and equipment, Entity A cannot reconcile the differences between the regulatory capital base and property, plant and equipment. Therefore, Entity A concludes that there is no direct relationship between the regulatory capital base and property, plant and equipment.

↑ Source: Illustrative Example 2 (EFRAG, 2025c)

This has been a much discussed issue in the re-deliberation period of the Project, in particular in the meeting of the *Consultative Group for Rate Regulation* (CGRR) on 28 March 2022 and at the IASB meetings in October and November 2022. The discussion arises from paragraph B7 when linking the depreciation expenses that may be included in the calculation of the total allowed compensation with the accounting figures. Among the comment letters received, there are some relevant to discussions on possible courses of action on this issue, such as:

a. The Project proposes that differences between the rate of recovery of the regulatory asset base and the useful life of the assets would result in timing differences that would be accounted for as regulatory assets or regulatory liabilities. These timing differences would not represent adjustments to future rates. Some participants referred to these differences as "non-monetary timing differences". Others commented that these regulatory assets or regulatory liabilities would not provide useful information.

b. Participants subject to incentive-based schemes noted that an entity's regulatory asset base cannot be linked or reconciled to the fixed asset register used by the entity for accounting purposes. These participants indicated that the recognition of regulatory depreciation (i.e. regulatory compensation to recover the regulatory capital base) should be based on the regulatory agreement, rather than on the timing of the recognition of accounting depreciation.

In response to these comments, the IASB staff put forward three possible proposals for action on this issue:

1. Evaluate the relationship between regulatory and accounting depreciation.
2. Aggregate comparison between accounting and regulatory bases.
3. Confirm the current proposal.

Proposals 2 and 3 were rejected as confusing and complex.

Proposal 1 consists of assessing whether there is a direct relationship between regulatory depreciation (which is part of the regulatory capital base) and accounting depreciation (an expense recognised under IAS 16). Depending on this relationship, it was concluded that:

(a) If there is a direct relationship: regulatory assets or regulatory liabilities are recognised.
(b) If there is no direct relationship: no regulatory assets/regulatory liabilities are recognised, but qualitative disclosure is required.

Almost all CGRR members preferred this proposed course of action as they considered that it provides useful information without imposing unnecessary burdens, and is consistent with the timing differences model proposed by the IASB. Subsequently the IASB ratified this proposal by taking a tentative decision to recognise regulatory assets and regulatory liabilities only when there is a direct relationship between the regulatory capital base and assets (property, plant and equipment).

Based on the above, a measurement difference arises when the total amount of the compensation or deduction for an allowable expense or attributable income, determined by the regulatory agreement for all periods, differs from the total amount of the expense or revenue that an entity would recognise for all periods under IFRS. These measurement differences are not reversed over time.

The following are illustrative examples of this case.

Example 12: Differences in measurement

Entity A is entitled to receive compensation for the depreciation of its regulatory capital base. The assets in the regulatory capital base and Entity A's property, plant and equipment assets are substantially similar (i.e. same classes of items, same measurement basis and same useful life), and Entity A can track the differences between the regulatory capital base and property, plant and equipment. However, regulatory depreciation is determined as follows:

60% of the total compensation is based on the accounting depreciation determined in accordance with IAS 16;

The remaining 40 % is based on benchmarks, i.e. the average depreciation expense of entities operating in the same industry.

Entity A concludes that there is a direct relationship between the regulatory capital base and its property, plant and equipment.

Any difference between regulatory depreciation and depreciation expense is a measurement difference (not a timing difference).

↑ Source: Illustrative Example 3 (EFRAG, 2025c)

Regulatory assets or regulatory liabilities are recognised only if the entity's regulatory asset base has a direct relationship with property, plant and equipment assets, or the difference between the two can be reconciled.

Example 13: Allowable expenses and chargeable income related to the regulatory capital base (longer period than useful life under IAS 16) and property, plant and equipment - direct relationship

Entity A's regulatory capital base and property, plant and equipment have a direct relationship.

The regulatory capital base consists of a single asset of CU1,000, which is recovered over a period of 4 years. Under IFRS 15, the entity recognises CU250 of revenue each year, from year 1 to year 4.

Property, plant and equipment is also CU1,000 under IAS 16, but has a useful life of 3 years, and Entity A recognises depreciation on a straight-line basis. Entity A recognises CU333 of depreciation each year under IAS 16.

Regulatory capital base - compensation over 4 years					
CU	Year 1	Year 2	Year 3	Year 4	Total
Opening balance	1,000	750	500	250	-
Regulatory depreciation (1)	(250)	(250)	(250)	(250)	(1,000)
Closing balance	750	500	250	-	-

Property, plant and equipment according to statement of financial performance- useful life 3 years					
CU	Year 1	Year 2	Year 3	Year 4	Total
Opening balance	1,000	667	334	-	-
Depreciation (IAS 16) (2)	(333)	(333)	(334)	-	-
Closing balance	667	334	-	-	-
Timing difference (2) - (1)	83	83	84	(250)	-
Regulatory assets under E.D.	83	166	250	(A)	-

(A) In year 4, the regulatory asset of CU250 is derecognised with a corresponding regulatory expense.

IFRS statement of financial performance - before application of ED 2021					
CU	Year 1	Year 2	Year 3	Year 4	Total
Revenue IFRS 15	250	250	250	250	1,000
Depreciation	(333)	(333)	(334)	-	(1,000)
Profit (loss)	(83)	(83)	(84)	250	-

IFRS statement of financial performance - after application of ED 2021					
CU	Year 1	Year 2	Year 3	Year 4	Total
Revenue IFRS 15	250	250	250	250	1,000
Regulatory income (expense)	83	83	84	(250)	-
Total revenue	**333**	**333**	**334**	**-**	**1,000**
Depreciation	(333)	(333)	(334)	-	(1,000)
Profit (loss)	-	-	-	-	-

↑ Source: Illustrative Example 1 Regulatory asset (EFRAG, 2025c)

Example 14: Allowable expenses and chargeable income related to regulatory capital base (shorter period than useful life under IAS 16) and property, plant and equipment - direct relationship

(Same case as example11 except that the regulatory depreciation (recovery period) is shorter than the useful life under IAS 16).

Entity A's regulatory capital base and property, plant and equipment have a direct relationship.

The regulatory capital base consists of a single asset of CU1,000, which is recovered over a period of 3 years. Under IFRS 15, an entity recognises CU333 of revenue each year, from year 1 to year 4.

Property, plant and equipment is also CU1,000 under IAS 16, but has a useful life of four years, and Entity A recognises depreciation on a straight-line basis. Entity A recognises CU250 of depreciation each year under IAS 16.

Regulatory capital base - compensation over 3 years					
CU	Year 1	Year 2	Year 3	Year 4	Total
Opening balance	1,000	667	334	-	-
Regulatory depreciation (1)	(333)	(333)	(334)	-	(1,000)
Closing balance	667	334	-	-	-

Property, plant and equipment according to statement of financial performance- useful life 4 years					
CU	Year 1	Year 2	Year 3	Year 4	Total
Opening balance	1,000	750	500	250	-
Depreciation (IAS 16) (2)	(250)	(250)	(250)	(250)	(1,000)
Closing balance	750	500	250	-	-
Timing difference (2) - (1)	(83)	(83)	(84)	250	-
Regulatory liabilities under E.D.	(83)	(166)	(250)	(A)	-

(A) In year 4, the regulatory liability of CU250 is derecognised with a corresponding regulatory income.

IFRS statement of financial performance - before application of ED 2021					
CU	Year 1	Year 2	Year 3	Year 4	Total
Revenue IFRS 15	333	333	334	-	1,000
Depreciation	(250)	(250)	(250)	(250)	(1,000)
Profit (loss)	83	83	84	(250)	-

IFRS statement of financial performance - after application of ED 2021					
CU	Year 1	Year 2	Year 3	Year 4	Total
Revenue IFRS 15	333	333	334	-	1,000
Regulatory income (expense)	(83)	(83)	(84)	250	-
Total revenue	**250**	**250**	**250**	**250**	**1,000**
Depreciation	(250)	(250)	(250)	(250)	(1,000)
Profit (loss)	-	-	-	-	-

↑ Source: Illustrative Example 2 Regulatory liability (EFRAG, 2025c)

Example 15: Allowable expense unrelated to-property, plant and equipment that is added to the regulatory capital base and can be tracked through regulatory depreciation

Entity A recognises a maintenance expense of CU 200 in year 1.

The regulatory agreement treats the maintenance expense as an allowable expense and a part of the regulatory capital base, which can be recovered over a 4-year period.

The allowable expense of CU 50 per year is included in the rates charged to customers during that 4-year period.

Regulatory capital base - compensation for expenses recovered over 4 years					
CU	Year 1	Year 2	Year 3	Year 4	Total
Opening balance	200	150	100	50	-
Regulatory depreciation	(50)	(50)	(50)	(50)	(200)
Closing balance	150	100	50	-	-
Under IFRS, the maintenance expense of CU 200 is recognised as an expense, therefore the value of property, plant and equipment is zero.					
Timing difference	150 (200-50)	(50) (0-50)	(50) (0-50)	(50) (0-50)	-
Regulatory assets under E.D.	150	100	50	-	-

IFRS statement of financial performance - before application of ED 2021					
CU	Year 1	Year 2	Year 3	Year 4	Total
Revenue IFRS 15	50	50	50	50	200
Maintenance costs	(200)	-	-	-	(200)
Profit (loss)	(150)	50	50	50	-

IFRS statement of financial performance - after application of ED 2021					
CU	Year 1	Year 2	Year 3	Year 4	Total
Revenue IFRS 15	50	50	50	50	200
Regulatory income (expense)	150	(50)	(50)	(50)	-
Total revenue	**200**	**-**	**-**	**-**	**200**
Maintenance costs	(200)	-	-	-	(200)
Profit (loss)	-	-	-	-	-

↑ Source: Illustrative Example 3 Regulatory asset (EFRAG, 2025c)

Example 16: Recovery of part of the construction cost of an asset not yet available for use

The regulatory agreement specifies that Entity A is entitled to recover the cost of an asset that is under construction and not yet available for use (Construction work in progress - CWIP asset).

The cost of the CWIP asset is CU 100 in year 1. Recovery is made by including this cost in the rates charged to customers in the current period, which is included in revenue under IFRS 15.

The CU 100 represents an advance payment of the depreciation expense that Entity A will recognise in future periods. The total allowed compensation for the regulated goods or services to be provided in years 2 and 3 has already been included in revenue under IFRS 15 in year 1.

Thus, Entity A recognises a regulatory liability of CU 100 (this regulatory liability is derecognised over the period in which Entity A supplies regulated goods or services), i.e., the period in which it recognises the asset's depreciation expense.

Statement of financial performance			
CU	Year 1 (*)	Year 2	Year 3
Revenue under IFRS 15	100	-	-
Regulatory income (expense)	(100)	50	50
Total revenue	**-**	**50**	**50**
Depreciation	-	(50)	(50)
Profit (loss)	-	-	-

(*) Entity A recognises a regulatory liability of CU 100 in year 1, which is reversed in years 2 and 3.

↑ Source: Illustrative Example 4 Regulatory liability (EFRAG, 2025c)

Example 17: Gain on sale of an asset

Entity A is entitled to receive compensation for the depreciation of its regulatory capital base and concludes that there is a direct relationship between the regulatory capital base and its property, plant and equipment.
The regulatory agreement states that a gain on the sale of an item of property, plant and equipment is chargeable income; therefore, an entity must deduct this gain from future regulated rates. Assuming that:

- ✓ The regulatory period is 1 year.
- ✓ The regulated rate charged to customers is CU 1 per unit, and the quantity of goods sold is 100 units (no difference between estimated and actual).
- ✓ At the beginning of the first year, the entity purchases a property, plant and equipment asset for CU 200 with a useful life of two years (depreciation expense of CU 100 each year). At the end of the second year, the entity sells the asset, fully depreciated, for CU 15. This gain affects the regulated rate for the following year.
- ✓ At the beginning of the third year the entity purchases another property, plant and equipment asset for CU 200, with a useful life of 2 years.

Statement of financial performance			
CU	Year 1	Year 2 (*)	Year 3
Revenue under IFRS 15	100	100	85
Regulatory income (expense)	-	(15)	15
Total revenue	**100**	**85**	**100**
Depreciation	(100)	(100)	(100)
Profit (loss) on disposal of property, plant and equipment	-	15	-
Profit (loss)	-	-	-

↑ Source: Illustrative Example 5 (EFRAG, 2025c)

Example 18: Allowable expense unrelated to the regulatory capital base

The regulator determines that the regulated rate to be charged to customers in Year 1 is CU 2 per unit. This regulated rate is based on:

- ✓ allowed revenue of CU 200. This amount includes compensation for fixed input costs of CU 120 and for other operating costs of CU 80, on an estimated basis; and
- ✓ an estimated 100 units to be sold to customers.

In determining the regulated rate to be charged to customers in Year 2, the regulatory agreement gives Entity A the right to add (or the obligation to deduct) to the future regulated rate, the over-recovery of actual fixed input costs and other operating costs incurred by the entity in Year 1.

In Year 1, Entity A:

- ✓ supplies 100 units.
- ✓ applying IFRS, recognises fixed input costs of CU 140 and other operating costs of CU 70.

In Year 2, the estimated units sold and costs are the same as in Year 1, but there is no difference between actual and estimated costs and quantity sold:

CU	Year 1 (*)	Year 2
Revenue under IFRS 15	200	210
Regulatory income (expense)	10	(10)
Total revenue	**210**	**200**
Fixed input costs	(140)	(120)
Other operating costs	(70)	(80)
Profit (loss)	-	-

↑ Source: Illustrative Example 6 (EFRAG, 2025c)

Example 19: Compensation for allowable expense based on benchmark techniques

Entity A recognises variable operating expenses of CU 500 in Year 1. The regulatory agreement specifies that compensation for these expenses is determined using benchmarking techniques, which the regulator determines to be CU 600. The compensation includes: the recovery of variable operating expenses (CU 500), and an efficiency gain (CU 100) which is shared between the entity (70%) and its customers (30%).
In addition to the variable expenses, Entity A recognises fixed annual operating expenses of CU 1,000 and receives compensation for the same amount.

Compensation received by Entity A is included in the regulated rates in the same year (i.e., CU 1,600 in Year 1). However, the customers' share of the efficiency gain (i.e. CU 30) is subsequently adjusted in the regulated rates of Year T+2. The example assumes that there are no variable costs in Years 2 and 3.

- ✓ Entity A determines that the compensation for the allowable expense recognised in Years 1 to 3 is part of the total allowed compensation for the same year. Therefore, except for the part of the efficiency gain, no timing difference arises from the amount of compensation related to Entity A's allowable expense.
- ✓ For the efficiency gain, Entity A determines that its share (CU 70) is a measurement difference because it does not reverse over time. The remaining amount of the efficiency gain (CU 30) will be deducted when determining the regulated rates for Year 3, giving rise to a timing difference.

Statement of financial performance			
CU	Year 1 (*)	Year 2	Year 3
Revenue under IFRS 15	1,600	1,000	970
Regulatory income (expense)	(30)	-	30
Total revenue	**1,570**	**1,000**	**1,000**
Fixed expenses	(1,000)	(1,000)	(1,000)
Variable expenses	(500)	-	-
Profit (loss)	70	-	-

(*) At the end of Year 1, the entity has a regulatory liability of CU 30 that is reversed in Year 3.

↑ Source: Illustrative Example 7 (EFRAG, 2025c)

Performance incentives are part of the total allowed compensation in the period in which the performance occurs. A difference arises at the time of recognition if the incentive is included in the regulated rates charged to customers in a different period.

A performance incentive may be related to an entity's performance over various periods. In this regard, an entity should assess at the end of the reporting period whether it has an enforceable present right or obligation. If so, the entity shall estimate the total amount of the performance incentive and the part that is related to the reporting period.

Example 20: Performance incentives unrelated to the regulatory capital base

The regulatory agreement rewards (or penalises) Entity A with a bonus (or penalty) if it meets (or fails to meet) specific performance criteria in terms of customer satisfaction. The bonus or penalty affects the regulated rates that will be applied to customers in the next reporting period.

The bonus or penalty is determined at 2% of the amounts charged to customers during a specific period. The allowed revenue in the regulatory period are CU 100 per year as compensation for estimated expenses of CU 100 (no difference between estimated and actual expenses).

In Year 1, the regulator determines that Entity A does not meet the expected customer satisfaction performance. Therefore, a penalty is applied.

In Year 1, Entity A recognises as regulatory liability the obligation to deduct the penalty in determining the regulated rates to be charged to customers in future periods.

Statement of financial performance		
CU	Year 1 (*)	Year 2
Revenue under IFRS 15	100	98
Regulatory income (expense)	(2)	2
Total revenue	**98**	**100**
Expenses	(100)	(100)
Profit (loss)	(2)	-

(*) At the end of Year 1, the entity presents a regulatory liability of CU 2.

↑ Source: Illustrative Example 8 (EFRAG, 2025c)

Example 21: Performance incentive beyond the reporting period

The regulatory agreement grants Entity A a performance incentive for the construction of an asset (e.g. a 20% bonus or penalty on the efficiency gain or loss, based on the difference between target costs and actual costs). The asset is built over 3 years, and the bonus or penalty is reflected in the regulated rates in the year following its completion. Entity A estimates that it will incur a penalty.

Statement of financial performance				
CU	Year 1 (*)	Year 2	Year 3	Total
Target costs	5,000	5,000	5,000	15,000
Actual costs	4,900	5,400	5,450	15,750
Efficiency gains or losses	100	(400)	(450)	(750)
Penalty (20%)				150

In the example, construction is completed evenly (33.3% each year), the estimated penalty remains unchanged during construction, and the estimated and actual amounts are the same.

Under the IASB's tentative decisions, Entity A recognises the penalty as a reduction in the total allowed compensation in the period in which performance occurs. Since the incentive is related to performance over Years 1-3, Entity A allocates the estimated penalty based on construction progress, 33.3% each year.

If construction completion is uneven (e.g., year 1: 20%, years 2 and 3: 40% each) and the entity concludes that a reasonable allocation is still construction progress, the recognition of the estimated penalty would also be uneven.

Statement of financial performance				
CU	Year 1 (*)	Year 2 (*)	Year 3 (*)	Year 4
Revenue under IFRS 15	-	-	-	(150)
Regulatory income (expense)	(50)	(50)	(50)	150
Total revenue	**(50)**	**(50)**	**(50)**	**-**
Expenses	-	-	-	-
Profit (loss)	(50)	(50)	(50)	-

(*) The entity recognises a regulatory liability of CU 50 in year 1, CU 100 in year 2 and CU 150 in year 3. The regulatory liability of CU 150 is reversed in year 4 once the penalty is deducted from the regulated rates.

↑ Source: Illustrative Example 9 (EFRAG, 2025c)

Example 22: Volume variance

In Year 1, the regulator determines that the regulated rate to be charged to customers is CU 3 per unit, determined as follows:

- ✓ Allowed revenue of CU 300. This amount includes compensation for services and purchases of CU 200 and depreciation expenses of CU 100.
- ✓ An estimated quantity of 100 units to be sold to customers in Year 1.

In determining the regulated rate in Year 2, the regulatory agreement gives Entity A the right to add the amount of allowed revenue unrecovered or the obligation to deduct the amount of allowed revenue over-recovered in Year 1.

In Year 1, Entity A sells 80 units. Consequently, the amount of allowed revenue unrecovered is CU 60. (no difference between estimated and actual expenses).

Statement of financial performance	
CU	Year 1 (*)
Revenue under IFRS 15	240
Regulatory income (expense)	60
Total revenue	**300**
Expenses for services and purchases	(200)
Depreciation	(100)
Profit (loss)	-

(*) At the end of Year 1, the entity has a regulatory asset of CU 60.

↑ Source: Illustrative Example 10 (EFRAG, 2025c)

4 Analysis of the main impacts of the hypothetical application of the draft on Spanish standards

In order to anticipate the possible effects of the future standard on rate-regulated activities within the Spanish context, it is worth considering the preliminary results of the survey conducted by EFRAG (EFRAG, 2025b) between December 2024 and March 2025. This survey, addressed to preparers of financial statements of European entities that are likely to be within the scope of the standard, sought to assess the practicability of the requirements proposed by the IASB, as well as the expected costs and benefits of their implementation.

EFRAG received 28 responses, three from Spanish preparers, mainly companies in the electricity and gas sector, although entities from the motorway and railway sectors also participated. The results reveal that the impact of regulatory assets and liabilities could be highly significant, reaching up to 20% of total assets and 37% of total liabilities in some cases. In addition, regulatory income and regulatory expenses could represent up to 30% of regulatory income.

The results obtained also enable the identification of several relevant aspects that could significantly influence the practical application of the standard:

- The diversity in inflation treatment in European regulatory agreements, with nominal, real and hybrid approaches.
- Mixed views on the difficulty of identifying regulatory assets and regulatory liabilities according to the unit of account proposed by ED 2021.
- Significant differences between the regulatory capital base and the assets recognised under IFRS. 50% of respondents indicated that there is a *direct relationship* between the two, and within this group, regulatory assets and regulatory liabilities arising from timing differences related to the regulatory capital base are expected to have moderate materiality. On the other hand, 70% of respondents who identify a *non-direct relationship* anticipate that the unrecognised regulatory assets and regulatory liabilities arising from such differences could be moderately material or even material.
- Divergent views on the need to calculate a minimum interest rate and concerns regarding the determination of the discount rate and the timing of recovery or repayment of regulatory assets and regulatory liabilities.
- A largely favourable perception of the cost-benefit ratio of the disclosure requirements, although some practical challenges were noted.
- Transition reliefs were generally considered more helpful than measurement-related reliefs (e.g. discounting). The majority of respondents plan to apply the modified retrospective approach.

- Implementation costs are generally not considered to be high. However, for 10% of respondents, costs related to systems and processes could be significant, and for 65%, these costs, together with audit costs, are expected to be recurrent rather than one-off.

These preliminary results provide a basis for reflecting on possible impacts on Spanish standards.

The fieldwork conducted out to identify the main impacts of the hypothetical application of the draft on Spanish standards has consisted of the following activities:

1. Interviews with preparers of financial information, as well as technicians from advisory bodies for accounting regulation.
2. Analysis of the consolidated financial statements of companies that apply IFRS and operate in the regulated sectors identified.

As part of the fieldwork, meetings were held with technicians and staff members of international regulatory bodies and advisors, as well as with preparers of financial information from Spanish companies, in order to identify the sectors in which the application of the IASB draft could have the most significant impact. These discussions also made it possible to compare positions on the most controversial aspects of the exposure draft (ED 2021) and to gather qualified opinions on the potential impact of its implementation on different sectors, including energy, transport, infrastructure and water.

Analysis of consolidated financial statements of companies applying IFRS and operating in the regulated sectors identified.

A review of the 2024 consolidated financial statements of a number of Spanish companies that apply IFRS and operate in regulated sectors has been carried out. The study focused on companies in the energy, transport and infrastructure sectors, where the IASB's forthcoming standard on regulatory assets and regulatory liabilities is expected to have the greatest impact. Specifically, the explanatory notes of Iberdrola, Endesa, Naturgy, Enagás and Red Eléctrica in the energy sector, and those of Aena and Ferrovial in the transport, industry and construction sectors were reviewed. Additionally, the financial statements of other European companies applying IFRS in these same sectors have also been reviewed. As a general observation , it is noted that the explanatory notes do not record or explicitly mention regulatory assets and regulatory liabilities, although some do include details of regulatory agreements and rate-setting mechanisms.

Some of the issues arising from this review are presented below for illustrative purposes.

- **Aena 2024**

  Although no regulatory assets or regulatory liabilities are recognised or explicitly mentioned in Aena's financial statements, as their recognition is not permitted under current IFRS, it is foreseeable that the future IASB standard on rate-regulated activities will have a significant impact on the company. This is because Aena operates in a highly regulated environment, where its revenues are conditioned by a regulatory framework that sets limits and criteria for cost recovery, including the cost of capital. This type of regulation could lead, under the new standard, to the accounting recognition of assets and liabilities that are currently not reflected in the financial statements.

  The regulated nature of its business is reflected in note 2.16 on revenue recognition, which details how airline rates are subject to legal regulation, and how the Annual Maximum Revenue per Passenger (IMAP) and its annual adjustment (IMAAJ) are set in accordance with the Airport Regulation Document (DORA). This regulatory mechanism could lead, under the new standard, to the recognition of regulatory assets and regulatory liabilities that are currently not accounted for.

*"...**2.16.1 Revenue from aeronautical services.** The majority of the Group's revenues are derived from aeronautical services rendered, which mainly correspond to the use of airport infrastructure by airlines and passengers (including public charges and private fares). For this type of revenue, under IFRS 15, the customers are considered to be airlines, with whom there are no long-term contracts, and to which **regulated rates that are approved by law are applied, in accordance with the regulatory framework in force as the infrastructure is used**, and therefore revenue is recognised at the time the airport service is provided.....*

*In relation to the revenues to be received by Aena, the law establishes a **ceiling on revenues per passenger,** the Maximum Annual Revenue per Passenger (IMAP). This ceiling should **allow for the recovery of the operator's effectiveness costs**, including the cost of capital. The Maximum Annual Revenue per Passenger (IMAP) **will be adjusted** annually according to the **penalties/bonuses for compliance with certain service quality levels** and in relation to the annual investment programme, thus establishing the Adjusted Maximum Annual Revenue per Passenger (IMAAJ). In addition to the above, Act 18/2014 establishes that the Airport Regulation Document (hereinafter, DORA) is the instrument that must determine the five-year regulatory conditions of the entire Aena airport network. The DORA fixes the variation of the Maximum Annual Revenue per Passenger (IMAP) for five-year periods, establishing an initial value, IMAP0, and an annual variation percentage, X, equal for all the years of the five-year period, which will be applied to the Maximum Annual Revenue per Passenger (IMAP) of the previous year in each year of the regulatory period". (Note 2.16.1 of the Explanatory Notes to the Consolidated Financial Statements 2024 of Aena).*

- **Iberdrola**

Although Iberdrola does not explicitly recognise regulatory assets and regulatory liabilities in its financial statements under current IFRS, it is foreseeable that the future IASB standard on rate-regulated activities could have a significant impact on the company, given the regulated nature of a large part of its business. As stated in note 4.2 of the 2024 consolidated financial statements,

*"The Group is present in the **regulated electricity transmission and distribution segments** in Spain, the United Kingdom, the United States and Brazil, as well as in the **distribution of natural gas** in the United States, and supplies regulated-rate customers in the United States and Brazil" (Note 4.2. of the Explanatory Notes to the Consolidated Financial Statements 2024 of Iberdrola)*

In addition, in relation to receivables, it is noted that "*the balances 'Other current and non-current financial investments' and 'Trade receivables and other non-current assets' correspond mainly to concession contracts signed with Brazilian public administrations and amounts receivable related to rate-regulated activities in Spain and the United States*", including "*receivables from the regulated business in the United States explicitly recognised by the regulator*" (Note 15.b of the Explanatory Notes to the Financial Statements 2024 of Iberdrola).

Note 38 also details the following:

"Net revenues include an estimate of the revenues pending collection derived from the remuneration methodology in force for the distribution activity, which establishes that the facilities commissioned in year 'n' begin to be remunerated as of year "n+2"" (Note 38 of the Explanatory Notes to the Consolidated Financial Statements 2024 of Iberdrola).

This regulatory structure, which conditions cost recovery and future remuneration, could lead, under the new standard, to the accounting recognition of regulatory assets and regulatory liabilities that are currently not reflected in the financial statements. Furthermore, it is stated that "*the remuneration of transmission and distribution activities is determined by their regulated margin recognised by the corresponding regulator*", and that "*deviations between estimated and actual costs are recorded as revenues or expenses only when their collection or payment is guaranteed regardless of future sales*" (Note 15.b of the Explanatory Notes to the Consolidated Financial Statements 2024 of Iberdrola), which makes the existence of rights and obligations that could be recognised under the new regulatory framework, foreseeable.

- **National Grid.**

Additionally, within the European environment, the financial information of National Grid plc, a leading international electricity and gas company with significant operations in both the United Kingdom and the United States, has been reviewed. It is active in the transmission and distribution of electricity. National Grid operates in a regulated environment where its revenues are determined by regulatory agreements that set the prices to be charged for services provided. In its financial statements, the company recognises that its regulatory economic performance may differ from that presented under IFRS, because regulators permit the use of deferred regulatory balances, whereas current IFRS does not permit the recognition of regulatory assets or regulatory liabilities. As stated in its annual report for 2024, "*Statutory IFRS does not allow us to recognise regulatory assets or liabilities (for the difference between collected and allowed regulatory revenues)*" (National Grid's 2024 Consolidated Financial Statements Report: p. 83), which has led the entity to use alternative performance measures to better reflect its performance of rate-regulated activities.

Additionally, in note 3 on revenue, it is stated that "*revenue in respect of regulated activities is determined by regulatory agreements that set the price to be charged for services in a given period based on pre-determined allowed revenues*". In the event of deviations between collected and allowed revenues (*over-recoveries or under-recoveries*), regulatory agreements allow for adjustments to future revenues, although no assets or liabilities are recognised for these differences, as they relate to future services not yet provided (Note 3 of the Explanatory Notes to the Consolidated Financial Statements 2024 of National Grid). This situation shows that, under the future IASB standard, which does provide for the recognition of regulatory assets and regulatory liabilities, National Grid may be significantly affected, as its financial statements would incorporate elements that are currently not recognised.

- **National Air Traffic Services (NATS)**

NATS is the UK's leading provider of air traffic control services. NATS represents an interesting case of how an entity is applying the IFRS Conceptual Framework to fill the current regulatory gap in regulatory contexts. In its 2024 Annual Report, under section 3. *Critical judgements and key sources of estimation uncertainty*, NATS explains that, in the absence of a specific IFRS governing the recognition of regulatory assets and regulatory liabilities arising from the NERL agreement[6], it has developed its own accounting policy based on significant judgements. This policy seeks to provide useful and reliable information for users of financial statements, accurately reflecting the financial position, performance and cash flows, as well as the economic substance of NERL's specific regulatory framework. In doing so, the company has first considered the related IFRS standards and, not applying IFRS 14, has relied on the 2001 Conceptual Framework, concluding that the definitions of assets and liabilities are met. Accordingly, it has adopted an accounting policy by analogy with IFRS 15. It is especially striking that, despite the revised 2010 Conceptual Framework being in force, the entity has chosen to continue using the 2001 Framework as the reference for its accounting policy. NATS also acknowledges, in the same note to the consolidated financial statements, that the future IASB standard on regulatory assets and regulatory liabilities could have a material impact on its accounting, and will assess its applicability once it is adopted (Note 3 of the Explanatory Notes to the Consolidated Financial Statements 2024 of NATS).

In terms of the rates system, NERL operates under a licence granted by the *Transport Act 2000* and is regulated by the *Civil Aviation Authority* (CAA), which sets ex ante allowable revenues for five-year price control periods.

The annual unit rate charged to airspace users is based on this allocation and air traffic forecasts. If the actual traffic differs from the forecast, an adjustment mechanism is triggered that allows the rate to be modified in year *n+2* to recover or refund under- or over-recovered amounts. These amounts are recognised in the balance sheet as regulatory assets or regulatory liabilities:

> *"NERL **recognises its entitlement to amounts under-recovered and its liability for amounts over-recovered in its statement of financial position** as Amounts recoverable or payable under regulatory agreement, classified as current or non-current according to the period in which it is expected to be settled."*

These balances are measured considering the probability of reversal and discounted at the incremental cost of funding at the balance sheet date. It is interesting to note that, in line with the approach adopted by analogy with IFRS 15, NERL applies the "highly probable" threshold used in that standard for the recognition of variable consideration, which represents a more prudent approach than that set out in ED 2021.. Moreover, it also departs from this proposal in terms of

6 NERL (NATS En Route plc) is the entity licensed by the UK Government to provide en-route air traffic control services within UK airspace.

the discount rate used, as it does not use the discount rate of the regulatory agreement, but the incremental cost of funding prevailing at the balance sheet date.

> *"Amounts recoverable or payable under regulatory agreement reflecting the recoverability of projected future cash flows, are stated at an amount for which **it is highly probable that a significant risk reversal will not subsequently occur**. Amounts are **discounted** at inception at the **incremental cost of borrowing** at the balance sheet date."*

Outlook for the hypothetical implementation of ED 2021 in Spain

The analysis shows that ED 2021 could have a significant impact in Spain, although limited to certain economic sectors, mainly energy, transport and infrastructure. In these areas, the existence of regulated rate frameworks could lead to the recognition of regulatory assets and regulatory liabilities, in line with the criteria set out in the future IASB standard.

However, in order to properly assess the scope of the standard in the Spanish context, it is essential to carry out a detailed analysis of the regulatory framework applicable in each sector. This analysis would identify whether regulatory agreements give rise to enforceable rights and obligations that meet the conditions for the accounting recognition of regulatory assets and regulatory liabilities. In this regard, it would be advisable to set up a consultative working group, consisting of preparers from companies in the aforementioned sectors, auditors and users, to facilitate the technical interpretation of each regulatory framework and their impact on financial reporting. This initiative has already been adopted in countries such as Germany and the UK, and applied by the IASB (with the CGRR) and EFRAG (RRAWG) during the process of issuing the standard.

The study has also identified that, in the absence of specific regulation on the accounting treatment of rate-regulated activities, some entities (such as National Air Traffic Services in the UK) have developed their own accounting policies based on the IFRS Conceptual Framework for the recognition of regulatory assets and regulatory liabilities. This approach, while legitimate, may lead to disparities in accounting practice and affect comparability between entities. It is therefore considered necessary to move forward in Spain towards a national standard that defines the accounting treatment of rate-regulated activities, especially for those companies that apply the General Accounting Plan (PGC) and are not obliged to apply IFRS.

This standard clearly has a supplementary focus to the standard governing revenue recognition. For this reason, it would be advisable to introduce the standard in Spain through a specific resolution, both to complement the General Accounting Plan (PGC) and the Resolution of the Spanish Accounting and Auditing Institute (RICAC) on revenues and to adapt the sectoral PGC to concessionaires. In this regard, the interaction between ED 2021 and IFRIC 12 on service concession arrangements needs to be analysed in detail.

Finally, it should be noted that, from the information obtained, it appears in this this last phase prior to the final publication of the standard, that the IASB is working on simplifying the content of the standard, moving technical aspects from the application guides to the main body of the standard, expanding the illustrative examples and developing more detailed guidance to facilitate the identification of the direct/non-direct relationship between the regulatory capital base and the accounting assets. The final publication of the standard is expected to take place in the second quarter of 2026.

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Annex 1

Summary of meetings reviewed

Body	Date of meeting	Topics covered
ASAF **(I)**	28–29 June 2021	**Objective: Comments from each group of jurisdictions represented in the ASAF on the Exposure Draft: Regulatory Assets and Regulatory Liabilities.** *Scope* *Specific guidelines and illustrative examples* *Total allowed compensation* *Measurement* *Discounting estimated future cash flows* *Use of the minimum interest rate as a discount rate* *Possible interactions with IFRIC 12 - Service Concession Arrangements*
IASB meeting.	Oct-21	**Objective: Summary of comments received on the ED, including from users of financial statements. II.** *Background* ***Comments received from all respondents except users.*** *Scope* *Profitability of assets not yet available for use* *Regulatory assets and regulatory liabilities arising from differences between the regulatory recovery rate of the assets and their useful lives* *Minimum interest rate* *Possible interactions with IFRIC 12 - Service Concession Arrangements* ***Comments received from users of financial statements*** *Return on assets not yet available for use (fixed assets under construction)* *Regulatory assets and regulatory liabilities arising from differences between the regulatory recovery rate of the assets and their useful lives* *Recognition, measurement and discount rate* *Presentation* *Information to be disclosed* *Transition* *Other comments* ***Summary of CLs received***
IASB meeting	Nov-21	**Objective: Discuss remaining CL proposals not dealt with in October 2021** *Presentation* *Disclosure* *Effective date and transition* *Likely effects and other comments*
IASB meeting	Dec-21	**Objectiveto analyse the plan in order to redeliberate the ED's proposals.** *Controversial aspects* *Deliberation plan*
IASB meeting	Feb-22	**Objectivestart of new discussions on the scope set out in the ED.** *Issues for discussion: proposals in scope* *Recommendations on the Scope of application of the proposed model* *Recommendations on the role of the "regulatory body".*
CGRR **(III)**	Mar-22	**Objectiveto discuss possible actions to be considered by the IASB on its pro-posal on regulatory returns from work in progress (CWIPs).** *Profitability of assets not yet available for use: two approaches* *Profitability of assets not yet available for use: two approaches. Preferred option of CLs*

		Profitability of assets not yet available for use: proposals for action *Proposal for action 1: Extending the scope of the standard* *Proposal for action 2: Expand the definition of "goods or services supplied".* *Proposal for action 3: Delete paragraph B15* *Proposal for action 4: Confirm current proposal* *Proposal for action 5: Apply only to long-term projects* *Profitability of assets not yet available for use: proposals for action. Conclusions of the CGRR.*
CGRR **(III)**	Mar-22	**Objectivediscuss possible measures to be considered by the IASB on differences between useful life and regulatory asset base** *Background to the draft* *Proposals for action* *Proposal for action 1: Assess the relationship between regulatory and accounting depreciation.* *Proposals 2 and 3* *Conclusions of the CGRR.* *Next steps*
ASAF **(I)**	31 March - 1 April 2022	**Objective: How to approach the definition of the scope of the future standard**
IASB meeting	May-22	**Objective: Continue redeliberation on the Exposure Draft proposals on Total Allowed Compensation (TAC)** *TAC: Characteristics of different regulatory schemes.* *TAC: Notes of the meetings of the CGRR (4 and 28 March 2022)* *TAC: Overview of total allowed compensation and issues to be redeliberated* *Scope: term "customers"* *Scope: regulatory assets and liabilities related to financial instruments*
IASB meeting	Jul-22	**Objective: Continue redeliberation on the Exposure Draft proposals** *TAC: components* *TAC: Regulatory returns on assets not available for use* *TAC: Regulatory returns on assets not available for use. Extended analysis*
ASAF **(I)**	29-Sep-22	**Objective: Discussion of IASB decisions** *Tentative IASB decisions discussed: TAC* *Tentative IASB decisions discussed: Scope of the standard* *Additional decisions on scope (March 2022)*
IASB meeting	Sep-22	**Objective:** **Continue with the redeliberation of the draft** *Summary of proposals, comments received and tentative decisions by the IASB* *Interaction of the draft with IFRIC 12*
CGRR **(III)**	Oct-22	**Objective:** **To discuss two key issues related to the draft** *Capitalisation of financial costs of loans* *Inflation adjustment*
IASB meeting	Oct-22	**Objective:** **Continue with the redeliberation of the draft** *Definition of allowable expenses and benchmarking-based expenses.* *Differences between the regulatory recovery period and the useful life of the assets* *Information from the advisory group on rate regulation.*
IASB meeting	Nov-22	**Objective:** **Continue with the redeliberation of the draft** *Analysis of how regulatory returns on assets under construction should be treated for accounting purposes when an entity capitalises borrowing costs in accordance with IAS 23.* *Discussion on the interaction between regulatory returns on assets under construction and capitalisation of borrowing costs under IAS 23.*
IASB meeting	Dec-22	**Objective:** **Continue with the redeliberation of the draft** *Inflation adjustments to the regulatory capital base.* *Accounting for allowable expenses and performance incentives.* *Direct/non-direct relationship between regulatory capital base and fixed assets*
IASB meeting	Feb-23	**Objective: Continue with the redeliberation of the draft** *Issues for redeliberation on recognition*

		Recognition threshold for regulatory assets and regulatory liabilities *How the assessment of enforceability interacts with recognition* *Accounting treatment of performance incentives*
ASAF **(I)**	27–28 March 2023	**Objective: Discussion of IASB decisions**
IASB meeting	Apr-23	**Objective:** **Continue with the redeliberation of the draft** *Long-term performance incentives* *Derecognition of regulatory assets and regulatory liabilities*
IASB meeting	May-23	**Objective:** **Continue with the redeliberation of the draft** *Interaction with IAS 12 Income Taxes* *Proposed amendments to IAS 8 and other IFRS standards (AP9B).*
IASB meeting	June-23	**Objective:** **Continue with the redeliberation of the draft** *Measurement: cash-flow-based technique* *Measurement: estimation of uncertain cash flows*
ASAF **(I)**	28-Sep-23	**Objective: Discussion of IASB decisions**
IASB meeting	Sep-23	**Objective:** **Continue with the redeliberation of the draft** *Credit and other risks* *Analysis of responses to the survey on the concept of direct/non-direct relationship* *Information content of the survey* *FASB-IASB Education Meeting*
CGRR **(III)**	Oct-23	**Objective:** **Discuss two key issues related to the draft** *Regulatory interest rate as discount rate* *Minimum interest rate proposal* *Uneven regulatory interest rate*
IASB meeting	Oct-23	**Objective:** **Continue with the redeliberation of the draft** *Direct/non-direct relationship between regulatory assets and physical assets* *Limits of regulatory agreements*
CGRR **(III)**	Nov-23	**Objective:** **Discuss two key issues related to the draft** *Disclosure proposals*
IASB meeting	Dec-23	**Objective:** **Continue with the redeliberation of the draft** *Unit of account* *Presentation* *Items affecting regulated rates only when cash is paid or received*
IASB meeting	Feb-24	**Objective:** **Continue with the redeliberation of the draft** *Limits of regulatory agreements* *Limits of regulatory agreements: Diagram* *Amendments to IAS 36* *Disclosure requirements of the draft* *Disclosure requirements: new requirements* *Disclosure requirements: draft requirements for the standard*
ASAF **(I)**	25–26 March 2024	**Objective: Discussion of IASB decisions**
IASB meeting	Mar-24	**Objective:** **Continue with the redeliberation of the draft** *Discount rate for future cash flows* *Consideration of reduced disclosure requirements*
IASB meeting	Apr-24	**Objective:** **Continue with the redeliberation of the draft** *Discount rate: minimum interest rate* *Scope: Interaction with IFRS 17* *Amendments to IFRS 3 and IFRS 5*
IASB meeting	May-24	**Objective:** **Continue with the redeliberation of the draft**

		Interaction with IAS 12 *Amendments to IAS 8 and other IFRSs*
IASB meeting	Jul-24	**Objective:** **Continue with the redeliberation of the draft** *Extension of measurement proposals* *Extension of presentation proposals* *Transition and implementation date: Recommendations on the date of entry into force* *Transition and implementation date: analysis of transitional exemptions for those applying the modified retrospective approach.* *Transition and date of application: proposals on past business combinations and amendments to Appendix C of IFRS 1* *Transition and date of implementation: recommendations on date of entry into force* *Criteria for re-exposure and regulatory process: the need for a new draft is raised.* *Re-exposure criteria and standard-setting process: review of steps followed and issuance of new standard*
ASAF **(I)**	26–27 Sept 2024	**Objective: Discussion of IASB decisions**
ASAF **(I)**	5–6 Dec 2024	**Objective: Discussion of IASB decisions**
EEG **(IV)**	17–18 Dec 2024	**Objective: Discussion of IASB decisions**
IASB meeting	Mar-25	**Objective:** **Continue with the redeliberation of the draft** *Reduced disclosure for entities applying IFRS 19*
IASB meeting	May-25	**Objective:** **Continue with the redeliberation of the draft** *Minor technical issues*

Notes

(I)	ASAF	Accounting Standards Advisory Forum The objective of the ASAF is to provide a consultative forum where members can contribute constructively to the IASB's objective of developing high quality, globally accepted accounting standards. It is composed of a minimum of 12 and a maximum of 16 members from different regions. The chairman or the vice-chairman of the IASB acts as chairman of the ASAF.
(II)	Term	Response rate among respondents
	Almost all of them	All except a very small minority
	Most of them	A large majority, with a few exceptions
	Many	A small majority or a large minority
	Some	A small minority, but more than a few exceptions
	A few of them	A very small minority
(III)	Consultative Group for Rate Regulation - CGRR	In April 2013, the Council established an advisory group to aid it in its project on rate regulation, bringing in a range of expert perspectives, including preparers, auditors and users of financial statements, and regulators. The group consists of senior professionals with extensive practical experience in the operation of various rate regulation systems.
(IV)	Emerging Economies Group (EEG).	The Emerging Economies Group (EEG) was established in 2011 at the direction of the IFRS Foundation, with the objective of enhancing the participation of emerging economies in the development of IFRS. The members of the EEG are national accounting standard setters from emerging economies, appointed for this purpose.

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