Staff paper

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IASB® meeting

Date	**February 2024**
Project	**Rate-regulated Activities**
Topic	**Amendments to IAS 36**
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Objective

1. This paper sets out staff analysis and recommendations in relation to the amendments to IAS 36 *Impairment of Assets* proposed in the Exposure Draft *Regulatory Assets and Regulatory Liabilities* (Exposure Draft).

Staff recommendations

2. The staff recommend that the final Accounting Standard:

   (a) retain the proposal to exclude regulatory assets from the scope of IAS 36—(paragraph 15);

   (b) omit the amendments to paragraphs 43 and 79 of IAS 36 proposed in the Exposure Draft—(paragraph 31);

   (c) amend the Basis for Conclusions on IAS 36 to explain that, although regulatory assets are excluded from the scope of IAS 36, an entity would have to consider the cash flows arising from regulatory assets and regulatory liabilities when applying paragraphs 43 and 79 of IAS 36 (to avoid double-counting future cash flows and to ensure consistency between the recoverable amount and the carrying amount of a cash-generating unit)—(paragraph 31); and

(d) not provide any further guidance on the application of IAS 36—(paragraph 35).

Structure of the paper

3. This paper is structured as follows:

   (a) proposals in the Exposure Draft (paragraphs 5–7);

   (a) feedback (paragraphs 8–11); and

   (b) staff analysis (paragraphs 12–36).

4. The appendix to this paper sets out the amendments to IAS 36 proposed in the Exposure Draft.

Proposals in the Exposure Draft

5. The Exposure Draft proposes to exclude regulatory assets from the scope of IAS 36. It also proposes two further amendments to IAS 36:[1]

   (a) paragraph 43 of IAS 36 states that, to avoid double-counting, the estimates of future cash flows used in measuring value in use of an asset or a cash-generating unit do not include 'cash inflows from assets that generate cash inflows that are largely independent of the cash inflows from the asset under review' and 'cash outflows that relate to obligations that have been recognised as liabilities'. The Exposure Draft proposes to add regulatory assets and regulatory liabilities as examples of such assets and liabilities.

   (b) paragraph 79 of IAS 36 states that, for practical reasons, the recoverable amount of a cash-generating unit is sometimes determined after consideration of assets that are not part of the cash-generating unit or liabilities that have been recognised. In such cases, the entity adjusts the carrying amount of the cash-generating unit so that it is consistent with the recoverable amount. The

[1] See Appendix A of this paper for the proposed amendments to paragraphs 2, 43 and 79 of IAS 36.

Exposure Draft proposes to add regulatory assets and regulatory liabilities as examples of such assets and liabilities.

6. The Basis for Conclusions accompanying the Exposure Draft explains why the IASB proposed to exclude regulatory assets from the scope of IAS 36 (**emphasis added**):

> BC141 The measurement [of regulatory assets and regulatory liabilities] would be based on updated estimates of future cash flows, including any estimated changes caused by, for example, demand risk or credit risk. **Thus, there would be no need for a separate impairment test for regulatory assets.** Furthermore, the Board proposes to specify that regulatory assets are outside the scope of IAS 36 *Impairment of Assets*. Because cash flows arising from regulatory assets are **largely independent** of cash flows generated by any other assets, regulatory assets are not part of any cash-generating unit for the impairment test required by IAS 36 (**paragraphs BC55 and BC58**, and proposed amendments to paragraphs 43 and 79 of IAS 36 in Appendix D of the Exposure Draft).

7. The Basis for Conclusions accompanying the Exposure Draft also outlines the IASB's view that the cash flows from regulatory assets and regulatory liabilities are largely independent of the cash inflows from other assets. This view underpins the proposed amendments to paragraphs 43 and 79.

> BC55 … regulatory assets and regulatory liabilities give rise to cash flows that are largely independent of the cash flows generated by the other rights and obligations created by the regulatory agreement, as discussed in paragraphs BC58–BC62. Thus, the Board views regulatory assets and regulatory liabilities as cleanly separable from the other rights and obligations created by the regulatory agreement. The proposed model treats them as rights or obligations to add or deduct a fixed or determinable amount in determining regulated rates for goods or services to be supplied in the future. …
>
> …
>
> BC58 The cash flows that arise from a regulatory asset or regulatory liability are incremental—they occur only because the entity has that asset or liability. They are also largely independent of the cash flows that

result from the other rights and obligations created by the regulatory agreement. Therefore, an entity can measure regulatory assets and regulatory liabilities separately by reference to estimates of those cash flows. In the Board's view, recognising regulatory assets and regulatory liabilities separately and measuring them by reference to those cash flows would provide useful information to users of financial statements.

Feedback

8. Most respondents did not comment on the proposed amendments to IAS 36. Those who commented were mainly accounting firms and preparers.

9. A few respondents stated that they supported the proposed amendments without making any further comments.

10. Most of the comments were about the proposed amendments to paragraphs 43 and 79 of IAS 36 and the statement in paragraph BC141 that 'Because cash flows arising from regulatory assets are largely independent of cash flows generated by any other assets, regulatory assets are not part of any cash-generating unit for the impairment test required by IAS 36'.

    (a) A few respondents disagreed with the statement that cash flows arising from regulatory assets are largely independent of cash flows generated by any other assets. An accounting firm said that regulatory assets will be recovered through the regulated rates charged for goods or services supplied in future periods and their cash flows are therefore highly interrelated with the cash flows from supplying those future goods or services.

    (b) A few others said that it may not always be possible to separate cash flows of regulatory assets and regulatory liabilities from the cash flows of a cash-generating unit. Of these respondents a few said that regulatory assets and regulatory liabilities should be included in the cash-generating unit to which they belong.

(c) A few respondents requested guidance or illustrative examples on how to assess for impairment a cash-generating unit that includes regulatory assets.

11. An accounting firm said that applying the proposed amendment to paragraph 79 of IAS 36 may not lead to a meaningful comparison between the carrying amount of the cash-generating unit and its recoverable amount, especially if the regulatory assets and regulatory liabilities have a long life. They said the discount rate used in measuring the carrying amount of a regulatory asset or regulatory liability may be different from the discount rate used in measuring the recoverable amount of the cash-generating unit.

Staff analysis

12. This section is structured as follows:

(a) scope of IAS 36 (paragraphs 13–15);

(b) paragraphs 43 and 79 of IAS 36 (paragraphs 16–31);

(c) differing discount rates (paragraphs 32–35); and

(d) recommendations on amendments to IAS 36 (paragraph 36).

Scope of IAS 36

13. The proposal to exclude regulatory assets from the scope of IAS 36 is consistent with other scope exclusions in IAS 36. The scope of IAS 36 excludes certain assets which are subject to specific measurement requirements that address impairment or reduced recoverability of assets (for example, inventories, contract assets recognised using IFRS 15 *Revenue from Contracts with Customers* and financial assets within the scope of IFRS 9 *Financial Instruments*). In the case of regulatory assets, the Exposure Draft does not propose a separate impairment test for regulatory assets. This is because the measurement of regulatory assets would be based on updated

estimates of future cash flows, including any estimated changes caused by, for example, demand risk or credit risk.[2]

14. The IASB has already redeliberated important aspects of the measurement proposals in the Exposure Draft. The IASB has tentatively decided the final Accounting Standard would retain the proposals:

    (a) that an entity estimate uncertain future cash flows using whichever of the two methods—the 'most likely amount' method or the 'expected value' method—the entity expects would better predict the cash flows;

    (b) that an entity estimating future cash flows arising from a regulatory asset or a regulatory liability reflect in the estimates the uncertainty about the amount or timing of future cash flows; and

    (c) not to require a separate impairment test for regulatory assets.[3]

15. The tentative decisions described in paragraph 14 mean that the measurement of regulatory assets continues to be based on updated estimates of future cash flows. Consequently, we think the proposal to exclude regulatory assets from the scope of IAS 36 remains appropriate. We recommend that the final Accounting Standard retain the proposal to exclude regulatory assets from the scope of IAS 36.

Paragraphs 43 and 79 of IAS 36

16. In contrast to the proposal to exclude regulatory assets from the scope of IAS 36, the proposed amendments to paragraphs 43 and 79 are not essential. This section considers whether the amendments to paragraphs 43 and 79 proposed in the Exposure Draft should be retained in the final Accounting Standard.

[2] Paragraph BC141 of the Basis for Conclusions accompanying the Exposure Draft.
[3] IASB Update June 2023 and IASB Update September 2023.

Paragraph 43 of IAS 36

17. Paragraph 43 of IAS 36 provides guidance to avoid double-counting when determining the composition of estimates of future cash flows—it states those estimates should not include cash flows from assets that generate cash flows that are largely independent of the cash flows from the asset under impairment review. It includes 'financial assets such as receivables' as an example of an asset that generates cash flows that are largely independent of the cash flows from the asset under review. Although regulatory assets are not financial assets, discussions on this project have identified some similarities between regulatory assets and financial assets.[4] Paragraph 43 of IAS 36 also states that those estimates should not include cash flows that relate to obligations that have been recognised as liabilities.

18. The rationale for the proposed amendment to paragraph 43 of IAS 36 was linked to the rationale for the separate recognition of regulatory assets and regulatory liabilities.[5] Most respondents agreed that an entity should account for regulatory assets and regulatory liabilities separately from the rest of the regulatory agreement, with many of them explicitly agreeing with the rationale developed by the IASB.[6]

19. A few respondents disagreed with the IASB's assertion that cash flows arising from regulatory assets are largely independent of the cash flows arising from other rights and obligations created by the regulatory agreement (paragraph 10(a)) or said that it would be difficult to separate those cash flows from the cash flows of a cash-generating unit (paragraph 10(b)). One of these respondents said the fact that cash flows arising from regulatory assets will be recovered through regulated rates charged for goods or services supplied in future periods makes them highly interrelated with the cash flows from supplying those future goods or services.

20. We acknowledge regulatory assets will be recovered by adding amounts to future regulated rates. However, the rationale used by the IASB when developing the

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

[5] Question 2(d) of the Invitation to Comment and paragraphs BC55, BC58 and BC141 of the Basis for Conclusions accompanying the Exposure Draft (paragraphs 6 and 7 of this paper).

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

proposals explains that the mechanism for recovering regulatory assets does not mean the cash flows arising from them are highly interrelated with the cash flows from supplying future goods or services (**emphasis added**):

> BC62 Future cash flows result from a regulatory asset or regulatory liability only if the entity also has an enforceable present right or an enforceable present obligation to supply goods or services in the period when the regulatory agreement permits or obliges the entity to include that increase or decrease in the regulated rates. Including that increase or decrease in the regulated rate in future periods is the **mechanism** for recovering the regulatory asset or fulfilling the regulatory liability. The **need for that mechanism** affects the boundary of the regulatory agreement (paragraphs BC142–BC158), but **does not create interdependence between the cash flows arising from the regulatory asset or regulatory liability and the cash flows from the other rights or obligations** created by the regulatory agreement.

21. Although we agree with the rationale about the mechanism for recovering regulatory assets, we have considered whether it is always the case that cash flows arising from regulatory assets are largely independent of the cash flows generated by other assets. We think that whether cash flows arising from regulatory assets are largely independent could depend on the nature of these regulatory assets.

22. Consider, for example, the case of a bonus relating to a performance period that will be added to the regulated rates charged in a future period. The cash flows recovering that bonus that would be added to future regulated rates are independent of the cash flows generated by other assets within the cash-generating unit such as property, plant and equipment. The entity has an enforceable right to recover the bonus by adding amounts to future regulated rates charged—these cash flows are independent of the cash flows generated by other assets. Similar examples would be regulatory assets arising from the recovery of volume variances, input costs, taxes or pensions.

23. However, the cash flows arising from some regulatory assets might be interrelated with the cash flows generated by other assets. We think this might be the case for regulatory assets related to property, plant and equipment when an entity's regulatory capital base has a direct relationship with its property, plant and equipment. For

example, a regulatory asset may arise when the recovery period of the regulatory capital base is longer than the asset's useful life.[7] In this case, the cash flows arising from that regulatory asset are a portion of the cash flows arising from the recovery of the asset (an item of property, plant and equipment) for which the regulator has determined a longer recovery period.

24. We do not think that the statement about cash flows arising from regulatory assets being largely independent of the cash flows generated by other assets is necessary to support the proposals to recognise regulatory assets separately and exclude regulatory assets from the scope of IAS 36:

(a) the IASB has concluded that regulatory assets meet the definition of an asset and that accounting for regulatory assets separately would provide useful information. As stated in the Basis for Conclusions accompanying the Exposure Draft, the IASB views the rights giving rise to regulatory assets as being cleanly separable from the *other rights* created by the regulatory agreement such as the right to charge a regulated rate for goods or services to be supplied in future periods, designed to provide the entity with the total allowed compensation for those goods or services. Most respondents agreed that an entity should account for regulatory assets and regulatory liabilities separately, with many of them explicitly agreeing with the rationale developed by the IASB (paragraph 18).[8]

(b) the proposal to exclude regulatory assets from the scope of IAS 36 is substantiated by the proposed measurement requirements—based on updated estimates of future cash flows that result in a separate impairment test being unnecessary—rather than by their cash flows being largely independent (paragraphs 13–15). Assets are excluded from the scope of IAS 36 when there are requirements in other IFRS Accounting Standards that ensure they are carried at appropriate amounts.

[7] Example 2B accompanying the Exposure Draft illustrates this case.
[8] Paragraphs BC40, BC55 and BC58 of the Basis for Conclusions accompanying the Exposure Draft.

25. The IASB could modify the statement in the Basis for Conclusions on the final Standard to acknowledge that in some cases there may be interdependence between the cash flows arising from a regulatory asset and those generated by other assets within the cash-generating unit. However, that interdependence does not affect the rationale in the Basis for Conclusions that recognising regulatory assets separately and measuring them by reference to estimates of future cash flows would provide useful information to users of financial statements.[9] We do not think the amendment to paragraph 43 of IAS 36 is required—if the IASB did not amend paragraph 43, entities would use judgement in applying the requirements of IAS 36 to their facts and circumstances.

Paragraph 79 of IAS 36

26. Although paragraph 22 of IAS 36 requires that the recoverable amount be determined for an individual asset (or an individual cash-generating unit), paragraph 79 of IAS 36 acknowledges that 'For practical reasons, the recoverable amount of a cash-generating unit is sometimes determined after consideration of assets that are not part of the cash-generating unit … or liabilities that have been recognised….'. The final sentence of paragraph 79 explains that in such cases an entity increases (decreases) the carrying amount of the cash-generating unit by the carrying amount of those assets (liabilities).

27. We contacted some of the respondents that said it would be difficult to separate the cash flows of regulatory assets from the total cash flows generated by a cash-generating unit (paragraph 10(b)) to see whether the proposed amendment to paragraph 79 would help address this issue. They have acknowledged that the proposed amendment could be used by entities in this situation. However, we think that if the IASB did not amend paragraph 79, entities could still use the approach outlined in paragraph 79 if required. Consequently, we do not think the amendment to paragraph 79 of IAS 36 is required.

[9] Paragraph BC58 of the Basis for Conclusions accompanying the Exposure Draft.

28. A few respondents requested further guidance on how regulatory assets and regulatory liabilities would affect impairment testing (paragraph 10(c)). We think the general principles in IAS 36 are sufficient to enable entities to understand how to apply the requirements and that no additional guidance is necessary. Paragraphs 32–35 consider a more specific request for guidance for dealing with the case when there are different discount rate requirements.

Conclusions on paragraphs 43 and 79 of IAS 36

29. In many cases the cash flows arising from regulatory assets will be largely independent of the cash flows generated by other assets (paragraph 22). However, in some other cases they may not (paragraph 23).

30. We have explained that the amendments to paragraphs 43 and 79 of IAS 36 are not necessary because the requirements in IAS 36 to avoid double-counting cash flows and to ensure consistency between the recoverable amount and the carrying amount of a cash-generating unit would still apply. However, we think that the Basis for Conclusions on IAS 36 could explain that entities would have to consider the cash flows arising from regulatory assets and regulatory liabilities when applying paragraphs 43 and 79 of IAS 36. We think this explanation could be added to the Basis for Conclusions on IAS 36 as part of the rationale for excluding regulatory assets from the scope of IAS 36.

31. We recommend that the final Accounting Standard:

    (a) omit the amendments to paragraphs 43 and 79 of IAS 36 proposed in the Exposure Draft; and

    (b) amend the Basis for Conclusions on IAS 36 to explain that, although regulatory assets are excluded from the scope of IAS 36, an entity would have to consider the cash flows arising from regulatory assets and regulatory liabilities when applying paragraphs 43 and 79 of IAS 36 (to avoid double-counting future cash flows and to ensure consistency between the recoverable amount and the carrying amount of a cash-generating unit).

Differing discount rates

32. A respondent said that the proposed amendment to paragraph 79 of IAS 36 may not lead to a meaningful comparison between the carrying amount of the cash-generating unit and its recoverable amount, especially if the entity has long-term regulatory assets and regulatory liabilities (paragraph 11). The respondent commented that the discount rate used in measuring the carrying amount of a regulatory asset or regulatory liability may be different from the discount rate used in measuring the recoverable amount of the cash-generating unit (by using either fair value less costs of disposal or value in use).

33. The Exposure Draft proposes that, with limited exceptions, the discount rate used for measuring regulatory assets and regulatory liabilities would be the regulatory interest rate. This could differ from the discount rate used to determine the recoverable amount of a cash-generating unit.

34. Our recommendation to omit the proposed amendment to paragraph 79 would not address the respondent's concern in paragraph 32. However, we do not think the final Standard should add further guidance on this matter for the following reasons:

    (a) the need to consider the effect of different discount rate requirements when making impairment assessments is not unique to regulatory assets and regulatory liabilities. It can also occur if an entity determines the recoverable amount of a cash-generating unit after consideration of provisions and pensions.

    (b) the effect of different discount rates is only one type of differences that an entity might need to consider to ensure consistency between the amounts being compared.

    (c) IAS 36 does not currently provide any guidance on how entities can ensure consistency between the amounts being compared. However, we think providing such guidance is beyond the scope of this project and considering this in relation to only regulatory assets and regulatory liabilities could have unintended consequences.

35. We recommend that the final Accounting Standard not provide any further guidance on the application of IAS 36.

Recommendations on amendments to IAS 36

36. We recommend that the final Accounting Standard:

    (a) retain the proposal to exclude regulatory assets from the scope of IAS 36—(paragraph 15);

    (b) omit the amendments to paragraphs 43 and 79 of IAS 36 proposed in the Exposure Draft—(paragraph 31);

    (c) amend the Basis for Conclusions on IAS 36 to explain that, although regulatory assets are excluded from the scope of IAS 36, an entity would have to consider the cash flows arising from regulatory assets and regulatory liabilities when applying paragraphs 43 and 79 of IAS 36 (to avoid double-counting future cash flows and to ensure consistency between the recoverable amount and the carrying amount of a cash-generating unit)—(paragraph 31); and

    (d) not provide any further guidance on the application of IAS 36—(paragraph 35).

Question for the IASB
1. Does the IASB agree with the staff recommendations in paragraph 36?

Appendix—Proposed amendments to IAS 36

A1. This appendix sets out the amendments to IAS 36 *Impairment of Assets* proposed in Appendix D of the Exposure Draft.

Paragraphs 2, 43 and 79 are amended. Deleted text is struck through. New text is underlined.

Scope

2 **This Standard shall be applied in accounting for the impairment of all assets, other than:**

...

(h) contracts within the scope of IFRS 17 *Insurance Contracts* that are assets and any assets for insurance acquisition cash flows as defined in IFRS 17;~~ and~~

(i) non-current assets (or disposal groups) classified as held for sale in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*~~.~~<u>; and</u>

<u>(j) regulatory assets (see [draft] IFRS X *Regulatory Assets and Regulatory Liabilities*).</u>

…

Composition of estimates of future cash flows

...

43 To avoid double-counting, estimates of future cash flows do not include:

(a) cash inflows from assets that generate cash inflows that are largely independent of the cash inflows from the asset under review (for example, financial assets such as receivable<u>s, and regulatory assets)</u>; and

(b) cash outflows that relate to obligations that have been recognised as liabilities (for example, payables, pensions<u>,</u>~~ or~~ provisions<u> and regulatory liabilities</u>).

...

Recoverable amount and carrying amount of a cash-generating unit

...

79 For practical reasons, the recoverable amount of a cash-generating unit is sometimes determined after consideration of assets that are not part of the cash-generating unit (for example, receivables or other financial assets<u>, and regulatory assets</u>) or liabilities that have been recognised (for example, payables, pensions<u>,</u> ~~and~~ other provisions <u>and regulatory liabilities</u>). In such cases, the carrying

amount of the cash-generating unit is increased by the carrying amount of those assets and decreased by the carrying amount of those liabilities.