IFRS Accounting

Staff paper

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IASB® meeting

Date	**July 2024**
Project	**Rate-regulated Activities**
Topic	**Past business combinations**
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Objective

1. This paper sets out staff analysis and recommendations in relation to the proposals in the Exposure Draft *Regulatory Assets and Regulatory Liabilities* (Exposure Draft):

   (a) to permit entities currently applying IFRS Accounting Standards to elect not to apply the model retrospectively to past business combinations; and

   (b) to amend the exemption in Appendix C of IFRS 1 *First-time Adoption of International Financial Reporting Standards* to specify how to account for the derecognition of goodwill-related regulatory balances. Appendix C of IFRS 1 permits first-time adopters to elect not to apply IFRS 3 *Business Combinations* retrospectively to past business combinations.

Staff recommendations

2. The staff recommend that the final Accounting Standard:

   (a) not include a requirement for an entity to apply the retrospective or simplified approach to regulatory assets acquired or regulatory liabilities assumed in a past business combination but instead require the entity to apply the transitional requirements of the final Accounting Standard to these regulatory assets and regulatory liabilities;

(b) require that the entity takes the net adjustment on transition, including that related to regulatory assets acquired and regulatory liabilities assumed in a past business combination, to retained earnings (or another category of equity, as appropriate); and

(c) omit the proposal in the Exposure Draft to amend paragraph C4 of IFRS 1 to specify how the derecognition of goodwill-related regulatory balances is accounted for by an entity that first adopts IFRS Accounting Standards.

Structure of the paper

3. This paper is structured as follows:

   (a) entities already applying IFRS Accounting Standards (paragraphs 5–20); and

   (b) first-time adoption (paragraphs 21–32).

4. The appendix contains other comments on the proposed approach for past business combinations.

Entities already applying IFRS Accounting Standards

5. This section is structured as follows:

   (a) proposals in the Exposure Draft (paragraphs 6–8);

   (b) feedback (paragraphs 9–12); and

   (c) staff analysis and recommendations (paragraphs 13–20).

Proposals in the Exposure Draft

6. The Exposure Draft proposes to require an entity to apply the final Standard retrospectively to a past business combination, unless the entity elects to apply the simplified approach described in paragraph C4 of the Exposure Draft. As explained in the Basis for Conclusions accompanying the Exposure Draft, an entity applying the

final Standard retrospectively to a past business combination would be required to determine the carrying amount of goodwill at the date of transition by:

(a) breaking down the carrying amount of goodwill at the date of transition by each past business combination.

(b) reconsidering each past business combination to determine the initial carrying amount of all regulatory assets and regulatory liabilities that the entity would have recognised at the acquisition date, and the difference between that initial carrying amount and the carrying amount of regulatory assets, regulatory liabilities and regulatory balances the entity recognised at that date. That difference (net of related deferred tax) would determine the amount of the adjustment to goodwill or to the bargain purchase gain at the acquisition date (and to any non-controlling interests, if not measured at fair value).

(c) establishing how much of the adjustment to goodwill would remain at the date of transition, after considering any impairments, reversals of impairment and disposals between the acquisition date and the date of transition.[1]

7. Paragraph C4 of the Exposure Draft proposes that an entity can elect not to apply the final Standard retrospectively to a past business combination.[2] If an entity makes this election, paragraph C4 proposes a simpler approach which is described in Table 1 (**emphasis added**).

[1] Paragraph BC209 of the Basis for Conclusions accompanying the Exposure Draft.

[2] The Exposure Draft says that ‘a past business combination is a business combination for which the acquisition date is before the date of transition’.

Table 1—Proposed simplified approach for past business combinations
If an entity elects to use the proposed simplified approach, it would at the date of transition: (a) apply the election to **all** of its past business combinations. (b) apply the requirements in subparagraphs (c)–(g) separately to each past business combination. (c) recognise and measure, applying the Standard, all regulatory assets acquired, and all regulatory liabilities assumed, in a past business combination, which still exist at the date of transition. (d) derecognise all items (such as some regulatory balances) that were recognised as assets or liabilities in that past business combination but would not have been recognised if the Standard had always been applied. (e) recognise any deferred tax effects of the adjustments described in subparagraphs (c)–(d). (f) adjust the carrying amount of non-controlling interests from that past business combination remaining at the date of transition for their proportionate share of the net amount of the adjustments described in subparagraphs (c)–(e), if the entity measured those non-controlling interests at their proportionate share in the recognised amounts of the acquiree's identifiable net assets, rather than at fair value. (g) **adjust the carrying amount of goodwill still remaining from that past business combination for the net amount of the adjustments** described in subparagraphs (c)–(f). If that adjustment reduces the carrying amount of goodwill to nil, the entity would recognise any remaining amount of adjustment in retained earnings or, if appropriate, another category of equity.

8. Paragraphs BC207–BC213 of the Basis for Conclusions accompanying the Exposure Draft describe the reasoning behind the IASB's proposals. Paragraph BC213 is shown below.

> BC213 The simpler approach to past business combinations explained in paragraph BC211 is similar to an optional exemption for past business combinations made available for first-time adopters by IFRS 1 *First-time Adoption of International Financial Reporting Standards*. However, a first-time adopter applying IFRS 1 would recognise the change resulting from

recognising regulatory assets and regulatory liabilities at the date of transition to IFRSs, and from derecognising regulatory balances (other than the goodwill-related regulatory balances discussed in paragraphs BC253–BC258), by adjusting retained earnings, not by adjusting the carrying amount of goodwill (paragraph C4(b) of IFRS 1).

Feedback

9. Some respondents commented on the proposals for past business combinations. Of those who commented, most agreed with the proposals.

10. A few respondents—including accounting firms, and European standard-setters and a preparer—suggested the IASB require an entity to recognise the net amount of the adjustments for past business combinations in retained earnings (or another category of equity, if appropriate), instead of adjusting the carrying amount of goodwill. An accounting firm said that adjusting retained earnings would be consistent with the requirements in other IFRS Accounting Standards and would avoid unintended consequences. Another accounting firm said there is no evidence that the adjustment arises from facts and circumstances that existed at the acquisition date and that without such evidence, the adjustments should be taken to equity.

11. Two standard-setters queried the need for the relief proposed by paragraph C4 of the Exposure Draft. One considered that this would indicate the IASB reads the existing IFRS Accounting Standards as requiring the restatement of past business combinations, including the restatement of goodwill, whenever a change in accounting policy occurs. Both requested the IASB clarify the interaction between paragraph 50 of IFRS 3 *Business Combinations* and the requirements in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* dealing with the full retrospective approach.[3] Paragraph 50 of IFRS 3 states:

[3] When it issued IFRS 18 *Presentation and Disclosure in Financial Statements* in April 2024, the IASB changed the title of IAS 8 to *Basis of Preparation of Financial Statements.*

> 50 After the measurement period ends, the acquirer shall revise the accounting for a business combination only to correct an error in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

12. A few respondents raised other questions and concerns about aspects of the proposal. These comments are analysed in the appendix.

Staff analysis and recommendations

13. This section is structured as follows:

    (a) assessing the need for specific requirements to deal with regulatory assets acquired or regulatory liabilities assumed in past business combinations (paragraphs 14–19); and

    (b) other comments (paragraph 20).

Assessing the need for specific requirements to deal with regulatory assets acquired or regulatory liabilities assumed in past business combinations

14. The Exposure Draft proposes that an entity can apply the final Standard retrospectively to a past business combination or apply the simplified approach described in paragraph C4 of the Exposure Draft (paragraph 6). In both approaches, the Exposure Draft proposes that an entity take the net adjustments to goodwill.

15. We think in some cases an entity might find it difficult to differentiate between regulatory assets acquired and regulatory liabilities assumed in a past business combination and those that have not. In addition, as mentioned by a respondent in paragraph 10, some adjustments for items acquired in a past business combination could relate to events that occurred after the acquisition and therefore be unrelated to the goodwill recognised at the acquisition date.

16. The Basis for Conclusions accompanying the Exposure Draft does not explain why an entity applying IFRS Accounting Standards should adjust goodwill on transition when applying either the retrospective approach or the simpler approach.[4]

17. We note that in some IFRS Accounting Standards, their specific requirements mean that there is no need to consider separately how to deal with assets acquired or liabilities assumed in past business combinations. For example, IFRS 17 *Insurance Contracts* requires the net adjustment on transition, including adjustments related to assets acquired and liabilities assumed in past business combinations, to be taken to retained earnings (or another component of equity, as appropriate). Some Standards are silent on where the net adjustment on transition should be recognised. However, we have learned that taking the net adjustment on transition to retained earnings is common practice.

18. We think that removing the requirement for an entity to elect to apply the retrospective or simplified approach to regulatory assets acquired or regulatory liabilities assumed in a past business combination but instead requiring the entity to apply the transitional requirements of the final Standard to all regulatory assets or regulatory liabilities, taking the net adjustment on transition to retained earnings (or another category of equity, as appropriate) would:

    (a) be appropriate as some adjustments may be unrelated to the goodwill recognised at the acquisition date;

    (b) avoid the need for entities to differentiate between regulatory assets acquired and regulatory liabilities assumed in a past business combination and those that have not;

    (c) address concerns raised by a few stakeholders about the proposals to take the net adjustments to goodwill (paragraphs 10–11); and

    (d) align with recently issued Standards, for example, IFRS 17.

[4] Paragraph BC208 of the Basis for Conclusions accompanying the Exposure Draft.

19. Consequently, we recommend that the final Standard:

    (a) not include a requirement for an entity to elect to apply the retrospective or simplified approach to regulatory assets acquired or regulatory liabilities assumed in a past business combination but instead require the entity to apply the transitional requirements of the final Standard to these regulatory assets and regulatory liabilities; and

    (b) require that the entity takes the net adjustment on transition, including that related to regulatory assets acquired and regulatory liabilities assumed in a past business combination, to retained earnings (or another category of equity, as appropriate).

Question for the IASB
1. Does the IASB agree with the staff recommendation in paragraph 19?

Other comments

20. A few respondents made other comments on the proposed approach for past business combinations. The appendix sets out those comments and the staff response. We have not identified any additional amendments that are required.

Question for the IASB
2. Does the IASB have any comment or questions on the matters discussed in the appendix?

First-time adoption

21. This section is structured as follows:

    (a) proposals in the Exposure Draft (paragraphs 22–25);

    (b) feedback (paragraph 26); and

    (c) staff analysis and recommendations (paragraphs 27–32).

Proposals in the Exposure Draft

22. IFRS 1 permits an entity to elect not to apply IFRS 3 retrospectively to past business combinations.[5] Appendix C of IFRS 1 sets out the exemptions for past business combinations and the requirements if an entity elects to make use of these exemptions. Paragraph C4 of IFRS 1 requires that an entity using this exemption takes most adjustments to retained earnings (or another component of equity, as appropriate) but it requires that an entity reclassify to goodwill an intangible asset that no longer qualifies for recognition.

23. The Exposure Draft proposes to amend paragraph C4 of IFRS 1 to also require that an entity reclassify to goodwill a goodwill-related regulatory balance. A goodwill-related regulatory balance is a balance that has arisen because a regulator allows goodwill to be included in the regulated rates charged to customers in the future.

24. The Exposure Draft does not view goodwill-related regulatory balances as fulfilling the proposed regulatory asset definition. As explained in paragraph BC255 of the Basis for Conclusions accompanying the Exposure Draft, a goodwill-related regulatory balance arises from a transaction (being the business combination) and not any supply of goods or services before the business combination. Consequently, goodwill-related regulatory balances do not give rise to a regulatory asset when the business combination occurs and need to be derecognised.

25. The rationale for the Exposure Draft's proposal to amend paragraph C4 of IFRS 1 (to require that first-time adopters derecognise goodwill-related regulatory balances by reclassifying them to goodwill) is that, if those regulatory balances had not previously been recognised as regulatory balances, the carrying amount of goodwill would have been higher.[6]

[5] Paragraph C1 of IFRS 1 describes past business combinations as 'business combinations that occurred before the date of transition to IFRSs'.

[6] Paragraph BC256 of the Basis for Conclusions accompanying the Exposure Draft.

Feedback

26. There were no specific comments on the proposed amendments to paragraph C4 of IFRS 1.

Staff analysis and recommendations

27. Although there were no specific comments on the proposal to amend paragraph C4 of IFRS 1, we have considered whether the recommendation in paragraph 19 of this paper has any implications for that proposal.

28. Paragraph 19 recommends that an entity transitioning to the final Standard take the net adjustment (including regulatory assets acquired and regulatory liabilities assumed in past business combinations) *to retained earnings* (or another component of equity, as appropriate). This would also include any adjustment for derecognising goodwill-related regulatory balances.

29. First-time adopters using the exemption for past business combinations in IFRS 1 are required to take most adjustments for a past business combination to retained earnings (or another category of equity).[7] However, they are required to adjust goodwill for:

    (a) the derecognition of intangible assets recognised in accordance with previous generally accepted accounting principles (GAAP) that no longer qualify for recognition; and

    (b) the recognition of an intangible asset that was subsumed within goodwill in accordance with previous GAAP.[8]

30. Goodwill-related regulatory balances are closely related to goodwill and the arguments for reclassifying derecognised intangible assets to goodwill could also be applied to goodwill-related regulatory balances.

[7] Paragraph C4(b) of IFRS 1.
[8] Paragraph C4(g) of IFRS 1.

31. The requirement in IFRS 1 to reclassify derecognised intangible assets reflected a concern that intangible assets were often included in the amount recognised as goodwill.[9] However, the proposal in the Exposure Draft to amend IFRS 1 would make IFRS 1 more complex but might affect only a limited number of entities. We do not expect goodwill-related regulatory balances to be prevalent. We understand that this regulatory treatment occurs only in the United States and only for some regulators in that country. It could affect entities in other countries if they have operations in the United States. We therefore think a first-time adopter should be required to take an adjustment for the derecognition of goodwill-related regulatory balances to retained earnings (or another component of equity, as appropriate).

32. Consequently, we recommend that the final Accounting Standard omit the proposal in the Exposure Draft to amend paragraph C4 of IFRS 1 to specify how the derecognition of goodwill-related regulatory balances is accounted for by an entity that first adopts IFRS Accounting Standards.

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

[9] Request for Information, Post-implementation Review: IFRS 3 *Business Combinations* (January 2014).

Appendix—Other comments

A1. A few respondents made other comments on the proposed approach for past business combinations. Table 2 sets out those comments and the staff response. We have not identified any additional amendments that are required.

Table 2—Other comments and staff response	
Comments received	**Staff response**
Clarify the phrase 'which still exist'	
A European preparer body and a standard-setter suggested the IASB clarify the reference in paragraph C4(c) of the Exposure Draft to 'all regulatory assets acquired, and all regulatory liabilities assumed, in a past business combination, **which still exist** at the date of transition'.	Paragraph 19 of this paper recommends that the transitional requirements of the final Standard apply to all regulatory assets or regulatory liabilities, regardless of whether they arise from a past business combination. We think this recommendation would help address the comment received on the left column.
Part of an operation	
A preparer from Asia-Oceania said that past business combinations may form part of an operation subject to a regulatory agreement. The proposals would lead to an entity applying the proposed simpler approach to past business combinations, and the full retrospective transition to the remaining part of the operation. The respondent said this would result in different transition applications creating inconsistency and misleading information.	Paragraph 19 of this paper recommends that the transitional requirements of the final Standard apply to all regulatory assets or regulatory liabilities, regardless of whether they arise from a past business combination. Agenda Paper 9D discussed at this meeting discusses a possible modified retrospective approach for the final Standard.

Table 2—Other comments and staff response	
Comments received	**Staff response**
Alternative approach	
An accounting firm suggested simplifying the measurement of regulatory assets acquired, and all regulatory liabilities assumed, in a past business combination based on the remaining cash flows at the date of transition. The respondent further suggested requiring the adjusted goodwill to be tested for impairment at the date of transition, regardless of whether there is any indication that the goodwill may be impaired.	The measurement simplification suggested by the respondent is what the Exposure Draft proposes. If the IASB agrees with the recommendation in paragraph 19, an entity will take the net adjustment on transition, including that related to regulatory assets acquired and regulatory liabilities assumed in past business combinations, to retained earnings (or another category of equity, as appropriate. If the IASB does not agree with that recommendation (and requires that the adjustment goes to goodwill), we do not think it would be necessary to introduce a requirement to test goodwill following the application of the final Standard. IAS 36 *Impairment of Assets* already requires annual testing of goodwill acquired in a business combination, irrespective of whether there is any indication of impairment.