Staff paper

Agenda reference: 9C

IASB® meeting

Date	**April 2024**
Project	**Rate-regulated Activities**
Topic	**Amendments to IFRS 3 and IFRS 5**
Contacts	Mariela Isern (misern@ifrs.org)

Objective

1. This paper sets out staff analysis and recommendations in relation to the amendments to IFRS 3 *Business Combinations* and IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* proposed in the Exposure Draft *Regulatory Assets and Regulatory Liabilities* (Exposure Draft).

Staff recommendations

2. The staff recommend that the final Accounting Standard retain the proposals:
   (a) to create an exception to the recognition and measurement principles in IFRS 3 for regulatory assets acquired and regulatory liabilities assumed; and
   (b) to exclude regulatory assets from the scope of IFRS 5.

Structure of the paper

3. This paper is structured as follows:
   (a) IFRS 3 *Business Combinations* (paragraphs 5–18);
   (b) IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* (paragraphs 19–24); and

(c) staff recommendations and question to the IASB (paragraph 25).

4. The appendix to this paper sets out the proposals in the Exposure Draft and extracts from the Basis for Conclusions accompanying the Exposure Draft.

IFRS 3 *Business Combinations*

5. This section is structured as follows:

   (a) proposals in the Exposure Draft (paragraphs 6–7);

   (b) feedback (paragraphs 8–10); and

   (c) staff analysis (paragraphs 11–18).

Proposals in the Exposure Draft

6. The Exposure Draft proposes to create an exception to the recognition and measurement principles in IFRS 3 for regulatory assets acquired and regulatory liabilities assumed in a business combination. It proposes that an entity apply the recognition and measurement principles in the Exposure Draft to such regulatory assets and regulatory liabilities, rather than recognising and measuring them at fair value.

7. The Basis for Conclusions accompanying the Exposure Draft explains that, without such an exception, an entity might (see appendix):

   (a) not recognise some regulatory assets acquired or regulatory liabilities assumed; and

   (b) incur significant costs in applying the requirements in IFRS 3.

Feedback

8. Only a few respondents commented on the proposed amendment to IFRS 3. A national standard-setter and an accounting firm said they supported the proposal for the reasons outlined in the Basis for Conclusions accompanying the Exposure Draft.

9. A European national standard-setter disagreed with the proposal because, in its view, an acquiring entity may recognise a higher amount of goodwill by not recognising at fair value all regulatory assets acquired and all regulatory liabilities assumed in a business combination. The respondent said this could further complicate the impairment test in accordance with IAS 36 *Impairment of Assets*.

10. An accounting firm that agreed with the proposal suggested the IASB further investigate whether the application of the proposed amendment would have any unintended consequences, in particular regarding day 2 measurements. This respondent also suggested the IASB consider the impact of the proposed amendment on impairment of assets.

Staff analysis

11. This section is structured as follows:

    (a) impact on goodwill recognised (paragraphs 12–14); and

    (b) subsequent measurement (paragraphs 15–18).

Impact on goodwill recognised

12. The impact of the proposed exception on the amount of goodwill recognised in a business combination will depend on the net amount of the regulatory assets and regulatory liabilities recognised, compared to what an entity would have recognised without such an exception. The proposed exception could lead to *more or less* goodwill being recognised than if the recognition and measurement principles in IFRS 3 were applied. The amount of goodwill recognised as a result of a business combination would be assessed for impairment in accordance with IAS 36 in the usual way. The IASB has tentatively decided to exclude regulatory assets from the scope of IAS 36.[1]

13. We do not think the impact of the proposed exception on the amount of goodwill recognised in a business combination, or the subsequent application of IAS 36 to that

[1] See Agenda Paper 9B discussed at the February 2024 IASB meeting.

goodwill, is relevant to the IASB's rationale for the proposed exception. That rationale was based on an assessment of the costs and benefits of using the recognition and measurement principles in IFRS 3 for regulatory assets acquired and regulatory liabilities assumed in a business combination. The IASB concluded that the proposed exception would provide information that is relevant to users of financial statements and save costs for preparers. We think that the IASB's rationale, as outlined in paragraphs BC260–BC261 of the Basis for Conclusions, remains appropriate.

14. We do not think any further action is required in relation to the comments about goodwill and impairment.

Subsequent measurement

15. An accounting firm suggested the IASB further investigate whether the application of the proposed amendment has any unintended consequences, in particular regarding day 2 measurements.

16. When developing the Exposure Draft the IASB noted that if an acquirer was required to initially recognise regulatory assets and regulatory liabilities at fair value in accordance with IFRS 3, but thereafter was required to revert to applying the cash-flow-based measurement technique, this could result in the recognition of subsequent gains or losses. These gains or losses would not depict any economic phenomena but would simply reflect the effect of changing from one measurement basis to another.[2] Consequently, it would be unlikely that recognition of these gains and losses would provide relevant information to users of financial statements. The IASB also noted that there are existing exceptions to the measurement requirements in IFRS 3 for IAS 12 *Income Taxes* and IAS 19 *Employee Benefits* to avoid the reporting of post-combination gains or losses arising solely from subsequent measurement using a different measurement basis.[3]

17. We do not think any further action is required in relation to this comment.

[2] This matter was considered in Agenda Paper 9A discussed at the July 2019 IASB meeting.

[3] Paragraph BC261 of the Basis for Conclusions accompanying the Exposure Draft.

18. Consequently, we recommend that the final Accounting Standard retain the proposal to create an exception to the recognition and measurement principles in IFRS 3 for regulatory assets acquired and regulatory liabilities assumed.

IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*

Proposals in the Exposure Draft

19. The Exposure Draft proposes to exclude regulatory assets from the scope of IFRS 5.

20. The IASB was of the view that it would be difficult to determine the fair value of regulatory assets and that the measurement requirements proposed in the Exposure Draft would provide useful information.

Feedback

21. There was no feedback on the proposed amendment to IFRS 5.

Staff analysis

22. The rationale for excluding regulatory assets from the scope of IFRS 5—that it would be difficult to determine the fair value of regulatory assets[4]—is consistent with the rationale for some existing scope exclusions in IFRS 5. It is also consistent with the rationale for the proposed exception to the recognition and measurement principles in IFRS 3.

23. There was no opposition to the proposed scope exclusion. We think the rationale for excluding regulatory assets from the scope of IFRS 5 remains appropriate.

---

[4] Paragraph BC13 of the Basis for Conclusions accompanying IFRS 5 explains that deferred tax assets, assets arising from employee benefits and assets arising from insurance contracts are excluded from the scope of IFRS 5 because there might be difficulties in determining their fair value.

24. Consequently, we recommend that the final Accounting Standard retain the proposal to exclude regulatory assets from the scope of IFRS 5.

Staff recommendations and question to the IASB

25. We recommend that the final Accounting Standard retain the proposals:

    (a) to create an exception to the recognition and measurement principles in IFRS 3 for regulatory assets acquired and regulatory liabilities assumed; and

    (b) to exclude regulatory assets from the scope of IFRS 5.

Question for the IASB
1. Does the IASB agree with the recommendations in paragraph 25?

Appendix—Proposals in the Exposure Draft

A1. This appendix sets out:

(a) the proposals in the Exposure Draft to amend IFRS 3;

(b) the proposals in the Exposure Draft to amend IFRS 5; and

(c) paragraphs BC260–BC263 of the Basis for Conclusions accompanying the Exposure Draft.

IFRS 3 *Business Combinations*

Paragraph 28C and a heading above that paragraph are added. New text is underlined.

Exceptions to both the recognition and measurement principles

...

<u>**Regulatory assets and regulatory liabilities**</u>

<u>28C</u> <u>The acquirer shall recognise and measure all regulatory assets acquired and regulatory liabilities assumed in a business combination in accordance with [draft] IFRS X *Regulatory Assets and Regulatory Liabilities*.</u>

IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*

Paragraph 5 is amended. New text is underlined.

Scope

...

5 The measurement provisions of this IFRS do not apply to the following assets, which are covered by the IFRSs listed, either as individual assets or as part of a disposal group:

...

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

Extracts from the Basis for Conclusions accompanying the Exposure Draft

IFRS 3 *Business Combinations*

BC260 The Exposure Draft proposes that, as an exception to the recognition and measurement principles in IFRS 3, an entity should recognise and measure regulatory assets acquired and regulatory liabilities assumed in a business combination applying the recognition and measurement principles proposed in the Exposure Draft, rather than recognise and measure them at fair value. Without such an exception, an entity might:

(a) not recognise regulatory assets acquired, or regulatory liabilities assumed, in a business combination if it is uncertain whether they exist. In contrast, applying the proposals in the Exposure Draft, an entity would recognise regulatory assets or regulatory liabilities if it is more likely than not that they exist.

(b) incur significant costs in:

  (i) determining the discount rate needed to measure regulatory assets and regulatory liabilities at fair value. The entity might incur significant costs because regulatory assets and regulatory liabilities are not traded in active markets and there are generally few observable inputs that could be used in determining an appropriate discount rate—one that market participants would use when pricing those assets and liabilities.

  (ii) tracking separately regulatory assets acquired or regulatory liabilities assumed in a business combination at a discount rate that is not explicit in the regulatory agreement.

  (iii) determining the discount rate to use subsequently if the regulatory agreement changes the applicable regulatory interest rate.

BC261 The Board concluded that the proposed exception would:

(a) provide information that is relevant to users of financial statements;

(b) save costs for preparers; and

(c) for items affecting regulated rates only when related cash is paid or received, provide a simple and understandable outcome for regulatory assets and regulatory liabilities measured using the same measurement basis as used for the related liability or related asset (paragraphs BC174–BC177).

IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*

BC262 Paragraph BC13 of the Basis for Conclusions on IFRS 5 says that the Board decided that non-current assets should be excluded from the scope of the measurement requirements in IFRS 5 only if they are already carried at fair value with changes in fair value recognised in profit or loss, or if it would be difficult to determine their fair value.

BC263 The Board proposes to exclude regulatory assets from the scope of the measurement requirements in IFRS 5. In the Board's view, it would be difficult to determine the fair value of regulatory assets because of difficulties in determining the discount rate as discussed in paragraph BC260(b). In the Board's view, the measurement requirements proposed in the Exposure Draft would provide useful information. Thus, the Board concluded that incremental benefits, if any, of providing the fair value of regulatory assets would not outweigh the costs of determining their fair value.