IFRS

STAFF PAPER

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Project	**Rate-regulated Activities**		
Paper topic	Transition		
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Purpose of this paper

1. The purpose of this paper is to recommend transition requirements for the accounting model for regulatory assets and regulatory liabilities (model).

Summary of staff recommendations

2. The staff recommend that the following entities should apply the model retrospectively to each prior reporting period presented applying IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* ('full retrospective approach'):
   (a) entities that currently apply IFRS Standards and do not recognise regulatory balances; and
   (b) entities that currently apply IFRS Standards, possibly including IFRS 14 *Regulatory Deferral Accounts*, and recognise regulatory balances.
3. For first-time adopters of IFRS Standards, the staff recommend:

(a) that these entities should apply the model at the date of transition to IFRS Standards as defined in IFRS 1 *First-time Adoption of International Financial Reporting Standards*; and

(b) retaining the deemed cost exemption in paragraph D8B of IFRS 1. The staff will align the drafting of that exemption with the descriptions used for the model.

4. For entities that currently apply IFRS Standards, the staff recommend that they should be permitted to elect not to apply the model retrospectively to past business combinations. If an entity uses that election, it should recognise and measure, using the model, only those regulatory assets and regulatory liabilities arising from all past business combinations that still exist at the date of initial application of the model. Any resulting change should adjust the carrying amount of goodwill. If that adjustment reduces the carrying amount of goodwill to zero, any remaining adjustment should be recognised in retained earnings or, if appropriate, another category of equity.

5. In some jurisdictions where entities currently recognise regulatory balances, some regulators consider goodwill an allowable cost for inclusion in the rates charged to customers. This paper refers to those balances as ‘goodwill-related regulatory assets’. Both for entities that currently apply IFRS Standards and for first-time adopters of IFRS Standards, the staff recommend that they should reclassify goodwill-related regulatory assets to goodwill. Amounts of such regulatory assets that have already been derecognised prior to application of the model would not be reclassified.

Structure of the paper

6. In developing our recommendations for the transition requirements of the model, we have considered:

(a) the *Conceptual Framework for Financial Reporting (Conceptual Framework)*, users’ preferences and costs and benefits of transition requirements (paragraphs 8–11);

(b) the following three categories of entities that will be within the scope of the model:

(i) entities that currently apply IFRS Standards and do not recognise regulatory balances (paragraphs 12–20);[1]

(ii) entities that currently apply IFRS Standards, possibly including IFRS 14, and recognise regulatory balances (paragraphs 21–28);

(iii) first-time adopters of IFRS Standards (paragraphs 29–38); and

(c) business combinations (paragraphs 39–63).

7. Throughout this paper:

(a) the ‘date of initial application’ is used to describe the first day of the annual reporting period in which an entity first applies the model.

(b) the term ‘regulatory item’ refers to regulatory assets, regulatory liabilities, regulatory income and regulatory expense.

Conceptual Framework, users’ preferences and costs and benefits of transition requirements

8. The *Conceptual Framework* identifies comparability as an enhancing qualitative characteristic. Paragraph 2.24 of the *Conceptual Framework* states:

> Users’ decisions involve choosing between alternatives, for example, selling or holding an investment, or investing in one reporting entity or another. Consequently, information about a reporting entity is more useful if it can be compared with similar information about other entities and with similar information about the same entity for another period or another date.

9. In general, users prefer retrospective application of new accounting requirements and the resulting restatement and reclassification of comparative amounts because it results in comparable information that facilitates their analysis of trends.

[1] Staff research to date indicates that, in jurisdictions using IFRS Standards (including those that transitioned to IFRS Standards prior to the publication of IFRS 14 *Regulatory Deferral Accounts*), regulatory balances are not generally recognised, however, there is some diversity in practice (see Table 2 in appendix of Agenda Paper 9E discussed at the July 2019 Board meeting—this table is based on Exhibit 59 of the Research Paper *Rate-regulated Activities*, published in November 2018 by the Canadian Accounting Standards Board).

10. However, requiring entities to apply new accounting requirements retrospectively can be burdensome for preparers. In some cases, this could require entities to gather several years of information. This information may not exist and it may be difficult to recreate the circumstances that applied historically without the use of hindsight.

11. Consequently, in developing new or revised IFRS Standards, the Board develops specific transition requirements when the cost of generating information for retrospective application exceeds the incremental benefit.

Entities that currently apply IFRS Standards and do not recognise regulatory balances

12. This group would encompass entities that are within the scope of the model and do not currently recognise regulatory balances in their financial statements because they transitioned to IFRS Standards either before IFRS 14 was published or after IFRS 14 was published but decided not to adopt that Standard or were not eligible to apply it.

Staff analysis and recommendations

13. As mentioned in paragraph 9, users are likely to prefer a full retrospective approach for transition to the model as it would result in comparable information that would facilitate a more complete analysis of trends in financial performance.

14. We expect that most of the information required to apply the model should already be available because of the detailed record-keeping requirements in regulatory agreements.[2] Nevertheless, we understand that these entities may still need to develop and/or modify their systems and processes to capture the necessary data to comply with the model's requirements and may incur costs of preparation and costs relating to the audit of the comparative figures.

15. As an alternative to restating comparative figures, we considered whether an entity should be permitted to transition to the model using a modified

[2] Summary of information received from the Consultative Group for Rate Regulation (CGRR), December 2017

retrospective approach through which it would recognise the cumulative effect of applying the model in the opening balance of retained earnings (or other component of equity, as appropriate) at the date of initial application.[3]

16. Although a modified retrospective approach may provide entities with some cost relief on transition, the staff do not recommend this approach. This is because the resulting lack of comparability at transition between the current period and the comparative period(s) may make it more difficult for users of financial statements to understand the reported financial performance which is likely to outweigh the potential savings in costs. For example, assume an entity applies the model from 1 January X2 using a modified retrospective approach. Assume also that:

    (a) revenue in X1 includes customer prepayments for construction of an item of property, plant and equipment that is used to supply goods or services to customers in X2. In this case, no regulatory expense would have been recognised in X1 for the related regulatory liability arising in that period but regulatory income will be recognised in X2 once the asset is put in use and the regulatory liability is being fulfilled. The resulting information could be misinterpreted as reporting the same income in profit or loss twice (as revenue in X1 and as regulatory income in X2).

    (b) revenue in X1 does not include compensation for allowable expenses incurred in X1 and this compensation is included in the rate(s) charged to customers in X2. In this case, no regulatory income would be recognised in X1 but regulatory expense would be recognised in X2 as the regulatory asset is recovered. This could be misinterpreted as reporting expense in X1 for which the entity was not entitled to receive any compensation and as reporting in X2 revenue which it generated by supplying goods or services in a period other than X1.

17. The staff therefore recommend that the Board require these entities to apply the model retrospectively to each prior reporting period presented applying IAS 8 (‘full retrospective approach’). In our view, this would result in comparable

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[3] The transition requirements in IFRS 9 *Financial Instruments*, IFRS 15 *Revenue from Contracts with Customers* and IFRS 16 *Leases* permit this approach.

information that would facilitate a more complete analysis of trends in financial performance and provide a more faithful representation of the entity's financial performance and financial position across all the period(s) presented. On transition to the model under the full retrospective approach, an entity would:

(a) recognise regulatory assets and regulatory liabilities in accordance with the recognition requirements of the model;

(b) apply the measurement requirements of the model to all recognised regulatory assets and regulatory liabilities; and

(c) recognise any resulting adjustment to retained earnings (or other component of equity, as appropriate) at the beginning of the earliest comparative period presented.

Disclosures

18. When applying a full retrospective approach on transition to the model (paragraph 17), an entity currently applying IFRS Standards would need to provide disclosures required by IAS 8.

19. In considering whether there should be any specific disclosure requirements on transition, the staff have considered the presentation and disclosure requirements of the model and the usefulness of the resulting information for users of financial statements.[4]

20. The model requires separate presentation of regulatory items in the primary financial statements, supplemented by related disclosures. Consequently, we think that the information needs of the users of financial statements on transition will be addressed without the need for any additional disclosures other than those required by IAS 8 and the model, as the effects of the model can be readily identified in both the current period and the comparative period(s), thus enabling a more complete like-for-like comparison across all the period(s) presented in the financial statements. Therefore, we do not recommend requiring these entities to provide any additional disclosures on transition to the model.

[4] Agenda Papers 9C-9D discussed at the November 2018 Board meeting.

Question for the Board

Entities that currently apply IFRS Standards (excluding IFRS 14) and do not recognise regulatory balances
1. Does the Board agree with the staff recommendation that these entities should apply a full retrospective approach on transition to the model?

Entities that currently apply IFRS Standards (possibly including IFRS 14) and recognise regulatory balances

21. This group would comprise entities that are within the scope of the model, whose financial statements are prepared in accordance with IFRS Standards and that currently recognise regulatory balances in their financial statements applying:

    (a) IFRS 14 (see paragraphs 22–26); or

    (b) accounting policies they have developed in accordance with IAS 8 (see paragraph 27).

Staff analysis and recommendations

22. IFRS 14 permits first-time adopters of IFRS Standards that already recognised regulatory deferral account balances in their financial statements in accordance with their previous GAAP to continue doing so, thus 'grandfathering' the outcome of their previous GAAP requirements dealing with recognition and measurement.[5] The previous GAAP of these entities is often US GAAP or local GAAP based on US GAAP. However, for presentation and disclosure, these entities are applying the specific presentation and disclosure requirements in IFRS 14 instead of their previous GAAP presentation and disclosure requirements.

[5] IFRS 14 is intended to be a short-term interim solution to help such entities avoid making a major change to their accounting policies for those balances until the project on Rate-regulated Activities is completed.

23. The model retains the requirements of IFRS 14 to present regulatory items in separate line items in the primary financial statements, though it does not retain the requirement to draw sub-totals before those line items.[6]

24. We think that the implementation costs for many entities applying IFRS 14 may arise mainly because of the differences between the model and the requirements in US GAAP, or similar requirements in local GAAP based on US GAAP. This is because we understand that US GAAP or local GAAP based on US GAAP is the GAAP that these entities currently use for recognising and measuring regulatory balances. Our assessment is that the model would result in similar outcomes to US GAAP but that the principles underpinning the requirements are different.[7] Accordingly, in our view, the costs of applying the model are likely to be lower for these entities than for entities that do not currently recognise such balances. This is because even though the former may need to modify their current methodologies for recognising and measuring regulatory balances these modifications should be less costly than applying the requirements from scratch.

25. Because these entities currently recognise regulatory balances, considering the costs that they are likely to incur for implementing the model, we recommend that these entities should be required to apply the full retrospective approach on transition to the model. In addition, applying the modified retrospective approach discussed in paragraphs 15–16, the regulatory items for the comparative period(s) would be recognised and measured on a basis different from the basis used in subsequent periods. That would undermine comparability of information for the period(s) presented on transition. That lack of comparability would not be mitigated by the model's requirements for presentation of regulatory items in separate line items in the primary financial statements.

26. Consequently, we recommend that the Board require these entities to apply the model using the full retrospective approach using IAS 8. This recommendation also considers the merits of the full retrospective approach discussed in

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6 Agenda Paper 9C was discussed at the November 2018 Board meeting.

7 The staff provided analysis of the main differences between the model and the requirements contained in Topic 980 Regulated Operations in the US Financial Accounting Standards Board's *Accounting Standards Codification* (US GAAP)—see Agenda Paper 9F discussed at the June 2019 Board meeting and Table 1 in appendix of Agenda Paper 9E discussed at the July 2019 Board meeting.

paragraph 17. On transition to the model under the full retrospective approach, an entity would:

(a) recognise regulatory assets and regulatory liabilities in accordance with the recognition requirements of the model;

(b) derecognise regulatory balances that in accordance with the model do not qualify for recognition as regulatory assets or regulatory liabilities;

(c) reclassify items that in accordance with the model must be recognised as a regulatory asset or a regulatory liability but in accordance with previous GAAP (or accounting policies developed in accordance with IAS 8—see paragraph 27) were recognised as a different type of asset or liability;

(d) apply the measurement requirements of the model to all recognised regulatory assets and regulatory liabilities; and

(e) recognise any resulting adjustment to retained earnings (or other component of equity, as appropriate) at the beginning of the earliest comparative period presented.

27. Some entities currently applying IFRS Standards have not adopted IFRS 14 but already recognise regulatory balances in their financial statements (in accordance with accounting policies they developed in accordance with IAS 8), typically within the receivables and payables categories.[8] We consider that our analysis in paragraphs 22–25 also applies to these entities and therefore we recommend such entities also apply the same transition requirements as we recommend for those entities that currently recognise regulatory balances using IFRS 14.

Disclosures

28. In our view, the discussion relating to disclosures in paragraphs 18–20 for entities that currently apply IFRS Standards and do not recognise regulatory balances is also appropriate for entities that already recognise regulatory balances and therefore we do not recommend requiring these entities to provide any additional

[8] AP9: Initial analysis of responses to the Discussion Paper *Reporting the Financial Effects of Rate Regulation*

disclosures on transition to the model other than those required by IAS 8 and the model.

Question for the Board

Entities that currently apply IFRS Standards (possibly including IFRS 14) and recognise regulatory balances
2. Does the Board agree with the staff recommendation that these entities should apply a full retrospective approach on transition to the model?

First-time adopters of IFRS Standards

29. This group would encompass entities that are within the scope of the model and are first-time adopters of IFRS Standards in the period when they apply the model for the first time. For these entities the effects of applying the model (including the model's implementation costs) would vary depending on whether they are currently recognising regulatory balances or not.

Staff analysis and recommendations

30. As mentioned in paragraph 14, we understand that the detailed record-keeping requirements in regulatory agreements enable identification and tracking of individual adjustments to the rates charged to customers. Therefore, even if a first-time adopter does not currently recognise regulatory balances, our expectation is that such entities already have sufficiently quantitative and qualitative source data to apply the model.

31. A first-time adopter is required to restate comparative information applying IFRS 1 throughout its financial statements. This is because first time adoption requires an orderly adoption of all IFRS Standards from the date of transition to IFRS Standards, as defined in IFRS 1, to provide a suitable starting point for

entities applying IFRS Standards.[9] Accordingly, we think that the transition requirements of the model for these entities should be aligned with the objective of IFRS 1.[10]

32. The Board designed the regime for first-time adoption of IFRS Standards to achieve comparability within an entity over time, between different first-time adopters and between first-time adopters and entities that already apply IFRS Standards.[11] Paragraph BC14 of the Basis for Conclusions on IFRS 1 states:

> The Board will consider case by case when it issues a new IFRS whether a first-time adopter should apply that IFRS retrospectively or prospectively. The Board expects that retrospective application will be appropriate in most cases, given its primary objective of comparability over time within a first-time adopter's first IFRS financial statements.

33. Requiring first-time adopters to restate comparative information would also be consistent with the staff recommendation on transition requirements for entities that currently recognise regulatory balances applying IFRS 14 as a result of the grandfathering of previous GAAP requirements permitted for these balances (see paragraphs 22–26).

34. Accordingly, the staff recommend that a first-time adopter should apply the model at the date of transition to IFRS Standards as defined in IFRS 1. In our view, this would create comparability within a first-time adopter's first IFRS financial statements in line with the Board's emphasis on achieving comparability over time within a first-time adopter's first IFRS financial statements and between different entities adopting IFRS Standards for the first time at a given date.[12]

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[9] The beginning of the earliest period for which an entity presents full comparative information under IFRSs in its first IFRS financial statements (see Appendix A of IFRS 1).

[10] The objective of IFRS 1 is to ensure that an entity's *first* IFRS financial statements, and its interim financial reports for part of the period covered by those financial statements, contain high quality information that:

(a) is transparent for users and comparable over all periods presented;

(b) provides a suitable starting point for accounting in accordance with *International Financial Reporting Standards (IFRSs)*; and

(c) can be generated at a cost that does not exceed the benefits.

[11] Paragraph BC9 of the Basis for Conclusions on IFRS 1.

[12] Paragraph BC10 of the Basis for Conclusions on IFRS 1.

Exemption for deemed cost

35. *Improvements to IFRSs* issued by the Board in May 2010 introduced an exemption permitting entities to use – at the date of transition to IFRS Standards – as deemed cost the previous GAAP carrying amount of an item that is used, or was previously used, in operations subject to rate regulation.[13] The exemption was amended on publication of IFRS 14 to align it with the terminology used in that Standard.

36. The following is a summary of the rationale used by the Board for providing this exemption to first-time adopters:[14]

    (a) without this exemption, an entity would have either to restate those items retrospectively to remove the non-qualifying amounts, or to use fair value as deemed cost (ie the exemption in paragraph D5 of IFRS 1). Both of those alternatives pose significant practical challenges.

    (b) most first-time adopters with operations subject to rate regulation accounted for property, plant and equipment largely in accordance with a historical cost model consistent with IAS 16 *Property, Plant and Equipment* and the item for which the exemption is used is required to be tested for impairment using IAS 36 *Impairment of Assets* at the date of transition.[15]

37. The Board regarded this exemption as consistent with the exemptions already included in IFRS 1 in that it avoids excessive costs while meeting the objectives of the IFRS. We are not aware of any subsequent developments that would challenge the validity of the rationale used by the Board for this exemption.

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[13] Paragraph D8B of IFRS 1.

[14] Paragraphs BC47F-BC47K of the Basis for Conclusions on IFRS 1.

[15] Under previous GAAP, an entity might have capitalised, as part of the carrying amount of items of property, plant and equipment, amounts that do not qualify for capitalisation under IFRS Standards. For example, IFRS Standards do not permit an entity to capitalise an imputed cost of equity. However, the Board concluded that the cost and effort required to achieve total compliance in this area for the purposes of preparing an entity's first IFRS financial statements is not warranted to meet the objective of providing a suitable starting point for accounting under IFRS Standards, Also, each item for which the exemption is used is tested for impairment at the date of transition (see paragraphs BC47F and BC47J of the Basis for Conclusions on IFRS 1).

38. Accordingly, the staff recommend retaining the exemption in paragraph D8B of IFRS 1 and amending its drafting to align it with the descriptions used for the model.

Questions for the Board

First-time adopters of IFRS Standards
3. Does the Board agree with the staff recommendation that a first-time adopter should apply the model at the date of transition to IFRS Standards as defined in IFRS 1?
4. Does the Board agree to retain the exemption in paragraph D8B of IFRS 1? The staff will consider in drafting how to align the wording of that exemption with the descriptions used for the model.

Business combinations

39. This section discusses the transition requirements for accounting for past business combinations involving the acquisition of entities with regulatory assets or regulatory liabilities within the scope of the model. Past business combinations in this context refer to those business combinations that occurred before the date of initial application, or for first-time adopters before the date of transition to IFRS Standards.

40. The Board has tentatively decided that, as an exception to the recognition and measurement principles of IFRS 3 *Business Combinations*, an entity should recognise and measure regulatory assets acquired and regulatory liabilities assumed in a business combination in accordance with the recognition and measurement principles of the model.[16]

[16] Agenda Paper 9A discussed at the July 2019 Board meeting.

Current practice

41. Entities that currently apply IFRS Standards and do not recognise regulatory balances account for business combinations in accordance with IFRS 3. Because these entities do not currently recognise regulatory balances, we think it is likely that such balances in past business combinations would have been subsumed within goodwill or, less frequently, would have resulted in a gain from a bargain purchase.

42. Entities that currently apply IFRS 14 are exempted from applying IFRS 3 and are permitted to continue to apply their previous GAAP accounting policies for the recognition, measurement, impairment and derecognition of regulatory deferral account balances.[17] IFRS 14 requires the acquiree's regulatory deferral account balances to be recognised in the consolidated financial statements of the acquirer in accordance with the acquirer's policies, irrespective of whether the acquiree recognises those balances in its own financial statements.

Staff analysis and recommendations

43. In our view, once accounting for a business combination is complete, users of financial statements are unlikely to want entities to modify subsequently the initial carrying amounts of the assets and liabilities determined at the date of the acquisition. Also, acquiring entities are unlikely to review the purchase price allocations for past business combinations on a recurring basis and, consequently, revising the accounting for past business combinations to comply with the model would require historical information that may no longer be available and may be difficult to estimate.

44. We think that benefits, if any, from information resulting from revising the accounting for past business combinations would be minimal and unlikely to outweigh the potential costs because:

[17] See paragraphs B17-B18 of IFRS 14.

(a) any remaining regulatory assets and regulatory liabilities would be recognised and measured using the model at transition and going forward; and

(b) goodwill would be tested for impairment on a recurring basis.

45. We also note that IFRS 1 exempts a first-time adopter from applying IFRS 3 retrospectively to past business combinations.[18] In our view, adopting a similar approach for entities that currently apply their previous GAAP accounting policies to regulatory balances using IFRS 14 would be consistent with these requirements in IFRS 1.

46. Accordingly, the staff recommend that entities that currently apply IFRS Standards, irrespective of whether they currently recognise regulatory balances, should be permitted to elect not to apply the model retrospectively to past business combinations. If an entity uses that election, it should recognise and measure, using the model, only those regulatory assets and regulatory liabilities arising from **all** past business combinations that **still exist** at the date of initial application of the model. Any resulting change should adjust the carrying amount of goodwill.[19] If that adjustment reduces the carrying amount of goodwill to zero, any remaining adjustment should be recognised in retained earnings or, if appropriate, another category of equity.[20]

47. This election would relieve entities from revising the purchase price allocations for past business combinations retrospectively. The election would be required to be applied for all past business combinations (ie separate elections for separate business combinations would not be permitted).

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[18] Appendix C of IFRS 1.

[19] The measurement of non-controlling interests and deferred tax follows from the measurement of other assets and liabilities. Therefore, adjustments to recognised assets and liabilities would also affect non-controlling interest and deferred tax.

[20] This approach is similar to the requirements of IFRS 1 relating to past business combinations for:
(a) intangible assets subsumed in recognised goodwill in accordance with previous GAAP but that qualify for recognition as an asset in accordance with IAS 38 *Intangible Assets* (paragraph C4(g)(i) of IFRS 1); and
(b) items that may have been classified and recognised as an intangible asset but that do not qualify for recognition as an asset in accordance with IAS 38 (see paragraph C4(c) of IFRS 1).

48. As mentioned previously, for first-time adopters IFRS 1 already provides exemptions for business combinations that occurred before the date of transition to IFRS Standards (see Appendix C of IFRS 1). We do not recommend any modifications to those exemptions for first-time adopters other than for goodwill-related regulatory assets (see paragraphs 49–63).

Questions for the Board

Entities that currently apply IFRS Standards
5. Does the Board agree with the staff recommendation that entities that currently apply IFRS Standards should be permitted to elect not to apply the model retrospectively to past business combinations?
6. If so, does the Board agree that when an entity uses that election, it should: (a) recognise and measure, using the model, only those regulatory assets and regulatory liabilities arising from **all** past business combinations that **still exist** at the date of initial application of the model; and (b) adjust the carrying amount of goodwill for any resulting change. If that adjustment reduces the carrying amount of goodwill to zero, any remaining adjustment should be recognised in retained earnings or, if appropriate, another category of equity?

Goodwill and regulatory assets

49. Despite our recommendation to permit entities that currently apply IFRS Standards to elect not to apply the model retrospectively to past business combinations (see paragraph 46), these entities would still need to apply the model at the date of initial application (ie any regulatory assets and regulatory

liabilities outstanding at the date of initial application would be recognised and measured in accordance with the requirements of the model).

50. Similarly, first-time adopters of IFRS Standards that do not apply IFRS 3 retrospectively to past business combinations are required to exclude from their opening IFRS statement of financial position any item recognised in accordance with previous GAAP that does not qualify for recognition as an asset or a liability under IFRS Standards.[21]

51. In some jurisdictions where entities currently recognise regulatory balances, we understand that some regulators consider goodwill an allowable cost for inclusion in the rates charged to customers.[22] We are aware that in such situations, entities applying previous GAAP recognise regulatory assets for goodwill (called in this paper 'goodwill-related regulatory assets') that are then derecognised as related amounts are included in the rates charged to customers.[23] IFRS Standards prohibit amortisation of goodwill but require it to be tested for impairment in accordance with IAS 36.[24]

52. Because goodwill arises from a business combination that is neither directly nor indirectly related to the supply of goods or services, the model would not recognise a regulatory asset relating to goodwill even if the regulator allows it to be included in the rates charged to customers.

53. Entities that currently recognise such regulatory assets would have to derecognise them on transition to the model. This would apply both to entities that currently apply IFRS Standards (possibly including IFRS 14) and those that will be first-time adopters of IFRS Standards. We have identified two possible approaches for the Board to consider as follows:

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[21] Paragraph C4(c) of IFRS 1.

[22] On the basis of evidence gathered from our limited outreach, we understand that this regulatory treatment occurs only in the United States, and only for some regulators in that country. Although it appears that this issue may not arise outside the US, it could affect first-time adopters in other countries if they have US operations.

[23] Topic 980 Regulated Operations in the US Financial Accounting Standards Board's *Accounting Standards Codification* (US GAAP) requires amortisation of goodwill if the regulator permits all or a portion of goodwill to be amortised over a specific time period as an allowable cost for rate-making purposes.

[24] Paragraph BC131A of the Basis for Conclusions on IAS 36 *Impairment of Assets*.

(a) Approach 1—reclassification to goodwill (paragraphs 55–59)

(b) Approach 2—recognition in equity (paragraphs 60–63)

54. This consequence would not arise for entities that currently apply IFRS Standards and do not recognise regulatory balances, because they have no such balances to derecognise.

Approach 1—reclassification to goodwill

55. This approach would require an entity to reclassify such goodwill-related regulatory assets to goodwill. Goodwill is defined in IFRS 3 as an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognised. Essentially, goodwill is measured as a residual amount resulting from the purchase price allocation for a business combination. Accordingly, if such regulatory assets had not been recognised as part of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed, goodwill recognised would have resulted in a higher amount.

56. Also, the outstanding balances of the goodwill-related regulatory assets are yet to be included in the rates charged to customers and consequently have not yet resulted in the recognition of revenue. Therefore, we think that it is appropriate to require such amounts to be reclassified to goodwill. Because this requirement would apply only to outstanding balances of goodwill-related regulatory assets as of the date of initial application (or the date of transition to IFRS Standards for first-time adopters), amounts that have already been derecognised in accordance with previous GAAP would not be reclassified.

57. The disadvantage of this approach is that once such outstanding goodwill-related regulatory assets are reclassified to goodwill, they will not be derecognised when they are recovered by inclusion in the rates charged to customers. However, when they are recovered in this manner, the IAS 36 impairment test could, to some extent and in some circumstances, lead to the recognition of an impairment loss in the cash-generating unit to which the goodwill-related regulatory asset had been allocated, if not offset by other items in the cash-generating unit (‘headroom’). That loss would be labelled as an impairment loss, not as recovery of the goodwill-related regulatory assets.

58. Nevertheless, this approach would result in outcomes consistent with the outcomes for business combinations that occur **after** the transition to the model. That is, any amounts relating to goodwill that are permitted by the regulator to be included in the rates charged to customers, will, in effect, be subsumed in goodwill by the acquirer. Also, adopting this approach would be similar to the requirements of IFRS 1 for intangible assets recognised in past business combinations.[25]

59. If the Board adopts this approach for entities already applying IFRS Standards, the staff recommend that it should also be applied to first-time adopters, for the same reason. For first-time adopters, this approach would require an amendment to Appendix C of IFRS 1.

Approach 2—recognition in equity

60. This approach would require an entity to write off goodwill-related regulatory assets to retained earnings. For some entities, this might reduce the amount of their distributable reserves, until the related amounts are ultimately included in the rates charged to customers, which might not occur for several years.

61. The advantage of this approach is that it would not add amounts to goodwill and thus would avoid the issue discussed in paragraph 57. However, this approach would treat goodwill-related regulatory assets differently depending on whether they relate to past business combinations or business combinations that occur after transition to the model. Goodwill-related regulatory assets arising from business combinations after transition to the model would, in effect, be recognised by being subsumed in goodwill (paragraph 58).

62. Considering the merits and drawbacks of the two approaches discussed above, the staff recommend Approach 1. This would require entities to reclassify such amounts to goodwill to ensure consistency of accounting treatment for business combinations, irrespective of whether they occur before or after the transition to the model.

[25] Paragraph C4(c)(i) of IFRS 1 requires a first-time adopter to reclassify to goodwill an item that, from a past business combination, was recognised in accordance with previous GAAP as an intangible asset but does not qualify for separate recognition in accordance with IAS 38.

63. If the Board rejects the staff recommendation and instead adopts Approach 2 for entities already applying IFRS Standards, the staff recommend that Approach 2 should also apply to first-time adopters for consistency of treatment for goodwill-related regulatory assets. In this case, an amendment to IFRS 1 would not be needed.[26]

Questions for the Board

Goodwill-related regulatory assets
7. Does the Board agree with the staff recommendation that entities currently applying IFRS Standards (possibly including IFRS 14) should reclassify goodwill-related regulatory assets to goodwill (ie Approach 1 in paragraph 53)?
8. If so, does the Board agree with the staff recommendation to also require the same approach for such items for first-time adopters of IFRS Standards?

[26] Paragraph C4(c)(ii) of IFRS 1 requires a first-time adopter to exclude from its opening IFRS statement of financial position any item recognised in accordance with previous GAAP that does not qualify for recognition as an asset or liability and recognise the resulting change in retained earnings unless such item is an intangible asset that shall be reclassified to goodwill (see footnote 25).