# IFRS 3, IFRS 13 and IAS 37: Asset Retirement Obligations Assumed in a Business Combination or Asset Purchase

## Extract, IFRS Discussion Group Report on Meeting – June 12, 2014

Paragraph 18 of IFRS 3 Business Combinations requires an acquirer to measure all identifiable assets acquired and liabilities assumed at their acquisition date fair values. Although there are limited exceptions to this measurement principle, none relate to long-term provisions (such as decommissioning liabilities) assumed by the acquirer as part of a business combination. IFRS 13 *Fair Value Measurement* provides guidance on how to measure fair value. In accordance with paragraph 54 of IFRS 3, an acquirer subsequently measures and accounts for assets acquired and liabilities assumed in accordance with other applicable IFRSs for those items. In the case of long-term provisions assumed by the acquirer as part of a business combination, the applicable standard is IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

Applying IFRS 13 to measure a provision assumed as part of a business combination at the acquisition date, and then IAS 37 subsequently, can result in a Day 2 adjustment to the value of the provision due to differences between the measurement guidance in those two IFRSs (including those pertaining to credit risk).

*Fact Pattern:*

A decommissioning liability is assumed by the acquirer as part of a business combination. Applying IFRS 13, the acquirer determines the acquisition date fair value of the decommissioning liability to be $100. The following day, the acquirer remeasures the liability under IAS 37, arriving at a value of $120. Thus, the liability is increased by $20.

There is diversity in views on the other side of the Day 2 accounting entry. Some take the view that the $20 should go to profit or loss, while others would apply IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* by analogy and increase the value of property, plant and equipment. More importantly, diversity in practice may exist with respect to the recognition of a Day 2 adjustment in the first place. Some entities may initially measure the decommissioning liability on the acquisition date using the measurement guidance in IAS 37 as a practical expedient even though this is not in accordance with IFRS 3. Accordingly, no adjustment is needed on Day 2. In the case at hand, this can result in the $20 residing in goodwill instead of property, plant and equipment and, therefore, profit or loss of subsequent periods, even if the effect on future profit or loss is rarely material for the reasons discussed below.

*The Group's Discussion*

Group members discussed:

- the likelihood of a material difference between the IFRS 13 fair value of an asset retirement obligation assumed in a business combination or asset purchase and the measurement value for that obligation resulting from the application of IAS 37; and

- whether there is diversity in practice.

On the first point, Group members observed that, based on their experience, there can be a material difference between the measurement values obtained by applying IFRS 13 versus IAS 37. A Group member noted that this difference is primarily due to the different treatment of credit risk between the two standards. Several Group members noted that the difference in measurement values was most important in circumstances when the business combination results in the recognition of a bargain purchase gain.

One Group member noted that significant measurement differences between IFRS 13 and IAS 37 were perhaps most likely to arise in oil and gas, and mining companies. For these companies, IFRS 13 requires that a profit element be factored into fair value estimates, whereas IAS 37 clearly states that the measurement value should reflect management's best estimate and many entities perform the remediation themselves.

From a technical perspective, Group members agreed that the accounting required by IFRS 3 for asset retirement obligations assumed in a business combination is clear (i.e., they should be measured at their acquisition date fair value). The Group's overall observation was that Day 2 complexities resulting from a strict application of IFRSs as currently worded point to possible flaws in the standards, which provide neither a scope nor measurement exception in IFRS 3 for this item. The Group noted that this issue preceded the adoption of IFRS 13 and, therefore, was not new. One Group member pointed out that uncertain income tax positions acquired in a business combination, which the Group has previously discussed, is another area involving Day 2 accounting complexities.

The Group was of the view that there is probably diversity in practice on this issue, both in Canada and globally, as a result of the different approaches taken by both preparers and valuators. Some Group members had the impression that some reporting issuers are not recognizing a Day 2 adjustment, but instead, are applying IAS 37 to determine the acquisition date value of asset retirement obligations assumed as part of a business combination. However, other preparers are applying a proper technical interpretation of the standards. The Group noted that the AcSB's *comment letter* to the IASB on that Board's post-implementation review of IFRS 3 took the view that there is diversity in practice regarding the initial measurement of the asset retirement obligation and the recognition of a Day 2 adjustment, and offered to provide the IASB the results of the Group's discussion at its June 2014 meeting.

The treatment in practice of any Day 2 adjustments recognized by reporting issuers was less clear. Although one Group member was not aware of any instance where the adjustment was reflected in profit or loss at the outset, another knew of one such instance.

Group members noted that, in addition to the AcSB's comment letter, several audit firms made mention of this issue in their responses. Therefore, the Group recommended that this issue be monitored for any action on the IASB's part and, if it is not addressed, that it be recommended to the AcSB as an issue to be referred to the IASB or the IFRS Interpretations Committee.