STAFF PAPER

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Rate-regulated Activities Consultative Group

The Appendix to this paper reproduces IASB Agenda Paper 9A, October 2013

Project	**Rate-regulated Activities: Rate regulation research project**
Paper topic	Business combinations

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Purpose of this paper

1. The purpose of this Agenda Paper 3 is to ask the Consultative Group to assist us understanding the impact of rate regulation on the valuation of rate-regulated entities and on the accounting for the acquisition of a rate-regulated entity.

2. IFRS 3 *Business Combinations* requires that, with a limited number of exceptions, the assets and liabilities acquired in a business combination are usually measured at fair value at the date of acquisition. This is consistent with US GAAP and some other local GAAP requirements. We understand that one of the valuation techniques used to measure the acquisition-date fair value of the assets and liabilities of a rate-regulated entity is to use the book value.

3. The explanation that we have seen for this approach is that the fair value is generally deemed to approximately equal the book value. This approach is predicated on the view that the regulated nature of the rate-regulated entity's operations means that the entity can only recover its (cost-based) book value (commonly referred to as the rate base) plus a 'fair and reasonable' return. This return is determined in accordance with the rate regulation.

4. To help us more clearly understand and assess this approach, we would like members of the Consultative Group to discuss the following questions during the meeting:

(a) In your jurisdiction, is the technique outlined in paragraph 2 commonly used for valuing assets and liabilities of rate-regulated assets and liabilities acquired in a business combination?

(b) If so, is the use of book value as deemed fair value applied to all assets and liabilities within the rate-regulated operations, including property, plant and equipment, regulatory deferral account balances and intangible assets, such as the licence to operate in accordance with the rate-regulations?

(c) If not, what valuation techniques are used for other assets and liabilities within the rate-regulated operations?

(d) If book value is not commonly used as the deemed fair value of rate-regulated assets and liabilities acquired in a business combination, what valuation techniques are commonly used? Does this have other consequences for the accounting for rate-regulated account balances? For example, is an additional regulatory account balance recognised for the difference between the value of the item reported in the financial statements and its value for rate-setting purposes?

(e) Typically, the drivers for goodwill include synergies, intangible assets that cannot be separately recognised (such as an assembled workforce) and valuation differences due to some assets and liabilities being recognised at an amount that differs from fair value (such as deferred taxation). In accounting for the acquisition of a rate-regulated entity, what does goodwill typically comprise?

(f) Are there any other specific aspects of the accounting for the acquisition of a rate-regulated entity that you think we should consider in the Discussion Paper being developed for this project?