UK Endorsement Board

Rate-regulated Activities Technical Advisory Group:

Meeting summary - Meeting held on 23 June 2023 (in-person with option to attend virtually)

Item No.	Agenda Item
1.	**Welcome**
2.	**IASB Tentative Decisions**
3.	**Economic impact study**
4.	**Accounting issues— the Direct (no direct) relationship concept**
5.	**IFRS 15 Post Implementation Review**
6.	**ISSB Request for information**
7.	**AOB**

Present	
Name	**Designation**
Phil Aspin	RRA TAG Chair
Simon Davie	RRA TAG Member
William Gardiner	RRA TAG Member
Claire Howells	RRA TAG Member
Kelly Martin	RRA TAG Member
James Sawyer	RRA TAG Member

Present	
Name	**Designation**
Samuel Vaughan	RRA TAG Member
Stefanie Voelz	RRA TAG Member
Stuart Wills	RRA TAG Member
Robin Cohen	UKEB Board member
IASB staff	Observers
EFRAG staff	Observers

Apologies:

Suzanne Gallagher (RRA TAG Member)

Dean Lockhart (RRA TAG Member)

Relevant UKEB Secretariat team members were also present.

Welcome and Introduction

1. The Chair welcomed members to the meeting.

IASB tentative decisions

2. The Secretariat updated members on the IASB tentative decisions made after the March 2023[1] RRA TAG meeting, which related to:

   a) Long-term performance incentives.

   b) Derecognition.

   c) Timing of initial recognition.

[1] Refer here for the IASB's meeting overviews for April 2023 and May 2023.

Long-term performance incentives

3. The meeting paper set out that the IASB had tentatively decided to retain the proposal to require an entity to estimate the amount of a long-term performance incentive, and to determine the portion of that estimated amount that relates to the reporting period using a reasonable and supportable basis (using the 'most likely amount' method or the 'expected value' method[2]). The paper asked members' views on the tentative decisions.

4. Members agreed that uncertainties exist in determining the portion of the rate regulated performance incentive relating to the reporting period. However, they considered that entities would continue to be able to make estimates as the proposals in the ED were consistent with other areas of measurement uncertainty within IFRS Accounting Standards.

5. Members from the energy and water sectors provided examples of other performance adjustments, such as the five-year price control total expenditure (Totex) sharing mechanism, which included inherent uncertainty about estimates. A member from the energy sector noted that their experience was that they had data to reliably estimate the numbers. A member from the water sector agreed that estimates would be materially correct.

6. Members also supported the IASB's tentative decision that an entity would estimate the amount of the performance incentive using the 'most likely amount' method or the 'expected value' method.

7. This group is generally satisfied with the IASB's tentative decisions relating to long-term performance incentives.

Derecognition

8. The meeting paper set out that the IASB made a number of tentative decisions relating to derecognition, including when an entity will be required to derecognise a regulatory asset or regulatory liability and guidance on the most common ways in which derecognition will take place. The paper asked for members' views on the tentative decisions.

9. A member noted that in practice, there could be different structures through which regulatory assets and regulatory liabilities could be settled. However, it could be unclear whether regulatory assets or regulatory liabilities exist. An example of this would be the supplier of last resort arrangement. Under the supplier of last resort arrangement, the entity (also known as the supplier) would take on the customers

[2] The meeting paper did not include both of these options, but this was pointed out and the ensuing discussions included both options.

and associated liability to provide services to them, while the regulator would assume the responsibility to pay the entity for the said liability.

10. A member noted that for Ofgem, with these types of transactions, the regulatory accounting period was re-opened so that these liabilities would be matched with income within the period, therefore not creating any timing difference.

11. Some members noted that the regulator could retrospectively change an agreed adjustment from revenue (the regulatory income statement) to RAB. This would mean that an existing regulatory asset or regulatory liability would be immediately derecognised, based on the IASB's current proposals. Because allowable expenses that pass directly to the RAB (and in the absence of a direct relationship between RAB and PPE), cannot be recognised as a regulatory asset or liability.

The absence of a direct relationship between RAB and PPE

12. The Chair considers that the absence of a direct relationship between RAB and PPE is a key item. The water sector had 25 adjustments that could give rise to regulatory assets and liabilities. Some of these adjustments are allocated entirely to revenue (the regulatory income statement), some are allocated to RAB and some allowable expenses are a hybrid of both. The Chair also noted that these amounts were often quite large and asked if that was an acceptable outcome for the model or if there were alternative options.

13. The group is generally satisfied with the IASB's tentative decisions on derecognition, but the issue of the direct (no direct) relationship concept needs to be addressed again with respect to adjustments going through the RAB. Timing of initial recognition

14. The meeting paper stated that the IASB tentatively decided that the prospective standard would retain the proposal to require recognition of all regulatory assets and all regulatory liabilities existing at the end of the reporting period. The paper asked for members' views on this tentative decision.

15. Members were in support of this tentative decision.

16. Members were generally satisfied with the IASB's tentative decisions relating to timing of initial recognition.

17. The meeting paper also stated that the IASB tentatively decided to retain the proposal to treat any regulatory assets or regulatory liabilities arising from regulated rates denominated in a foreign currency as monetary items when applying IAS 21. There was no discussion of this point.

Project timeline

18. The meeting paper stated that the IASB staff expect the analysis and redeliberations of the remaining topics will be finalised during the second half of

2024, with the drafting and publication of the final standard being in 2025. The paper also shared comment made by IASB Board members during the IASB's discussions of this aspect. The paper sought members' views on the projected timeline.

19. IASB staff commented that the purpose of sharing the project timelines was to manage stakeholder expectations regarding when the final standard would be published. The details of the topics that are still to be discussed by the IASB are outlined in the May 2023 IASB Staff paper.

20. A member asked whether the IASB would willing to reopen the discussion regarding the proposals for the cost-based schemes and incentive-based schemes[3] in future, to which IASB staff said they were currently analysing survey responses on this topic to assist the IASB in assessing whether further work needed to be done on this topic.

21. The Chair commented that some items under the incentive-based schemes[4] may be material, and that the current model proposed by the IASB did not address the needs of such UK entities and asked whether the IASB would be open to receiving solutions regarding the possible accounting for these items.

22. The IASB staff said the proposals were also still being discussed with other jurisdictions that also operate under incentive-based performance schemes, the general consensus in these jurisdictions has been that they are satisfied with the current proposals. A member responded that, although other jurisdictions also operated under incentive-based schemes, the recognition of amounts using a Totex approach was uncommon in these jurisdictions, and they therefore did not face the same challenges as UK entities regarding the current IASBs proposal. Further discussions need to be had to address the concerns of UK entities including adjustments that would have material economic impact for entities.

23. Comparability was also highlighted as being an area that also needs careful consideration, as it seems that the future standard could potentially only address the needs of one regulatory regime and not other regimes. This therefore may create comparability challenges between entities.

24. A member stated a concern if there was no comparability due to differing interpretations of the same regulatory regime. Therefore, the direct and indirect relationship was sufficiently clear to avoid that. The member continued that there may need to be an acceptance that different regimes needed to be accounted for differently and that would naturally reduce comparability.

3 This refers to the direct (no direct) relationship concept, discussed by the IASB at it December 2022 meeting. Meeting paper AP9D.

4 Entities within the incentive-based regime (the most prevalent in the UK) typically have no direct relationship between the PPE and RAB.

The direct (no direct) concept

25. It was observed by IASB staff that the existence of different regulatory regimes i.e.: cost-based schemes and incentive-based schemes, is a key issue in this project but that some comments received by the IASB indicated that regulatory depreciation of the RAB was a general allowance intended to recover regulatory capital and not specific to components. These respondents also said the RAB is a regulatory construct incorporating more than PPE and intangible assets so therefore could not be disaggregated. The feedback received during this discussion, however, seems to indicate otherwise. TAG members were of the view that the responses to the IASB indicate the challenges preparers experience.

26. A member asked the IASB staff whether a direct or no direct relationship of the PPE to the RAB had to be explicitly included in the standard, to which the IASB staff responded yes. The member asked whether the IASB would consider a direct relationship between working capital and RAB and used the example of the National Air Traffic Services (NATS) whose RAB included all working capital movements. For example, the traffic risk sharing mechanism is adjusted through RAB. The member also stated that there were also some air traffic controllers in Europe that do the same. The IASB staff responded to this point that they were not aware of this adjustment going through RAB.

27. The UKEB Secretariat will continue monitoring the IASB's tentative decisions and prioritise topics for discussion at future meetings, including the direct (no direct) relationship concept.

Economic impact study

28. The Secretariat presented the initial findings of the economic impact study and requested comments from the members, including entities in scope, accounting issues of economic relevance and the anticipated economic effects of the current IASB proposals.

29. The following observations were made:

30. The interconnectors[5] (these are typically joint ventures between energy companies and other entities) were included in scope of the economic study but may have to be removed as they did not fall in scope of the expected standard due to how the regulator sets the price.

31. The IASB staff noted that the current figures for inflation adjustment may be exceptionally high due to the current inflation level. However, a UKEB staff member noted that, even during times of moderate inflation, the adjustment would

[5] Interconnectors are high voltage cables that are used to connect the electricity systems of neighbouring countries. They allow National Grid to trade excess power, such as renewable energy created by the sun, wind and water, between different countries. (Source: https://www.nationalgrid.com/national-grid-ventures/interconnectors-connecting-cleaner-future)

still be material to the RAB and the income statement. The economic outlook has to be monitored closely as inflation may not reset to almost zero in the future, as happened post-2009. Even in case of moderate inflation, the current IASB tentative decisions would not allow for the economics to be reflected in the financial statements, which would not benefit investors and users.

32. UKEB Secretariat noted that typically, deferred taxes would not have a significant economic impact, however, clarity is sought with regards to whether the existence of deferred taxes created a regulatory asset for entities? IASB staff said that the topic of deferred tax will be redeliberated by the IASB at a future meeting, but also highlighted that the Exposure Draft indicated that a fact pattern analysis may indicate that a regulatory asset could arise because of deferred taxes.

33. IASB staff also observed that there currently does not seem to be a methodology in place where the regulator reflects the deferred tax amounts that may be recovered in the future, and asked members how well defined the regulation was today? Members responded that the current regulation methodology was one that matched the cash tax that will be paid back and results in entities recovering the right amount of revenue on a post-tax basis. The methodology also best reflects the tax an entity will pay in the future. Members also commented that deferred tax balances are material and may lead to significant adjustments; it will therefore be important for the IASB to look at this topic closely.

34. The final findings of the economic impacts study will be presented to the group at its next meeting in September 2023.

Accounting issues –the direct (no direct) relationship concept

35. The meeting paper set out a description of the direct (no direct) concept and that it is a priority for the UK to assess whether the tentative decisions made by the IASB will address the types of regulatory agreements in the UK. The information presented included a table with the IASB's tentative decisions on specific issues with regards to the direct (no direct) relationship concept[6] regulatory depreciation, inflation, allowable expenses and performance incentives. The paper asked for members' views on these tentative decisions.

36. Members agreed that assessing whether an entity's RAB had a direct or no direct relationship with its PPE would not be a complex process and entities could quickly come to this conclusion. One member also added that guidance may also be beneficial particularly where an entity had operations in jurisdictions with different regulatory regimes.

37. A member commented that the UK water regulator was considering proposals for regulatory mechanisms with a direct relationship between the RAB and PPE., They asked that if this proposal was approved, would the historical RAB be treated as a

[6] The IASB December 2022 meeting paper was used as a basis for the table.

separate unit of account from the new RAB? Other members agreed that this was a key matter and would be a transition issue that should be discussed at future meetings. It was noted that users would need to be made aware of this new type of regulatory mechanism because it may affect comparability.

38. It was discussed that there were adjustments made to the RAB that were not directly related to capital expenditure and whether these adjustments would therefore need their own unit of account? A member shared that there were projects that were agreed with the regulator, which fell outside of the price control period and therefore the regulator would opt to split the RAB. This split then resulted in a portion of the RAB earning a different rate of return to that of the RAB within the price control period.

39. A member explained that allowable expenses are accounted for by most entities using Total expenditure mechanism (Totex mechanism) for items within the price control period. Through this mechanism, a notional split between operating expenditure (Opex) and capital expenditure (Capex) which make up the total expenditure, is used. The Capex portion of the allowance would be allocated to the RAB, with the Opex portion being allocated to revenue. The issue of whether the notional allocation aligned with the actual expenditure incurred by the entity was irrelevant. Members also agreed that both Ofgem and Ofwat were in favour of a greater portion of allowance being allocated to RAB to lighten the burden on the customers, while entities may prefer a greater allocation towards revenue.

40. Another factor considered by the regulators in allocating the split in the allowance is the entity's capital investment programme for the price control period.

41. A member agreed that the Totex mechanism and its impact on allowable expenses and performance incentives, is important as it affected most, if not all UK entities, and should be considered by the IASB at its future meetings. The RRA TAG group would also discuss the topic as a separate agenda item at a future meeting.

42. The UKEB Secretariat asked how significant regulatory depreciation is to entities in UK, and whether a regulatory asset or liability should be recognised for regulatory depreciation adjustments. Members responded that in both the water and electricity sectors the regulatory depreciation was important and noted the following:

    a) In both sectors, regulatory depreciation is always higher than accounting depreciation due to inflation being allowed to be included in the RAB by the regulator.

    b) The approach used by the regulator in determining the useful life of the assets and depreciation charge was also different from that of IFRS accounting.

    c) In the electricity sector they apply a useful life of 45 years to the RAB.

d) Also in the electricity sector, in determining the amount to be allowed for inflation, the regulator uses an average of the opening and closing values of the RAB.

e) The difference between the regulatory depreciation charge and the accounting depreciation could be determined by establishing whether the two amounts had a direct relationship. Where there was no direct relationship, the adjustment could not be recognised as regulatory asset or regulatory liability. This applies to both the water and electricity sectors.

43. The UKEB Secretariat highlighted that investors would be interested to see the differences that exist between the RAB and the PPE as this could be important information for them. It was suggested that disclosures could be appropriate in addressing this need.

44. The UKEB Secretariat introduced the topic of allowable expenses and performance incentives and asked how significant these were for UK entities and whether a regulatory asset or liability should be recognised for them. Members responded by sharing the following:

a) If an amount relating to a performance incentive is to be recovered in the future, some entities would add this amount to the RAB while others did not. The inclusion or non-inclusion in the RAB by entities is driven by whether such amounts could be recovered during the current price-control period or not i.e. where recovery occurs at a future date in the current price-control period, an entity would recognise a regulatory asset, while an asset could not be recognised where the recovery of the amount would only occur in a different price-control period. These inconsistencies in practice therefore have an impact on comparability between companies even though they both would recover the amount in the future. The ultimate objective is to recover these performance incentives through revenue, with the RAB being temporarily used as an area where such amounts were kept until such a time that they could be recognised through revenue. The performance incentives do, however, earn returns while included in the RAB. [This comment appears to be explaining in a different way that items that go directly to RAB, under the current proposals are not permitted to be recognised as a regulatory asset or liability.]

b) A member commented that they are able to confidently calculate these performance incentive amounts. The challenge for this member, however, was that it was not yet determined whether there was an enforceable right on amounts in a subsequent price period when a mechanism had not been agreed with the regulator. It is unclear whether it is the licence that gives the right, or the agreement with the regulator. It was agreed that it will be important to gain clarity on the process, including the regulator's involvement.

45. The UKEB Secretariat will investigate the adjustment mechanisms, especially those passing through the RAB (including the Totex mechanism) and, with the assistance of members, prepare papers on a sample of adjustments.

IFRS 15 Revenue from Contracts with Customers Post-implementation Review (PIR)

46. The UKEB Secretariat noted that the slides included an overview of the IASB's post implementation review process, what the IASB heard during Phase 1 of the PIR i.e. no fatal flaws in the standard. The Secretariat invited general comments from members of cause for concern with the standard as a whole, the five-step revenue recognition model, the importance of retaining convergence with FASB Topic 606 and any of the nine topics that the IASB were looking to cover in its upcoming request for information (RFI)[7].

47. One user member had observed a number of issues in the technology sector and suggested further outreach in this might area be useful.

48. The UKEB Secretariat asked members to engage further after the meeting, if there were any other areas of the standard where guidance was unclear and needed to be changed.

ISSB Request for Information

49. The UKEB Secretariat provided an overview of the ISSB Request (RFI)[8] for Information and asked for the members to indicate their priority for the four proposed projects in the RFI with a show of hands. The members' unanimous view was that the ISSB should focus primarily on implementing current standards IFRS S1 and IFRS S2.

50. A member noted that as the ISSB standards were yet to be finalised the ISSB should not move onto other areas. The member also noted that the interaction between the new sustainability disclosure standards, accounting standards and EU ESRS standards was the priority area of work.

51. Members were invited to comment on the UKEB draft comment letter which was open for consultation until 23 July 2023.

AOB

52. No other business was noted, and the Chair closed the meeting.

53. The next meeting will take place on 22 September 2023.

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7 The IASB published its Request for Information on the Post-implementation review of IFRS 15 on 29 June 2023
8 Find more information about the RFI here.

END OF MEETING