UK Endorsement Board

Rate-regulated Activities—Update

Executive Summary

Project Type	Influencing
Project Scope	Significant

Purpose of the paper

The purpose of this paper is to:

- describe the feedback we have received to-date relating to the top-down approach; and
- set out the work the UKEB Secretariat plan to present to the Board over the next three months to further develop the top-down approach.

Summary of the Issue

The paper summarises the feedback on the top-down approach received to-date. It also sets out the key questions the UKEB Secretariat plan to address and present to the Board to help further develop the approach. These questions are:

- What is the difference between the top-down approach and the IASB's proposals?
- Do the assets and liabilities arising from the top-down approach meet the definitions of regulatory asset and/or regulatory liability as per IASB proposals?
- Does top-down approach meet recognition criteria in the IASB's proposals?
- Does the top-down approach meet the unit of account requirements in the IASB's proposals?
- What items comprise the difference between RCB and PPE?
- Can the timing differences reflected in RCB be tracked and monitored?
- Does the top-down approach meet the measurement requirements in the IASB's proposals?
- Does the top-down approach meet the disclosure requirements in the IASB's proposals? (This will include a discussion on the proposed requirement that an entity disclose the nature of unrecognised regulatory assets and unrecognised regulatory liabilities. There is no quantitative disclosure requirement.)
- Transition for the top-down approach.

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Decisions for the Board
• Do Board members agree that these are the right questions to be explored relating to the top-down approach? • Does the Board have any questions or comments on the timeline attached?
Recommendation
That the Board members agree with the questions to be explored and the timings suggested by the Secretariat.
Appendices
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Background

1. At the March 2024 meeting, the Board agreed that the Secretariat should continue to explore the top-down approach to the recognition of timing differences that are reflected in the regulatory capital base (RCB) for entities have no direct relationship between property, plant and equipment (PPE) and RCB. The purpose of this paper is to:

   a) describe the feedback received to-date relating to the top-down approach; and

   b) set out the work the UKEB Secretariat plan to present to the Board over the next three months to further the top-down approach.

IASB's proposals

2. Almost all UK rate-regulated entities have no direct relationship between PPE and RCB. The IASB's tentative decisions to-date are:

   a) **For entities with no direct relationship between its PPE and RCB** (called no direct relationship entities): prohibit the recognition of allowable expenses or performance incentives (penalties) that are timing differences and reflected in RCB. This is due to it being "…difficult and costly for entities to track the movement of individual items of allowable expense or performance incentives included in the regulatory capital base."[1] Preliminary estimates of the impact of this decision is that, for UK water entities only approximately 40% of the total timing differences arising would be recognised.

   b) **For all rate-regulated entities**: prohibit the recognition of inflation adjustments that are timing differences and reflected in RCB. This is because "… the costs arising from the recognition of that asset would outweigh the benefits of the information provided for users […]."[2] This issue generally affects only entities that use the real interest model. Almost all UK rate-regulated entities use a real interest model.

3. In 2023, the IASB undertook a survey on the direct (no direct) relationship. It found that the direct (no direct) relationship is "… an appropriate approach for determining whether differences in timing arise from the regulatory compensation an entity receives on its regulatory capital base in a variety of regulatory

1 Paragraph 23, IASB paper 9C, December 2022: https://www.ifrs.org/content/dam/ifrs/meetings/2022/december/iasb/ap9c-other-items-included-in-the-regulatory-capital-base.pdf

2 Paragraph 48, IASB paper 9A, December 2022: https://www.ifrs.org/content/dam/ifrs/meetings/2022/december/iasb/ap9a-inflation.pdf

schemes."[3] It found that approximately 50% of entities surveyed did not have a direct relationship. This means that the IASB acknowledge that 50% of entities in scope of the proposed standard will not be able to recognise timing differences reflected in RCB[4].

4. The current expectation is that the IASB's standard will be published during 2025. The IASB have very few topics left to redeliberate, as set out below:

   a) Minimum interest rates (to be discussed at IASB's April meeting).

   b) Interaction with other IFRS Accounting Standards.

   c) Amendments to other IFRS Accounting Standards.

   d) Effective date and transition.

5. As indicated to the UKEB at the March 2024 meeting, the UKEB Secretariat aims to further explore and develop the top-down approach between May–July 2024.

Feedback

6. The UKEB Secretariat is consulting with NSS and others.

   a) We have asked EFRAG's Consultative Forum of Standard Setters (CFSS) for comments on the papers that the UKEB discussed at its March 2024 meeting. At the time of writing (17 April 2024), we have not received any written comments. Verbal feedback is supportive but clear that others need to fully understand the IASB's proposals, the impact on their entities and whether the UKEB's approach would address any concerns arising. We think more concrete feedback should emerge by the time UKEB presents the top-down approach at the May 2024 meeting of EFRAG's RRA Working Group (RRAWG).

   b) The UKEB Secretariat has also asked for comments on the papers that the UKEB Board discussed at its March 2024 meeting from AFIAG members on conceptual issues and/or technical accounting issues. At the time of writing (17 April 2024), we have not received any comments.

7. The UEKB Technical Director, Seema Jamil-O'Neill, will be presenting an overview of the top-down approach at the April 2024 International Forum of Accounting

3 Page 19, IASB paper 9B, September 2023: https://www.ifrs.org/content/dam/ifrs/meetings/2023/september/iasb/ap9b-the-direct-no-direct-relationship-concept-report-on-findings-from-the-survey.pdf

4 Paragraphs 34–37, IASB paper 9A, October 2023 discusses the types of adjustments in RCB in the UK: https://www.ifrs.org/content/dam/ifrs/meetings/2023/october/iasb/ap9a-survey-on-the-direct-no-direct-relationship-concept-additional-feedback.pdf

Standard Setters (IFASS) conference. As that conference is taking place in parallel with the finalisation of the UKEB Board papers, a verbal update will be provided at the meeting.

8. We will update the Board when we have further feedback.

Exploring the top-down approach

9. Below is a set of questions, together with the estimated timing, that the Secretariat plans to analyse for Board discussion over the next three months.

	Question	Estimated meeting
1	What is the difference between the top-down approach and the IASB's proposals?	May 2024
2	Do the assets and liabilities arising from the top-down approach meet the definitions of regulatory asset and/or regulatory liability as per IASB proposals?	May 2024
3	Does top-down approach meet recognition criteria in the IASB's proposals?	May 2024
4	Does the top-down approach meet the unit of account requirements in the IASB's proposals?	May 2024
5	What are the items that comprise the difference between RCB and PPE?	May 2024
6	Can the timing differences reflected in RCB be tracked and monitored?	May 2024
7	Does the top-down approach meet the measurement requirements in the IASB's proposals?	June 2024
8	Does the top-down approach meet the disclosure requirements in the IASB's proposals? (This will include a discussion on the proposed requirement that an entity disclose the nature of unrecognised regulatory assets and unrecognised regulatory liabilities. There is no quantitative disclosure requirement.)	June 2024
9	Transition for the top-down approach.	July 2024

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Questions	
1.	Do Board members agree that these are the right questions to be explored relating to the top-down approach?
2.	Does the Board have any questions or comments on the timeline attached?