

Rate-Regulated Activities: Draft comment letter

Executive Summary

Project Type	Influencing
Project Scope	Significant
Purpose of the paper	
<p>The purpose of this paper is to:</p> <ol style="list-style-type: none"> 1. Obtain Board feedback on a draft comment letter on the IASB's ED <i>Regulatory Assets and Regulatory Liabilities</i>. 2. Request the Board's approval to publish the draft comment letter on the website for stakeholder consultation. 3. Request the Board's approval for the plan for the finalisation of the comment letter. 	
Summary of the Issue	
<p>This IASB ED seeks to develop an accounting standard that improves the usefulness and comparability of the financial statements of entities' that are subject to rate regulation. It was published on 28 January 2021 and the comment deadline is 30 July 2021. Exposure Draft <i>Regulatory Assets and Regulatory Liabilities</i>–The ED, Basis for Conclusions and Illustrative Examples can be accessed at the IFRS Foundation website.</p> <p>The UKEB Secretariat's work so far has indicated that UK stakeholders have concerns relating to certain aspects of the Exposure Draft. These concerns have been incorporated into the response.</p>	
Decisions for the Board	
<ol style="list-style-type: none"> 1. Does the Board have any comments on the responses in the draft comment letter? 2. Does the Board approve the draft comment letter for public consultation? 3. Does the Board agree with the plan for the finalisation of the comment letter? 	
Recommendation	
<p>We recommend the publication of the UKEB draft comment letter for stakeholder consultation for a two-week period ending on 26 July 2021.</p>	
Appendices	
Appendix 1	Sectors subject to economic regulation
Appendix 2	Draft Comment Letter: Exposure Draft <i>Regulatory Assets and Regulatory Liabilities</i>

Rate-Regulated Activities: Draft comment letter

Background

1. The IASB's Exposure Draft (ED) *Regulatory Assets and Regulatory Liabilities*¹ (IASB's ED) seeks to develop an accounting standard that improves the usefulness and comparability of the financial statements of entities' that are subject to rate regulation.
2. The IASB's ED was published on 28 January 2021 and the comment deadline is 30 July 2021.
3. This project aims to provide information to investors and users that supplements the existing information provided by explaining the effect a regulatory agreement has on the timing of revenue, profit and cash flows.
4. At its May 2021 meeting the UKEB approved a project initiation plan for the project to develop a comment letter on this IASB ED, permitting a curtailed outreach programme to ensure a timely response could be provided to the IASB.

Overview of UK regulation

5. There are over 90 regulators in the UK². However, there are only "...five regulators ... that are independent economic regulators, which promote competitive forces in industries which would otherwise be natural monopolies due to high network or infrastructure costs"³. They are:

Regulator	Estimated number of publicly listed companies regulated by them
The Office of Communications (Ofcom)	N/A ⁴
The Civil Aviation Authority (CAA)	–
The Office of Rail and Road (ORR)	2
The Water Services Regulation Authority (Ofwat)	11
The Office of Gas and Electricity Markets (Ofgem)	14

6. Only parts of the sectors that they regulate are covered by economic regulation (see Appendix 1). For example, in the electricity market, Ofgem regulates the generation, transmission, distribution and retail sectors. However, only transmission and distribution are subject to economic regulation. A description of economic regulation is set out below:

¹ The ED, Basis for Conclusions and Illustrative Examples can be accessed here: <https://www.ifrs.org/projects/work-plan/rate-regulated-activities/exposure-draft-and-comment-letters/#consultation>

² National Audit Office: "A Short Guide to Regulation", September 2017, page 4: <https://www.nao.org.uk/wp-content/uploads/2017/09/A-Short-Guide-to-Regulation.pdf>

³ National Audit Office: "A Short Guide to Regulation", September 2017, page 5.

⁴ Entities regulated by Ofcom are subject to regulation that does not take the form of economic regulation.

Economic regulation is intended to protect consumers from the adverse effects of companies having significant market power. Such regulation aims to simulate market outcomes while, at the same time, ensuring conditions for private sector provision, such as an adequate return on investment for efficient companies. Economic regulation is distinct from health and safety, environmental and other types of regulation to which all infrastructure activities are subject.

While the precise form of economic regulation varies by sector, the general approach has been to link prices to the required returns on investments made at a market cost of capital, commensurate with the risks involved, while at the same time incentivising progressively more efficient operations.

The aim of regulation is also to ensure necessary service quality levels to facilitate the appropriate level of investment required to secure supply and to ensure that prices to customers do not include abnormal returns to private sector providers.⁵

7. Other types of regulation, for example, a price cap, are also used. A price cap is a “form of regulation that limits the prices that can be charged on a volumetric basis. Companies regulated on a price cap basis might be therefore exposed to demand risk as prices are set based on forecast volumes and shortfalls are not necessarily adjusted or ‘trued up’ in following periods”⁶.
8. The IASB’s ED proposes that an entity which has a particular type of regulatory agreement, defined as “a set of enforceable rights and obligations that determine a regulated rate to be applied in contracts with customers”, is required to recognise all its regulatory assets and regulatory liabilities. To have this type of regulatory agreement the following conditions must exist:
 - a) an entity is party to a regulatory agreement;
 - b) the regulatory agreement determines the regulated rate the entity charges for the goods or services it supplies to customers; and
 - c) part of the total allowed compensation for goods or services supplied in one period is charged to customers through the regulated rates for goods or services supplied in a different period (past or future)⁷.
9. We consider that the scope of the IASB’s ED is most likely to encompass entities subject to economic regulation. Regulatory agreements that use price caps on the price that entities can charge customers for their goods or services, are not within the scope of these proposals if they do not give rise to:
 - a) rights to increase future rates because of goods or services already supplied; or
 - b) obligations to decrease future rates because of amounts already charged to customers.

Outreach

10. Since the 18 May UKEB meeting, the Secretariat has undertaken outreach activities by meeting with preparers, other National Standard Setters (NSS) and others to discuss the Exposure Draft. Further outreach meetings are arranged for July and will inform the

⁵ UK Regulated Infrastructure: An Investor Guide, UK Regulators Network, December 2014, pages 14 and 16: <https://www.ukrn.org.uk/wp-content/uploads/2018/06/Investor-guide.pdf>

⁶ UK Regulated Infrastructure: An Investor Guide, UK Regulators Network, December 2014, page 70.

⁷ IASB Exposure Draft, paragraphs 3–6.

final comment letter. In particular, we have arranged to meet with a credit ratings agency and are hoping to secure meetings with users.

Draft comment letter

11. The IASB's ED has 13 questions. At this stage, due to lack of evidence from outreach conducted so far, the draft comment letter does not respond to all the questions. Questions with no draft response relate to items that have not been identified as an issue in the UK.
12. The Secretariat intend to continue with outreach activities while the draft comment letter is out for consultation, with a view to updating responses to the questions, if appropriate.

Question for the Board	
13.	Does the Board have any comments on the responses in the draft comment letter?
14.	Does the Board approve the draft comment letter for consultation?

Next Steps

15. The closing date for submission to the IASB is 30 July 2021. The next UKEB meeting is 20 July and that is too close to this meeting to enable enough time for stakeholders to respond. Therefore, we recommend finalising the comment letter out of session, via a sub-committee of members including the Chair.
16. Assuming the Board agrees with the Secretariat's recommendations above, we propose the following timeline:

Date	Milestones
9 July – Board meeting	Approve draft comment letter
w/c 12 July	Publish draft comment letter (2-week comment period ending 26 July)
Public consultation period	14 July–26 July 2021 [~2 weeks]
w/c 26 July	Sub-committee to comment on, and approve final comment letter
30 July	Submit final comment letter to IASB
17 September – Board meeting	Approve Feedback statement

Question for the Board	
17.	Does the Board agree with the plan for the finalisation of the comment letter?