UKEB
UK Endorsement Board

Dr Andreas Barckow
Chair
International Accounting Standards Board
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Dear Dr Barckow

IASB Project: Regulatory Assets and Regulatory Liabilities

1. I am writing to you on behalf of the UK Endorsement Board (UKEB) in relation to the IASB's project on the development of a standard for entities subject to regulatory agreements that are capable of creating regulatory assets and regulatory liabilities.

2. The UKEB commends the IASB and its staff on their ongoing work on development of the standard. It is a much-needed standard on a topic where, as the IASB itself recognised, the existing accounting standards do not permit reporting the full effect of rate-regulated activities on current and future revenues, and associated assets and liabilities. As a result, there is significant diversity in accounting practice, both here in the UK and globally. In the UK this has led to a proliferation of alternative performance measures (APMs) by rate-regulated entities. Such entities currently produce APMs to help better explain their results, which are not otherwise easily understandable to investors and other users of their accounts.

3. We understand that the IASB set itself the objective, while developing this standard, of providing users with insights into how regulatory assets and regulatory liabilities will affect the amount, timing and uncertainty of the reporting entity's future cash flows. This required the development of a model that would reflect the total allowed compensation for goods and services supplied in a period as part of an entity's reported financial performance. Additionally, an entity would be required to recognise its regulatory assets and regulatory liabilities in its statement of financial position.

4. The IASB's initial tentative decision in December 2022, made in response to stakeholder feedback on the Exposure Draft, was to identify separately entities with a direct relationship and those with no direct relationship between their property, plant and equipment (PPE) and their regulatory capital base (RCB). We consider this a positive development; the different features of the regulatory regimes in individual jurisdictions mean that the IASB's objective of recognising total allowed compensation and related regulatory assets and liabilities may need

to be achieved in different ways for the types of regulatory regimes for the standard to be operational in practice.

5. However, the follow-on tentative decision – not to permit recognition of regulatory assets and regulatory liabilities for entities with no direct relationship between PPE and RCB – was made on the basis that a potential regulatory asset or regulatory liability met the recognition criteria but could not be tracked through a 'bottom-up' reconciliation between PPE and RCB. IASB's own survey[1] of stakeholders shows that approximately 50% of entities that responded to the survey and were within the scope of the standard concluded that there was a direct relationship between their PPE and their RCB. We acknowledge the challenges faced by the IASB but consider that there may be other ways to meet the IASB's original objective for such entities.

6. The nature of rate-regulation in the UK is incentive-based. Entities operating under incentive-based regulation that are within scope of this [draft] Standard typically have no direct relationship between their PPE and RCB. Consequently, applying the IASB's proposed approach to recognising regulatory assets and regulatory liabilities does not report the full extent of their financial performance and financial position. Examples of potential regulatory assets/liabilities that would not be recognised on the statement of financial position for such entities include:

   a) The difference between accounting and regulatory capitalisation of expenditure, including the capitalisation of interest;

   b) The difference between accounting and regulatory depreciation;

   c) Inflation adjustments included in the RCB[2]; and

   d) Any other incentive mechanism adjustment to RCB.

   As a result, the affected entities would need to continue to utilise APMs to facilitate investors' understanding of their financial information.

7. As you are aware, we asked the UKEB Secretariat to explore potential alternatives to the IASB's tentative decisions regarding its no direct relationship approach. Our Secretariat has developed the top-down approach to an initial concept level as one possible solution (see the attached Consolidated Report on the UKEB Secretariat's top-down approach ('the report')). Although the UKEB has had some preliminary

1 IASB Agenda Paper 9B – September 2023.

2 Excluding inflation for entities whose PPE and RCB have no direct relationship does not create parity between the two models. In the nominal rate model (cost-based regimes where entities' PPE and RCB would typically have a direct relationship) inflation is recovered in the period through revenue as the return on capital component in revenue is the nominal (real + inflation) return. In the real rate model (incentive-based regimes where entities' PPE and RCB would typically have no direct relationship) inflation is recovered through revenue in the future. The in-period return on capital component in revenue is only the real return.

discussions on this top-down approach and believes it is worth exploring further, the Board has not reached any conclusions on its viability.

8. Nonetheless, we consider that this approach is worth further consideration as one way for entities with no direct relationship between their PPE and RCB to fully reflect the entity's total allowed compensation for the period and recognise the related regulatory assets and regulatory liabilities on the statement of financial position.

9. This approach has been developed as a supplement to the IASB's existing approach for recognition of regulatory assets for entities with a direct relationship between their PPE and RCB. It aims to maintain consistency with the IASB's objectives for the new standard as well as concepts within the IFRS Foundation's Conceptual Framework for Financial Reporting.

10. However, we acknowledge that further work is necessary to develop fully the top-down approach and field test it with entities in the UK and in other jurisdictions. We would therefore encourage the IASB to consider this top-down approach further for possible inclusion in the standard at a suitable juncture.

Yours sincerely

Pauline Wallace
Chair
The UK Endorsement Board

Enclosed: Consolidated report on the UKEB Secretariat's top-down approach