UKEB
UK Endorsement Board

Meeting summary of the UKEB's Rate-regulated Activities Technical Advisory Group meeting held on 29 November 2024 from 11:00 until 14:00 (MS Teams meeting)

Item No.	Agenda Item
1	Welcome and apologies
2	Hybrid models
3	IFRS 3, past business combinations and impairment
4	Provisions – Targeted Improvements
5	Outstanding issues
6	AOB - Cash flow project

Present	
Name	**Designation**
Phil Aspin	Chair
Seema Jamil-O'Neill	Technical Director, UK Endorsement Board
Stefanie Voelz	Observer with speaking rights
Claire Howells	RRA TAG member
Will Gardner	RRA TAG member
Dean Lockhart	RRA TAG member
Sam Vaughan	RRA TAG member
James Sawyer	RRA TAG member

Present	
Name	**Designation**
Kelly Martin	RRA TAG member
Stuart Wills	RRA TAG member
Simon Davie	RRA TAG member
Suzanne Gallagher	RRA TAG member

Relevant UKEB Secretariat ('the Secretariat') team members were also present. Observers from the IASB and EFRAG project teams also attended.

Welcome and apologies

1. The Chair welcomed the members and observers.

Paper 2: Hybrid models

2. The Secretariat introduced the paper that included background information and an example to illustrate the following aspects:

   a) The existing nominal and real interest models used by regulators to determine the return on capital included in an entity's allowed revenue.

      i. The *nominal return on capital* includes compensation for inflation, allowing the entity to recover inflation immediately in revenue.

      ii. The *real return on capital*, which is currently used by all UK regulated entities, does not include inflation. Under the real model, regulators adjust an entity's regulatory capital base (RCB) for inflation which the entity recovers through the return of capital (regulatory depreciation), included in allowed revenue over an extended period – typically between 25 and 100 years.

   b) One UK regulator has proposed the use of a hybrid model, which attempts to match revenue more closely with finance costs on index-linked debt:

      i. The hybrid model would mean that a portion of an entity's RCB would be subject to a nominal return on capital with no indexation for inflation, while the other portion would be subject to a real return on capital with inflation indexation.

      ii. Earning a nominal return on some of its capital would allow entities to recover some inflation immediately in revenue. These entities may appear more competitive in the short term compared to

entities in the real model, impacting the fundamental qualitative characteristics and several enhancing characteristics in the *Conceptual Framework for Financial Reporting*.

3. During the discussion the following points were made:

   a) Members agreed that, in the UK, the application of the IASB's proposals may lead to a profile gap between the income statements of entities subject to the hybrid model and the income statements of entities subject to the real model.

   b) Members agreed that the paper reflects the conversations they are having with this regulator. They also confirmed that entities subject to the hybrid model will benefit from an enhanced earnings profile in the short term, but that this is offset by a lower growth in the RCB over the long-term.

   c) Several members commented that the regulator will start off with a notional model assuming all entities have around 30% index-linked debt regardless of actual levels of index-linked debt.

   d) A member noted that there are still some aspects of the model that has not yet been finalised, including the benchmark notional nominal/real ratio and whether derivatives will be taken into account in the regulator's decision on the specific ratio for each entity.

   e) Members discussed the regulator's approach to accelerate regulatory depreciation of gas networks, including the implications for meeting the requirements relating to performance obligations under IFRS 15 *Revenue from Contracts with Customers.* Members also noted that possible future impairment of property, plant and equipment, and changes to depreciation rates or methods to manage this risk.

Paper 3: Amendment to IFRS 3 *Business Combinations*, Past Business Combinations, and Impairment

4. The Secretariat introduced the paper which covered the following aspects:

   a) The IASB tentative decisions relating to the interaction with IFRS 3 *Business Combinations*, which is to exclude regulatory assets acquired and regulatory liabilities assumed in a business combination from fair value measurement for determining goodwill. The paper also noted stakeholder feedback that indicated a concern relating to possible double counting of regulatory assets individually and in goodwill.

   b) The IASB tentative decisions relating to transition and a Secretariat example on the proposed treatment of regulatory assets acquired and

regulatory liabilities assumed in past business combinations[1], including an analysis of the possible impact on subsequent impairment. The paper summarised stakeholder concerns regarding stripping out regulatory assets from a cash-generating unit (CGU) in an impairment review. Stakeholders are also concerned that adjusting retained earnings on transition for the effect of recognising regulatory assets or liabilities, with no adjustment to goodwill, may increase the risk of impairment of goodwill in the first year after transition.

5. During the discussion, the following points were made:

   a) On the interaction with IFRS 3, a concern was raised about the challenge with assessing the CGU within which a regulatory asset acquired in business combinations will sit and that it may result in 'orphaned' goodwill that remains in the CGU. Members agreed that the CGUs in these types of entities may be very large, which could lead to goodwill created by a regulatory asset in a business combination being shielded and never impaired.

   b) On the requirements relating to past business combinations, members generally agreed that separating the cash flows for short-term timing differences such as penalties and bonuses should not be too challenging.

   c) Regarding the impairment of a CGU, a member noted a concern with the amount used in stripping out the cash flows relating to a regulatory asset from a CGU, and whether the same amount should be removed from both the carrying amount and the recoverable amount. The IASB observer responded that the IASB did not consider it necessary to amend paragraph 43 and 79 of IAS 36 as this was considered not to be unique to this project and providing additional guidance would be inconsistent with other standards. The IASB observer went on to explain that, if national standard setters continue to have concerns with the risk of impairment of goodwill in the year after transition, IASB staff would need to understand the pervasiveness of this issue and would need evidence.

Paper 4: Provisions – Targeted Improvements

6. The Secretariat provided an overview of proposals being developed by the IASB to make targeted improvements to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets.*

7. As part of this project, the IASB is considering amendments:

[1] Refer to the IASB AP9E – July 2024.

a) to the definition of a liability, and the requirements and guidance for applying the present obligation recognition criterion using concepts from the *Conceptual Framework for Financial Reporting*;

b) to indicate more clearly the rate an entity uses to discount a long-term provision to its present value; and

c) to clarify which costs an entity must consider in measuring an obligation.

8. In relation to the proposed amendments to the recognition criteria, the group discussion mainly focused on the proposed requirements for 'threshold-triggered costs' (Exposure Draft paragraph 14P):

a) Members noted that certain emission trading schemes could be in scope as some of these schemes have links to specified targets.

b) The UK Electricity Generator Levy (EGL) could potentially be in scope. Concerns were raised as to the increased level of estimation uncertainty the threshold-triggered cost guidance could add to the EGL provision, if the proposed amendments resulted in earlier recognition. A question was also raised as to how the seasonality in electricity prices would be reflected in applying the proposed amendments.

c) Overall, it was noted that a detailed assessment was needed to fully understand the potential implication of the proposed amendments.

9. Members agreed with the IASB proposal to specify that an entity discounts a provision using a risk-free rate, with no adjustment for non-performance risk. They believed that this approach was common practice within the industry.

10. The Secretariat noted that a UKEB Draft Comment Letter is aimed to be presented for Board consideration at the December 2024 meeting and encouraged members to share feedback.

Paper 5: Outstanding issues

11. The Secretariat introduced the paper which contains the outstanding issues that remain a concern, some of which were discussed in the meeting. The paper also highlights areas of concern for other national standard setters.

12. A member asked how a new outcome adjustment mechanism, to be introduced by their regulator, will be accounted for under the IASB's proposed model. There is expected to be an extended time lag before the outcome of the adjustment mechanism (bonus or penalty amount) is known for an entity as it will be linked to the performance of the industry. The Secretariat noted that the IASB's tentative decision on recognition and measurement of performance incentives relating to benchmarks is likely to address this.

13. A member commented on the concerns relating to the application of the proposals on the unit of account in practice and the proposals requiring tracking of timing differences at individual asset level. The member asked that the paper should also include the concern about applying the proposals on unit of account at project level.

AOB

Cash Flow Statement project

14. The Secretariat asked whether members would be willing to engage with the UKEB's project team on the Cash Flows project. The UKEB Technical Director highlighted that there is particular interest in preparer and investor perspectives. The Chair also commented that feedback on cash flows relating to developers would be useful. Several preparer members and an observer expressed willingness to engage on this.

15. The next TAG meeting is scheduled for 27 March 2025.

16. There being no other business, the meeting ended.