UK Endorsement Board

Meeting summary of the UKEB's Rate-regulated Activities Technical Advisory Group meeting held on 27 June 2024 from 14h00 until 17h00

Item No.	Agenda Item
1	Welcome and apologies
2	Top-down approach: Verbal update
3	Discount rate and discounting estimated future cash flows
4	Items affecting the regulated rate only when cash is paid or received
5	Interaction with IFRS 3 *Business Combinations*
6	Interaction with IFRS 19 *Subsidiaries without Public Accountability: Disclosures* (catch-up ED)
3	Power Purchase Agreements
6	IASB tentative decisions
3	AOB – IASB request for preparer participants in planned fieldwork

Present	
Name	**Designation**
Phil Aspin	Chair
Seema Jamil-O'Neill	Technical Director, UK Endorsement Board
Claire Howells	RRA TAG member
Dean Lockhart	RRA TAG member (virtual)
Sam Vaughan	RRA TAG member (virtual)
Stefanie Voelz	RRA TAG member (virtual)

Present	
Name	**Designation**
Suzanne Gallagher	RRA TAG member
Will Gardner	RRA TAG member (virtual)
Stuart Wills	RRA TAG member
Simon Davie	RRA TAG member

Relevant UKEB Secretariat team members were also present. Observers from the IASB project team and EFRAG project team also attended the meeting virtually.

Welcome and apologies

1. The Chair welcomed the members and observers. Apologies were noted from Kelly Martin and James Sawyer.

Paper 2: Top-down approach: Verbal update

2. The UKEB Technical Director shared that the UKEB's work on the top-down approach had not been shared at the meeting as the UKEB was required to observe the pre-election sensitivity period. The next updates on the project were expected to be shared at the UKEB July Board meeting, which would be held after the UK general election. The papers will also be shared with the group once they are published.

Paper 3: Discount rate and discounting estimated future cash flows

3. The UKEB Secretariat introduced the paper which provided the background on the Exposure Draft (ED) proposals relating to the discount rate and discounting of future cash flows. It also set out the recommendations included in the UKEB's final comment letter and the IASB's tentative decisions made at its March 2024 and April 2024 meetings. The paper also included an analysis of the real and nominal interest models and how discounting might be done under the different models. Members' views were sought on the questions in the paper.

Discounting estimated future cash flows

4. Members generally agreed that discounting estimated future cash flows is appropriate. In the discussion that followed:

   a) some members noted that they were unsure how the proposals will be applied in practice as entities would need clarification on whether they need to discount using the nominal rate or the real rate depending on what their respective starting points are.

b) other members highlighted that including examples in the proposed standard would be useful in addressing this concern.

c) Members agreed that the WACC is an appropriate discount rate to be used in discounting estimated future cash flows.

d) On the question of whether the proposed standard would explicitly state that the WACC is the appropriate rate to be used, the IASB observer clarified that the ED requires an entity to determine the regulatory interest rate that the regulatory agreement provides for specific differences in timing only. In certain cases, in practice, the regulator provides in the regulatory agreement a WACC for differences in timing that arise but would either provide a lower or no WACC for differences in timing that are reversed within a few years. It therefore stands that it is an entity's regulatory agreement which determines which rate to apply in discounting cash flows and the WACC is a default rate for all entities.

e) Other members noted that, in the UK, regulators use the WACC, and any adjustments to future cash flows are made by applying the WACC. The IASB observer agreed that, for short term timing differences, the regulator would not provide a regulatory interest rate as the WACC provided in the regulatory agreement is assumed to be sufficient. These types of agreements are common in Europe. Where the regulator does not apply the WACC, an entity will then have to apply the minimum interest rate proposals in determining an appropriate rate to use in discounting future cash flows. This is will be clarified in the final standard.

5. A member asked whether examples will be included in the proposed standard to assist with the application of this requirement and whether it will apply to agreements with a nominal rate and those with a real rate? The IASB staff member responded that the IASB had decided at it April 2024 meeting to include guidance using existing principles in IFRS standards related to discount rates such as the incremental borrowing rate techniques in IFRS 16 *Leases*.

Exemption from discounting

6. A member agreed with the appropriateness of providing the exemption from discounting, as proposed by the IASB.

7. Another member shared that the threshold to apply the exemption being 12 months or less may not be met in the UK as the adjustments to the regulated rates that entities can charge is usually known at least 15 months in advance.

Uneven regulatory interest rate

8. A member from the energy sector said the entity-specific WACC is updated annually for UK energy entities but that the updated rates are not known in advance. So, they do not expect to estimate a single discount rate but would

account for changes in the rates in accordance with the ED proposals when the rate changes take place.

9. Another member noted that in the energy sector there are instances where a specific project will have a separate regulatory capital base (RCB) for a period of time until it is complete. During this time, this separate RCB will have a different discount rate applied to it. However, once the project is completed, it is combined with the larger overall RCB and the WACC specified in the regulatory agreement is applied to it.

10. Members were generally supportive of the IASB's tentative decisions on discounting.

Discounting of future cash flows – Minimum interest rate

11. Members were of the view that in most cases the WACC stipulated in the regulatory agreement is sufficient to compensate entities for the time value of money.

12. Another member questioned what would happen to the interest rate in times of uncertainty or when an entity is distressed, as this could potentially be an area of difficulty.

13. Another member noted that since the objective of the proposed standard is economics, could entities be permitted to use their incremental borrowing rates similar to that prescribed in IFRS 16 *Leases* to address the issue of uncertainty. This member further questioned whether the proposed standard could state that if an entity assumed its WACC is materially different from the actual cost of borrowing then the actual cost of borrowing should be used by entities instead. This could be an exception for entities that are either distressed or overperforming.

14. The IASB observer clarified that the minimum interest rate requirements are not intended to challenge whether the regulator is providing a sufficient or insufficient WACC. Instead, it is intended to test what rate an entity should have received to compensate for the time value of money and uncertainties for these shorter time periods. A user member noted that the information resulting from the requirement to adjust the discount rate to the minimum interest rate might not be considered useful information. When entities are in stress the cost of capital usually increases and adjusting the discount rate will typically result in future regulatory liabilities being discounted at a higher discount rate. In turn, this will result in a reduced liability than would be reflected in future cashflows.

Real vs nominal interest rate approaches

15. Members agreed that currently all UK regulatory agreements operate under a real interest model.

16. One member commented that the UK energy regulator is currently consulting on various options of how to deal with this in future price control periods, including the possibility of moving to a nominal interest approach.

17. There was a question on whether the real and nominal interest models will reduce comparability, and why this was of significant importance? It was clarified that the UKEB is required to consider comparability as part of the statutory assessment of whether to endorse a standard for use in the UK. In that context, comparability is a key technical assessment criteria as it allows investors to access and compare financial information produced by companies within and across industries which therefore and understand the outcomes. Investors' ability to compare and understand company results is key to efficient capital allocation decisions.

Paper 4: Items affecting the regulated rate only when cash is paid or received

18. The Secretariat presented the background to the ED proposals, final UKEB comment letter and the IASB's tentative decisions on the topic and sought members' views on the tentative decisions.

19. A member noted that the energy regulator is currently consulting on cash flow allowances for capital expenditure (Capex) and is looking to possibly change the timing at which the tariffs for Capex are allowed i.e. allowing the tariff changes to occur in-period instead of at a later stage. This would therefore have an impact on the cash flow allowances that entities are given. Although this has not been finalised by the regulator, there is a potential risk that cash flows may be different from what entities had initially anticipated.

20. Another member said it will be important to determine the potential deferred tax impact of this tentative decision and requested that members assist the UKEB Secretariat to better understand these potential consequences.

Paper 5: Interaction with IFRS 3 *Business Combinations*

21. The Secretariat presented the background to the ED proposals, final UKEB comment letter and the IASB's tentative decisions on the topic and sought members views on the tentative decisions.

22. A member provided clarification that the PPE is not typically revalued as a multiple of RAB during an acquisition. Instead, the RAB to PPE multiple is only used as a market cross-check of the fair value of PPE, after the fair valuing exercise has been completed.

23. Members agreed with the assessment that the remeasurement to fair value of the net assets in a business combination will not affect the individual entity accounts and that licenses typically remain unaffected after a business combination. The only exception noted were for some water companies, where the licenses were merged as a result of the acquisition.

24. A user member shared that while the licenses were merged for some water companies as a result of acquisitions, there are no fair value adjustments made to the RCB.

25. Another member commented on the example by noting that, in practice, there would be less of a difference in fair value between PPE and RCB for entities that have a direct relationship compared to entities with no direct relationship. This is because these amounts are already much closer to each other for entities with a direct relationship.

26. By reference to the example, the TAG considered the question of, whether the proposed standard will lead to different amounts of goodwill being recognised for identical fact patterns under a direct approach or no direct approach. There was general consensus that the differences highlighted in the example were expected to arise in practice.

27. Regarding the fair value of PPE arising on a business combination, the TAG members considered whether the PPE would be impaired at year end as there might be no recovery of benefits beyond the RCB value? Members confirmed that this may lead to impairment of the PPE.

Paper 6: Interaction with IFRS 19 *Subsidiaries without Public Accountability: Disclosures* (catch-up ED)

28. UKEB staff introduced a brief summary on IFRS 19 *Subsidiaries without Public Accountability: Disclosures* including the scope of the standard. In the following discussions, RRA TAG members made the following points:

    a) On the scope of IFRS 19, they confirmed that unlisted subsidiaries that have regulatory assets and regulatory liabilities might not have public accountability and therefore would be eligible to use IFRS 19. However, they noted that subsidiaries using FRS 101 are unlikely to switch to IFRS 19.

    b) Members supported developing reduced disclosures at the same time as the forthcoming IFRS Accounting Standard *Regulatory Assets and Regulatory Liabilities* is issued. However, if that not feasible ie due to timing issue, reduced disclosures should be developed by the effective date of the forthcoming standard.

Paper 7: Power Purchase Agreements (PPAs)

29. UKEB staff introduced a brief summary of the IASB Exposure Draft (ED) and highlighted the main aspects of the UKEB Draft Comment Letter (DCL). In the following discussions, RRA TAG members made the following points:

a) One member highlighted concern at introducing a specific carve out just for renewables, which did not sit comfortably with the principle of IFRS that it is uniformly applicable.

b) Members confirmed that they had a mix of contracts, including some physical PPAs where they do not have a problem meeting 'own use' currently, and some contracts which are currently measured at fair value.

c) Members raised the complexity of arrangements - for example a tripartite arrangement involving one physical contract, and one virtual 'shaping' contract.

d) One member noted the complexity in this area and reflected that there seemed to be an effort being made to justify not fair valuing these contracts, but wondered whether there was a risk of overcomplicating this, and that there may be a point where these contracts need to be fair valued, and that clarity would be welcomed.

e) It was noted that fair valuing of these contracts is not necessarily simple, due to the lack of observable prices beyond 2-3 years.

f) Members had limited interest in the hedge accounting proposals, and indicated they would be likely to live with any income statement volatility.

g) On disclosures, concern was expressed at the challenges of determining the average market price for a multinational. It was also noted that there were already a number of disclosure requirements that may apply - e.g. IFRS 13 and IFRS 15 disclosure requirements, and that these proposals added potentially quite a lot of additional information, which may include a lot of commercially sensitive information, or be significant in volume where an entity is party to a lot of contracts.

Paper 8: IASB tentative decisions

30. The Secretariat introduced the paper and provided the background on the proposals of the ED, the UKEB's final comment letter and the IASB's tentative decisions on: Interaction with IAS 12 *Income Tax*; amendments to IFRS 5 *Non-current assets held for sale and Discontinued Operations;* amendments to IAS 8 *Accounting policies, Changes in Accounting Estimates and Errors* and suggested amendments to other IFRSs; and scope—Interaction with IFRS 17 *Insurance Contracts.* No comments were received on the above tentative decisions.

Topics tracker

31. A member asked about the transition requirements for the new standard. It was noted that the IASB is expected to discuss this at its July 2024 meeting.

AOB – Field testing request

32. An IASB request for UK entities to participate in the field testing of the IASB proposed standard was highlighted to members. They were asked to inform the Secretariat via email if they were interested in participating in the field testing .

33. The Secretariat committed to sharing details in relation to expected timelines and time commitments via email to enable members to decide on whether they would have capacity to participate.

34. The Chair thanked members and observers for their contributions and reminded the group that the next meeting is on 20 September 2024.

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