UKEB
UK Endorsement Board

Rate-regulated Activities Technical Advisory Group:

Meeting summary - Meeting held on 22 September 2023 (in-person with option to attend virtually)

Item No.	Agenda Item
1.	**Welcome**
2.	**IASB tentative decisions**
3.	**Regulatory adjustments**
4.	**Direct (no direct) relationship concept: Summary of feedback from interviews**
5.	**Topics Tracker Document**
6.	**Application of the 'own use' exception to some power purchase agreements**
7.	**AOB**

Present	
Name	**Designation**
Phil Aspin	RRA TAG Chair
Simon Davie	RRA TAG Member
William Gardiner	RRA TAG Member
Claire Howells	RRA TAG Member
Kelly Martin	RRA TAG Member

Present	
Name	**Designation**
James Sawyer	RRA TAG Member
Samuel Vaughan	RRA TAG Member
Stefanie Voelz	RRA TAG Member
Dean Lockhart	RRA TAG Member
Suzanne Gallagher	RRA TAG Member
Stuart Wills (virtual attendance)	RRA TAG Member
Robin Cohen (virtual attendance)	UKEB Board member
IASB staff	Observers
EFRAG staff	Observers

Relevant UKEB Secretariat team members were also present.

Welcome and Introduction

1. The Chair welcomed members to the meeting.

Agenda Paper 2: IASB tentative decisions

Overview of the IASB's tentative decisions

2. The UKEB Secretariat updated members on the IASB tentative decisions made after the June 2023[1] RRA TAG meeting, which related to estimating uncertain future cash flows.

[1] Refer here for the IASB's meeting summary for June 2023.

Member views and discussions

3. Members broadly agreed that both methods of estimating uncertain future cash flows—the 'most likely amount' method or the 'expected value' method—where the entity picks the method by choosing which would better predict the cash flows - appear reasonable. It was noted that this accounting treatment is consistent with the methods in IFRIC 23 *Uncertainty over Income Tax Treatments* and the approach taken in IFRS 15 *Revenue from Contracts with Customers.*

4. A member stated that the choice of the two methods may lead to less prudent (more aggressive) entities to push a particular agenda but that it would be up to the auditors to assess the judgements made.

5. Another member stated that the most likely amount could put tension on commercial sensitivities, particularly in cases where there was a determination or appeal with the regulator which may have two possible outcomes.

6. Members were in agreement with the IASB's tentative decision to not provide additional guidance on the circumstances under which either method could be used. Members' views are that the approach is well-established in other standards and that additional guidance or examples may prevent entities from using their own judgement and may create confusion.

7. This group is generally satisfied with the IASB's tentative decisions relating to estimating uncertain future cash flows.

Agenda Paper 3: Regulatory Adjustments

Background to paper and appendices

8. The UKEB Secretariat introduced Paper 3, explaining that the purpose of the paper and its appendices was to allow the members to discuss some of the regulatory adjustments that form part of total allowed compensation (TAC). The adjustments covered in the appendices were:

   a) Appendix A: Total expenditure (Totex) adjustment mechanism.

   b) Appendix B: Outcome Delivery Incentive (ODI) – Sewer collapses.

   c) Appendix C: Traffic Risk Sharing (TRS) mechanism.

9. Members' views were invited on whether the papers accurately reflected these adjustments as it is important to have a robust description of the adjustments and how the current IASB model would work.

10. The Chair emphasised that the implication of direct (no direct) relationship concept for UK regulated entities, since they have no direct relationship, is that entities would not be permitted to recognise material regulatory assets and

regulatory liabilities for those adjustments that pass through the regulatory capital base (RCB). He mentioned that, in the water sector, there are more than 20 ex-post adjustments, including the Totex adjustment, and that many of these passes through the RCB. The Totex adjustment consists of both operational expenditure (Opex) and capital expenditure (Capex).

Agenda Paper 3 Appendix A: Total Expenditure (Totex) Mechanism

Introduction

11. The UKEB Secretariat briefly introduced Appendix A and the example of the Totex Adjustment subject to Standard Sharing Rates included in this paper. The example shows that a portion of the overspend is allocated directly to TAC (and the regulated rate). The portion passing through the RCB does not get added directly to TAC but is included in TAC (and the regulated rate) through the cost of capital (return on the RCB) adjustment and the regulatory depreciation adjustment to the RCB. This seems to meet the definition of a regulatory asset or regulatory liability. The Chair confirmed that this was a good articulation of how the adjustment works and invited comments from the members.

Member views and discussions

12. A member said that the current proposed IASB model only addressed how the unwind would work for the direct relationship, which was quite problematic. For no direct relationship models, some information (being the return allocated to the RCB) about revenue generation would be off balance sheet. They had not tested whether this was the right answer, or if it was, whether there was another way to address it.

13. A member confirmed that the paper accurately reflected the Totex adjustment in the electricity industry. The Chairman said the example was a good articulation of what had happened in terms of adjustments. He explained that the revenue adjustments were related to the next five-year price control, whereas adjustments going through a regulatory capital base were articulated through regulatory depreciation. The entity also earned a return on the amount in the RCB that had not yet been depreciated.

14. The Group discussed the issues of the split between Opex and Capex that ended up in the Totex over- or underspend and that the IASB's proposals may lead to large amounts being left off the balance sheet. Members also noted that consideration should be given to the timing of the Totex spend throughout the price-control period. For example, usually the regulator would consider an arbitrary split between opex and capex, say 70% is capex and 30% opex. This could mean booking assets and revenue, while not having incurred the economic costs through the income statement yet. The example therefore needed to be built to include opex and capex over- and underspends.

15. It was agreed that the UKEB Secretariat will expand the Totex example in Appendix A to include more than one period and to also include opex and capex adjustments.

16. The UKEB Secretariat questioned how the amounts are treated across the five-year price control period and what would happen to projects running beyond the price control period. A member confirmed that the regulatory performance reporting was updated annually for energy and water. Another member stated that timing differences in spending is usually expected to unwind over the price control period but that sometimes the spend would straddle two price control periods.

17. Another member questioned what would happen if there was an underspend which continued right up to the end of the price control period, and whether it was rolled forward or lost. Another member responded and said that it was nuanced, and the allowance did not matter as long as the outcomes had been delivered. Any underspend was not rolled forward. Underspend was treated as a gain to be shared 50% between customers and the entity, but there was still an obligation to complete the asset.

18. A member stated that this is a boundary question. It is important to address whether cash flows beyond the price control period should be considered for a regulatory asset or regulatory liability. The member also stated that there could be a further unit of account issue here to consider. Should one go down to the project level to consider regulatory assets and regulatory liabilities or should one assess the regulatory agreement as a whole, whereby the under- or overspend on different projects are effectively netted off.

19. The Chair stated that, from a regulatory perspective, there is netting off within the regulatory agreement. The UKEB Secretariat responded by saying that this may not necessarily be the case for the accounting.

20. A member commented that there may also be different rates of return on different projects. This again raises the issue of unit of account which is a topic for future discussion.

21. A member and the UKEB Secretariat both asked whether a return of the cost of capital would be recognised as a regulatory asset. The member mentioned that it seems the IASB has not discussed this. The Chair commented that there would probably be a higher cash flow in future and that it would be discounted back, so no extra amount would be recognised for this.

22. The UKEB Secretariat commented that their understanding was that this would not be recognised in the absence of a direct relationship between the entity's PPE and the RCB. This understanding was confirmed by various members. An Observer commented that their understanding was that the higher cost of capital (due to the uplift of the RCB for the amount of overspend) will be received in the regulated rate in the following year and that it could be recognised as a regulatory asset.

They also stated that this issue is not related to the direct (no direct) relationship concept.

23. A few members stated that this surprised them and that they were of the opinion that the paper on Totex was correct in stipulating that these amounts would not be recognised in the absence of a direct relationship. One member stated that it did not seem appropriate to recognise a “short term” asset and not the “long term” asset. The Chair observed that this was a subtlety. The regulator would look at the overspend of the previous five-year price control period and what the regulatory depreciation and the cost of capital would have been. The mechanism was part of the next price control period and therefore an asset or liability rather than another kind of adjustment.

24. The Chair observed that if for example an entity planned to spend 100 units each year for five years, and spent 110 in each year, five units of which were recovered back, this would effectively have some depreciation and return on capital in the current five-year period. The paper was looking at what the depreciation and return on capital would be going forward. A further component was the cost incurred to that point. It was not clear whether this was rolled up into the amount or not. A member noted that there would be more justification to recognise the full recoverable value than an arbitrary amount of depreciation within a set price control window.

25. An observer noted that this was a good summary. In some cases, an overspend is recovered directly in the allowed revenue of the next year, while in others it would go through rates over time, as a component of the regulatory depreciation of the RCB. An entity could track and account for the overspend but amounts going to the RCB an entity could not track, and therefore no regulatory asset or regulatory liability was recognised.

26. The UKEB Secretariat noted that it came down to what items could be tracked or not.

27. The Chair observed that there was compensation for the time value of money and in the rate of return on the overspend and depreciation in the period just ended, to be recovered in the next period. The amounts in Appendix A are the depreciation and the return on the RCB asset being booked, while it is not the same as the retrospective adjustment for having spent more money over five years – a cost of capital compensation and a possible depreciation component.

28. A UKEB Board member observed that this was not a clear distinction between the TAC in the next period and that stored up for subsequent periods. The Board member also stated that it was arbitrary to allow recognition of the amounts for the next five years but not those in later periods and that the point of the RCB was that it is a promise of the money that would be collected over time. The Chair agreed that there is a subtlety here but that had the overspend been factored into

the budget for the period when the overspend was incurred, effectively this looked at what revenue and RCV would have been based on.

29. A member stated that they struggled to understand how this would be accounted for and what it looks like over time. The UKEB Secretariat confirmed that a multi-year example will be brought to the Group's meeting in December 2023 and that, for the sake of simplicity, the example is likely to cover a three-year price control period and also two or three consecutive price control periods. The Chair responded that it would have been received through revenue, return on the RCB and regulatory depreciation and that more detailed examples are needed and that it would be important that the UKEB Secretariat test some of the assumptions with members ahead of the December 2023 meeting.

30. The UKEB Secretariat observed that the main purpose of discussing these issues is to build up an example that everyone will understand.

Agenda Paper 3 Appendix B: Performance Incentives – Sewer Blockages

31. The Chair noted that Appendix C covers the Traffic Risk Sharing (TRS) mechanism and that this is similar to the Totex mechanism in Appendix A.

32. A member observed that the time lag varied on different performance incentives. The Chair confirmed that, although the example in Appendix B assumes the incentive is received in the following year, in practice, the time lag was nearly two years.

Agenda Paper 3 Appendix C: Traffic Risk Sharing (TRS) Mechanism

33. A member stated that the adjustment in Appendix A has a notional split between "fast" money and "slow" money, whilst the adjustment in Appendix C is purely related to the timing of the adjustment. He was not challenging the accuracy of the paper but wanted to tease out the difference between the TRS mechanism and the Totex mechanism (in Appendix A).

34. Another member commented that the air traffic control entity was already recognising revenues that were earned but not yet collected. This entity recognised it in working capital, which forms part of the RCB of the entity.

Agenda Paper 4: Direct (no direct) relationship concept: Summary of feedback from interviews

35. The UKEB Secretariat presented a paper on feedback received from 1-2-1 engagement with stakeholders (regulators, preparers, users) on the direct (no direct) relationship. On balance, interviewees suggested that:

    a) Recognising regulatory assets/liabilities arising from "slow money" would provide a better reflection of the underlying economics and would be relevant to generalist investors.

b) Estimation of regulatory assets/liabilities arising from slow money is possible.

c) A reconciliation of regulatory assets/liabilities with IFRS reported figures would potentially be possible but laborious to obtain.

36. The UKEB Secretariat asked three questions to the TAG. These are discussed below together with feedback from TAG members.

37. The UKEB Secretariat asked whether it would be economically meaningful to recognise assets/liabilities from slow money. TAG members responded that:

a) It would be desirable to have regulatory assets/liabilities arising from slow money as this would improve information for users of accounts, especially generalist ones, for example, in terms of timing differences and performance penalties which are only partly represented in IFRS revenues.

b) Without recognising "slow money", there would be a 'blended' approach in the financial statements such that some amounts are based on accrual accounting and some amounts are based on cash accounting. The balance of each of these amounts would vary purely on where a company is in their price control period

c) Inflation adjustments are material and therefore should in principle be recognised.

d) Disclosures may better clarify how regulatory assets arising from slow money are calculated.

38. The UKEB Secretariat asked whether it would be possible to reconcile regulatory assets arising from slow money and IFRS accounts. TAG members responded that:

a) It would be possible for prospective adjustments; however, it would be impossible to disentangle the components of an already existing RCB,

b) Because of how Totex mechanisms are designed, amounts recognised in the RCB would therefore not necessarily represent the cost of assets being built. PPE will therefore be always different to RCB, making reconciliation difficult or not possible.

c) Some TAG members suggested that instead of a full retrospective reconciliation a top-down approach could be followed.

39. The UKEB Secretariat asked whether recognition of regulatory assets arising from slow money may lead to double counting. TAG members responded that:

a) There may be risk of double-counting when unwinding regulatory assets over multiple years.

b) In the absence of a full reconciliation between RCB and PPE double counting could be a risk.

Agenda Paper 5: Topics Tracker Document

40. A member stated that the unit of account is a topic that should be discussed by the Group (also taking into account the timing of the IASB redeliberating the topic) as it is something that needs to be explored further. Another member stated that within the entity there could be different sharing mechanisms for different products and services such as water or wastewater disposal. This could lead to two different models in the same bill. The UKEB Secretariat confirmed that it has been included in the topics tracker for future discussions.

41. The UKEB Secretariat will investigate the unit of account and prepare a paper for discussion at the next RRA TAG meeting.

42. There were implications in these adjustments for inflation which were probably even more challenging than this topic. Inflation continued to be a big component of these businesses especially in recent months.

43. The topics tracker was not discussed by the Group but the members were in agreement that the papers suggested for the Group's meeting in December 2023 are top priority. These are:

a) Totex – a multi-year example illustrating the unwinding of the adjustments involving both capex and opex.

b) Unit of account.

c) Inflation.

Agenda Paper 6: Application of the 'own use' exception to some physical power purchase agreements

44. The UKEB Secretariat noted that, in June 2023, the IFRS Interpretations Committee (the Committee) referred[2] a request to the IASB about the application of IFRS 9 *Financial Instruments* paragraphs 2.4 to 2.6 (the "own use" exception) to certain physical power purchase agreements (PPAs). The own use exception, broadly, enables entities to avoid derivatives accounting for such agreements.

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[2] See IFRIC Update June 2023. See also Staff Paper Agenda Reference 2 which summarises the IFRIC initial considerations and paragraph 85 includes the recommendation and rationale. The fact patterns submitted were summarised in the UKEB April 2023 IASB General Update Appendix 8H.

45. Following the Committee's referral, in July the IASB tentatively decided to add[3] a research project on this topic to its workplan. The IASB's research will focus not only on the application of the own-use exception to physical PPAs, but it will also consider the hedge accounting requirements using a virtual PPA as the hedging instrument.

46. Members considered that, in the UK, PPAs were increasingly prevalent in the electricity industry. The UKEB Secretariat requested members assistance in understanding the use of PPAs in the UK.

AOB

47. The UKEB Secretariat thanked members for their assistance towards finding a way forward. They added that IASB Staff has asked them to consider how regulatory adjustments under a no direct relationship model could be tracked and monitored. This means that there is further work to be done by the UKEB Secretariat and the members.

48. There being no other AOB, the Chair closed the meeting at 13h00.

END OF MEETING

[3] See IASB Update July 2023 and IASB July 2023 Agenda Paper 12.