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*Submitted electronically through the IFRS Foundation website (www.ifrs.org)*

30 July 2021

Dear Dr Barckow,

**Invitation to comment on Exposure Draft ED/2021/1 *Regulatory Assets and Regulatory Liabilities***

I am pleased to provide a response on behalf of United Utilities Group PLC ('UUG') to the invitation to comment on the proposals set out in in Exposure Draft ED/2021/1 *Regulatory Assets and Regulatory Liabilities.*

UUG is the UK's largest listed water and wastewater company. Our purpose is to provide great water and more for the North West, with our core activities being the delivery of essential water and wastewater services for household and business customers across the North West of England.

Customers in England and Wales are served by 10 large licensed water and wastewater companies and smaller companies providing water-only services. Our regulated entity, United Utilities Water Limited, is the second largest, based on the size of our Regulatory Capital Value (RCV), which represents the value of accumulated investment in the company's asset base. We serve over seven million people, with over three million household customers and over 200,000 business customers. In the business marketplace, we provide wholesale services to water retailers who manage the end customer relationship.

As a monopoly provider of essential services, we are regulated by various bodies. We have been granted a 25-year rolling licence to operate by The Water Services Regulation Authority ('Ofwat'), which acts as the industry's economic regulator. Ofwat sets the price, service and incentive package that companies must deliver in five-year periods, known as Asset Management Plan periods (AMPs), and determines the level of remuneration that companies will receive for the delivery of this essential service through amounts charged to customers.

As both a rate-regulated entity and an organisation that prides itself on high quality and reliable corporate reporting that enables all interested stakeholders to make an informed assessment of our company's financial performance and position, we welcome this opportunity to provide input into the IASB's work in this area.

Overall, we support the proposals set out in the Exposure Draft. We consider that the proposed model addresses a significant gap in current IFRS reporting requirements between the economic substance of arrangements under which entities subject to rate regulation operate and their reported financial performance and position; by reflecting regulatory assets and regulatory liabilities in their financial statements, entities subject to rate regulation should be able to present a more complete depiction, thus providing useful information to users. Furthermore, we consider the supplementary nature of the proposals to be sensible and that they would not undermine or compromise application of existing standards.

Our principal comments are summarised below with details set out in the appendix to this letter.

1. We do not consider that the component of total allowed compensation associated with a return on specific assets that are not yet in use should be deferred until the assets come into use, as this approach would not conceptually reflect the economic substance of the business model. This return is a component of the overall regulatory return calculated by applying a rate of return to a regulatory capital base and is not contingent on specific assets becoming operational. In addition, as the regulatory business model does not track expenditure on an asset-by-asset basis, the application of the standard as drafted would likely lead to unreliable information with significant judgement needing to be exercised to determine the element of return to be deferred. Furthermore, the associated complexity of creating and tracking such information would likely lead to significant challenges for the standard in passing a cost benefit assessment.

2. As currently drafted, we consider that there is a risk that the scope of the proposed standard could be unintentionally broader than anticipated in terms of the entities for whom it would be applicable. We recommend that the scope be clarified by making it more explicit that the regulatory agreement refers only to certain kinds of economic regulation, and that the regulatory agreement is between an entity and an independent third party body (i.e. a regulator). We also believe that specifically excluding certain types of contracts and agreements, such as service concession arrangements, would be appropriate. While we believe that UUG would be firmly within the scope of the proposals, we are aware that stakeholders more generally would welcome additional clarity on the points noted.

3. We believe that further clarity is required as to how the boundary of the regulatory agreement, i.e. the period of time over which regulatory assets and regulatory liabilities can be recovered, should be defined, and therefore how the measurement criteria within the proposals should be implemented. We do not consider the proposals to be sufficiently clear in terms of whether the boundary should be strictly applied as being the end of a price control period, the end of the licence period, or beyond the end of the licence period where there is a reasonable expectation of compensation should the licence terminate. We believe the latter approach to be the most appropriate in terms of enabling entities to present the most complete depiction of the effects of their regulatory agreement and would welcome additional clarity on this point.

4. The proposed model for discounting could be simplified in a way that benefits both preparers and users without any material compromise on the usefulness of information provided in the financial statements. For example, a rebuttable presumption that the regulatory interest rate is an appropriate discount rate for both regulatory assets and regulatory liabilities would reduce the burden on preparers of making an assessment over the sufficiency of the discount rate at each reporting period except in rare cases where specific circumstances indicate that this is not appropriate. We would also question whether different criteria for discounting regulatory assets and regulatory liabilities adds to the usefulness of financial information in any material way, and therefore consider that this could be simplified by requiring the same rate to be applied to both assets and liabilities.

We hope that you find the points raised in our letter helpful, and would welcome the opportunity to discuss our thoughts further and provide additional input as required.

Yours faithfully,

**Phil Aspin**
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***United Utilities Group PLC***

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## APPENDIX

| Question 1: Objective and scope |
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| Paragraph 1 of the Exposure Draft sets out the proposed objective: an entity should provide relevant information that faithfully represents how regulatory income and regulatory expense affect the entity's financial performance, and how regulatory assets and regulatory liabilities affect its financial position. Paragraph 3 of the Exposure Draft proposes that an entity apply the [draft] Standard to all its regulatory assets and all its regulatory liabilities. Regulatory assets and regulatory liabilities are created by a regulatory agreement that determines the regulated rate in such a way that 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).[1] The [draft] Standard would not apply to any other rights or obligations created by the regulatory agreement—an entity would continue to apply other IFRS Standards in accounting for the effects of those other rights or obligations.<br><br>Paragraphs BC78–BC86 of the Basis for Conclusions describe the reasoning behind the Board's proposals. They also explain why the Exposure Draft does not restrict the scope of the proposed requirements to apply only to regulatory agreements with a particular legal form or only to those enforced by a regulator with particular attributes.<br><br>a) Do you agree with the objective of the Exposure Draft? Why or why not?<br><br>b) Do you agree with the proposed scope of the Exposure Draft? Why or why not? If not, what scope do you suggest and why?<br><br>c) Do you agree that the proposals in the Exposure Draft are clear enough to enable an entity to determine whether a regulatory agreement gives rise to regulatory assets and regulatory liabilities? If not, what additional requirements do you recommend and why?<br><br>d) Do you agree that the requirements proposed in the Exposure Draft should apply to all regulatory agreements and not only to those that have a particular legal form or those enforced by a regulator with particular attributes? Why or why not? If not, how and why should the Board specify what form a regulatory agreement should have, and how and why should it define a regulator?<br><br>e) Have you identified any situations in which the proposed requirements would affect activities that you do not view as subject to rate regulation? If so, please describe the situations, state whether you have any concerns about those effects and explain what your concerns are.<br><br>f) Do you agree that an entity should not recognise any assets or liabilities created by a regulatory agreement other than regulatory assets and regulatory liabilities and other assets and liabilities, if any, that are already required or permitted to be recognised by IFRS Standards?<br><br>[1] A regulatory agreement is defined in the Exposure Draft as a set of enforceable rights and obligations that determine a regulated rate to be applied in contracts with customers. |

Our response to this question focuses on the following areas where we believe further clarity is required or where we have concerns around the proposals:

- Objectives and scope (questions 1(a) and 1(b)); and
- Clarity of proposals in enabling an entity to assess whether its regulatory agreement is in scope (question 1(c) and 1(d));

***Objectives and scope (questions 1(a) and 1(b))***

We agree with the objective of the Exposure Draft, and believe that what is proposed would go a long way in addressing a gap that currently exists within existing IFRSs. The proposals would result in companies subject to rate regulation providing relevant information to investors and other users in a way that would better reflect the economic substance of the regulatory agreements (within the scope of the proposed requirements) to which they are subject. This would be a significant step forward in enabling companies subject to rate regulation (as defined in the proposals) to reflect their economic returns in the periods to which they relate, and thus increase comparability between those companies subject to rate regulation and those that are not.

While we consider the proposed scope outlined in the Exposure Draft to be reasonable, it is not immediately clear that many types of regulatory agreement are out of scope. We feel that the drafting of the proposals could be tightened in order to avoid its application becoming broader than intended, and that preparers and users would benefit from the proposals explicitly setting out the types of contracts and agreements that are out of scope in a similar way to how this is done in paragraph 5 of IFRS 15. As well as providing additional clarity, we consider that this would be consistent with the fact that the proposed model will supplement information already provided by applying existing IFRSs and is therefore not an alternative standard to be used instead of something already applied. Contracts with customers accounted for in accordance with IFRS 15 could be referenced, and the relationship between the entity and its regulator (or the effects of the regulatory agreement to which it is subject) could be demonstrated as being distinct from (though related to) the relationship between the entity and its customers, which is the source of revenue recognised under IFRS 15.

The proposals being more explicitly clear that the rate regulation in the context of the proposed standard would refer to a only small subset of what are commonly referred to as “regulatory agreements”, namely economic regulation. The title of the definition of “regulatory agreement” could be amended to make this clearer (e.g. by changing the title to “economic regulatory agreement” or “specified regulatory agreement”), and further examples could be given to demonstrate where regulatory agreements in the broader sense would and would not be within the scope of the proposed standard.

We understand that arrangements involving a price cap in which a regulator sets a limit at which customers can be charged, but where the entity bears “demand risk” and is therefore not assured of recovery, would not fall within the scope of the proposals. For example, water retailers operating in a non-household sector subject to market competition may be regulated in terms of the maximum price per unit that can be charged, and may be able to increase default tariffs in future years to recover some of their bad debt cost suffered to date. However because customers can switch supplier to avoid the extra cost, recovery is not assured. This or a similar example could be included within the text of any future standard to illustrate and explain that in such instances the regulatory agreement would not be in scope.

We also have concerns around the inclusion of service concession arrangements within the scope of IFRIC12 in the scope of the proposed standard, and feel that this is both unnecessary and that it adds additional complexity to the proposals. We do not understand how an operator under the financial asset model set out in paragraph 16 of IFRIC 12 would have additional unrecognised amounts that should be recognised as regulatory assets and regulatory liabilities, and for an operator under the intangible asset model set out in paragraph 17 or IFRIC 12 we similarly feel it needs to be made clear as to whether, and how, additional unrecognised amounts that may be recognised as regulatory assets or

regulatory liabilities over and above what is already recognised, would arise. We therefore recommend that for the avoidance of doubt such arrangements should be excluded from the scope, or that practical examples should be given as to why their inclusion is appropriate.

***Clarity of proposals in enabling an entity to assess whether its regulatory agreement is in scope (question 1(c) and 1(d))***

We do not agree that the proposals in the Exposure Draft are clear enough to enable an entity to determine whether a regulatory agreement gives rise to regulatory assets and regulatory liabilities. In addition to the points raised above, we disagree with the reasoning in paragraph BC86 that it is unnecessary to define the regulatory, as we consider the existence of a third party that is independent of the entity to be a fundamental component of any regulatory agreement from which the rest of the proposed standard flows.

We believe that explicitly defining a regulator as an third party body that is established independently of the entity and has powers to create legally enforceable agreement giving rise to rights and obligations on the part of both the regulatory and the regulated liability, would be beneficial in mitigating the risk that the proposed standard is applied more broadly than envisaged, and to reduce instances of it being inappropriately applied. This definition could be further enhanced by requiring all or part of the express purpose of the independent regulator to be regulation of an entity's economic returns, thus further addressing our concerns stated in response to questions 1(a) and 1(b).

We do not think that such a definition would be overly restrictive or that it would be incompatible with the fact that regulatory agreements can take various forms. Such a definition need not require the existence of a body whose sole purpose is to regulate companies operating in a given industry, and could, for example, encompass government departments or the state in cases where economic regulation is undertaken primarily through legislation rather than a specific regulatory body.

In making it an explicit requirement that a regulatory agreement must be with an independently established third party, this would also ensure that self-regulated entities are not included in the scope of the proposals, and we believe this would also reduce structuring opportunities that entities may seek to take advantage of. For example, this would make it immediately clear that a transfer pricing agreement between a parent and one of its subsidiaries does not constitute rate regulation as defined in the standard, and would reduce the opportunity for an entity to establish a regulator within its group structure or appoint a regulator that notionally sits outside of the group structure that has legally enforceable powers. We do not believe such arrangements should constitute a regulatory agreement in the context of the proposed standard, however it is currently unclear whether such arrangements would be specifically excluded.

| **Question 2: Regulatory assets and regulatory liabilities** |
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| The Exposure Draft defines a regulatory asset as an enforceable present right, created by a regulatory agreement, to add an amount in determining a regulated rate to be charged to customers in future periods because part of the total allowed compensation for goods or services already supplied will be included in revenue in the future. The Exposure Draft defines a regulatory liability as an enforceable present obligation, created by a regulatory agreement, to deduct an amount in determining a regulated rate to be charged to customers in future periods because the revenue already recognised includes an amount that will provide part of the total allowed compensation for goods or services to be supplied in the future. |

| **Question 2: Regulatory assets and regulatory liabilities** | |
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| a) | Paragraphs BC36–BC62 of the Basis for Conclusions discuss what regulatory assets and regulatory liabilities are and why the Board proposes that an entity account for them separately. |
| b) | Do you agree with the proposed definitions? Why or why not? If not, what changes do you suggest and why? |
| c) | The proposed definitions refer to total allowed compensation for goods or services. Total allowed compensation would include the recovery of allowable expenses and a profit component (paragraphs BC87–BC113 of the Basis for Conclusions). This concept differs from the concepts underlying some current accounting approaches for the effects of rate regulation, which focus on cost deferral and may not involve a profit component (paragraphs BC224 andBC233–BC244 of the Basis for Conclusions). Do you agree with the focus on total allowed compensation, including both the recovery of allowable expenses and a profit component? Why or why not? |
| d) | Do you agree that regulatory assets and regulatory liabilities meet the definitions of assets and liabilities within the Conceptual Framework for Financial Reporting (paragraphs BC37–BC47)? Why or why not? |
| e) | Do you agree that an entity should account for regulatory assets and regulatory liabilities separately from the rest of the regulatory agreement (paragraphsBC58–BC62)? Why or why not? |
| f) | Have you identified any situations in which the proposed definitions would result in regulatory assets or regulatory liabilities being recognised when their recognition would provide information that is not useful to users of financial statements? |

We believe that the proposed definitions of regulatory assets and regulatory liabilities are appropriate, and that they meet the definitions of assets and liabilities within the Conceptual Framework for Financial Reporting.

We consider regulatory assets and regulatory liabilities as defined within the proposals to be distinct from other elements of the regulatory agreement as they directly reflect balances that will be recovered or fulfilled through changes in the rates charged to customers. In focusing on only these aspects of the regulatory agreement the IASB's proposals are balanced and proportionate in supplementing existing IFRSs and providing relevant information to users of the financial statements of those entities subject to rate regulation.

We have not identified any specific situations in which the proposed definitions would result in regulatory assets or regulatory liabilities being recognised when their recognition would provide information that is not useful to users of financial statements. We do, however, share the UKEB's concerns with regards to how certain requirements in the proposals would be implemented and whether the resulting information would be of sufficient benefit to users to outweigh these practical and conceptual concerns. Further detail of our concerns is set out in our responses to the questions that follow below.

| **Question 3: Total allowed compensation** |
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| Paragraphs B3–B27 of the Exposure Draft set out how an entity would determine whether components of total allowed compensation included in determining the regulated rates charged to customers in a period, and hence included in the revenue recognised in the period, relate to goods or services supplied in the same period, or to goods or services supplied in a different period. Paragraphs BC87–BC113 of the Basis for Conclusions explain the reasoning behind the Board's proposals.<br>a) Do you agree with the proposed guidance on how an entity would determine total allowed compensation for goods or services supplied in a period if a regulatory agreement provides:<br>(i) regulatory returns calculated by applying a return rate to a base, such as a regulatory capital base (paragraphs B13–B14 and BC92–BC95)?<br>(ii) regulatory returns on a balance relating to assets not yet available for use (paragraphs B15 and BC96–BC100)?<br>(iii) performance incentives (paragraphs B16–B20 and BC101–BC110)?<br>b) Do you agree with how the proposed guidance in paragraphs B3–B27 would treat all components of total allowed compensation not listed in question 3(a)? Why or why not? If not, what approach do you recommend and why?<br>c) Should the Board provide any further guidance on how to apply the concept of total allowed compensation? If so, what guidance is needed and why? |

We are broadly supportive of the overarching concept of total allowed compensation and how this would be used in the context of accounting for regulatory assets and regulatory liabilities, however there are two main areas we believe require further consideration, which form the focus of our response to question 3. These are:

- Accounting for the interaction between components of total allowed compensation; and
- Regulatory returns on a balance relating to assets not yet available for use.

***Accounting for the interaction between components of total allowed compensation***

We do not feel that the Exposure Draft is sufficiently clear in setting out how the interaction between the various components of total allowed compensation would be accounted for in practice, and recommend that the requirements would benefit from guidance in this area.

The Exposure Draft sets out the three components of total allowed compensation as:

(a) amounts that recover allowable expenses minus chargeable income (see paragraphs B3-B9);

(b) target profit (see paragraphs B10-B20); and

(c) regulatory interest income and regulatory interest expense (see paragraphs B21-B27).

However in practice there may be overlap between these components. For example, there could be allowable expenses that are recovered under the regulatory agreement but where the recovery of all or some of the expenses may be in a future period(s) by being added to the regulatory base on which a return is earned as part of target profit. To give a practical example, allowable expenses could be forecast at the beginning of a price control period using an assumed level of inflation, and be recovered as part of the rates charged to customers over the course of the period subject to a true-up at the end of the price control period to reflect outturn inflation. To the extent that outturn inflation is higher or

lower than the assumption at the beginning of the period, this true-up could be recovered through the rates charged by being added to or deducted from the regulatory base on which regulatory returns in future periods are calculated.

In such a case it is currently unclear whether the component of the regulatory base relating to this inflation true-up should be treated as an allowed expense recovered in future periods, or as part of the regulatory return in arriving at target profit. This is complicated further where the regulatory base is treated by the regulator and regulated entity as an homogenous construct, as is the case for the UK water industry, rather than being something that can be readily disaggregated into its component parts.

Similarly, rewards or penalties arising as a result of performance incentives could be recovered through the rates over a relatively short period of time, or could be added to the regulatory base and recovered over a much longer period as the returns on this base are received.

It is unclear whether the recovery of such regulatory assets or fulfilment of regulatory liabilities would be recognised as part of the regulatory return by applying a return rate to a base in accordance with paragraph B13 of the ED, or if these components of the regulatory base should be carved out of the base on which the return is earned and instead accounted for as a separate component.

Conceptually we believe there is a tension between the regulatory return in arriving at target profit, which would appear to reflect the long-term recovery of an entity's investment in the asset base it uses to deliver goods and services, and the inclusion of elements relating to the shorter-term true-up of operating expenditure or performance incentives as part of the regulatory base, which stand apart from the primary reason regulatory returns are received; these items could be treated as separate and distinct regulatory assets, but the recovery mechanism is such that they are included as part of the regulatory base and charged through the rates over much longer periods of time.

An argument could potentially be made to treat these separate regulatory assets/liabilities as distinct from the rest of the base on which returns are earned through application of a rate, with these balances deducted from the regulatory base in calculating target profit. As a practical expedient these regulatory assets/liabilities could then unwind over the period of time the regulatory base would be expected to unwind when the regulatory asset/liability is initially recognised. Whereas the remainder of the regulatory base may be reassessed in line with changes to the regulatory agreement (e.g. negotiations with the regulator as part of the periodic regulatory determination process), and could therefore be subject to a changing recovery profile, the recovery period of allowable expenses or performance incentives added to or deducted from the regulatory base need not necessarily be revisited in order to provide a meaningful representation of their recovery through the rates charged to customers.

We feel that guidance in this area, which should be accompanied by illustrative examples, would benefit preparers and users by indicating how the components of total allowed income should be assessed alongside one another in determining the most appropriate way to account for them.

***Regulatory returns on a balance relating to assets not yet available for use***

We do not agree with the proposals relating to regulatory returns on a balance relating to assets not available for use, whereby regulatory returns would be deferred on the balance sheet and would only start to be recognised in the income statement when the asset becomes available for us.

We believe requiring entities to account for regulatory returns on assets not yet in use would be contrary to the stated objectives of the proposals, being the provision of relevant information that

faithfully represents how regulatory income and regulatory expense arising from a regulatory agreement affect the entity's financial performance, and how regulatory assets and regulatory liabilities affect its financial position. The requirements currently set out in the Exposure Draft would result in regulatory income and expense being presented in a way that is not consistent with the underlying regulatory agreement on which the proposals are predicated.

Within our industry the return on a balance relating to assets not yet available for use is not dependent on the assets becoming operational. Instead, the assets under construction form part of the homogenous regulatory capital base on which returns are calculated. This is because the focus of our regulator, Ofwat, is on the delivery of outputs by an entity rather than on the specific expenditure incurred on an asset-by-asset basis. Entities may be regulated on outcomes (rather than on assets built), and so while funding is allowed under the regulatory agreement and gets added to a regulatory base, with returns earned as this funding is spent, it is up to the entity to determine how the required outcomes will be delivered. This may or may not involve the construction of assets and bringing them into use.

We would question whether matching regulatory returns to the depreciation expense recognised over the life of the asset is conceptually consistent with the principle that an entity should reflect the total allowed compensation for goods and services supplied in a period as part of its financial performance for that period. The goods and services supplied by rate-regulated entities are often not linked directly to a specific asset or on inputs such as capital spend. Instead, they are supplied through the operation of a much wider pool of assets on which an allowed return is earned. We believe it is incongruous to link the recognition of allowed compensation to periods that may be many years in the future when the entity's outputs on which it is compensated under the regulatory agreement can be delivered in a number of ways that may not require the completed construction of an asset.

In addition to this, the regulatory returns on an entity's asset base, which is often a broad aggregated pool of assets rather than a collection of individual assets, may flow to the entity over a different time period to the useful lives of the assets themselves, thus creating a mismatch that could be difficult to explain in a way that users of financial statements would find helpful. By permitting entities for whom returns earned in arriving at target profit are not linked to specific assets to reflect regulatory returns on the total regulatory base (i.e. including those assets not yet in use), we believe this would give a more conceptually satisfactory outcome that would present more relevant, reliable and understandable information, as well as being more closely aligned to the way in which this rate regulation operates.

We also do not agree with the IASB's assessment in paragraph BC247 of the Exposure Draft that it *"does not expect the costs of applying the proposals, both on initial application and on an ongoing basis, to be significant because to a large extent, the proposed model would use inputs that the Board expects an entity already needs to gather and process in determining regulatory rates."* Regulators do not always have, or require the entities they regulate to have, detailed records of their regulatory asset base, and instead maintain records at a much higher level. Existing records may therefore not contain the level of detail needed to apply the proposed requirements.

This in turn means that preparers operating under such arrangements may have not been historically required to maintain records of returns on specific assets, whether those under construction or in use. For these entities it would be extremely costly and require extensive effort to create new set of records which would, in effect, be a 'regulatory fixed asset register' to be maintained in parallel with the entity's accounting fixed asset register.

The cost and practical challenges of this should not be underestimated, and exhaustive work would be required to establish the status of regulatory returns for each asset in order to implement the new standard on a fully retrospective basis, which we believe would be required given that under a prospective or modified retrospective basis it would take an extremely long time for the accounting for assets pre- and post-adoption of the standard to converge onto the same basis.

This process would also involve a high degree of subjective estimation in the absence of detailed historic records, and the unwinding of associated regulatory assets and regulatory liabilities would be extremely complex to the point of confusion for both preparers and users. We therefore do not consider that these proposals would be likely to result in meaningful or reliable adjustments, and therefore that this aspect of the proposals would fail any cost-benefit assessment.

| **Question 4: Recognition** |
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| Paragraphs 25–28 of the Exposure Draft propose that:<br>• an entity recognise all its regulatory assets and regulatory liabilities; and<br>• if it is uncertain whether a regulatory asset or regulatory liability exists, an entity should recognise that regulatory asset or regulatory liability if it is more likely than not that it exists. It could be certain that a regulatory asset or regulatory liability exists even if it is uncertain whether that asset or liability will ultimately generate any inflows or outflows of cash. Uncertainty of outcome would be addressed in measurement (Question 5).<br>Paragraphs BC122–BC129 of the Basis for Conclusions describe the reasoning behind the Board's proposals.<br>a) Do you agree that an entity should recognise all its regulatory assets and regulatory liabilities? Why or why not?<br>b) Do you agree that a 'more likely than not' recognition threshold should apply when it is uncertain whether a regulatory asset or regulatory liability exists? Why or why not? If not, what recognition threshold do you suggest and why? |

We agree that an entity should recognise all its regulatory assets and regulatory liabilities (as defined within the proposals) as to not do so would be to provide incomplete, and therefore less relevant, information to users.

We agree that a 'more likely than not' recognition threshold is appropriate given the level of estimation and uncertainty inherent in regulatory agreements that are often subject to periodic negotiation. We feel that a 'more likely than not' threshold would give a more balanced view and reflect management's assessments compared with a higher threshold. In assessing whether or not a regulatory asset or regulatory liability should be recognised, we would recommend that the ED explicitly states that where significant judgement is required the nature of this should be disclosed in accordance with IAS 1.

| **Question 5: Measurement** |
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| Paragraph 29 of the Exposure Draft specifies the measurement basis. Paragraphs 29–45 of the Exposure Draft propose that an entity measure regulatory assets and regulatory liabilities at historical cost, modified by using updated estimates of future cash flows. An entity would implement that measurement basis by applying a cash-flow-based measurement technique. That technique would involve estimating future cash flows—including future cash flows arising from regulatory interest—and updating those estimates at the end of each reporting period to reflect conditions existing at that date. The future cash |

| Question 5: Measurement |
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| flows would be discounted (in most cases at the regulatory interest rate—see Question 6). Paragraphs BC130–BC158 of the Basis for Conclusions describe the reasoning behind the Board's proposals. |
| a) Do you agree with the proposed measurement basis? Why or why not? If not, what basis do you suggest and why? |
| b) Do you agree with the proposed cash-flow-based measurement technique? Why or why not? If not, what technique do you suggest and why? |
| If cash flows arising from a regulatory asset or regulatory liability are uncertain, the Exposure Draft proposes that an entity estimate those cash flows applying whichever of two methods—the 'most likely amount' method or 'expected value' method—better predicts the cash flows. The entity should apply the chosen method consistently from initial recognition to recovery or fulfilment. Paragraphs BC136–BC139 of the Basis for Conclusions describe the reasoning behind the Board's proposal. |
| c) Do you agree with this proposal? Why or why not? If not, what approach do you suggest and why? |

The boundary of the regulatory agreement i.e. the period of time over which regulatory assets and regulatory liabilities can be recovered, is fundamental to the measurement requirements proposed, and we believe that further clarity could be given as to how this boundary should be defined, and therefore how the measurement criteria within the proposals should be implemented.

We do not consider the proposals to be sufficiently clear in terms of whether the boundary should be strictly applied as being the end of the price control period over which there is certainty, the end of the licence period, or beyond the end of the licence period if regulatory assets and regulatory liabilities have been recognised and there is a reasonable expectation that the licence will review or that at termination of the regulatory agreement they would be compensated for in full based on their value at the point of the termination event, rather than curtailed at the amounts that would be recovered strictly to the end of the licence period. We believe the latter approach to be the most appropriate in terms of enabling entities to present the most complete depiction of the effects of their regulatory agreement, however clarity on this point is needed.

We appreciate that the ability of either party to cancel the regulatory agreement, and whether or not a cancellation event would give rise to compensation, goes some way in addressing these concerns. However, we believe the Exposure Draft could be more explicit or provide illustrative examples to demonstrate what is considered to be enforceable where there is a shorter-term price control period and a longer-term arrangement/framework/licence setting out the overarching agreement. For example, it is unclear whether future price control periods that have not yet been agreed but fall within the overarching licence period should be included within the boundary of the regulatory agreement.

We would also appreciate further clarity around the extent to which regulatory assets and regulatory liabilities could be measured based on a valid expectation (e.g. through previous interactions with the regulator) that a licence will renew and therefore that assets could continue to be recovered beyond what is considered to be the strict, legally enforceable, boundary of the regulatory agreement. For example, where a regulatory asset may be recognised to reflect the expected recovery of a deferred tax liability as this unwinds and becomes cash tax payable (allowable under the regulatory agreement and measured using the same measurement basis as the underlying deferred tax liability in accordance with paragraphs 59-66 of the Exposure Draft), it is unclear as to whether the full extent of the regulatory asset would be recognised, and therefore whether the deferred tax liability would be fully (or largely) offset by this, or if measurement would be strictly truncated at what is considered to be the boundary

of the agreement even if there is a valid expectation that the licence will continue to be renewed and the regulatory asset therefore recovered beyond this point.

Our view is that in order to truly reflect the way in which the regulatory agreement compensates entities subject to rate-regulation, if there is a valid and supportable expectation that the licence will renew or that at termination of the agreement any regulatory assets and liabilities would be subject to compensation, then the measurement of regulatory assets or regulatory liabilities need not be curtailed. By extension, it follows that any regulatory asset or regulatory liability where recovery under business as usual would extend beyond the licence period would be measured based on the full expected recovery.

However, if any future standard were to require such curtailment we would propose that entities be permitted to include in their disclosures amounts that are expected to be recovered beyond the end of the boundary period. This would be similar to disclosures around contingent assets or contingent liabilities that could crystallise based on the occurrence or non-occurrence of a future event, such as the renewal of the regulatory agreement. This could potentially be reflected as an addition to the maturity analysis split out by time bands as required by paragraph 80 of the Exposure Draft. We feel that this would result in relevant information being presented as to amounts that are less certain but are nevertheless expected to be recovered or fulfilled.

**Question 6: Discount rate**

Paragraphs 46–49 of the Exposure Draft propose that an entity discount the estimated future cash flows used in measuring regulatory assets and regulatory liabilities. Except in specified circumstances, the discount rate would be the regulatory interest rate that the regulatory agreement provides. Paragraphs BC159–BC166 of the Basis for Conclusions describe the reasoning behind the Board's proposals.

a) Do you agree with these proposals? Why or why not? If not, what approach do you suggest and why?

Paragraphs 50–53 of the Exposure Draft set out proposed requirements for an entity to estimate the minimum interest rate and to use this rate to discount the estimated future cash flows if the regulatory interest rate provided for a regulatory asset is insufficient to compensate the entity. The Board is proposing no similar requirement for regulatory liabilities. For a regulatory liability, an entity would use the regulatory interest rate as the discount rate in all circumstances. Paragraphs BC167–BC170 of the Basis for Conclusions describe the reasoning behind the Board's proposals.

b) Do you agree with these proposed requirements for cases when the regulatory interest rate provided for a regulatory asset is insufficient? Why or why not?

c) Have you identified any other situations in which it would be appropriate to use a discount rate that is not the regulatory interest rate? If so, please describe the situations, state what discount rate you recommend and explain why it would be a more appropriate discount rate than the regulatory interest rate.

Paragraph 54 of the Exposure Draft addresses cases when a regulatory agreement provides regulatory interest unevenly by applying a series of different regulatory interest rates in successive periods. It proposes that an entity should translate those rates into a single discount rate for use throughout the life of the regulatory asset or regulatory liability.

d) Do you agree with the proposal? Why or why not? If not, what do you recommend and why?

The proposed model for discounting could be simplified in a way that benefits both preparers and users without any material compromise on the usefulness of information provided in the financial statements. For example, a rebuttable presumption that the regulatory interest rate is an appropriate discount rate unless the indicators set out in paragraph 52 of the Exposure Draft are present, would be of significant benefit to preparers in reducing the burden of carrying out these assessments and justifying rates to auditors at each reporting period. Disclosure of the indicators in paragraph 52 where the regulatory interest rate is not considered to be a sufficient discount rate could also be required. The proposals could also clarify that, given the nature of rate-regulation, instances where the regulatory rate is not considered to be sufficient are expected to be rare.

We would question whether the additional complexity and subjectivity associated with estimating a minimum interest rate for a regulatory asset but not for regulatory liabilities, rather than simply requiring that the same rate be used for both, would provide significant benefit to users of the financial statements. We would encourage the IASB to consider whether in its outreach work it has identified instances where the regulatory rate is not considered to sufficiently compensate the entity, and how common such instances are.

| **Question 7: Items affecting regulated rates only when related cash is paid or received** |
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| In some cases, a regulatory agreement includes an item of expense or income in determining the regulated rates in the period only when an entity pays or receives the related cash, or soon after that, instead of when the entity recognises that item as expense or income in its financial statements. Paragraphs 59–66 of the Exposure Draft propose that in such cases, an entity would measure any resulting regulatory asset or regulatory liability using the measurement basis that the entity would use in measuring the related liability or related asset by applying IFRS Standards. An entity would adjust that measurement to reflect any uncertainty that is present in the regulatory asset or regulatory liability but not present in the related liability or related asset. Paragraphs BC174–BC177 of the Basis for Conclusions describe the reasoning behind the Board's proposals.<br>a) Do you agree with the measurement proposals when items of expense or income affect regulated rates only when related cash is paid or received? Why or why not? If not, what approach do you suggest for such items and why?<br>When these measurement proposals apply and result in regulatory income or regulatory expense arising from remeasuring the related liability or related asset through other comprehensive income, paragraph 69 of the Exposure Draft proposes that an entity would also present the resulting regulatory income or regulatory expense in other comprehensive income. Paragraphs BC183–BC186 of the Basis for Conclusions describe the reasoning behind the Board's proposal.<br>b) Do you agree with the proposal to present regulatory income or regulatory expense in other comprehensive income in this case? Why or why not? If not, what approach do you suggest and why? |

We support of the proposals in paragraphs 59-66 of the Exposure Draft that where a regulatory agreement includes an item of expense or income in determining the regulated rates in the period only when an entity pays or receives the related cash, or soon after that, that measurement of the regulatory asset or regulatory liability should use the same measurement basis that the entity would use in measuring the related liability or related asset by applying IFRS standards.

We consider this to be an important consideration for many rate-regulated entities, and believe that the proposals are pragmatic and sensible. In particular, where regulatory agreements allow for the recovery of tax through the rates on a cash tax paid basis, we believe that the proposals would enable entities to recognise a regulatory asset on the balance sheet that would largely offset against the

deferred tax liability which unwinds over time to become current tax that is paid in cash. In permitting measurement on the same basis this would provide a fair reflection of the overall impact of tax recovery mechanisms included in a regulatory contract and therefore provide relevant information to users.

| **Question 8: Presentation in the statement(s) of financial performance** |
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| Paragraph 67 of the Exposure Draft proposes that an entity present all regulatory income minus all regulatory expense as a separate line item immediately below revenue. Paragraph 68 proposes that regulatory income includes regulatory interest income and regulatory expense includes regulatory interest expense. ParagraphsBC178–BC182 of the Basis for Conclusions describe the reasoning behind the Board's proposals.<br>a) Do you agree that an entity should present all regulatory income minus all regulatory expense as a separate line item immediately below revenue (except in the case described in Question 7(b))? Why or why not? If not, what approach do you suggest and why?<br>b) Do you agree with the proposed inclusion of regulatory interest income and regulatory interest expense within the line item immediately below revenue? Why or why not? If not, what approach do you suggest and why? |

We agree with the proposal in question 8(b) of the Exposure Draft for the inclusion of regulatory interest income and regulatory interest expense within the same line item as other elements of regulatory income and regulatory expense. However, we not do agree that presenting this as a separate line item immediately below revenue is necessarily the most appropriate presentation.

Instead, we would recommend that entities be permitted to choose between including this line item within 'Revenue' on the face of the income statement and then disaggregated between revenue from contracts with customers and net regulatory income/expense in the notes, or as a separate line item on the face of the income statement immediately under 'Revenue from contracts with customers' with a subtotal for 'Total revenue' also included.

This is because we consider net regulatory income/expense to be an amount that supplements revenue recognised in accordance with IFRS 15 in order to provide a more complete picture of the entity's underlying income from its ordinary activities; it should not be forgotten that revenue encompasses a broader definition than income received from contracts with customers, and can include other income that forms a core part of an entity's normal operations. For rate-regulated entities the regulatory income/expense will represent a key component of total income, which we do not consider to be sufficiently distinct in nature to be presented outside of revenue.

| **Question 9: Disclosure** |
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| Paragraph 72 of the Exposure Draft describes the proposed overall objective of the disclosure requirements. That objective focuses on information about an entity's regulatory income, regulatory expense, regulatory assets and regulatory liabilities, for reasons explained in paragraphs BC187–BC202 of the Basis for Conclusions. The Board does not propose a broader objective of providing users of financial statements with information about the nature of the regulatory agreement, the risks associated with it and its effects on the entity's financial performance, financial position or cash flows.<br>a) Do you agree that the overall disclosure objective should focus on information about an entity's regulatory income, regulatory expense, regulatory assets and regulatory liabilities? Why or why not? If not, what focus do you suggest and why? |

| **Question 9: Disclosure** |
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| b) Do you have any other comments on the proposed overall disclosure objective?<br>Paragraphs 77–83 of the Exposure Draft set out the Board's proposals for specific disclosure objectives and disclosure requirements.<br>c) Do you have any comments on these proposals? Should any other disclosures be required? If so, how would requiring those other disclosures help an entity better meet the proposed disclosure objectives?<br>d) Are the proposed overall and specific disclosure objectives and disclosure requirements worded in a way that would make it possible for preparers, auditors, regulators and enforcement bodies to assess whether information disclosed is sufficient to meet those objectives? |

While we agree that the overall disclosure objective should focus on information about an entity's regulatory income, regulatory expense, regulatory assets and regulatory liabilities, we do not agree with the decision of the IASB to not require disclosure of the nature of, and the risks associated with, the rate regulation that establishes the prices that the entity can charge customers for the goods or services it provides.

As set out in paragraphs BC191-BC194 of the Exposure Draft, the IASB acknowledges that information about the nature of, and risks associated with, rate regulation is useful to users of financial statements, though users do not rely on financial statements to provide that information. Paragraph B192 of the Exposure Draft states that *"IFRS Standards do not require entities to disclose such information about any other form of regulation and the Board sees no reason to require entities to provide such information for rate regulation."* It goes on to say that rate regulation can have pervasive effects on every aspect of an entity's financial performance, financial position and cash flows, and that an objective of enabling users to assess such pervasive effects would go beyond what financial statements can feasibly provide.

We believe that a balance should be struck between providing sufficient disclosure to enable users to understand the broad nature of the regulatory agreement giving rise to regulatory assets and regulatory liabilities, while not seeking to explain all aspects of the pervasive impact of rate regulation, which we agree goes beyond the requirements of general purpose financial reports.

Depending on the final drafting of the proposed standard, judgement may be required in assessing whether an entity is captured within the scope of the standard, and in determining the boundary of the regulatory agreement. While disclosure of significant judgements is required by IAS 1, we feel that a specific disclosure requirement in the proposed standard with regards to the nature of the regulatory agreement should be included in order to provide users with context to any such judgements. In doing this, we believe that this would enhance consistency in how judgements are disclosed across entities subject to rate regulation. It is for this reason, rather than to act as the main source of information on regulatory agreements that users rely on, that we recommend a specific disclosure requirement be included in the final drafting of the proposed standard.

In addition, as set out in our response to question 5 we believe that disclosures could be enhanced by either requiring or permitting entities to disclose amounts expected to be recovered/fulfilled beyond the boundary of the regulatory agreement where there is a reasonable expectation that it could be recovered but not enough certainty to recognise a regulatory asset or a regulatory liability.

| Question 10: Effective date and transition |
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| Appendix C to the Exposure Draft describes the proposed transition requirements. Paragraphs BC203–BC213 of the Basis for Conclusions describe the reasoning behind the Board's proposals.<br>a) Do you agree with these proposals?<br>b) Do you have any comments you wish the Board to consider when it sets the effective date for the Standard? |

We would encourage the IASB to engage with preparers to identify the detailed challenges associated with determining the opening balance for regulatory assets and regulatory liabilities.

Conceptually we feel that the proposed fully retrospective transition approach is appropriate given the long time frames over which certain regulatory assets and regulatory liabilities could unwind; we do not believe it would be appropriate to permit prospective application or a modified retrospective approach that would result in a mismatch that would not quickly correct itself between regulatory assets and liabilities included in the balance sheet on adoption and those arising subsequently.

However, we would urge the IASB not to underestimate the level of cost and effort required to establish this opening balance position, particularly if this would require the estimation of how components of the regulatory capital base will unwind on an asset-by-asset basis (see response to question 3).

| Question 11: Other IFRS Standards |
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| Paragraphs B41–B47 of the Exposure Draft propose guidance on how the proposed requirements would interact with the requirements of other IFRS Standards. Appendix D to the Exposure Draft proposes amendments to other IFRS Standards. Paragraphs BC252–BC266 of the Basis for Conclusions describe the reasoning behind the Board's proposals.<br>a) Do you have any comments on these proposals? Should the Board provide any further guidance on how the requirements proposed in the Exposure Draft would interact with any other IFRS Standards? If yes, what is needed and why?<br>b) Do you have any comments on the proposed amendments to other IFRS Standards? |

We do not have any comments on these proposal set out in paragraphs B41-B47 of the Exposure Draft, or the proposed amendments to other IFRS Standards as set out in Appendix D to the Exposure Draft.

| Question 12: Likely effects of the proposals |
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| Paragraphs BC214–BC251 of the Basis for Conclusions set out the Board's analysis of the likely effects of implementing the Board's proposals.<br>a) Paragraphs BC222–BC244 provide the Board's analysis of the likely effects of implementing the proposals on information reported in the financial statements and on the quality of financial reporting. Do you agree with this analysis? Why or why not? If not, with which aspects of the analysis do you disagree and why?<br>b) Paragraphs BC245–BC250 provide the Board's analysis of the likely costs of implementing the proposals. Do you agree with this analysis? Why or why not? If not, with which aspects of the analysis do you disagree and why? |

| Question 12: Likely effects of the proposals |
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| c) Do you have any other comments on how the Board should assess whether the likely benefits of implementing the proposals outweigh the likely costs of implementing them or on any other factors the Board should consider in analysing the likely effects? |

We broadly agree with the IASB's analysis of the likely effects of implementing the proposals, and believe that the proposals will enhance the quality of financial reporting and improve comparability between entities subject to rate regulation that would be within the scope of the proposals, and between these entities and entities not affected by the proposals in that it will enable users to more easily compare the underlying financial position when all economic factors are taken into consideration.

While we agree with the analysis in BC235 that application of the model would typically lead to an entity recognising regulatory income or regulatory expense in the same period as related effects on expenses or on revenue, we refer back to our response to question 3 which indicates that this will not always be the case. Where regulatory agreements are such that returns on investment are not tracked on an asset-by-asset basis but rather based on an homogenous pool of assets, we do not consider that the regulatory returns would necessarily match the related depreciation expense when an asset that is under construction is brought into use, as returns could be earned on the investment as a whole earlier than this based on the outputs of delivering goods or services, rather than the inputs of costs incurred in building a specific asset. We would therefore suggest that the wording be amended to make it clearer that although the model would typically lead to an entity recognising regulatory income or regulatory expense in the same period as related effects on expenses or revenue, this will depend on the regulatory agreement and will not always be the case.

As also referenced in our response to question 3, we do not agree with the IASB's analysis of the likely cost of implementing the proposals for entities that are not currently required to track regulatory returns on an asset-by-asset basis. The IASB states in paragraph BC247 that it does not expect the costs of applying the proposals, both on initial application and on an ongoing basis, to be significant because to a large extent, the proposed model would use inputs that the IASB expects an entity already needs to gather and process in determining regulated rates.

Based on the proposals as currently drafted, we and other UK water and wastewater companies would be required to create new records to track regulatory returns on an asset-by-asset basis in order to begin recognising the regulatory income or regulatory expense only when that asset comes into use. This is because regulatory returns for these companies are based on a pooled view of the regulatory base rather than a regulatory base that is broken down into component parts.

As well as involving a significant level of subjective estimation, the cost and effort required to create a 'regulatory fixed asset register' to run in parallel with the 'accounting fixed asset register' should not be underestimated. We would therefore recommend that the IASB conduct further outreach to understand the extent to which the inputs required under the model already exist.

| Question 13: Other comments |
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| Do you have any other comments on the proposals in the Exposure Draft or the UKEB's Draft Comment on the proposals in that Exposure Draft? |

We have no additional comments.