Accounting Standards Board

Newsletter March 2021 Edition

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Upcoming events

IPSASB proposes new requirements for *Leases*

The International Public Sector Accounting Standards Board (IPSASB) issued a revised IPSAS on *Leases* for comment (ED 187). The ASB is consulting on the proposals in the revised IPSAS to obtain views from stakeholders locally on South African specific issues.

We will be hosting a series of discussions in March and April – the education sessions will explain the high-level changes and principles in the proposed IPSAS and the roundtable discussions are aimed at preparers, auditors and others sharing views, and providing technical and other inputs on the concepts in the Exposure Draft. These views will be shared with the IPSASB in the comment letter to be submitted to them.

ED 187 can be accessed by following this link. If you are interested in attending a session, please email tsholot@asb.co.za.

Date	Event	Stakeholder group
8 March	Education session	All stakeholders
15 March	Education session	All stakeholders
30 March	Education session	Auditors, firms, technical specialists, professional bodies, and academics
12 April	Roundtable discussion	All stakeholders
19 April	Roundtable discussion	All stakeholders
3 May	Roundtable discussion	Auditors, firms, technical specialists, professional bodies, and academics

Attend the IPSASB's next meeting

The IPSASB will meet again on the 16th to 19th and 23rd of March 2021. As the meetings continue to be held virtually, it is a great opportunity to observe the IPSASB's deliberations on key projects.

The meeting will be held from 1 pm to 4 pm South African time each day. You will need to register to observe the meeting, which can be done by following this link. The agenda and meeting papers will be made available closer to the time.

Who wins? The lawyers or the accountants?

When it comes to the financial statements, the accountants always win…

Why do the accountants win?

The purpose of the financial statements is to faithfully represent the economic phenomena underlying transactions and events. Faithfully representing the economics of transactions and events means that the principles in the Standards of GRAP that describe relationships and their elements – revenue, expenses, assets and liabilities – are used to prepare the financial statements. Sometimes, these principles are different from the legal form described in contracts or legislation. This overarching principle is outlined in the Conceptual Framework and as is called "substance over form".

While it may seem illogical that legal and accounting principles should differ, consider the following examples:

- An arrangement is called an "operating lease" in a contract, but the economic reality of the transaction is that the lessee is required to make payments to the lessor that equal the value of the asset over its economic life. From a legal perspective, the lessee is contractually obliged to make payments to use an asset for an agreed period. From an economic perspective, the lessee acquires control of the benefits of an asset and must make payments to the lessor.
- An entity issues equity instruments to raise funding for its capital acquisition programme. The entity agrees to buy back the equity instruments from the holder should they exercise their discretion to sell. Although legally an "equity instrument" has been issued, the economics of the transactions require the entity to buy back the instruments at any point in time. This means that the entity has a liability, rather than equity.
- Legislation may indicate that one entity "controls" another because of certain decisions that it can take regarding the other entity's activities. As the financial statements are prepared only for those activities where an entity can direct, and benefit from, the financial and operating policies of another, control could differ from a legal and economic perspective. Similar differences could exist for other "relationships" which could be described differently in law and Standards of GRAP. These include principal-agent arrangements, service concession arrangements (or Public-Private Partnership Arrangements), and related parties.

The examples above illustrate that, although certain transactions or events may be given certain "labels" in law, they are not always accounted for using these "labels". The underlying definitions of specific transactions or relationships, the definitions of assets, liabilities, revenue and expenses, as well as the recognition, measurement and presentation principles in the Standards of GRAP, should always be applied in preparing the financial statements.

The Standards are law too….

The ASB is mandated by the Public Finance Management Act to set Standards of GRAP for a variety of entities in the public sector. The Minister of Finance also prescribes the application of the Standards to specific entities by issuing a Government Gazette.

This means that the Standards of GRAP are issued in terms of the law. As a result, they are "secondary legislation". This means that the Standards of GRAP, along with any other pronouncements that the Board issue, are legally required to be applied by entities in preparing their financial statements. It also means that the views expressed by the Board on certain matters in the pronouncements have legal standing.

Are legal views on arrangements helpful?

Contracts and legislation give rise to specific rights and obligations in arrangements. It is always important to understand what rights and obligations exist in arrangements and their legal consequences. Legal experts have the necessary expertise to interpret the legal implications of arrangements. They do not necessarily possess the expertise to interpret the concepts and principles in the Standards and apply them to economic phenomena. Interpreting the Standards of GRAP and applying them to specific transactions and events requires knowledge of the entire suite of Standards, as well as the application of professional judgement.

Opinions from legal experts on the Standards of GRAP carry no more weight than opinions provided by accounting or other experts.

For more information on the Standards of GRAP, read the ASB's *Conceptual Framework on General Purpose Financial Reporting* here.

Read the JSE's latest Proactive Monitoring Report

The JSE issues an annual report outlining its review of entities' financial statements that have listed equity and debt instruments. The review includes entities that report on IFRS Standards (equity issuers) and Standards of GRAP (some debt issuers).

The review is aimed at improving the quality of the financial statements in the market to ensure that investors have the necessary information to make informed decisions.

The report highlights issues that are pervasive and relevant regardless of the reporting framework applied. In particular, the report highlights issues with the following:

- Incorrect, or non-application of materiality in the preparation of the financial statements.
- The need for more comprehensive information about judgements, assumptions, and estimates used to prepare the financial statements.
- The need for better described/defined accounting policies and avoiding "boilerplate" disclosures.
- Various issues related to the presentation and compilation of the cash flow statement.

The full report can be accessed by following this link.

IASB issues proposed accounting for rate-regulated activities

Some entities' activities are regulated in terms of the prices they can charge for the goods or services they provide. In South Africa, these include the sale of oil, petroleum and related products, and electricity. In the context of electricity, Eskom and municipalities distribute electricity based on tariffs determined by the National Energy Regulator of South Africa, i.e. the regulator.

The tariffs determined by the regulator are usually based on the costs entities incur to deliver or produce the goods or services and their rate of return. The regulator determines what fixed and variable costs are permissible and set limits for the rates of return. In terms of the licence and other operating conditions granted by the regulator to the entity, the regulator agrees that these costs and rates of returns will be recovered over the period of the licence or other specified period through the tariffs charged. This means that the tariffs allowed by the regulator may be higher or lower in periods – depending on whether costs and returns need to be recouped or refunded based on future sales of goods or services.

There has been a long-standing accounting debate about whether the rights to charge higher, or the obligation to charge lower, tariffs result in an asset or a liability that should be recognised in the financial statements. The IASB issued a proposed IFRS on *Regulatory Assets and Regulatory Liabilities* for comment by 30 June 2021. The proposed IFRS indicates that assets and liabilities – along with related revenue and expenses – should be recognised in the financial statements of the entity providing regulated goods or services.

While the ASB has a policy of converging with IPSAS, the IPSAS are based on IFRS Standards. As there are activities in the public sector that are subject to rate regulation, there are some entities that could potentially be affected by these accounting proposals. The ASB will be hosting a discussion on the 8th of April from 09:00 to 11:00 to share views on the proposed accounting. These views will be included in a submission to the IASB to ensure that public sector issues are also considered.

Should you be interested in attending the discussion, please contact Jeanine Poggiolini at jeaninep@asb.co.za.

The Exposure Draft can be accessed by following this link.

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