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Online submission

28 June 2021

Chairman of the Board

COMMENTS ON ED/2021/1 REGULATORY ASSETS AND REGULATORY LIABILITIES

We are pleased, as the staff of the South African Accounting Standards Board (ASB), to submit comments on the proposed accounting for regulatory assets and regulatory liabilities.

The ASB sets accounting standards for the South African public sector. The ASB aligns its Standards with International Public Sector Accounting Standards (IPSAS) and International Financial Reporting Standards (where relevant). As many public sector entities undertake regulated activities which are subject to rate regulation, we have an interest in this Exposure Draft and the outcome of the project. The distribution of electricity and gas, is at present, the most significant a regulated activity undertaken in the South African public sector.

In forming the view expressed in this letter, we consulted entities that undertake regulated activities subject to rate regulation, consultants, auditors, professional service firms and other interested parties.

As there was no support for the recognition of regulatory assets and regulatory liabilities, we have not responded to the individual questions outlined in the Exposure Draft. Our views are outlined in the Annexure to this letter.

Board Members: Mr C Braxton (Chair), Mr D Dlamini, Ms W de Jager, Ms K Maree,
Dr P Masegare, Ms P Moalusi (Deputy-Chair), Ms M Sedikela, Ms N Themba, Mr A van der Burgh
Chief Executive Officer: Ms E Swart, Technical Director: Ms J Poggiolini

Should you have any queries, please feel free to contact me on jeaninep@asb.co.za.

Yours sincerely

Jeanine Poggiolini

Technical Director

ANNEXURE

We do not support the recognition of regulatory assets and regulatory liabilities

We do not believe that an asset or a liability should be recognised on the basis that there is no past event. We do not believe that the incurrence of a past sales transaction, or the incurrence of past expenditure results in a receivable or payable for either increased or reduced compensation. The event that gives rise to the receivable or payable is the future sales transaction, at a price that includes any potential recoupment of the under or over recovery. The proposed accounting effectively results in recognising current sales at future prices, which we do not believe is conceptually sound.

We question whether the recognition of regulatory assets is consistent with IAS 19 on *Provisions, Contingent Liabilities and Contingent Assets.* Many stakeholders raised concerns about whether the recognition criteria for assets would be met – particularly whether it is probable that there would be an inflow of resources - and drew an analogy to contingent assets. Many respondents did not believe that it would be possible to demonstrate that an inflow of resources is probable.

As an alternative to the recognition of assets and liabilities, stakeholders suggested improved disclosure of regulated activities. Given the disagreement with the approach and its practical application, narrative disclosures would likely be supported as opposed to complex, quantitative disclosures.

Practical application of approach

Stakeholders expressed concern about the complexity of the approach. They noted the following:

- There may be more than one "regulator" which makes the decisions (or potential decisions) difficult to implement (or assess). This could make assessing whether regulatory assets or regulatory liabilities exist subjective.
- Tariff structures are complex and may depend on the nature of customer (e.g. household or industrial consumers), the volume of consumption (e.g. the tariff increases for higher consumption) and the time of consumption (e.g. peak and off peak tariffs). Given the potential variables, it is difficult to understand how sales volumes and prices now would be affected by future under or over recoveries.
- The unit of account is based on individual timing differences. While theoretically this is possible, it is difficult to implement practically for the reasons noted in the preceding point.
- Entities often manage regulated activities and regulated submissions through templates issued by the regulator. Entities' accounting or ERP systems are generally not used to record or report on these activities. As a result, entities would need to rely entirely on manually generated information to comply with the approach suggested in the Exposure Draft. Stakeholders raised concerns about the complexity and resource implications of having to do this manually, and questioned the cost-benefit of the information provided to users.

Specific comments on Exposure Draft

Paragraph 27 lists potential facts and circumstances that should be considered in deciding whether regulatory assets and regulatory liabilities exist. We do not support the inclusion of (g), (h) and (i) for the following reasons:

- (g) – Indirect precedents: As entities usually submit their own applications for tariffs to regulators, there may be specific facts and circumstances that affect the tariff determination for each entity. We therefore do not believe that there is always uniformity in how tariffs are determined, and suggest that this be deleted.
- (h) – Preliminary views expressed by the regulator: As regulated activities are governed by law, contract or equivalent, we do not believe that views expressed by individuals at a regulator would supersede laws, contracts or equivalent. We do not believe that expressed views would provide a sound basis for assessing the existence of regulatory assets or regulatory liabilities.
- (i) Advice from legal advisers: While this may be helpful, we see this advice as being similar to the assessment of whether contingent assets or contingent liabilities arise. Similar to the views expressed for (h), we do not believe that (i) is a factor in considering whether legal rights and obligations exist.

Respondents questioned how internal charges between departments should be accounted for in the proposed approach. For financial statement purposes these expenses are reflected in the statement of financial performance, but for regulated activities, internal charges are often not recoverable. An example explaining the application of the approach to internal charges would be useful.