20 November 2009

International Accounting Standards Board
30 Cannon Street
LONDON EC4M 6XH
United Kingdom

Email: CommentLetters@iasb.org

Dear Sir/Madam

SAICA SUBMISSION ON EXPOSURE DRAFT *RATE-REGULATED ACTIVITIES*

In response to your request for comments on the IASB's exposure draft, *Rate-regulated Activities*, attached is the comment letter prepared by The South African Institute of Chartered Accountants (SAICA). Please note that SAICA is not only a professional body, but also secretariat for the Accounting Practices Board (APB), the official standard-setting body in South Africa. The SAICA comment letter results from deliberations of the Accounting Practices Committee (APC), which is the technical advisory body to the APB.

We thank you for the opportunity to provide comments on this document.

Please do not hesitate to contact us should you wish to discuss any of our comments.

Yours sincerely

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Project Director – Accounting

cc: Moses Kgosana (Chairman of the Accounting Practices Board)
Prof Alex Watson (Chairman of the Accounting Practices Committee)

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GENERAL COMMENTS

In our discussions on the exposure draft, the majority of commentators did not support the proposed accounting standard. The reasons for this view have been set out below:

Non compliance with the *Framework for the Preparation and Presentation of Financial Statements* (the Framework)

Accounting for over-recoveries

- In terms of any over-recoveries (regulatory liabilities) determined by the regulator at a year-end, we believe there is no present obligation relating to a past event as required in terms of paragraph 61 and 63 of the Framework. Furthermore, a liability is defined in IAS 37 – *Provisions, Contingent Liabilities and Contingent Assets,* as *"a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits."* The settlement of the regulatory liability is conditional upon future events including:

  - Future services to be rendered;
  - Future volumes of output to be consumed by users (such as petrol or electricity); and
  - The continuation of regulation (regulatory framework and rules).

- There is in, our view, no binding obligation for the entity to repay the customers at the year end date, but rather a commitment to adjust prices in a future year.

Accounting for under-recoveries

- In the case of any under-recoveries (regulatory assets), the assets are not considered as meeting the definition of an intangible asset. This is because the resource is not controlled (paragraph 59 of the Framework) by the entity as a result of a past event. It is only as result of future sales that the economic benefits will flow to the entity. It can also be argued that the regulatory assets are better described simply as past costs, which the regulator allows the entity to recover through higher sales prices in the future.

- Paragraphs 19 – 21 in the Basis for Conclusions debate why these regulatory assets are within the control of the entity and the Board's view is that the entity controls the customer base even though the customer base changes. The IAS 38 – *Intangible Assets* definition of an intangible asset is *"an identifiable non-monetary asset without physical substance"*. Paragraph 12 of IAS 38 states that an asset is identifiable if it either *"(a) is separable, i.e. is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability; or (b) arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations"*. We believe the asset is not separable and does not arise from legal or contractual rights. The entity might not have any asset to dispose of as the future selling price might be the same for an acquirer of the business as well as a new start up company. In addition, the entity might have no legal or contractual rights with its customers; nor do the customers have a legal relationship with the regulator. While the regulator oversees the relationship between an entity and its customers, this does create a legal relationship between these parties. It is contended that in the case of both the regulatory asset and liability something must happen before the asset or liability can be recognised. The mere fact that the regulator has the authority to ensure a change in cash flows after year end is not seen as an event that can result in the recognition of a regulatory asset or liability at year end.

Other considerations in relation to the Framework

- The proposals argue that the regulatory assets and regulatory liabilities comply with the definition of an asset and a liability of the Framework. This being the case, it is unclear why this does not seem to have been the accepted view before the issue of the exposure draft.

- Accordingly, the proposals seem to be a deviation from the Framework and thus may create confusion amongst the users of financial statements. If this deviation is intended to be an exception, the basis for the exceptional circumstances should be motivated.

- The proposed standard is only applicable if there is a cause-and-effect relationship between an entity's cost and its rate-based revenue. This creates the impression that the matching principle in the proposed standard has been given far more weight than it has been given in the Framework.

- Further concerns regarding the proposals in relation to the Framework are contained in the Appendix to this letter.

Other reasons for not supporting the proposals

- The proposed standard prescribes accounting for regulatory assets and liabilities for certain rate-regulated entities, but this option is not applicable to unregulated entities. We are not convinced that the accounting treatment of rate-regulated and unregulated entities should be different, as generally tariff setting for rate-regulated and unregulated entities are very similar. The proposed accounting treatment will result in the smoothing of profits for rate-regulated entities whereas this is not permitted for unregulated entities.

- The proposed standard is considered to be a rule-based solution, rather than a principle-based one.

- There is a concern that some of the principles illustrated in this proposed standard may be used by analogy for other accounting issues.

- The proposals are regarded as being simplistic as they do not consider all possible application issues that could arise from implementing the proposals, as outlined further in Appendix A.

If the IASB agrees with the above comments, then this could result in the abandonment of this project. In this case we would be concerned if no guidance was issued, as then it would be unclear as to the what the Board's views on this matter were, i.e. it would not be clear if the view was that the proposed treatment was unacceptable as it was incorrect or what the appropriate treatment should be when following the hierarchy in IAS 8 – *Accounting*

Policies, Changes in Accounting Estimates and Errors.. Therefore, it might be appropriate for guidance to be issued that could focus on the appropriate disclosures for rate-regulated activities, which could also explain the Board's view on regulatory assets and liabilities. If, however, the IASB decide to proceed with this project on the basis proposed in the exposure draft, then we believe the final standard should indicate clearly that this is a departure from the Framework and that it has been created to fulfil the needs of the users and preparers of financial statements of rate-regulated industries.

SPECIFIC COMMENTS

Scope

Question 1
The exposure draft proposes two criteria that must be met for rate-regulated activities to be within the scope of the proposed IFRS (see paragraphs 3–7 of the draft IFRS and paragraphs BC13–BC39 of the Basis for Conclusions).
Is the scope definition appropriate? Why or why not?

We do not believe the scope definition is appropriate. We question why the exposure draft is only applicable if there is a cause-and-effect relationship between an entity's cost and its rate-based revenue. If the exposure draft was intended to apply only in areas where costs are recouped, it is not clear why a profit margin is included as well, as envisaged by the exposure draft.

When an entity's regulation revenue in terms of paragraph 6 is based on targeted or assumed costs, for example industry averages, rather than the actual costs incurred or expected to be incurred by the entity, the rate-regulated activities are not in the scope of the proposed standard. This does not appear logical as this entity (without the regulatory cause-and-effect relationship) may also be required to reduce or increase tariffs in the same way as an entity that complies with the regulatory cause-and effect relationship. In our view, if it is believed that there is a link between expenditures incurred or avoided in the current period and the recognition of future revenue resulting in a regulatory asset or liability that can be justified in terms of the Framework, then this should not be limited to actual costs. Based on this and if the project goes ahead, it is suggested that the scope be widened to include rate-regulated industries as suggested in paragraph 6, which are required to reduce tariffs in the future if there is an over-recovery or increase tariffs in future in the case of under-recoveries, whether based on actual costs or not.

This raises the question as to whether there might be circumstances where this should also apply to non rate-regulated industries. For example, an entity might publically state that its prices are determined on a basis that accords with the basis specified in the exposure draft. This public information may meet the requirements for a constructive obligation as defined in IAS 37. Accordingly, it is not clear why the proposals require the need for a regulator.

The rationale for this last comment is borne out by the definition of a regulator which is seen to be very wide and could be construed to incorporate any board of directors. If it is decided that the scope of the proposed standard is not to be broadened, then we suggest that the definition of a regulator include a board, only in the case where it is required by statute (local and central government), and is monitored by an independent body.

There is some uncertainty as to whether one has to apply the proposed standard on rate-regulated activities or IFRIC 12 - *Service Concession Arrangements,* or both. For example, paragraph 5 of IFRIC 12 states that it applies to public-to-private service concession arrangements where the price may be regulated. Therefore, an entity within the scope of IFRIC 12 might also be regarded as a rate-regulated activity. That regulator may essentially require prices to be determined on a basis that is similar to that specified in the exposure draft (namely based on a return using an assumption that the assets on which a return is calculated are within the scope of IAS 16(AC 123) – *Property, Plant and Equipment*) and not on a financial asset or intangible asset basis as specified in IFRIC 12. In this case, could it be argued that the assets should be recorded by the entity in terms of IAS 16 (based on the requirements of paragraph 16 of the exposure draft)? In addition, would the assets as required by IFRIC 12 be derecognised? It is therefore suggested that clarification is needed regarding the interaction between application of IFRIC 12 and the proposed standard.

Recognition and measurement

Question 2
The exposure draft proposes no additional recognition criteria. Once an activity is within the scope of the proposed IFRS, regulatory assets and regulatory liabilities should be recognised in the entity's financial statements (see paragraphs BC40–BC42 of the Basis for Conclusions).
Is this approach appropriate? Why or why not?

Noting our views under general comments and our response to Question 1, should the IASB proceed to a final standard, this approach is acceptable.

Question 3
The exposure draft proposes that an entity should measure regulatory assets and regulatory liabilities on initial recognition and subsequently at their expected present value, which is the estimated probability-weighted average of the present value of the expected cash flows (see paragraphs 12–16 of the draft IFRS and paragraphs BC44–BC46 of the Basis for Conclusions).
Is this measurement approach appropriate? Why or why not?

We have a concern that there is an inconsistency between paragraphs 6 and 13. Paragraph 6 refers to the actual cost incurred by the specific entity, while paragraph 13 refers to future cash flows. In addition, these future cash flows are discounted. Paragraph 13 appears to be a surrogate for paragraph 6 (actual cost incurred). The relationship may need to be expanded upon because the direct cash flows in terms of paragraph 13 will not be the same after being discounted and applying probabilities. If previously incurred costs are to be recovered in the future, then the discounting should just affect the time value of money of such recovery, with impairment taking into account costs incurred that are not likely to be recovered in the future.

In paragraph 8(b) the words "*previously collected*" are used. It is suggested that the word 'collected' be replaced by either 'recognised' or 'collectable'.

The meaning in paragraph 13(d) relating to paragraph 6 is not clear and should be clarified by giving an example. We are not sure whether it is intended to cover inherent uncertainties such as a change in the regulatory rules, a change in the demand for the product of the entity, or something different.

The issue of whether the regulatory asset or liability affects revenue or not needs consideration. In other words, if there is a regulatory liability, does this mean that the revenue is overstated or costs understated? Example 9 in the Illustrative Examples suggests that costs should be adjusted and not revenue. This approach seems contrary to the Basis for Conclusions which states a liability is '*an obligation [that] arises because of a requirement to refund to customers amounts collected in previous periods*' [BC23].

We believe that the exposure draft does not adequately consider all possible situations that could arise and accordingly it may be difficult to apply in practice. Examples of potential difficulties on the practical application of the exposure draft are set out in the Appendix to this letter. Accordingly, it would be appropriate for these issues to be considered in finalising any proposed standard.

Question 4

The exposure draft proposes that an entity should include in the cost of self-constructed property, plant and equipment or internally generated intangible assets used in regulated activities all the amounts included by the regulator even if those amounts would not be included in the assets' cost in accordance with other IFRSs (see paragraph 16 of the draft IFRS and paragraphs BC49–BC52 of the Basis for Conclusions). The Board concluded that this exception to the requirements of the proposed IFRS was justified on cost-benefit grounds.

Is this exception justified? Why or why not?

This exception is not supported. The exception would result in inconsistent accounting treatment for property, plant and equipment and internally developed intangible assets between the entities operating in rate-regulated industries and other entities. In our view, there are many instances in which entities maintain different records for either regulatory, statutory or IFRS purposes, and this scenario does not warrant a special exception.

Differences in the following areas may result between a set of financial statements prepared in terms of the IFRS and this proposed standard: borrowing costs, research expenditure and other costs that are capitalised when constructing property, plant and equipment, e.g. "abnormal" expenditure such as compensation claims for injuries sustained on site. It is also possible that a regulator may specify an expected term over which the cost of an asset is expected to be recovered and may specify a nil residual value, or a residual value that differs from the useful life, or residual value as required in terms of IAS 16. It is not clear to what extent the exposure draft is suggesting departures from IFRS.

Another example of a lack of clarity in the proposed standard is that of the electricity utility in South Africa that does not include borrowing costs for rate-regulation purposes in the cost of property, plant and equipment when the rate-regulated return is determined. In this case, it is questioned whether it was intended that the entity should capitalise less than the amount allowed in terms of IFRS. Paragraph 16 creates the impression that it requires certain costs to be capitalised, when in terms of IFRS they would be expensed. This paragraph does not seem to provide for certain costs to be expensed, when in terms of IFRS they would normally be capitalised. It is not clear whether the proposed standard is suggesting that it may be appropriate to have a lower cost than required by IFRS.

The other area of concern is that if the proposals result in assets being carried at an amount that differs from that normally required in terms of IFRS, then other regulators may expect similar treatment (e.g. impairments by banking regulators). Regulators often have different rules for their reporting purposes. Accordingly, it is appropriate for separate returns to be submitted to the regulator and not to expect IFRS to meet to the requirements of a regulator. Also, where an entity has different rate-regulated activities within one entity, it could result in similar assets being measured differently depending on the various regulators' requirements.

Should the IASB proceed to a final standard and this proposal is carried forward, then guidance should be provided regarding the treatment of such items with respect to useful lives, residual values and depreciation/amortisation. In practice the regulator may have different views on matters such as useful lives of assets. Guidance is required to indicate whether the view of the regulator or the entity is used to determine the useful life of assets, etc. in the financial statements. Additional disclosures may also be required as to the measurement basis used for items of property, plant and equipment and intangible assets (see response to Question 6).

Question 5

The exposure draft proposes that at each reporting date an entity should consider the effect on its rates of its net regulatory assets and regulatory liabilities arising from the actions of each different regulator. If the entity concludes that it is not reasonable to assume that it will be able to collect sufficient revenues from its customers to recover its costs, it tests the cash-generating unit in which the regulatory assets and regulatory liabilities are included for impairment in accordance with IAS 36 Impairment of Assets. Any impairment determined in accordance with IAS 36 is recognised and allocated to the assets of the cash-generating unit in accordance with that standard (see paragraphs 17–20 of the draft IFRS and paragraphs BC53 and BC54 of the Basis for Conclusions).
Is this approach to recoverability appropriate? Why or why not?

Noting our views under general comments and our response to Question 1, if, however, the IASB proceeds to a final standard and if the scope is not changed, this approach is acceptable.

Disclosures

Question 6

The exposure draft proposes disclosure requirements to enable users of financial statements to understand the nature and the financial effects of rate regulation on the entity's activities and to identify and explain the amounts of regulatory assets and regulatory liabilities recognised in the financial statements (see paragraphs 24–30 of the draft IFRS and paragraphs BC59 and BC60 of the Basis for Conclusions). Do the proposed disclosure requirements provide decision-useful information? Why or why not? Please identify any disclosure requirements that you think should be removed from, or added to, the draft IFRS.

The disclosures as proposed in the exposure draft are supported. The disclosure of a sensitivity analysis and an age or maturity analysis will further improve the disclosure requirements. Information on when the next rate will be set is decision-useful information.

The meaning of paragraph 27(a)(ii) relating to what amounts should be disclosed is not clear. We are unsure whether the recognition amount refers to actual costs or discounted amounts shown as regulatory assets, or liabilities and future revenues. It is suggested that an example be included that illustrates the disclosure requirements of this proposed standard.

It is suggested that paragraph 30 regarding additional disclosures be deleted in the final standard, since the issue should already be addressed by the general requirement of fair presentation in IAS 1 – *Presentation of Financial Statements*.

It is unclear whether, or under what circumstances, an entity is allowed to offset amounts that refer to different periods. For example, an entity might have both regulatory assets and liabilities, but which are being recovered over different periods. If the asset is being recovered over the next three months, but the liability over the next six months, is there a regulatory asset to the extent the asset exceeds the portion of the liability to be settled in the next three months, with a liability for the amount to the settled in the next three months, or can the total asset and liability be offset? It is suggested that clarity be provided on this issue.

Paragraph 28 refers to disclosure requirements regarding impairment. There is some uncertainty when an amount is being impacted by re-measurement or is being impaired. Typically it would be expected that impairment would occur after an asset is recorded, but in this case uncertainty may occur in the initial recognition of an asset. In addition, if the same asset is re-measured at a later period, it might be difficult to distinguish between measurement and impairment changes. Accordingly, it is suggested that clarity be provided regarding the difference between re-measurement and impairment.

If the Board continues with the approach that allows different measurement of items of property, plant and equipment and intangible assets for regulatory purposes, additional disclosure should be required in the accounting policies and notes to the financial statements where this approach is adopted for rate-regulated and unregulated activities. While general disclosures are required in paragraphs 24 and 25, they may be too broad to address this issue and may not be sufficient. We suggest that additional disclosure requirements should be added in this regard.

Transition

Question 7
The exposure draft proposes that an entity should apply its requirements to regulatory assets and regulatory liabilities existing at the beginning of the earliest comparative period presented in the period in which it is adopted (see paragraph 32 of the draft IFRS and paragraphs BC62 and BC63 of the Basis for Conclusions). Any adjustments arising from the application of the draft IFRS are recognised in the opening balance of retained earnings.
Is this approach appropriate? Why or why not?

We agree with this approach.

Regarding property, plant and equipment and intangible assets, if amounts are capitalised as suggested in paragraph 16 that would not normally be capitalised in terms of IAS 16 or

IAS 38, this may create problems during the transition to the new standard in terms of depreciation calculations. It may be necessary to allow that the implementation is done prospectively if retrospective implementation is impractical.

First-time adoption

The exposure draft includes proposed amendments to IFRS 1 First-time Adoption of International Financial Reporting Standards (see paragraph C1 of the draft IFRS). These amendments are the result of the Board's exposure draft Additional Exemptions for First-time Adopters published in September 2008. These amendments reflect the comments received on that exposure draft and the Board's redeliberations.

We support this proposal.

Other comments

Question 8
Do you have any other comments on the proposals in the exposure draft?

Derecognition:
Paragraph 21 requires an entity to derecognise the entire carrying amount of regulatory assets and liabilities when the underlying activities fail to meet the criteria in paragraph 3. It may be possible that the assets and liabilities need to be derecognised as a result of actions taken by the regulator and not because the criteria in paragraph 3 are not met. For example, changing the rules may impact the recoverability from future revenue. It is suggested that clarity may be needed in those circumstances when the regulator changes the rules (e.g. retrospective change as to which costs can be capitalised, specified return that can be achieved, additional products subject to rate-regulation, etc).

APPENDIX

1. Further comments on non compliance with the Framework

As noted in our general comments, we do not believe the proposals comply with the Framework. In addition to those comments, we believe that the proposals do not adequately deal with the following issues:

- The proposals do not deal sufficiently with the distinction between actual and assumed costs. If assumed costs are used to determine prices, it can be argued that regulatory assets and liabilities are related to amounts already recorded as revenue and relates to the customer base as a whole, which are arguments used in BC25 for regulatory liabilities.

- Further, if customers do not know whether prices are based on actual or assumed costs, it is difficult to argue that *'the regulator has the authority to ensure that future cash flows from the customer base as a whole would be reduced to refund amounts previously collected'* [BC24]. This means that one entity will have an asset/liability, but another not when the same amount per unit is to be refunded, as indicated in the petrol example below.

- While the Basis for Conclusions argues that the regulator administers the rate-regulated asset/liability, this recovery/refund is dependent on future sales. It is argued that insufficient justification has been provided as to why this results in an asset/liability and not a contingent asset/liability.

- In the petrol example below it is difficult to argue that in the case of the first entity that *'the regulator provides no assurance that future economic benefits will result'* [BC17], but does provide assurance to the retailer when the same regulations apply to both entities. The validity of this argument could be further questioned by arguing that the proposed standard is saying that assurance can be given to an individual company, but not to a group where the retailer and the refiner it purchases product from, in the example below, is part of the same group.

- It is also believed that some of the arguments relating to intangible assets and rights to future cash flows are misleading. Generally the acquisition of such assets and future income arising from these assets are separate transactions. Entities expense operating expenditure when incurred and the amount expensed relates to the cost of services provided. However, by linking the regulatory asset/liability to actual costs incurred it is essentially arguing that part of the expense is an asset or that expenses are understated. It is difficult to argue this in relation to individual items of income and expense as these are appropriately determined. In the case of a regulatory asset the exposure draft is saying that part of the costs relate to the acquisition of an asset (namely right to recover certain costs from customers) from a party that does not have that right to sell. While that right could be acquired from the regulator (or other regulated entities that have that right), this does not occur in this case where nothing is paid for this right. To effectively say that part of the cost of some service provided is a right to recover those costs from customers is not a right normally associated with the acquisition of such services. If this is the expected approach, then it is argued that this approach should apply regardless of whether the entity was regulated or not. While the entity has the right to charge customers, it is only capitalised if it is acquired from a party who has that right to sell. The primary reason for the expenditure is the service acquired and to argue that the specific service (or services generally) is not appropriately recorded, because it creates an asset/liability to a fourth party (namely the customer) as a result of a right obtained from a third party regulator, is not what would be considered acceptable accounting.

2. Examples of practical application difficulties

2.1 An example of a possible difficulty in applying the proposals is an entity that is required to adjust future selling prices for a regulated product based on the difference between expected and actual costs incurred in a particular month. This could be achieved in various ways. If expected costs were CU 9 per unit sold, whereas actual costs were CU 10 per unit sold, the regulator might specify that the selling price for the next month is to be CU 1 (10-9) higher than would otherwise be the case. The regulator could deal with this as follows:

- The regulator might keep a running total of the amount of the under or over recovery. Accordingly if 10 000 units were sold in the month, then an under recovery of CU 10 000 would be recorded (10 000 * (10-9)); or

- The regulator might not keep a running total and might just specify the amount by which the following month's selling price is to be adjusted. Accordingly if in the next month more than 10 000 units are sold the entity would recover more than the extra costs incurred in the previous month and less if fewer than 10 000 units are sold, without this difference affecting future month's selling prices.

Whilst the first of these scenarios might be within the scope of the proposed standard, this might not apply to the second scenario. This is because it is not clear whether the price established by the regulator is designed to recover the specific costs or not. On the one hand it can be argued that the extent to which actual costs in one month differs from expected costs (on a unit basis) for the same month is the extent to which the price for the following month is adjusted. On this basis the criteria is regarded as being met. In this case, while paragraphs 8 and 10 of the exposure draft suggests that an asset of CU 10 000 should be raised, it is questioned whether based on paragraph 13 that the asset should be based on the lower of 10 000 units and the expected sales volume for the following month. On the other hand it can be argued that the criteria are not met because the pricing mechanism is not designed to recover the extra/(lesser) costs incurred because the difference in costs on a total basis (i.e. not on a per unit basis) would only be recovered/(refunded) if the sales volumes in the two months are identical, which is unlikely.

2.2 The situation of whether the proposed standard applies or not can be complicated further in some possible situations. For example:

- There can be an inappropriate determination of whether actual costs have been incurred or not. For example, prices for each month might be determined on the last day of the month based on information from the 16th of one month to the 15 th of the following month, but for regulatory purposes the running total might be based on volumes for the calendar month. Accordingly, while costs and volumes are both actual (and thus arguably within the scope of the proposed standard), when multiplied together they do not represent additional total costs incurred and thus would not be within the scope of the proposed standard.

- It is unclear whether the proposed standard applies only to costs expensed in the statement of comprehensive income. For example, an entity might purchase inventory in one month for CU 10 per unit, when it was expected that the cost would be CU 9 per unit and it is able to recover this additional CU 1 per unit in the next month. If this inventory had been acquired and sold in the same month, then the cost of the inventory would have been expensed and thus it can be argued that the 'excess costs' (i.e. CU 1 per unit) should be shown as an asset. If, however, inventory acquired in one month is only sold in the next month, then arguably the entity has two assets, namely inventory and a regulatory asset. The regulatory asset would, in terms of paragraph 8 of the exposure draft, be the cost of the inventory (being a specific previously incurred cost) plus the specified return it is allowed to earn. This is based on the wording referring to 'incurred cost' (as inventory is to be recorded at its incurred cost) and not expenses recorded in the statement of comprehensive income. Paragraph 10 suggests that costs incurred only relate to costs expensed and does not apply if a related asset (e.g. inventory) is recorded and thus there would be no regulatory asset in the second of these possible situations.

- Taking the two previous bullets together, it is not clear how the proposed standard would apply if the regulated price is based on actual purchases of inventory and actual volumes for a particular month, but there is unsold inventory at the end of that month. In this case, the regulatory asset would exclude costs relating to inventory acquired in previous months, but sold in the current month, if it is argued that the regulatory asset/liability only applies to purchases made in the current month. The regulatory asset/liability might conceivably exclude costs related to unsold inventory as a result of paragraph 10 and relates to the extent to which profits were higher/lower as a result of costs expensed differing from expected costs.

- Following on from this, it not clear how to apply the proposed standard if the regulatory requirements are based on actual amounts, but this differs from the required accounting. For example, the regulated price could be based on actual purchases or cost of goods sold, but if the proposed standard requires the regulatory asset/liability to the calculated using the other approach, does the proposed standard apply or not?

- While the proposals refer to actual costs, the need for this requirement is not clear. In South Africa it is possible that two similar entities might be subject to the same regulation, but one might be within the scope of the proposed standard while the other might not be even though they are required to apply the same selling price for a regulated product. For example, the price of petrol is regulated based on assumed costs. If the first entity imports and then refines oil which it then sells at the regulated price, then that entity would not be within the scope of the proposed standard as its costs would differ from the assumed costs. However, a petrol retailer might acquire refined petrol from another refiner and its purchase price might be equivalent to the assumed cost price (which includes a profit margin for the refiner). In this case the retailer would be within the scope of the proposed standard as the actual and assumed costs are the same. In both cases, it can be determined by how much the future profits are going to be affected by adjusting the regulated price, but while the first entity would not have the regulatory asset or liability, the retailer would have such an asset or liability. The man in the street might not know this and would also not know that purchasing from the retailer would affect that entity's regulatory asset/liability while purchasing the same product at the same selling price from the first entity would not result in any regulatory asset or liability. Accordingly the two entities are subject to exactly the same regulation, but their profits would not be comparable.

- Another issue that needs consideration is the composition of the regulatory selling price as it could include a combination of actual and assumed costs. Taking the example in the previous bullet further, the retailer might acquire petrol from the first entity at the refinery and then ship it to another location, or could acquire it from the refinery's depot in the other location. In this case the retailer would incur actual transport costs that might differ from the assumed transport costs included in the selling price relating to the depot purchase. In the case of purchasing product from the refinery, part of the selling price might be based on assumed costs and so the proposed standard might only partly apply and thus whether there is a regulatory asset/liability for the transport costs can depend on where the purchases were made.

- The specified return is another issue that needs to be considered. For example, an entity may incur costs that are the same as those expected, but it may not earn the specified return as a result of actual volumes being less than expected. It could be argued whether paragraph 8(a) applies in this situation. On the one hand, it could be argued that the requirements of this paragraph is not met on the basis that the inclusion of the word 'and' requires both requirements to be met and therefore if costs were in line with expectations the second part of that paragraph is then not considered on the basis that both parts are required to be met. The other argument is that the asset consists of two parts and thus if there is no asset for the first part there can still be an asset for the second part. While it could be argued that this second argument is the more logical interpretation, the wording of paragraph 10 seems to contradict this. That paragraph refers to amounts that might otherwise be included in the statement of comprehensive income. If actual costs are more or less than expected then it can be argued that in the absence of the proposed standard that these costs would be included in this statement. However, this does not apply in the case of the specified return only as in the absence of the proposed standard the additional return would not have been included in this statement.

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