



IMPACT OF IGRAP 1 ON REVENUE CONSIDERATIONS: HOW COLLECTABILITY OF REVENUE AFFECTS RECOGNITION

Many public sector entities are required in terms of legislation to provide non-exchange transactions, such as the levy of property rates, taxes, fines (traffic fines / library fines), licence fees, grants, subsidies and others, which results in revenue that needs to be appropriately recognised in terms of the Standards of GRAP. However, many times there are great uncertainty as to timing and extent of the collectability of these non-exchange revenues, resulting in possible material impacts on the revenue amounts disclosed in the annual financial statements of these public sector entities.

In May 2014, the Accounting Standards Board issued an updated Frequently Asked Questions on the Standards of GRAP (ASB FAQ), clarifying the recognition of **Revenue from Non-Exchange Transactions** in terms of GRAP 23 and iGRAP1 and as it pertains to **revenue recognised**. In July 2014, National Treasury further issued an Accounting Guideline which outlines the principles that should be applied in accounting for traffic fines, based on where an entity acts as principal in relation to the issuing of traffic fines.

This article sets out (i) a summary of iGRAP 1, applying the probability test on initial recognition of revenue; (ii) the ASB FAQ as to effect of iGRAP 1 on traffic fines as per Question 4.4. (May 2014 update); (iii) NT's traffic fine accounting principles; and (iv) Ducharme's summary of implementation issues / matters to consider regarding traffic fines revenue.

In essence, revenue recognition for non-exchange transactions can be summarised as follows:

- (i) Initial recognition based on the probability of **entitlement to collect**; and
- (ii) Subsequent measurement based on the probability of **collection**.

iGRAP 1 SUMMARY: PROBABILITY TEST ON INITIAL REVENUE RECOGNITION

The **revised interpretation of iGRAP 1** pertaining to revenue recognition was revised during 2012 to include non-exchange revenue, and became effective for reporting periods commencing on or after **1 April 2013**.

As per iGRAP1.07 and iGRAP1.08, the following issues are raised, in that:

- Public sector entities are required to provide goods or services and to levy taxes, fines, licence fees and other types of non-exchange revenue in accordance with their legislative mandate. At the time of invoicing, there may be uncertainty as to whether the revenue will ultimately be collected. Nevertheless, entities often continue to provide goods or services and levy taxes, fines, licence fees or other types of non-exchange revenue, despite non-payment as entities are required in terms of their legislative mandate to undertake these functions and collect the revenue due to them. For example, a municipality is required in terms of the Property Rates Act to levy property

rates on the property owner based on the value of the property. These rates are levied without considering the collectability thereof as any possible non-payment is a subsequent event

- Presently, different practices are applied when determining the probability on initial recognition of revenue. Some take into account the likelihood of not receiving all the revenue by considering the past collection experience, and reducing the amounts initially recognised by the estimated future losses. Others recognise the full amount on initial recognition and subsequently recognise an impairment loss.

iGRAP1.09 to iGRAP1.11’s consensus states that:

- (i) at the time of **initial recognition** of exchange and non-exchange revenue it is **not appropriate to assume that revenue will not be collected** as the entity has an obligation to collect all revenue and this would be contrary to normal business principles. Accordingly, the ASB Board concluded that the **full amount** of exchange and non-exchange revenue should be recognised at the **initial transaction date**.
- (ii) **Assessing and recognising impairment** is an event that **takes place subsequent** to the initial recognition of revenue charged. An entity assesses the probability of collecting revenue when accounts fall into arrears. Such an assessment should not be made at the time of initial recognition.
- (iii) The disclosure of the subsequent impairment improves the information provided to users of the financial statements.

iGRAP 1 Illustrative example 1:
Revenue from an exchange transaction

Entity A provides public goods and services to private households. Entity A bills individual households on a monthly basis for goods provided and services rendered. Entity A calculates, based on past experience, that only about 90% of the revenues are collected.

Entity A recognises the full amount of revenue based on the terms of the arrangement with each household, notwithstanding its knowledge based on past experience.

Consideration should be given to whether there is objective evidence that an impairment loss has been incurred when making the impairment assessment for subsequent measurement of the receivables at the reporting date.

iGRAP 1 Illustrative example 2:
Revenue from a non-exchange transaction

As required by the Property Rates Act, Municipality X levies property rates monthly on property owners. Municipality X estimates that, based on past experience, 95% of revenues are collected.

Municipality XYZ should recognise the full amount of property rates levied in terms of its legislative mandate, notwithstanding its expectations of the collection of the rates based on past experience.

Assessing and recognising an impairment loss for revenue not expected to be collected is performed subsequently.

Pre-IGRAP1: historic accounting for traffic fines

Before the amendments to iGRAP 1, public sector entities applied different accounting policies and methodologies for the initial recognition of revenue from traffic fines (especially relating to the timing and measurement of this revenue).

One common policy, for example, was that municipalities during the 2012/2013 reporting period recognised traffic fines revenue on the **cash basis** with additional revenue recognition at year end based on the payment history of traffic fines. Cash collected during the year was compared to average cash typically collected in the past – should history show a higher average annual collection amount than that collected during the year, an additional accrual is raised for the difference – such accrual is then again reversed at the beginning of the new financial year. This means that the municipality effectively included an assessment of the probability of non-payment in the initial recognition of the revenue from fines.

GAMAP 9 considerations

As per NT Accounting guideline: Traffic Fines, municipalities historically accounted for traffic fines by applying the principles in the Standard of Generally Accepted Municipal Accounting Practice on Revenue (GAMAP 9). GAMAP 9 outlined the following principles in relation to the recognition and measurement of revenue from traffic fines:

GAMAP 9.39: Revenue from the issuing of fines shall be recognised when:

- it is **probable** that the **economic benefits** or service potential associated with the transaction will flow to the entity, and
- the amount of the revenue can be **measured reliably**.

GAMAP 9.41: An estimate should be made for the revenue amount collected from spot fines and summonses based on past experience of amounts collected. Where a reliable estimate cannot be made of revenue from summonses, the revenue from summonses should be recognised when the public prosecutor pays over to the entity the cash actually collected on summonses issued.

GRAP 23's recognition of revenue from non-exchange transactions

As per NT Accounting guideline: Traffic Fines, the Standard of GRAP on Revenue from Non-Exchange Transactions (Taxes and Transfers) (GRAP 23) was issued in February 2008 and became effective for municipalities on 1 July 2012. As traffic fines are non-exchange revenue transactions, the principles in GRAP 23 should have been used by municipalities to account for traffic fines from 1 July 2012. GRAP 23 outlines the following broad principles for the recognition of revenue from non-exchange transactions:

GRAP23..43, “An **inflow of resources** from a non-exchange transaction recognised as an asset shall be recognised as **revenue....**”.

GRAP23..40 indicates that “An asset acquired through a non-exchange transaction shall **initially be measured** at its fair value at the date of acquisition.”

In terms of GRAP 23, fines are classified as “Transfers”. The following guidance is provided in GRAP 23 on the recognition and measurement of “transfers”:

GRAP23.78: “Transfers satisfy the definition of an asset when the entity **controls** the resources as a result of a **past event** and expects to receive **future economic benefits** or service potential from those resources. Transfers satisfy the criteria for recognition as an asset when it is **probable** that the **inflow of resources** will occur and their fair value can be **reliably measured**.”

Paragraph .79: “An entity obtains control of transferred resources either when the resources have been transferred to the entity, or the entity has an **enforceable claim** against the transferor. Many arrangements to transfer resources become binding on all parties before the transfer of resources takes place....”

GRAP23.89: “...Assets arising from fines are **measured** at the **best estimate** of the inflow of resources to the entity.”

ASB FAQ's: What is the effect of IGRAP 1 on traffic fines?

Question 4.4. of the ASB FAQ's on the Standards of GRAP, as updated in May 2014, stated the following as to effect of IGRAP 1 on traffic fines. The ASB advises that although the FAQs are not authoritative, it is compiled to assist preparers of AFS, with the encouragement to apply the relevant Standard of GRAP, Interpretation or Directive in the accounting for material items:

<p>Initial recognition: <i>Probable & measurable</i></p>	<p>The Standard of GRAP on Revenue from Non-exchange Transactions (Taxes and Transfers) (GRAP 23), requires that revenue is recognised when it is probable that future economic benefits or service potential will flow to the entity and these benefits can be measured.</p>
<p>Transaction date & initial recognition: <i>Full recognition</i></p>	<p>IGRAP 1 clarifies that an entity should recognise the full amount of revenue at the transaction date, even if there is an uncertainty about the entity's ability to collect such revenue based on past history, as the entity has an obligation to collect all revenue due to it. Entities should not consider or assess the probability of collecting revenue at the transaction date because this is a subsequent measurement event.</p>
<p>Subsequent date & measurement <i>Uncertainty on collection</i></p>	<p>Subsequent to initial recognition and measurement, an entity should assess the collectability of the revenue and recognise an impairment loss where appropriate.</p>
<p>Early settlement & other discounts</p>	<p>Although IGRAP 1 requires an entity to recognise the full amount of revenue at the transaction date, an entity may need to use estimates to determine the amount of revenue that it is entitled to collect. For example, an entity may offer early settlement discounts, or may offer reductions in the amount payable by the debtor in certain circumstances. Where these exist, an entity considers past history in assessing the likelihood of these discounts or reductions being taken up by debtors.</p> <p>For example, motorists qualify for a discount of 50% on a fine imposed if payment is made within a period of 32 days. Based on past history, 10% of motorists take advantage of this reduction. The entity will therefore recognise 90% of the fines at their full value and 10% of the fines at half their value.</p>

NT's proposed principles for accounting of traffic fines: From 1 July 2013 onwards

The NT issued a document entitled 'Accounting guideline: Traffic Fines' on 24 July 2014. The following section is an extract that has been made from NT Accounting Guideline. The full version can be found on their website. The NT Accounting Guideline provides:

- Consideration of the **Impact of GRAP 23 and IGRAP 1** on previous bases of accounting;
- **proposed accounting treatment** of revenue pertaining to traffic fines.

NT Accounting Guideline consideration (i): Impact of GRAP 23 and IGRAP 1 (policy impact)

As per the NT Accounting Guideline, when entities adopted GRAP 23 for the first time in the 2012/13 reporting period, they should have **developed policies** that resulted in traffic fines being recognised when the event that gives rise to enforceable claim occurs and a reliable measure of the receivable/revenue can be made.

It further also stated that GRAP 23 provides explicit guidance about the point at which **revenue from traffic fines** arises while GAMAP 9 was silent on this matter. **GRAP 23** requires revenue to be measured based on the fair value of the receivable at acquisition, using the entity's **best estimate of the inflow** of resources to the entity. GAMAP 9 specified that traffic fines could be measured using an estimate based on past experience of amounts collected. GAMAP 9 also acknowledged that where a reliable estimate could not be made, then revenue could be recognised on the cash basis. There are clear differences between GAMAP 9 and GRAP 23 both on the point at which receivables and revenue from traffic fines are recognised, as well as how they should be measured.

2012/13 Reporting period	2013/14 Reporting period
<p>In measuring receivables and revenue from traffic fines in accordance with GRAP 23 in the 2012/13 reporting period, entities should have considered all relevant facts and circumstances. As the amendment to IGRAP 1 was only effective for municipalities from 1 July 2013, the probability of non-payment may have been included in the initial recognition and measurement of revenue from traffic fines in the 2012/13 reporting period. All other relevant factors should however have been considered in initially recognising and measuring receivables and revenue from traffic fines. Where entities did not consider all other relevant factors as indicated in GRAP 23 in accounting for traffic fines in the 2012/13 reporting period, they should consider whether a correction of an error is necessary.</p>	<p>The amendment to IGRAP 1 is effective from 1 July 2013 and should be applied prospectively. This means that if an entity did include the probability of non-payment in the initial recognition and measurement of revenue in 2012/13, then in 2013/14 it need not retrospectively restate the comparative information to exclude the probability of non-payment.</p>

NT concurred that as per the ASB revision of IGRAP 1, the following considerations to revenue from non-exchange transactions (as applicable to municipalities from 1 July 2013) are applicable:

- entities should **not** consider the **probability of non-payment** on **initial** recognition of revenue; and
- that probability of **non-payment** should be considered as a **subsequent** event when assessing **impairment**.

NT Accounting Guideline consideration (ii): Proposed accounting treatment

The NT Accounting Guidelines also provides the following as how the principles in GRAP 23 and IGRAP 1 are applied in recognising and measuring receivables and revenues related to traffic fines:

Non-exchange transaction to give rise to an asset

For an entity to demonstrate that a non-exchange transaction gives rise to an asset, it needs to demonstrate that:

- It has **control** of the resource as a result of a past event; **and**
- **Economic benefits** or service **potential** are expected to flow to the entity.

Traffic fines result in amounts payable by offenders to the relevant authority. This means that the relevant authority issuing the fine (referred to as the “entity” in this document) has an enforceable claim against an offender to undertake specific actions, which in most instances for traffic fines means the payment of cash of a specific amount.

An entity should therefore test whether this enforceable claim or right to collect cash (receivable) meets the definition of an asset.

Control of an asset as a result of a past event: Traffic fines are defined as economic benefits or service potential received or receivable by an entity as a consequence of the breach of laws or regulations. The past event that therefore gives rise to the receipt of economic benefits or service potential is the breach of a law or regulation.

Control of the traffic fine is demonstrated through the existence of an enforceable claim. A notice, summons or other document outlining the breach of the law is usually issued by the entity at the same time (or shortly after) the breach to the offender. This outlines the details of the enforceable claim that the relevant authority has against the offender.

Future economic benefits or service potential are expected to flow to the entity: The entity has a claim that is enforceable in law. An entity can explore various legal means and processes to enforce the payment of the fines. This means that there is a high expectation that future economic benefits or service potential will flow to the entity in future. (IGRAP 1 is discussed in paragraph 23 in the context of initial recognition).

Initial recognition

Where the definition of an asset is met, the entity should consider whether it should be recognised. The asset (receivable) should be recognised when:

- it is probable that future economic benefits or service potential will flow to the entity and
- the value of the asset (in this case, fair value) can be measured reliably.

Probable that future economic benefits or service potential will flow to the entity: Paragraph 20 indicates that because a legally enforceable claim exists, there is a high expectation that economic benefits or service potential will result from the asset. The actual economic benefits or service potential received by entities in revenue transactions may however be low because of non-payment by offenders.

IGRAP 1 indicates that non-payment in exchange and non-exchange revenue transactions should be considered when assessing impairment rather than in the initial consideration of whether or not it is probable that economic benefits or service potential will flow to the entity. As public sector entities are required to collect all revenue due to them, IGRAP 1 ensures that appropriate accountability is exercised over this process.

Reliable measure of the asset: To recognise an asset from a non-exchange transaction, an entity must be able to reliably determine its fair value¹. The value of the fine that can be imposed on the offender is usually stipulated in legislation, regulation or equivalent, and will vary depending on the nature and severity of the offence. The amount due by a particular offender is usually indicated on the notice, summons or similar document issued. In these instances, the asset (receivable) can be measured reliably. Where the amount due by an offender is not specified, a separate legal process usually needs to be followed to determine the amount or other penalty due. In these instances, a reliable measure of the asset (receivable) may only be available upon completion of this process.

**Initial
measurement**
*(4 scenarios
and other
considerations)*

The asset should be recognised initially at **fair value**, which is the best estimate of the inflow of economic benefits.

The amount due by a particular offender should form the basis of the amount recognised initially as an asset (receivable) and as revenue.

There are various factors that need to be considered when determining the amount of the receivables and revenue that should be recognised initially. The following sets out NT's 4 most prevalent scenarios as well as other considerations thereto.

The most prevalent 4 scenarios as per NT include:

- where the amount amount due by a particular offender is specified on the notice, summons or equivalent document, &
 - reductions may be offered in certain instances; or
 - reductions are available, subject to further processes being undertaken and these processes are:
 - within the entity's discretion
 - not within the entity's discretion
- where the amount due by a particular offender is not specified on the notice, summons or equivalent document, it typically means that an additional judicial process needs to be followed.

<p><i>Scenario 1: Clear discount terms</i></p>	<p>Where the amount due by a particular offender is specified on the notice, summons or equivalent document, reductions may be offered in certain instances.</p> <p>NT example: fines issued in terms of the AARTO Act can be reduced by 50% if paid within a specified period of time. The offering of these reductions has the potential to reduce the amount that an entity is entitled to collect.</p>	<p>The entity will therefore need to estimate the likelihood of these discounts being taken up by offenders when measuring the asset (receivable) and amount of revenue that should be recognised.</p> <p>Any variations in the amount of reductions estimated are treated as a change in the estimated revenue and are accounted for as a change in accounting estimate in accordance with GRAP 3 <i>Accounting Policies, Changes in Estimates and Errors</i>. An entity should consider the disclosures in GRAP 1 <i>Presentation of Financial Statements</i> to ensure that relevant information is provided to users about how the assumptions applied in estimating revenue.</p>
<p><i>Scenario 2: Possible discounts, with further processes within entity's discretion</i></p>	<p>Where the amount due by a particular offender is specified on the notice, summons or equivalent document, the entity issuing the traffic fine may indicate that reductions are available, subject to further processes being undertaken, where these processes are within the entity's discretion.</p>	<p>Where the amount due by a particular offender is specified on the notice, summons or equivalent document, the entity issuing the traffic fine may indicate that reductions are available, subject to further processes being undertaken. Where these processes are within the entity's discretion (i.e. it can decide on the reductions) then these should also be estimated when measuring the asset (receivable) and the amount of revenue to be recognised. Any variations in the amount of reductions estimated are treated as a change in the estimated revenue and are accounted for as a change in accounting estimate in accordance with GRAP 3. Relevant disclosures should be made on the assumptions used to estimate revenue and any other relevant information.</p>
<p><i>Scenario 3: Possible discounts, with further processes not within entity's discretion</i></p>	<p>Where the amount due by a particular offender is specified on the notice, summons or equivalent document, the entity issuing the traffic fine may indicate that reductions are available, subject to further processes being undertaken, where these processes are not within the entity's discretion.</p>	<p>Where the amount due by a particular offender is specified on the notice, summons or equivalent document, the entity issuing the traffic fine may indicate that reductions are available, subject to further processes being undertaken. Where these reductions are not within the entity's discretion, for example, they are subject to a further judicial process which is outside the entity's control, then these reductions are not considered in measuring the asset (receivable) on initial recognition.</p> <p>This is because of the high degree of uncertainty in estimating the likely outcome of this process. Once this separate process has been concluded, any reductions are accounted for as a change in</p>

		estimated revenue and are accounted for as a change in accounting estimate. If an entity does have reliable information about reductions based on past history, then this information could be considered in the initial estimate. Relevant disclosures should be made on the assumptions used to estimate revenue and any other relevant information.
<i>Scenario 4: Further judicial processes</i>	Where the amount due by a particular offender is not specified on the notice, summons or equivalent document, it typically means that an additional judicial process needs to be followed	Where the amount due by a particular offender is not specified on the notice, summons or equivalent document, it typically means that an additional judicial process needs to be followed. In these instances, an entity can only make a reliable estimate of the receivable and revenue once this process has been completed.
<i>Other initial measurement considerations</i>	<ul style="list-style-type: none"> For both the fines issued in terms of the AARTO Act and the Criminal Procedure Act, regardless of whether an amount is specified or not, an offender has the option to appear in Court and make the necessary legal representations. The legal validity of the fine issued, e.g. fines that may not be legally valid because the equipment used was not calibrated correctly, or the fine was not issued within the specified time frame. 	In these instances, an entity should assess the impact on the initial measurement of the fine, and make appropriate adjustments based on reliable information. Relevant disclosures should be made on the assumptions used along with and any other relevant information.
<i>Subsequent measurement amount</i>	Paragraph 35 of the NT Accounting Guideline states that as traffic fines are statutory receivables, there is no explicit guidance on the subsequent measurement of these receivables for the 2013/14 reporting period.	An entity should develop its own accounting policy for the subsequent measurement of these receivables using Directive 5 <i>Determining the GRAP Reporting Framework</i> and GRAP 3.

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As at issue of this article, the information in this article is correct in considerations of these matters. These may change over time with new requirements and information. This article does not represent a legal opinion or professional advice, and it is advised that due consideration be given to all the applicable facts on the application of accounting standards, with necessary professional guidance, prior to its application.