



Comments due by 18 May 2012

DISCUSSION PAPER 7

**ASSETS AND LIABILITIES ARISING FROM NON-
CONTRACTUAL ARRANGEMENTS THAT HAVE THE
FEATURES OF FINANCIAL INSTRUMENTS**



Introduction

This Invitation to Comment (ITC) outlines the Board's Discussion Paper on *Assets and Liabilities Arising from Non-contractual Arrangements that have the Features of Financial Instruments*. The Discussion Paper discusses and outlines possible accounting approaches for assets and liabilities that are similar to financial instruments because they require settlement in cash or another financial asset, but arise from legislation or similar requirements. The Discussion Paper includes the Board's analysis of the key issues and any preliminary views reached. Respondents' views are sought in a number of areas.

Commenting on the Invitation to Comment

This ITC on *Assets and Liabilities Arising from Non-contractual Arrangements that have the Features of Financial Instruments* was prepared and published by the Board. Comment received may be used to inform the Board's development of further guidance in this area.

Comment should be submitted in writing so as to be received by **18 May 2012**. Email responses are preferred. Unless respondents to the ITC specifically request confidentiality, their comment is a matter of public record. Comment should be addressed to:

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Background and purpose of this Discussion Paper

Introduction

During the development of the Standard of GRAP on *Financial Instruments*, one of the most significant issues that arose was how to deal with receivables and payables that are similar to financial instruments, but arise from legislation or similar requirements rather than a contract. One of the options that was considered, but rejected at consultation, was to amend the definition of a financial instrument to include non-contractual arrangements that give rise to an asset or a liability that has the features of a financial instrument.

Based on the comment received, the Board agreed to deal with these types of receivables and payables as part of a separate project. This Discussion Paper is the first phase of that separate project.

The Discussion Paper outlines the key issues in accounting for these types of transactions, the practices in other countries, analyses possible alternatives and requests respondents' views on a number of proposals. The key issues discussed in this Discussion Paper are:

- What accounting requirements are currently prescribed for receivables and payables in existing Standards of GRAP?
- When is a transaction or arrangement contractual or non-contractual in nature?
- How should non-contractual receivables be accounted for?
- How should non-contractual payables be accounted for?

The purpose of this Discussion Paper is to receive input on these issues so that the Board can identify what guidance is necessary in accounting for these transactions. Depending on comments received, guidance may vary from the issuing of a separate pronouncement (possibly a Standard, an Interpretation or a Guideline) and/or amending existing Standards of GRAP.

Due process and timetable

As the Board intends to use the comment received on the discussions and views outlined in this Discussion Paper to inform its future work, it is appropriate to follow a due process. Preparers, users, auditors, standard-setters and other parties with an interest in public sector financial reporting are therefore invited to comment on the Discussion Paper.

Request for comment

Comment on this Discussion Paper is invited, and must be submitted by **18 May 2012**. The Board would particularly welcome respondents' views on the specific issues outlined in each section of the Discussion Paper. Respondents are also invited to comment on other aspects of the Discussion Paper by explaining the issue and identifying specific paragraphs, where appropriate.



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The basis for accepting or rejecting significant comment will be published on the Board's website.

Discussion Paper on *Assets and Liabilities Arising from Non-contractual Arrangements that have the Features of Financial Instruments*

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Introduction

Background

- IN1. When the Board initiated its project on financial instruments, it acknowledged that assets and liabilities that have the features of financial instruments, ie assets and liabilities that result in either the receipt or payment of cash or an equivalent financial asset, may arise from both contractual and non-contractual arrangements. Contractual arrangements would be concluded by agreement between parties, while non-contractual arrangements would arise from legislation or similar means.
- IN2. Financial assets and financial liabilities arising from contractual arrangements include deposits with financial institutions, loans and other debt instruments, derivative instruments and receivables and payables for goods and services. Assets and liabilities arising from non-contractual arrangements that have the features of financial instruments include receivables and payables for taxes, fines, appropriations and grants.
- IN3. A financial instrument is defined in GRAP 104 on *Financial Instruments* as “any contract that gives rise to a financial asset of one entity and a financial liability or a residual interest of another entity”. During the development of GRAP 104, the Board considered amending the definition of a financial instrument to include both contractual and non-contractual arrangements. At consultation, respondents expressed a range of views on this issue. The three predominant views expressed are:
- Amending the definition of a financial instrument to include non-contractual arrangements may have unintended consequences for existing accounting principles. The definition therefore should not be amended to include non-contractual arrangements.
 - As similar features are present in both contractual and non-contractual arrangements, it could be concluded that there should be no difference between the accounting treatment of such assets and liabilities. The definition could therefore be amended to include non-contractual instruments.
 - As the parties in non-contractual arrangements are often compelled to enter into a transaction or arrangement and the arrangement may not give rise to both rights and obligations for all parties to the arrangement, special consideration should be given to the recognition, measurement and disclosure of such transactions.

- IN4. As a result of the divergent views, the Board agreed to consider assets and liabilities arising from non-contractual arrangements that have the same features as financial instruments as a separate project.
- IN5. A similar approach has also been taken internationally by the IPSASB and many of its constituents.
- IN6. However, comprehensive guidance on such assets and liabilities does not exist either at an IPSASB level or within its constituents. As no comprehensive guidance exists nationally or internationally, the first phase of this project is the development of a Discussion Paper.

Basis for developing the Discussion Paper

- IN7. There are a number of existing Standards of GRAP that provide principles for the recognition, measurement, presentation and disclosure of assets and liabilities that arise from both contractual and non-contractual arrangements that have the features of financial instruments.
- IN8. Generally, the existing principles on the recognition, measurement, presentation and disclosure of assets and liabilities arising from contractual arrangements, have considered any financial instrument implications.
- IN9. The existing principles for non-contractual arrangements may not have fully considered the impact of assets and liabilities that have the features of financial instruments. As an example, GRAP 23 on *Revenue from Non-exchange Transactions (Taxes and Transfers)* does not consider that certain assets are similar to financial instruments and may thus require specific measurement considerations. This is largely due to the fact that, internationally, the accounting for non-exchange revenue was considered before financial instruments.
- IN10. As a result, one of the main objectives of the Discussion Paper is to assess whether the existing requirements in the Standards are appropriate given the nature of the transaction or arrangement or whether new guidance should be developed.
- IN11. While the purpose of the Discussion Paper is to focus on the accounting for receivables and payables that arise from non-contractual arrangements, it is important to understand the difference between contractual and non-contractual arrangements, and the types of transactions that may be affected. As a result, the requirements in the existing Standards of GRAP have been analysed based on contractual and non-contractual transactions that are common to the public sector. This analysis is included in Annexure A and B.
- IN12. In addition to an analysis of the requirements in the existing Standards, research has been undertaken into the accounting treatment of transactions that may give rise to



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assets and liabilities that arise from non-contractual arrangements that have the features of financial instruments within selected countries. The practices in New Zealand, Australia, Canada, the United States and the United Kingdom were examined. The practices of other countries that have adopted IPSASs (such as Austria, Switzerland and Estonia) were either not available, or were not available in English, at the time of undertaking the research.

SECTION 1 – ANALYSIS OF THE EXISTING PRINCIPLES IN THE STANDARDS OF GRAP

Introduction

1.1 Receivables and payables arise from a number of arrangements in the public sector. These arrangements can arise from contracts, legislation or similar means, and are usually settled by delivering cash or another financial asset to the other party, or by providing goods or services.

1.2 This Discussion Paper focuses on those receivables and payables that:

- are settled through the transfer of cash or another financial asset, ie they have the features of a financial instrument; and
- arise from legislation or similar means, ie they are non-contractual.

Common examples are tax receivables and payables, receivables and payables for fines and penalties, appropriations receivable and payable and social benefits payable to individuals.

1.3 The purpose of this Discussion Paper is to focus on formulating requirements for the recognition, initial and subsequent measurement, derecognition, presentation and disclosure of receivables and payables that arise from non-contractual arrangements. In formulating the accounting approach, the Discussion Paper outlines existing principles in the Standards of GRAP, as well as the practices in other countries regarding the accounting treatment of these receivables and payables.

1.4 This section of the Discussion Paper examines the existing requirements of the Standards of GRAP. The practices of other countries are included in sections 3 and 4.

Existing guidance in the Standards of GRAP

1.5 The discussion that follows outlines:

- how the nature of an arrangement should be assessed, ie how does an entity assess whether an arrangement is contractual or not using the existing guidance in the Standards of GRAP; and
- any existing recognition, measurement, presentation and disclosure requirements in the Standards of GRAP, distinguishing between assets and liabilities.

Defining contractual arrangements

1.6 As the focus of this Discussion Paper is the formulation of accounting requirements for receivables and payables that arise from non-contractual arrangements, it is important to understand what is meant by a contractual and a non-contractual arrangement. This

distinction is also important because some of the guidance in existing Standards of GRAP is applicable only to contractual arrangements, for example, GRAP 104 on *Financial Instruments*.

Existing guidance in GRAP 104

1.7 Transactions and arrangements in the public sector generally arise through three means - contracts, the exercise of legislation and common law¹. When GRAP 104 was developed, there was significant debate regarding what distinguished contractual arrangements (which are in the scope of GRAP 104) from non-contractual arrangements. As a result, the following explanation of contractual arrangements was included in the application guidance to GRAP 104:

AG29. Contracts, for the purposes of this Standard, are evidenced by the following three criteria:

- *contracts involve willing parties entering into an arrangement;*
- *the terms of the contract create rights and obligations for the parties to the contract, and those rights and obligations need not result in equal performance by each party. For example, a donor funding arrangement creates an obligation for the donor to transfer resources to the recipient in terms of the agreement concluded, and establishes the right of the recipient to receive those resources. These types of arrangements may be contractual even though the recipient did not provide equal consideration in return, ie the arrangement does not result in equal performance by the parties; and*
- *performance and remedy for non-performance are enforceable by law.*

Using the guidance in GRAP 104 to analyse the nature of transactions

1.8 Arrangements concluded through the exercise of legislation or other requirements, often do not meet the basic criteria of a contract for the following reasons:

- (a) They are often compulsory in nature, for example, the payment of taxes, fines and penalties, as well as the receipt and payment of appropriations and other inter-governmental transfers.
- (b) Rights and/or obligations may only arise for one party to the arrangement, for example, tax arrangements give rise to an obligation on the taxpayer, with no direct rights created in return.

1.9 It may be clear that certain transactions or arrangements that arise from legislation or similar means are non-contractual in nature. There are transactions, however, where this distinction is not as clear, for example, licences. In these types of arrangements, the licensee usually applies to the licensor for the right to use an asset or undertake an

¹ GRAP 19 on *Provisions, Contingent Liabilities and Contingent Assets* notes that a present obligation may arise from a contract, legislation or common law. Similarly, assets can arise from the same mechanisms.

activity, and is required to pay a fee to acquire such a right. If the application is successful, the licensor is required to provide the licensee access to use a particular asset or undertake a specified activity, and may also provide some form of regulation over the use of the asset or the activity undertaken. Even though these licences are issued in terms of specific legislation, they exhibit the features of a contractual arrangement because:

- (a) The parties to the arrangement are willing – individuals or entities know that if they want to use a particular asset or undertake a particular activity, a licence is needed.
- (b) Rights and obligations are created for both the issuer and holder of the licence.

- 1.10 Based on the circumstances described above, it may be possible that transactions that arise from legislation or other means may exhibit the features of contractual arrangements.
- 1.11 In practice, when considering whether arrangements are contractual or not, many entities may have only considered the legal substance of the arrangement. For example, entities may have concluded that because certain fees are receivable or payable in terms of legislation, the arrangement is automatically non-contractual in nature.
- 1.12 Section 2 provides a detailed discussion and analysis of the most common transactions in the public sector that arise from legislation or similar means and whether they are contractual or non-contractual in nature.

Existing guidance on accounting for assets that have the features of financial instruments

Initial recognition and initial measurement of assets

Outline of existing requirements

- 1.13 Under the existing Standards of GRAP, the initial recognition and initial measurement of assets is based on whether the transaction is an exchange or a non-exchange transaction rather than whether the transaction is contractual or not.
- 1.14 Exchange transactions do not always arise from contractual arrangements just as non-exchange transactions do not always arise from legislation or similar means. As a result, depending on the nature of the transaction, receivables arising from non-contractual arrangements are either recognised in accordance with GRAP 9 on *Revenue from Exchange Transactions* or GRAP 23 on *Revenue from Non-exchange Transactions (Taxes and Transfers)*.
- 1.15 The Standards of GRAP define exchange and non-exchange transactions as follows:

Exchange transactions are transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal

value (primarily in the form of cash, goods, services, or use of assets) to another entity in exchange.

Non-exchange transactions are transactions that are not exchange transactions. In a non-exchange transaction, an entity either receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange.

1.16 The key to classifying transactions as either exchange or non-exchange is:

- (a) whether parties to the transaction exchange approximately equal value; and
- (b) whether they do so directly with each other.

1.17 GRAP 23 requires that receivables arising from non-exchange transactions are recognised when the entity obtains control over resources and it is probable that there will be an inflow of economic benefits or service potential, and these benefits can be reliably measured. Where the recognition criteria are met, the receivable is recognised at its fair value at acquisition date. GRAP 23 does not provide explicit guidance about how fair value should be determined. The application guidance to GRAP 23 notes, however, that where the receivable arises from a contractual arrangement, and is settled in cash or another financial asset, the principles in GRAP 104 are also used in determining fair value on initial measurement.

1.18 GRAP 9 requires receivables to be recognised upon the satisfaction of a number of specified criteria which differ, depending on whether the nature of the transaction requires the provision of goods, services or the use of an entity's assets. Once these criteria have been satisfied, a receivable is recognised at the fair value of the consideration received or receivable. Fair value is the transaction price, unless the transaction price is not market-related. Where the transaction price is not market-related, fair value is usually determined by reference to the cash flows, discounted using a market interest rate. Similarly to non-exchange transactions, where the receivable arises from a contractual arrangement and is settled in cash or another financial asset, the principles in GRAP 104 are also used in determining fair value on initial measurement.

Subsequent measurement, derecognition, presentation and disclosure of assets

1.19 At present, the subsequent measurement of receivables is dependent on whether a transaction is contractual in nature. Where a receivable arises from a contractual arrangement and is settled in cash or another financial asset, GRAP 104 is applied to its subsequent measurement. GRAP 104 would also be applied in de-recognising the receivable, while the relevant revenue Standard and GRAP 104 would be applied in presenting the receivable and providing the relevant disclosures.

Contractual receivables

- 1.20 Under GRAP 104, contractual receivables can be measured at fair value or at amortised cost less impairment. Under the fair value approach, receivables are subsequently measured at fair value using market interest rates and prices that exist at reporting date. Under the amortised cost approach, receivables are measured subsequently at their discounted cash flows, using the original effective interest rate. Under the amortised cost approach, an entity would consider whether there is any indication that the receivable is impaired.

Non-contractual receivables

- 1.21 Other than the disclosure requirements in the Standards of GRAP that deal with revenue, no other requirements exist for the subsequent accounting for non-contractual receivables. In practice, entities would have formulated an accounting policy using the hierarchy outlined in the Standard of GRAP on *Accounting Policies, Changes in Accounting Estimates and Errors*. This may have resulted in an entity formulating an accounting policy for the subsequent treatment of these receivables using GRAP 104, other Standards that prescribe accounting for receivables or the *Framework for the Preparation and Presentation of Financial Statements* (Framework).
- 1.22 Decision Tree A outlines a summary of the existing requirements for receivables and those areas where guidance is required.

Existing guidance on accounting for liabilities that have the features of financial instruments

Recognition, measurement, presentation and disclosure

Outline of existing requirements

- 1.23 There are two Standards of GRAP that prescribe accounting requirements for liabilities:

- GRAP 19 on *Provisions, Contingent Liabilities and Contingent Assets*; and
- GRAP 104 on *Financial Instruments*.

While there is no specific Standard of GRAP for tax liabilities, the existing Standards require that any tax liabilities should be accounted for using IAS 12 on *Income Taxes*.

- 1.24 GRAP 19 requires the recognition of liabilities that are uncertain in timing and amount that:
- arise from contracts, legislation or common law; and

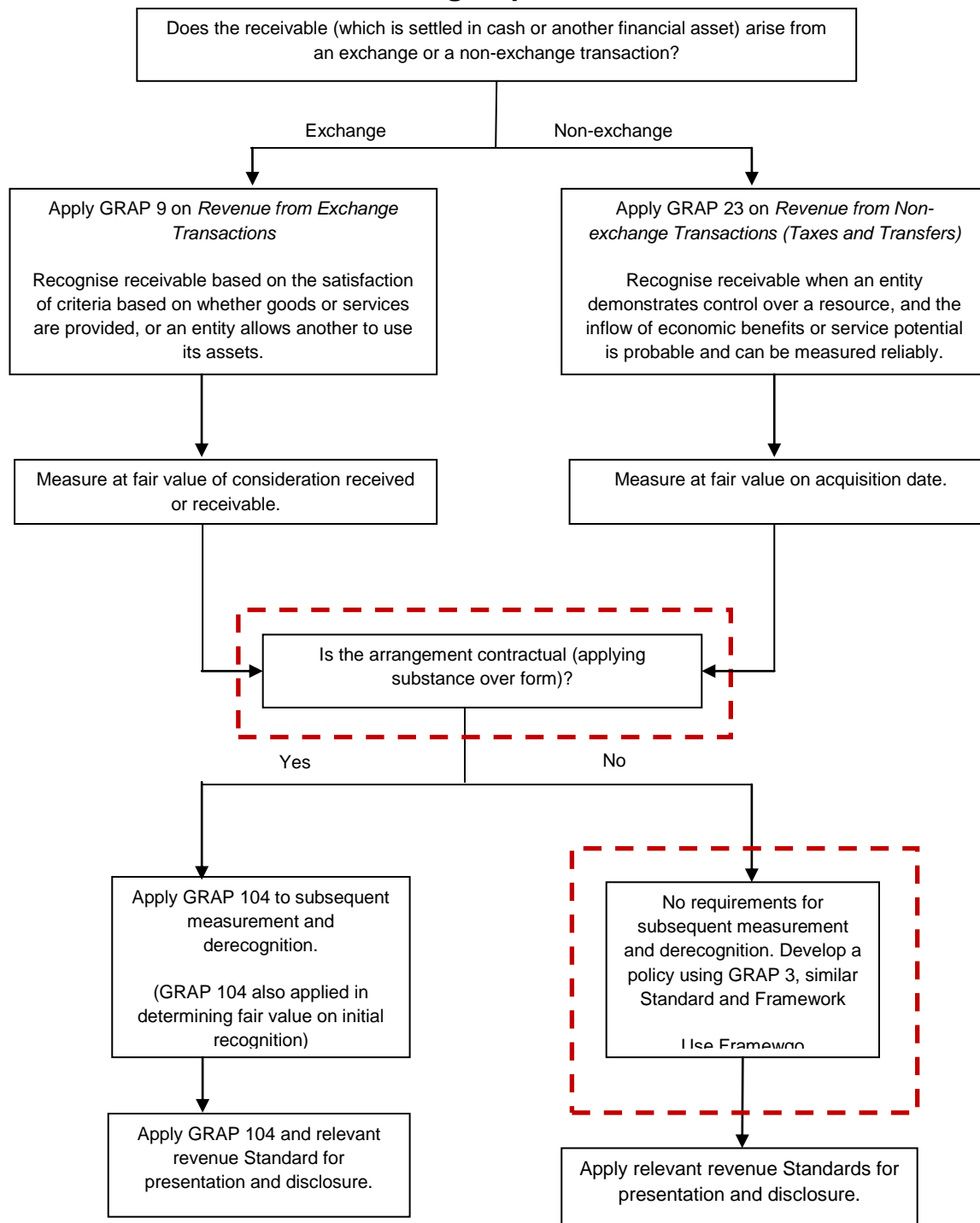
- apply to both those transactions that are settled in cash or another financial asset and those that are settled using other means.
- 1.25 Although GRAP 19 deals with liabilities that arise from contractual arrangements, it is only those contracts that require settlement in goods and services rather than cash that are within the scope of GRAP 19. If a liability arises from a contractual arrangement and is settled in cash or another financial asset, GRAP 104 is applied.
- 1.26 In accordance with GRAP 19, liabilities are measured at the best estimate of the amount required to settle the obligation at reporting date. The best estimate of the amount required to settle the obligation would generally be based on the discounted cash outflows required to settle the obligation, using a discount rate based on the risk of the liability at reporting date. After initial recognition, these estimates are revised using information available at each subsequent reporting date. Any reductions in the amount of the obligation as a result of settlement are deducted from the payable.
- 1.27 GRAP 104 prescribes the accounting requirements for all liabilities that arise from contractual arrangements and require settlement in cash or another financial asset. Payables arising from contractual arrangements are recognised initially at fair value². Fair value is the transaction price, unless the transaction price is not market-related. Where the transaction price is not market-related, fair value is usually determined by reference to the cash flows, discounted using a market interest rate. GRAP 104 also outlines specific derecognition requirements.
- 1.28 After initial recognition, liabilities are either measured at amortised cost or fair value. Under the fair value approach, payables are measured at fair value using market interest rates and prices that exist at reporting date. Under the amortised cost approach, payables are measured at their discounted cash flows, using the original effective interest rate.
- 1.29 For both GRAP 19 and GRAP 104, specific presentation and disclosure requirements are prescribed for either type of liability.
- 1.30 In the public sector, there are many non-contractual payables that are certain in their timing and amount and are similar to financial liabilities because they are settled in cash. These payables are often accounted for in accordance with GRAP 19 because there is no explicit guidance for non-contractual payables, even though they do not meet the definitions of the types of liabilities which are included in GRAP 19.
- 1.31 Decision Tree B outlines a summary of the existing requirements for payables and those areas where guidance is required.

² Where financial liabilities are subsequently measured at amortised cost, transaction costs are deducted from fair value at initial recognition.

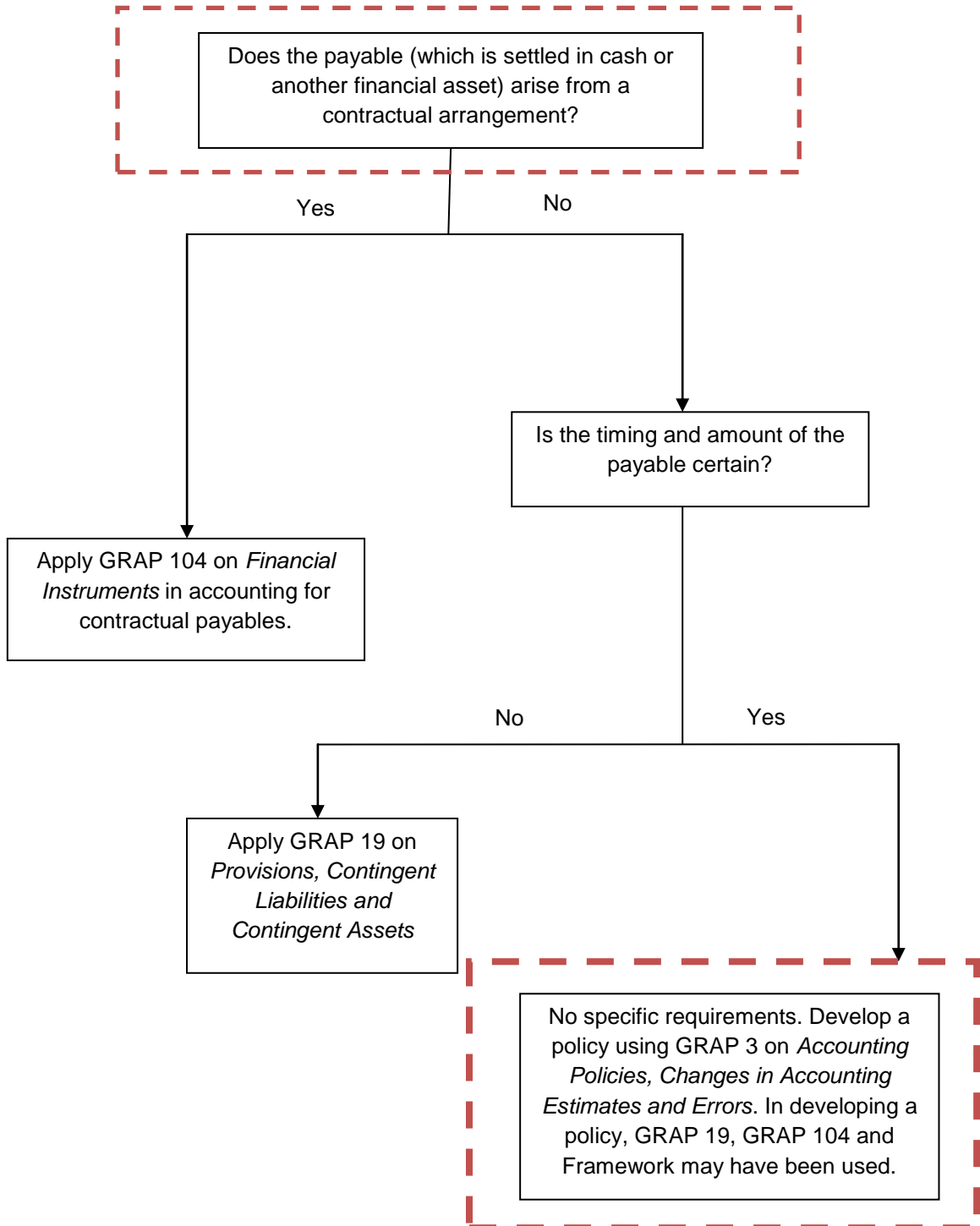
Summary

- 1.32 A summary of the existing requirements in the Standards of GRAP are included in:
- Decision Tree A which outlines the existing requirements for receivables.
 - Decision Tree B which outlines the existing requirements for payables.
- 1.33 As indicated by the dotted boxes in the respective decision trees, there are three key areas that require guidance in accounting for receivables and payables that arise from non-contractual arrangements and have the features of financial instruments:
- Determining whether an arrangement that gives rise to a receivable or a payable exhibits the features of a contractual arrangement or not.
 - Formulating subsequent measurement, derecognition, presentation and disclosure requirements for non-contractual receivables.
 - Formulating appropriate accounting requirements for non-contractual payables.
- 1.34 The remainder of this Discussion Paper formulates proposed accounting approaches to address these issues.

Decision Tree A – Existing requirements for receivables



Decision Tree B – Existing requirements for payables



SECTION 2 – DISCUSSION AND ANALYSIS OF THE NATURE OF COMMON TRANSACTIONS AND ARRANGEMENTS IN THE PUBLIC SECTOR

Introduction

- 2.1 There are a number of arrangements that arise from legislation or similar means in the public sector. In order to comprehend the accounting requirements that are needed for these transactions it is important to understand their nature, ie are they contractual or not. As accounting requirements already exist for contractual arrangements and, to a lesser extent, for non-contractual arrangements, in the existing Standards of GRAP, assessing the nature of an arrangement will determine whether they can be handled within the existing requirements and/or whether further guidance is needed.
- 2.2 This section of the Paper focuses on those transactions that the public sector most commonly enters into as a result of legislation or similar requirements, and include:
- taxes and fines (receivable and payable);
 - appropriations (receivable and payable) in the form of equitable share allocations transfers and grants;
 - donor funding (receivable and payable);
 - fees charged by entities in accordance with legislation, eg licence fees, quotas, rights and other fees receivable or payable for the undertaking of a specific activity or use of a specific asset; and
 - social benefits payable by the state.

Analysis of transactions – contractual or non-contractual?

- 2.3 In assessing whether an arrangement is contractual or not, an entity should consider the existing guidance in GRAP 104 (see paragraph 1.7). As noted in section 1, certain transactions that arise from legislation may exhibit the features of a contract. This outlines the notion that the substance rather than the legal form of a transaction should be considered in determining whether an arrangement is contractual or non-contractual.
- 2.4 Using substance over form to analyse whether transactions that arise from legislation or similar means may give rise to a number of transactions being considered contractual rather than non-contractual. This means that even though certain transactions may originate from legislation, they should be accounted for as if they are contractual in nature (ie they are within the scope of GRAP 104).
- 2.5 In analysing the nature of the arrangements listed in 2.2, the Board considered:

- (a) whether the arrangement exhibits the features of a contract using the guidance in GRAP 104; and
- (b) the substance and not only the legal form of the arrangement.

Taxes

- 2.6 Taxes, either receivable or payable by an entity, arise from the execution of specific legislation. A key feature of taxes is that they are compulsory transactions, often imposed on individuals and entities by a specific authority. For example:
- Individuals who earn income above a certain threshold are required to pay income tax to the South African Revenue Service using the rates specified in legislation.
 - Ratepayers who own property within a specific municipal boundary are required to pay property rates to the municipal council using a predetermined tariff specified in its policies.
- 2.7 Taxes also do not give rise to rights and obligations to both parties in the arrangement. For example, the receipt of taxes by government from individual taxpayers does not create an obligation to provide specific goods and services in return.
- 2.8 As taxes are not entered into willingly by parties and do not create rights and obligations for all parties to the transaction, taxes are non-contractual in nature.

Fines and penalties

- 2.9 Fines and penalties, either receivable or payable, are similar to taxes as they are also imposed on entities or individuals as a result of actions taken that are contrary to legislation. For example:
- Public sector entities impose fines on motorists who disobey the traffic laws within a particular jurisdiction.
 - Regulators and commissions may impose fines and penalties on entities that do not comply with certain regulatory requirements.
 - Penalties may be imposed by the South African Revenue Services on amounts for taxes and other levies that are not received within a specified timeframe.
- 2.10 Fines and penalties are used as a mechanism to encourage- (or discourage) certain behaviours and actions. When an entity fails to act or behave in a certain way, a fine or penalty is imposed. This gives rise to a unilateral obligation to pay (or right to receive) the fine or penalty.
- 2.11 As fines and penalties are compulsory transactions that do not give rise to rights and obligations for all parties to the transaction, they are non-contractual in nature.

Appropriations and donor funding

Appropriations

2.12 At a national level and within each province, money is appropriated to various departments, public entities and municipalities. In South Africa, this is done primarily through

- (a) equitable share allocations and inter-governmental transfers (often called “transfer payments”), and
- (b) specific appropriations which are made in the form of earmarked and specifically appropriated allocations (“earmarked allocations”) and grants.

Equitable share allocations and transfers

2.13 Equitable share allocations and transfer payments received or paid by entities are granted or paid in terms of legislation and budgets enacted nationally, within each of the nine provinces and by each municipal council. A key feature of these transactions is thus that they arise from specific laws.

2.14 In terms of these laws, equitable share allocations and transfers are compulsorily paid and received by entities when certain actions are satisfactorily met. These actions are usually only administrative in nature. For example, entities must demonstrate or confirm that bank accounts have been opened (or remain open) in the name of the entity and that sound financial management practices are in place within certain key areas.

2.15 Appropriations are compulsorily paid and received by entities as a result of specific actions required by legislation, which means that the parties to these transactions are not willing. Consequently, these transactions do not exhibit the features of a contract and are therefore non-contractual in nature.

Earmarked allocations and grants paid and received between entities in the public sector

2.16 Besides equitable share allocations and transfers, entities pay and receive cash resources from other public sector entities in the form of earmarked allocations and grants.

2.17 Equitable share allocations and transfers are usually appropriated to fund the general planned and budgeted activities of an entity. In contrast, earmarked allocations are provided to fund specific activities or projects. These types of allocations are similar to equitable share allocations and transfers as they are compulsorily paid in accordance

with legislation. This is an indication that these arrangements are non-contractual in nature.

- 2.18 At present, grants are provided by the national government to other government entities through supplementary allocations or incentives. The initial and ongoing payment and receipt of these grants may be dependent on the receiving entity demonstrating, amongst others, implementation of a strategic or performance plan, performance against the plan, and compliance with other requirements set out in legislation, such as the Division of Revenue Act. In certain instances, where entities do not utilise grants in accordance with the agreed plan or legislation, they may be required to repay the grant or any unspent portion thereof.
- 2.19 Grants differ in nature from other types of appropriations because:
- (a) Grants may only be given to entities which apply to receive them. As a result they may not always be compulsory transactions.
 - (b) The actions required to receive grants, both initially and on an ongoing basis, are often significantly more onerous than for other appropriations which usually only require compliance with certain administrative actions. The satisfaction of conditions on an ongoing basis gives rise to rights and obligations for either party.
- 2.20 Consequently, unlike other appropriations, grants may be contractual in nature, depending on the terms and conditions of individual grants. For example, if an entity has to apply to receive a grant and agrees to satisfy the ongoing conditions of the grant, it may be an indication that the arrangement is contractual in nature because:
- (a) The parties to the transaction are willing (the entity applies to receive a certain grant); and
 - (b) Rights and obligations arise for either party (the transferring entity agrees to pay over the grant based on the satisfaction of certain conditions, while the receiving entity agrees to receive the funding and spend it in accordance with the prescribed conditions).

As the requirements and purposes of the various grants provided in the public sector differ, it is important to analyse the terms and conditions of individual grants to determine whether they are contractual or non-contractual in nature.

Donor funding

- 2.21 Grants may also be provided to public sector entities by donors that are outside of the public sector, eg donor funds received from multi-lateral organisations. These types of arrangements are most often concluded through a formal contract or similar means.

GRAP 104.AG29 acknowledges that these arrangements may be contractual in nature because:

- (a) They are most often entered into willingly by either party; and
- (b) Rights and obligations are established for either party to the arrangement, ie the donor is required to pay the recipient in return for the undertaking of certain actions or activities; while the recipient is entitled to receive funds from the donor and has an obligation to undertake certain actions or activities.

2.22 As these arrangements may vary, the terms and conditions of each grant should be analysed to determine whether they are contractual or non-contractual in nature.

Fees charged by entities in accordance with legislation

2.23 Besides taxes, appropriations and donor funding, public sector entities may receive other revenue in terms of legislation. Examples of entities that receive other revenue in terms of legislation include:

- Sectoral education and training authorities – Skills Development Levies compulsorily paid by private sector employers.
- Independent Communications Authority of South Africa – Licence fees.
- Air Services Licensing Council – Licence fees.
- Financial Services Board – Levies and licence fees.
- Independent Regulatory Board for Auditors – Membership fees.
- Provincial gambling, betting and liquor boards – Licence and other regulatory fees including fees for licences, fees for the operation of specific gambling equipment, fees paid per staff member employed at a casino.
- Department of Mineral Resources – Prospecting and mining rights.
- Marine and Coastal Management – Fishing quotas.
- Road Accident Fund (RAF) – Levies paid by motorists (included in fuel levy).
- Unemployment Insurance Fund (UIF) – Contributions paid by employed individuals and their employers.
- National Home Builders Registration Council (NHBRC) – Contributions paid by homeowners on newly constructed homes.

2.24 The fees paid to the RAF, UIF and NHBRC result in an arrangement that is similar to an insurance contract. IFRS 4 defines an insurance contract as:

A contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.

2.25 Using the UIF as an example, it can be demonstrated that the arrangement is similar to an insurance contract for the following reasons:

- The UIF receives contributions from specific individuals to protect them against future unemployment. The UIF is the insurer, the individuals that contribute towards the fund are the policyholders, and unemployment is the specified uncertain future event that is likely to have an adverse effect on individuals.
- Although there is no specific “contract” concluded between the UIF and the individuals that contribute to the scheme, the effect of the arrangement is similar to a contract.

2.26 As insurance contracts pose unique accounting issues, the fees received and any resulting liabilities are excluded from the scope of this project.

2.27 As noted in section 1, paragraph 1.10, some of the fees charged and collected by entities in accordance with legislation may exhibit the features of a contract. The following examples illustrate the types of transactions that may be contractual.

Licence fees

In these types of arrangements, the licensee usually applies to the licensor for the right to use an asset or undertake an activity and is required to pay a fee to acquire such a right. If the application is successful, the licensor is required to provide the licensee access to use a particular asset or undertake a specified activity and, may also provide some form of regulation. Even though these licences are issued in terms of specific legislation, they exhibit the features of a contractual arrangement because:

- (a) The parties to the arrangement are willing – individuals or entities know that if they want to use a particular asset or undertake a particular activity, a licence is needed.
- (b) Rights and obligations are created for both the issuer and holder of the licence.

Membership fees

Certain professions may be regulated by the government. Individuals may be required to pay membership to a regulatory body in order to be accredited or recognised within a particular profession.

- (a) The parties to the arrangement are willing – individuals that operate within a specific profession are aware of such fees when they make the decision to enter the profession. This could therefore be seen as a voluntary transaction.
- (b) Rights and obligations are created for both parties – the payment of fees by the member affords him or her certain rights, eg the use of a professional designation, regulation over certain activities and other benefits. The regulatory body, on the other hand, is obliged to provide the services associated with membership of the body.

2.28 The following example illustrates the types of transactions that may be non-contractual in nature.

Skills development levies paid by private sector employers

Private sector employers contribute a percentage of their salary cost every month to the Department of Higher Education and Training. This is used to develop capacity and skill within various sectors. Employers who successfully submit workplace skills plans to a sector education and training authority (SETA) will receive a portion of the contributed levies towards training and developing their staff.

- (a) The parties to the arrangements are not willing – private sector employers are required by legislation to pay skills development levies to the Department of Higher Education and Training.
- (b) Rights and obligations are not created for both parties – the receipt of the levies by the Department of Higher Education and Training (or the SETA) does not result in an obligation for the Department (or the SETA). Such an obligation arises only once an employer submits a workplace skills plan outlining its education and training activities for a particular period, and it is accepted by the SETA.

2.29 As the terms of these various arrangements in the public sector differ, it may be possible that these arrangements are both contractual and non-contractual in nature. As a result, entities should assess whether individual arrangements are, in substance, contractual or not.

Social benefits

Nature of social benefit transactions

2.30 Cash payments are often made by public sector entities to individuals or organisations to accomplish a range of social objectives. For example, social benefits are paid to:

- individuals as basic income grants, old age pensions, child grants and subsidies to acquire certain goods and services (eg subsidies to purchase a house); and
- organisations such as non government organisations.

Social benefits paid to individuals

2.31 Payments to individuals are usually made in accordance with specific legislation. Despite the fact that social benefits are paid in terms of legislation, they may nevertheless be contractual in nature. Consider:

- Grants, and the criteria that must be met to qualify for such a particular grant, are stipulated in the Social Assistance Act.
- Individuals who satisfy the relevant eligibility criteria may apply to receive a particular grant.

- The Department of Social Development will assess the applications received and approve certain individuals as beneficiaries of particular grants.
- Once an individual has been approved as a beneficiary, he or she is required to demonstrate compliance with the respective eligibility criteria. For example, beneficiaries may be required to present themselves at social development offices once a year to demonstrate that they are still alive.

2.32 As beneficiaries apply to receive a particular grant and the Department of Social Development accepts beneficiaries based on the satisfaction of specific criteria, it can be considered a voluntary rather than a compulsory transaction. Also, rights and obligations are created for either party. The beneficiary, once approved, has a right to receive the grant, while the Department of Social Development has an obligation to pay the grant at specified intervals. Based on this analysis, social benefits may in fact be contractual in nature.

Transfers to organisations to meet social objectives

2.33 Payments made to organisations are usually made based on amounts included in a department's or a public entity's budget and may be as a result of an arrangement concluded between the parties. Typical examples of these arrangements are payments made to non government organisations. These arrangements are similar in nature to the donor funding received by public sector entities (see paragraphs 2.21 to 2.22). As the terms and conditions of these arrangements vary, they can be either contractual or non-contractual in nature.

Summary

2.34 As indicated in the introduction, the purpose of this section has been to analyse the nature of common public sector transactions to assess whether they can be accounted for within the existing requirements of the Standards of GRAP or if new guidance is required.

2.35 Based on the discussions in this section, there are some transactions that are contractual in nature and should be accounted for using GRAP 104. Even though these transactions are already within the scope of GRAP 104, additional guidance may be required outlining the Board's rationale and approach for dealing with such transactions. There are many transactions, however, that are non-contractual in nature and for which no, or limited, guidance exists. Consequently, specific guidance is required in this area. Sections 3 and 4 discuss proposed accounting requirements for non-contractual transactions in greater detail.

2.36 A summary of the Board's analysis of the nature of the various transaction-types is included in Table 1 below and will be used to inform the remainder of the proposals in this Paper.

Table 1 – Summarised analyses – Nature of common public sector transactions

Transaction	Non-contractual	Contractual
Taxes	X	
Fines and penalties	X	
Appropriations		
Equitable share allocations	X	
Transfers paid or received by entities	X	
Earmarked allocations	X	
Grants	X	X
Donor funds received from entities outside the public sector	X	X
Fees charged by entities in accordance with legislation	X	X
Social benefits		
Paid to individuals		X
Paid to organisations	X	X

Issue 1 – Nature of common public sector transactions

Question 1

2.37 Do you agree that, in assessing how an arrangement should be accounted for, the substance and not just the legal form of an arrangement should be considered in determining whether an arrangement is contractual or not? Please provide reasons for your view.

Question 2

2.38 In developing the Discussion Paper, two views were expressed regarding the nature of equitable share allocations, transfers and earmarked allocations. The Board's view is that such arrangements are not contractual (see paragraphs 2.14 and 2.15) because the transaction is compulsorily undertaken between parties as a result of legal actions and processes which are required to be followed in terms of legislation. A counter-argument is that such arrangements are contractual in nature because the parties to the arrangement are willing as they apply for a portion of the revenue raised annually by submitting a budget to the relevant authorities. In your view, are equitable share

allocations, transfers and earmarked allocations contractual or non-contractual in nature? Please provide reasons for your view.

2.39 Apart from equitable share allocations, transfers and earmarked allocations, do you agree with the Board's analysis of the other common public sector transactions (summarised in Table 1 above)? Please provide reasons for your view.

Question 3

2.40 Are there any other significant assets and liabilities that arise from legislation or similar means and which have the features of a financial instrument that the Board should consider as part of this project?

SECTION 3 – ACCOUNTING FOR NON-CONTRACTUAL RECEIVABLES

Introduction

- 3.1 The previous section considered the nature of a range of receivables that commonly arise in the public sector. It is important to understand the nature of a particular arrangement in order to understand what accounting requirements exist and may already be applied.
- 3.2 As requirements already exist for the initial recognition and initial measurement of receivables (see paragraphs 1.17 and 1.18), whether from contractual or non-contractual arrangements, the purpose of this section is to formulate appropriate principles for the subsequent measurement, derecognition, presentation and disclosure requirements for non-contractual receivables. In formulating those principles, the Board has considered the existing requirements in the Standards of GRAP and the practices in other countries. To assist respondents in commenting on the proposed accounting approach for non-contractual receivables and, contrasting this approach to that applied for contractual receivables, this section also summarises the accounting approach for contractual receivables.

Contractual receivables

- 3.3 As noted in section 1, there is a significant amount of guidance for receivables that arise from contractual arrangements. Depending on whether the transaction is exchange or non-exchange in nature, the receivable is recognised and initially measured in accordance with GRAP 9 or GRAP 23. GRAP 104 is applied to the subsequent measurement and derecognition of the receivable, while GRAP 104 and the relevant Standard on revenue is applied in presenting and disclosing information about the receivable. The Board considers that this accounting approach has been applied in practice in accounting for contractual receivables.
- 3.4 As noted in section 1, many entities may not have considered the substance of an arrangement in determining whether or not it is contractual. The Board is nevertheless of the view that substance and not only legal form should be considered in accounting for transactions. As a result, the Board has proposed in section 2 that entities should assess the nature of transactions, using the existing application guidance in GRAP 104, to determine whether an arrangement is contractual or non-contractual in nature.
- 3.5 In summary, the accounting approach for contractual receivables is as follows:

1. Consider whether the transaction arises from an exchange or a non-exchange transaction. If it arises from
 - an exchange transaction, apply GRAP 9 for the initial recognition and initial measurement of the receivable.
 - a non-exchange transaction, apply GRAP 23 for the initial recognition and initial measurement of the receivable.
2. Consider the guidance in GRAP 104 and determine whether the arrangement is contractual or non-contractual in nature.
3. Where the arrangement is contractual in nature, these instruments are within the scope of GRAP 104. This Standard should be applied in determining the fair value on initial measurement as well as applying the Standard to the subsequent measurement and derecognition of the receivable. GRAP 104 and the relevant revenue Standard are applied in presenting and disclosing information about the receivable.

Non-contractual receivables

- 3.6 In order that the Board could formulate a proposed accounting approach for non-contractual receivables, it considered the approaches available within the existing Standards of GRAP and also considered the practices in other countries. A summary of the practices in other countries is outlined in paragraph 3.7 below.

Summary of practices internationally

- 3.7 Based on the research undertaken into the practices internationally, the following accounting approaches are applied to non-contractual receivables:
- 3.7.1 Taxes: New Zealand, Australia and the United States all appear to measure taxes initially at cost (or a modified version of cost), while Canada initially measures tax receivables at net realisable value. New Zealand and Australia have explicitly indicated that tax receivables are not treated as financial instruments because they are not contractual in nature. In Canada, it is noted in PS3510 issued by the Public Sector Accounting Board (PSAB) that, for subsequent measurement, tax receivables are financial instruments similar to trade receivables.
 - 3.7.2 Appropriations and grants:
 - With the exception of Canada and Australia, the accounting requirements for appropriations received or receivable are not distinguished from the accounting requirements of other types of non-exchange revenue (with the exception of taxes).

- The Australian government has indicated that appropriations are not contractual and, as a result, should be recognised at their nominal amounts rather than their fair values. It has also been explicitly stated that because appropriations are not contractual, they are not financial instruments.
- Canada has prescribed specific rules for each type of government transfer.
- New Zealand applies IPSAS 23 to all non-exchange revenue transactions, except for the initial measurement of taxes.
- The UK applies IAS 20 on *Government Grants*.

3.7.3 Fees charged in accordance with legislation: internationally, most countries do not provide separate guidance for such transactions. They broadly prescribe the initial recognition and initial measurement of such transactions using the requirements of IPSAS 9 on *Revenue from Exchange Transactions*, IAS 18 *Revenue*, or IPSAS 23 *Revenue from Non-exchange Transactions (Taxes and Transfers)* (or their equivalents).

Outline of possible approaches

- 3.8 Based on the Board's analysis of the existing requirements in the Standards of GRAP and the research into the practices applied internationally, it is of the view that there are three possible measurement bases that can be used to account for non-contractual receivables - These are fair value, amortised cost and cost.
- 3.9 As GRAP 104 allows both fair value and amortised cost for the subsequent measurement of receivables which are settled in cash, the Board is of the view that these two measurement bases may also be appropriate for similar non-contractual receivables.
- 3.10 As a cost (or a modified cost) approach is applied in practice by some countries in accounting for non-contractual receivables, in particular taxes and appropriations, the Board believes that this may also be a feasible measurement basis to consider. Although some countries may have applied other measurement bases, such as net realisable value used in Canada, these are not commonly used within the existing Standards of GRAP and have therefore not been considered.
- 3.11 In considering the three measurement bases and how they might be applied within the existing suite of Standards to the transactions discussed in section 2 (see Table 1 in paragraph 2.36) the Board has formulated three possible accounting approaches. The three possible approaches are outlined below:
- Approach 1 – fair value approach: This approach is based on the initial recognition and initial measurement of non-contractual receivables at fair value

using either GRAP 9 or GRAP 23 (with consideration of the fair value principles in GRAP 104 in determining fair value on initial measurement), with subsequent measurement at fair value using the principles in GRAP 104 'by analogy'. Where non-contractual receivables are settled in cash, a counter-party has been identified and specific settlement terms are agreed, they are similar to financial assets. As result, where non-contractual receivables are similar to financial assets, GRAP 104 can be applied 'by analogy' to such instruments.

- Approach 2 – Amortised cost approach. This approach is based on the initial recognition and initial measurement of non-contractual receivables at fair value using either GRAP 9 or GRAP 23 (with consideration of the fair value principles in GRAP 104 in determining fair value on initial measurement), with subsequent measurement at amortised cost (which is amortised cost less impairment) using the principles in GRAP 104 by analogy.
- Approach 3 – Modified cost approach. This approach is based on the initial recognition and initial measurement of non-contractual receivables at fair value using either GRAP 9 or GRAP 23, with fair value becoming cost after initial recognition. After initial recognition, impairment is tested using the principles in the Standards of GRAP on *Impairment of Cash-generating Assets*. With the exception of the initial recognition at fair value, this approach is similar to the cost (or modified cost) approach described in earlier paragraphs and applied in countries such as Australia.

3.12 The application of each approach to the most common, non-contractual transactions in the public sector is outlined in the paragraphs that follow. Each approach assumes that an entity has analysed the terms and conditions of the transaction and concluded that it is non-contractual in nature.

Approach 1 – Fair value approach

3.13 The fair value approach has been drawn from the principles in existing Standards of GRAP, ie GRAP 9, GRAP 23 and GRAP 104. This approach has been developed on the premise that receivables that arise from non-contractual arrangements are similar in nature to financial instruments because they require settlement in cash or another financial asset.

- 3.14 Under this approach, non-contractual receivables would be accounted for as follows:
- Initially recognise and measure receivables in accordance with GRAP 9 or GRAP 23, but use the principles in GRAP 104, by analogy, to inform the determination of fair value.
 - Subsequently measure receivables at fair value using the principles in GRAP 104 by analogy.

Initial recognition and initial measurement

Determining the transaction price

Taxes, fines, penalties, appropriations and grants

3.15 Taxes, fines, penalties, appropriations and grants arise from non-exchange revenue transactions. As a result, any assets, liabilities and revenue arising from these transactions are initially recognised and initially measured using GRAP 23. The Standard requires assets to be measured at “fair value at the acquisition date”. There is no specific guidance, however, on the determination of fair value in GRAP 23 for these assets.

3.16 Consistent with the principles in other Standards of GRAP, it can be assumed that the best evidence of fair value on transaction date is the transaction price. The transaction price on initial recognition for the receivables arising from the following transactions may be determined in this manner:

- Tax receivables: Using prevailing legislation to determine (a) the income, activity or goods and services subject to tax, and (b) the applicable tax rates.
- Fines, and penalties: Based on tariffs specified in legislation. Depending on the nature of the fine or penalty, a scale of values may be provided in legislation which may then be adjusted by a regulator, court, commission or other body that is responsible for imposing the fine or penalty.
- Appropriations and grants: Using the values outlined in legislation, eg the Division of Revenue Act or published budgets.

Fees charged in terms of legislation

3.17 Fees charged in terms of legislation can be either exchange or non-exchange in nature. As a result, entities should evaluate the terms and conditions of the transaction and apply either GRAP 9 or GRAP 23 for the initial recognition and initial measurement of these transactions. Under both these Standards, the transaction price is likely to be the best evidence of fair value. The transaction price would be determined based on tariffs prescribed in legislation.

Determining the fair value using GRAP 9, GRAP 23 and GRAP 104

3.18 The discussion in the preceding paragraphs has noted that in the absence of any evidence to the contrary, it can be assumed that fair value on transaction date is the same as the transaction price. However, if receivables arising from non-contractual arrangements are considered to be similar in nature to financial instruments, then fair value would be the transaction price, but would also consider the effect of the time value of money. Most often, this means assessing the value of any credit granted, particularly where no, or a below market, interest rate is charged over the credit term.

The fair value of the credit granted is determined by applying a market interest rate (prevailing on the transaction date) to the transaction price over the credit period granted (called “discounting”).

- 3.19 Using tax receivables as an example, the possible effect of discounting on the fair value of a receivable is as follows:

Illustrative example 1 – Possible effect of discounting in determining the fair value of a receivable on initial recognition

Background

A company, which is required to pay VAT monthly, assesses that at the 31 March 2011, it owes R100,000 to SARS. The company is required to file an assessment and pay the required taxes by the 30th April 2011. No interest is levied during the 30 day filing period.

Analysis

In accordance with GRAP 23, an entity is required to recognise an asset when a taxable event occurs and it can make a reliable estimate. In this instance, the taxable event occurs when goods and services are purchased or sold. The amount of VAT that is either payable or refundable is based on the sale or purchase of goods and services during a specific period.

In theory, because entities have a period of time in which to file a return and make any payments, credit is granted for 1 month. As no interest is levied during this period, the effect of the time value of money should be considered. In determining the effect of time value money, the receivable should be discounted using a market-related rate of interest. In this example, a market rate of 12% per annum, which reflects that an amount of R991 interest should be reflected as revenue.

The following entries would be required to account for the transaction. This example is based on the assumption that a reliable estimate of the tax due can be made on the 31 March.

Amount of tax owing (transaction price)	R100,000
Date of assessment	31 March
Due date	30 April
Market interest rate	12% per annum
Interest for 1 month	R991

Entries on initial recognition – 31 March

Dr Tax receivable	99,009	
Cr Non-exchange revenue		99,009

[R100,000-R991]

Subsequent entries – 30 April

Dr Tax receivable	991	
Cr Interest received*		991

*Consideration would need to be given as to whether this interest should be classified as either exchange or non-exchange revenue. Classification as exchange revenue may pose practical challenges as separate disclosure is required in the statement of financial performance of exchange and non-exchange revenue, and separate classification of receivables from exchange and non-exchange transactions is required in the statement of financial position.

- 3.20 The initial discounting of receivables arising from taxes, appropriations, donor funding and fees charged in terms of legislation can become complex, particularly in determining the credit period to be used, as well as what constitutes a market rate at transaction date. The issues relating to the discounting of these various transactions are outlined in the paragraphs that follow.

Application of discounting to tax receivables

- 3.21 Determining the credit period for contractual receivables created significant debate during the development of GRAP 104. To clarify what this would mean in the public sector, the application guidance to GRAP 104.AG86-AG89 notes that short-term receivables and payables need not be discounted where the credit terms are consistent with those used in the public sector, either through established practices or legislation. If applied to tax receivables, the effect would be that as long as the period between the transaction date and the due date is consistent with legislation or established practice, the effect of discounting (as shown in illustrative example 1) would be ignored.
- 3.22 The determination of a market rate for tax receivables may give rise to a host of debates around what rate to use. Some would argue that because it is money/credit that is being priced, the rate should represent the market rate for a similar instrument with the same terms and risk profile. This may pose challenges in practice as it may be difficult to assess the risk profile or creditworthiness of each individual taxpayer.
- 3.23 Others may argue that because taxes are compulsory transactions between government and taxpayers, there is no market for such transactions. Proponents of this view note that the rate specified in legislation is the “market” rate for taxes. The rate specified in legislation may sometimes be arbitrary and may not represent a fair charge for a financing transaction.

Application of discounting to appropriations

- 3.24 The discounting of appropriations would be slightly more complex than taxes for the following reasons:

- Appropriations are paid over the reporting period for which they have been appropriated and are seldom paid on the basis of predetermined credit terms. They are generally paid in accordance with schedules determined by the relevant treasury and agreed with the recipient entities. These schedules may be revised on a continuous basis, however, to accommodate the level of spending at entities and the overall availability of cash at a national and provincial level. Determining the credit period is thus very subjective. Some would argue that in such arrangements, no credit has been granted or received by either party.
- Interest is not paid or levied on any outstanding amounts as there is no basis in legislation for doing so.

3.25 If appropriations receivable are treated as financial assets, their value would have to be revised on a continuous basis to accommodate changes in payment schedules. It is likely, however, that the relief provided in GRAP 104.AG86-AG89 can be applied to appropriations. As credit terms for appropriations are not stipulated in legislation, neither are they established through practice. It could be concluded that the effect of discounting should be ignored for appropriations when applying the existing relief in GRAP 104.

3.26 It may be easier to determine the interest rate for appropriations receivable, when compared to other receivables, as the counter-party is a national or provincial government. A government bond rate may be appropriate as it would already include the risk profile of the other party.

3.27 The same issues would exist for specifically earmarked allocations such as grants and donor funding arrangements.

Application of discounting to fees charged in accordance with legislation

3.28 Similar issues arise for fees charged in terms of legislation. The credit period could be determined once an application has been approved or a renewal notice issued. At this point, specified payment terms such as the due date for payment, as well as if, or from when, interest is levied on overdue amounts, are known and could be used to determine the effect of discounting.

3.29 The determination of a market rate, specifically the determination of an appropriate risk profile for each counter-party, may be difficult if a range of counter-parties exist for a particular transaction/arrangement. For example, it may be difficult for the Department of Transport to determine the risk profile of all the motorists who owe the department money for outstanding motor vehicle licences.

Subsequent measurement

3.30 Under the fair value approach, receivables arising from non-contractual arrangements are measured at fair value using the principles in GRAP 104 by analogy. Under a fair

value model, the present value of the cash flows associated with the receivable would be determined at every reporting date using a market rate at reporting date, and any changes in the value since the last reporting date recognised in surplus or deficit. The principles in GRAP 104 would be applied by analogy to the derecognition, presentation and disclosure of the receivable.

- 3.31 Many of the complexities that might exist for the initial measurement of non-contractual receivables in the same way as financial instruments also exist for their subsequent measurement, eg estimating cash flows and determining interest rates.

Approach 2 – Amortised cost approach

- 3.32 The amortised cost approach is similar to the fair value approach, except that the principles in GRAP 104 are used, by analogy, to the subsequent measurement of the receivable at amortised cost rather than fair value.
- 3.33 Under an amortised cost model, the present value of the cash flows associated with the receivable would be determined at every reporting date using the original effective interest method, discounted using the original effective interest rate. In practice, the effective interest rate is often the market rate that existed at transaction date as entities do not always levy interest on credit granted or, the interest levied is a fixed rate and not market-related. Under an amortised cost model, an entity would assess at every reporting date whether there is any indication of impairment.
- 3.34 Applying this approach would give rise to the same complexities as under the fair value approach as entities would be required to determine a market rate on transaction date and may need to assess the cash flows of the receivable at reporting date to determine if the receivable is impaired.

Approach 3 – Modified cost approach

- 3.35 An alternative to treating receivables arising from non-contractual arrangements in the same way as financial instruments, is to measure them using other Standards of GRAP. Under this approach, receivables would be accounted for as follows:
- Initially recognised and initially measured using GRAP 23 or GRAP 9 (whichever is applicable).
 - Subsequently measured using the principles in GRAP 26, ie receivables would be measured at the lower of their carrying value and recoverable amount. This approach is broadly consistent with a cost approach and means that an entity would:
 - (a) accrue interest only if interest is levied in terms of the arrangement and,
 - (b) assess whether there is objective evidence that the receivable is impaired. If such evidence exists, the recoverable amount of the asset should be determined using the higher of fair value less costs to sell and the value-in-use.

- In addition to complying with the disclosure requirements in GRAP 23 or GRAP 9 (whichever is applicable), the relevant disclosure requirements in GRAP 26 should be applied.

Application to taxes

- 3.36 Under this approach, tax receivables would be accounted for as follows:
- (a) Initially measure receivables at fair value in accordance with GRAP 23, with fair value being the transaction price on the transaction date.
 - (b) Subsequently measure receivables at cost (transaction price) less impairment, with impairment determined using the principles in GRAP 26 on *Impairment of Cash-generating Assets*.
- 3.37 Using the principles in GRAP 26, an entity would assess at every reporting date whether there is any evidence that the receivables are impaired. Under the value-in-use approach, the cash flows of the asset would be estimated taking into account a number of factors. However, to avoid the complexities of discounting, the cash flows would represent the expected undiscounted cash flows associated with the receivable.

Application to appropriations receivable

- 3.38 Appropriations could be accounted for in the same way. It is questionable though whether any subsequent measurement requirements are necessary for appropriations receivable other than accounting for increases and decreases in the appropriated amounts. Impairment may not be relevant for appropriations as the counter-party to the transaction is government. The same accounting could be applied for donor funding, except that impairment may be more relevant as the counter-party may be another government or multi-lateral agency.

Application to fees charged in terms of legislation

- 3.39 The application of this approach will be similar to taxes, except that the receivable could be recognised either in accordance with GRAP 9 or GRAP 23.

Proposal by the Board

- 3.40 In assessing the appropriateness of the three approaches, the Board considered the information needs of users, balanced with the challenges that entities may experience in applying the approach in practice. The Board also considered entities' current accounting practices in assessing the appropriateness of the proposed approach.
- 3.41 While the Board has outlined three possible approaches, it is of the view that approach 2, the amortised cost approach, would result in the most appropriate accounting treatment of receivables that arise from legislation or similar means. The Board's views on the three approaches are outlined in paragraphs 3.42 to 3.46 below.

- 3.42 The Board's support for the amortised cost approach is based on the conclusion that non-contractual receivables are similar in substance to financial instruments because they are settled in cash. As a result, the Board is of the view that this approach provides users with relevant and reliable information about the carrying value of receivables at the reporting date, including whether there are any amounts that may not be collectable. Applying this approach, together with certain disclosures in GRAP 104, would provide users with useful information about credit and liquidity risk.
- 3.43 The amortised cost approach requires the initial measurement of non-contractual receivables at fair value, including consideration of the fair value principles in GRAP 104. The Board concluded that because GRAP 9 and GRAP 23 already require the use of fair value for the initial measurement of receivables, many entities may have already applied the principles in GRAP 104 in determining initial measurement. As a result, this may not result in a significant change to existing principles.
- 3.44 As entities already apply a similar approach for contractual receivables, it is expected that entities are in a position to practically implement this approach. The Board also noted that applying one approach to contractual receivables and another approach to non-contractual receivables may be extremely challenging for those entities that have both types of revenue, eg municipalities that have both contractual and non-contractual revenue and receivables on one statement issued to customers and ratepayers.
- 3.45 The Board considered that although non-contractual receivables are similar to other financial assets, it may be extremely onerous for entities to measure their receivables at fair value at every reporting date. On this basis, the Board does not believe that using a fair value approach for subsequent measurement is practical.
- 3.46 While the modified cost approach is potentially easier to apply in practice, it ignores the fact that receivables are financing transactions. As the arrangements in question require settlement in cash, it is difficult to justify an approach that excludes the consideration of the cost of financing from their measurement. In addition, users may find it difficult to understand why certain receivables are measured at fair value or amortised cost, and others at cost. It is also important to note that in those jurisdictions where a cost (or modified cost) approach is applied, an equivalent of GRAP 9 or GRAP 23 may not exist. Unlike the Standards of GRAP, this means that there would not be an existing requirement to measure receivables at fair value on initial recognition.
- 3.47 The Board is aware that entities may experience practical challenges in applying the amortised cost approach to non-contractual receivables. While the purpose of this Discussion Paper is to develop principles that can be used to account for non-

contractual receivables, it is expected that more detailed application guidance can be developed as part of the next phase of the project.

- 3.48 As the Board is proposing that the principles in GRAP 104 should be used by analogy to non-contractual receivables, it will need to assess how best to communicate this proposed approach, for example, by issuing a Standard, Interpretation or Guideline (or any combination of these). This assessment will be made based on the results on the comment process.

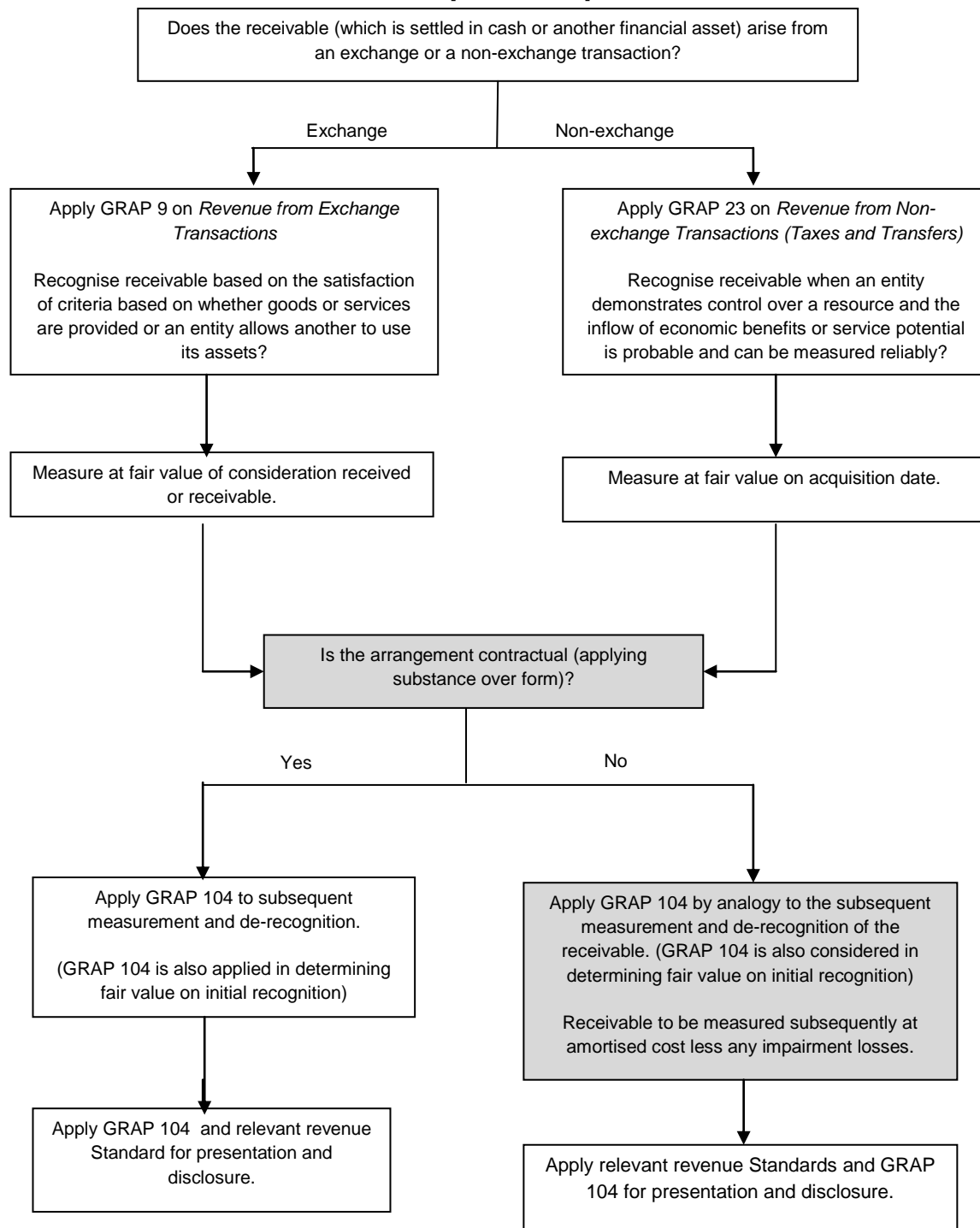
Issue 2 – Appropriateness of the amortised cost approach

Question 4

- 3.49 Do you agree with the Board that the amortised cost approach provides the most appropriate accounting treatment for receivables that arise from non-contractual arrangements and have the features of financial instruments? Please provide reasons for your view. If you do not agree that the amortised cost approach is appropriate, please indicate which approach should be used and why.
- 3.50 Are there any aspects of the proposed approach that may be difficult to apply in practice? If yes, please specify what transactions would be affected and what aspects of the proposed approach would be difficult to apply.

A revised Decision Tree A has been included at the end of this section outlining the proposed accounting approach.

Revised Decision Tree A – Proposed requirements for receivables



SECTION 4 – ACCOUNTING FOR NON-CONTRACTUAL PAYABLES

Introduction

4.1 As outlined in section 1, there are two Standards of GRAP that prescribe initial recognition, measurement, presentation and disclosure requirements for liabilities, ie GRAP 19 and GRAP 104. The purpose of this section is to examine the existing requirements in these Standards of GRAP, together with research into the practices internationally to identify possible approaches in accounting for payables that do not arise from contracts but have the features of a financial instrument, such as:

- Taxes payable.
- Appropriations and grants payable to recipients.
- Social benefits.
- Unspent portions of donor funding that should be repaid to the transferor or donor.
- Other payables that arise from the enforcement of specific legislation, eg fines and licences.

Similar to section 3, the Discussion Paper also summarises the accounting approach for contractual payables in order to assist respondents in commenting on the proposed accounting approach for non-contractual payables and, contrasting this approach to that applied for contractual payables.

4.2 In formulating an accounting approach for non-contractual payables, the Board is aware that there may be a number of other Standards of GRAP that outline requirements for contractual and non-contractual arrangements, for example, GRAP 19 and IGRAP 2 prescribe specific accounting requirements for decommissioning and similar liabilities. The intention of this Paper is not to deal with those transactions where specific guidance already exists.

Summary of practices internationally

4.3 In considering possible accounting approaches for non-contractual liabilities that have the features of financial instruments, the Board undertook research into the practices internationally. The results of the research are relatively limited as no international standards exist that deal specifically with non-contractual liabilities.

4.4 From the countries researched, only Canada provides explicit guidance on accounting for non-contractual payables. In particular, it provides guidance on the treatment of:

- (a) grants, distinguishing between grants paid to other government entities or institutions and grants paid to individuals in the form of social benefits; and

- (b) appropriations by the transferring entity.
- 4.5 PS 3410 issued by the PSAB notes that appropriations (called entitlements) should be accounted for by the transferring entity as follows: "Liabilities should be recognised by the transferring government for the estimated unpaid portions, at the end of the accounting period, of the entitlements due to other governments or institutions in accordance with the governing legislation or regulation."
- 4.6 PS 3410 prescribes the following accounting treatment for the two categories of grants payable:

Entitlements of other governments or institutions

.23 Liabilities should be recognized by the transferring government for the estimated unpaid portions, at the end of the accounting period, of the entitlements due to other governments or institutions in accordance with the governing legislation or regulation.

Entitlements of individuals

.19 Liabilities should be recognized by the transferring government for estimated unpaid entitlements due at the end of the accounting period to those individuals who had met eligibility criteria.

Contractual payables

- 4.7 As outlined in section 1, there are two Standards of GRAP that prescribe initial recognition, measurement, presentation and disclosure requirements for liabilities, ie GRAP 19 and GRAP 104. As indicated in section 3, entities may have hitherto considered only the legal form of arrangements in determining whether they are contractual or not. The Board is of the view, however, that substance - and not only legal form - should be considered in accounting for transactions. As a result, the Board has proposed in section 2 that entities should assess the nature of transactions, using the existing application guidance in GRAP 104, to determine whether an arrangement is contractual or non-contractual in nature.
- 4.8 If an entity has assessed that an arrangement is contractual in nature and will be settled in cash or another financial asset, it is within the scope of GRAP 104 and should be accounted for in accordance with that Standard.
- 4.9 In summary, the accounting approach for contractual payables is as follows:
1. Consider the guidance in GRAP 104 and determine whether the arrangement is contractual or non-contractual in nature.
 2. If the arrangement is contractual and is settled in cash or another financial asset, the liability is within the scope of GRAP 104 and should be accounted for as a

financial instrument. Any uncertainties regarding the timing and amount of the cash flows associated with the financial liability are considered when measuring the payable.

Non-contractual payables

Outline of possible approaches

4.10 In identifying possible measurement approaches, the Board considered both the research undertaken internationally, albeit limited, and the requirements in the existing Standards of GRAP. The approach adopted in Canada for certain transactions, which is to measure liabilities at the unpaid amounts at reporting date, could be seen as a cost based measure if no adjustment is made for the effect of time value of money. In terms of the existing measurement approaches in the Standards of GRAP:

- GRAP 19 requires the initial and subsequent measurement of liabilities using discounted cash flows; and
- GRAP 104 requires the use of fair value for initial measurement and amortised cost, or in limited instances, fair value for subsequent measurement. Both amortised cost and fair value may be determined using discounted cash flows.

4.11 Based on the analysis in paragraph 4.10, the Board is of the view that the following two measurement bases could be used to account for non-contractual payables:

- Measurement basis 1 – Best estimate of the amount required to settle the liability using the principles in GRAP 19 which requires the measurement of liabilities (provisions) at the best estimate of the discounted cash flows required to settle the obligation, both on initial recognition and at every reporting date.
- Measurement basis 2 - Amortised cost approach using the principles in GRAP 104 which require the initial measurement of financial liabilities at fair value and subsequent measurement at amortised cost.

Paragraphs 4.12 to 4.15 below outline the Board's rationale for selecting these two measurement approaches.

4.12 The Board did not identify the measurement basis adopted in Canada as a separate approach. The Board is of the view that "the amount required to settle the obligation" under GRAP 19 and the recognition of a liability at the unpaid amount using the Canadian guidance, are similar to the extent that the effect of discounting is immaterial. As a result, the Board is of the view that the measurement approach in GRAP 19 includes the approach adopted in Canada.

4.13 In considering the measurement bases under the existing Standards of GRAP, the Board noted that GRAP 104 allows financial liabilities to be designated at fair value. This designation is only allowed, however, to overcome an accounting mismatch. For

an accounting mismatch to exist, the assets and liabilities must be linked and the assets are required to be measured at fair value. As the Board has proposed in section 3 that amortised cost should be used for measuring non-contractual receivables, it is unlikely that an accounting mismatch would exist. Consequently, only amortised cost is discussed as a possible measurement basis. If comments on the Discussion Paper indicate a preference for fair value for the measurement of assets, fair value as a measurement basis for liabilities may need to be reconsidered.

4.14 The analysis outlined in section 1 noted that although a specific Standard of GRAP does not exist for taxes, the Standards of GRAP require taxes to be accounted for using IAS 12 on *Income Taxes*. The Board considered whether this approach to the treatment of income taxes is appropriate. The Board considered that the instances where taxes are paid by public sector entities are limited, particularly for those entities that apply Standards of GRAP. While many entities may pay tax to revenue authorities, they often do so in their capacity as an agent. For example:

- SITE and PAYE are levied on individuals who qualify to be registered as taxpayers. For administrative purposes, employers deduct these taxes on a monthly basis from their employees' salaries and make payments to the revenue authorities. However, the tax transaction is between the individual and national government. Any payments made by employers are made on behalf of their employees.
- VAT is an indirect tax based on consumption of goods and services in the economy. Revenue is raised for the government by requiring certain traders or vendors to register and to charge VAT on taxable supplies of goods or services. The tax transaction is effectively concluded between the entity/authority imposing the tax (national government) and consumers of goods and services in South African. Where public sector entities are registered for VAT and payments made, these payments are effectively made on behalf of consumers. Currently only municipalities and a limited number of public entities may register as VAT vendors.

4.15 The Board concluded that for those instances where income taxes are paid by entities, IAS 12 on *Income Taxes* should continue to be used. The two measurement bases outlined in paragraph 4.11 can be used to account for other taxes payable, eg property taxes.

Issue 3 – Two measurement approaches for liabilities

Question 5

4.16 Do you agree with the two measurement bases identified by the Board in paragraph 4.11? Are there any additional bases that should be considered? Please provide reasons for your view.

Question 6

4.17 Do you agree with the Board's view in paragraph 4.15 that:

- (a) IAS 12 should continue to be applied by those entities that do pay income tax; and
- (b) One of the measurement bases identified in paragraph 4.15 could be used to account for any other taxes that may arise? Please provide reasons for your view.

Application of the two bases to common public sector transactions

4.18 The paragraphs that follow outline the application of the two bases to the most common public sector transactions.

Best estimate of the amount required to settle an obligation

4.19 Under GRAP 19, liabilities are initially and subsequently measured using the best estimate of the amount required to settle the obligation. This approach considers the cash flows required to settle the obligation, which may be adjusted for any risk and uncertainty pertaining to those cash flows. In applying this to a number of public sector transactions, the best estimate would most likely be determined as follows:

- (a) For appropriations payable to entities, using the amount appropriated in legislation.
- (b) For social benefits, using the grant amount specified in legislation multiplied by the number of approved beneficiaries.
- (c) For payables arising from other non-contractual arrangements: eg fines, using the amount specified in legislation.

4.20 Where the liability will be settled some time after the reporting date, the best estimate would include consideration of the time value of money where this is material. Where the effect of the time value of money is material, the cash flows should be discounted using the current market assessment of the time value of money both for initial and subsequent measurement.

4.21 In applying this to the transactions outlined in paragraph 4.19, an entity would firstly need to consider whether the effect of discounting is material. In practice, this assessment requires a significant degree of judgement. Where an entity has determined that the effect of discounting is material, an appropriate discount rate should be determined. As the discount rate should reflect the current market

assessment of the time value of money, a government bond rate for the same maturity as the liability may be appropriate.

Amortised cost

4.22 Under amortised cost, payables would be recognised, measured, de-recognised, presented and disclosed using the principles in GRAP 104 by analogy. Using this measurement basis, payables would be accounted for as follows:

- (a) The liability would be recognised initially at fair value. The fair value would usually equal the transaction price, except if any evidence exists to the contrary. For example, if the credit terms related to the liability are not market-related, the transaction price would not equal the fair value on initial recognition. Where such conditions exist, the fair value at initial recognition would be based on the cash flows associated with the liability discounted using a market-related rate of interest for a similar instrument with the same risk profile, maturity and currency.
- (b) After initial recognition, the liability would be measured at amortised cost. Amortised cost is determined using the effective interest method, using the market-related interest rate that existed at initial recognition.

4.23 In applying this measurement basis, one of the most significant complexities would be the discounting of liabilities, particularly determining an appropriate discount rate. While GRAP 19 requires the use of a discount rate that reflects the time value of money, this approach requires discounting using a rate that reflects a market-related rate of interest for a similar instrument with the same risk profile, maturity and currency. The same complexities that exist in accounting for receivables also exist for payables such as appropriations, social benefits and, other payables such as fines.

Analysis of possible approaches

4.24 In assessing the appropriateness of the principles in GRAP 19 and GRAP 104 in accounting for non-contractual payables, the Board considered what the most appropriate measurement basis should be for liabilities that are settled in cash or another financial asset. The Board concluded that, ultimately, any measurement basis that includes the cash flows required to settle the obligation and considers the effect of the time value of money, is appropriate. Although the final amount of a liability recognised and measured under GRAP 19 and GRAP 104 may differ, the Board is of the view that both measurement bases are appropriate.

4.25 As the Board believes that both measurement bases are appropriate for measuring non-contractual liabilities that have the features financial instruments the remainder of this section focuses on formulating when an entity should apply GRAP 19 and when it should apply GRAP 104 by analogy.

Proposal by the Board

- 4.26 Unlike the approach to assets where only one of the three measurement bases (outlined in paragraph 3.11) will be used for the measurement of non-contractual receivables, the Board is proposing a “mixed” approach to the recognition, measurement, presentation and disclosure of non-contractual liabilities. Under the approach for liabilities, the Board is proposing that non-contractual liabilities should be accounted for, throughout their existence, either:
- (a) as liabilities that are within the scope of GRAP 19; or
 - (b) by using the amortised cost principles in GRAP 104 by analogy and applying any relevant presentation and disclosure requirements.
- 4.27 At present, liabilities are accounted for using GRAP 104 when they are contractual and the timing and amount of the liability is certain. Liabilities that do not arise from contracts, or that arise from contracts but whose timing and amount are uncertain, are accounted for using GRAP 19. The Board proposes that in assessing whether to use the requirements in GRAP 19 or GRAP 104 for non-contractual liabilities, a similar process is followed.
- 4.28 The Board is of the view that where a non-contractual liability exists to pay cash or another financial asset, and the timing and amount of the liability is certain at initial recognition, GRAP 104 should be used to account for those liabilities by analogy. Where the timing and amount of the cash flows related to a non-contractual liability are uncertain at initial recognition, GRAP 19 should be applied.
- 4.29 Assessing whether the timing and amount of cash flows are uncertain may require a high degree of judgement for both contractual and non-contractual arrangements. One of the factors that may be used in considering the certainty of the timing and amount of cash flows would be the existence of a clearly identified counterparty, with agreed terms and conditions of settlement. The application of this is best illustrated through an example.

Illustrative example 2 – Assessing whether cash flows are uncertain

This example is provided in the context of a social benefit scheme which is established in terms of legislation. Individuals are required to (a) apply to receive a particular benefit, and (b) satisfy the necessary eligibility criteria. For the purposes of this example the arrangement has been assessed, using the criteria in GRAP 104, as contractual in nature.

Entities that provide social benefit grants may recognise a liability for social benefits based on statistical information, such as birth and mortality rates, and economic information such as unemployment. In recognising this liability, specific beneficiaries may not have been identified and the specific timing of when and how the social

benefits will be paid may not be known. However, because the entity is aware that it has an obligation based on other information sources, it recognises this liability in its financial statements.

The same entity may have specifically identified beneficiaries, however, who have applied to receive the grant and have met all the eligibility criteria. In this instance, the entity is aware of the specific beneficiary to whom the benefits are owed, what amount should be paid and when they are payable.

Using the Board's proposed approach, the liability for specifically identified beneficiaries will be accounted for using GRAP 104. The liability raised for social benefit obligations should be accounted for using GRAP 19.

Summary of proposed approach

4.30 In summary, the Board considers that the following approach should be applied in accounting for non-contractual payables.

- (a) Non-contractual payables that are certain in timing and amount, at initial recognition, should be accounted for using the amortised cost principles in GRAP 104 by analogy.
- (b) Non-contractual payables that are uncertain in timing and amount, at initial recognition, should be accounted for as provisions in accordance with GRAP 19.

An entity assesses at initial recognition whether the timing and amount of the cash flows are certain. Once a non-contractual liability is accounted for under either GRAP 19 or using GRAP 104 by analogy, their accounting approach is not changed.

4.31 While this approach may be more complex than the approach used for assets, this is largely because there are currently two Standards of GRAP that deal with the recognition and measurement of liabilities. ie GRAP 19 and 104; while there is only one Standard, ie GRAP 104, that deals with the recognition and measurement of receivables. An alternative to applying this "mixed" accounting approach would be to account for all payables either using GRAP 19 or GRAP 104. These alternatives are explored in paragraphs 4.34 to 4.37 below.

4.32 In formulating an approach to liabilities which differs to the approach for assets, the Board considered the possible impact this asymmetry may have on the preparation of consolidated financial statements. The Board concluded that transactions where the counter-parties are both public sector entities, eg transactions involving inter-governmental transfers such as the transfer of equitable share allocations, appropriations and grants, would be most affected.

4.33 On analysis, the Board concluded that applying the proposed approach outlined in paragraph 4.30 would not result in a different measurement basis being applied for the

receivables and payables associated with such transactions. Using the proposed approach outlined in paragraph 3.40 to 3.48, the receivable would be measured at amortised cost. As the timing and amount of the payable is certain, GRAP 104 would be applied and the payable would also be measured at amortised cost. In addition, if the effect of discounting is ignored for such transactions (see paragraph 3.25), the receivable and payable would be measured at the same amount which would facilitate elimination of inter-entity transactions on consolidation.

Alternative approach - Continue with current practice and use GRAP 19 to account for non-contractual payables

4.34 In considering an approach using the existing Standards of GRAP, the Board was aware that, at present, most entities apply the requirements of GRAP 19 to account for all non-contractual payables. The Board considered this as an alternative approach rather than developing criteria for when an entity should use GRAP 19 and when it should use GRAP 104 by analogy.

4.35 In considering this as an alternative, the Board deliberated on the following issues:

- (a) In section 3, the Board has proposed using an amortised cost model for non-contractual receivables. If this is supported, then there will be a mismatch between the accounting approach used for the asset and the liability related to the same transaction if GRAP 19 is used to account for the liability. As noted in paragraph 4.32, this may have a significant effect on transactions that occur within the same economic entity, eg appropriations receivable and payable between National Treasury and a national department or national public entity.
- (b) As noted above, assessing whether the timing and amount of a transaction's cash flows are certain or not requires a high degree of judgement. If all non-contractual payables are accounted for using GRAP 19, this assessment is not necessary. Removing this element of judgement may promote consistent treatment of non-contractual liabilities but it would lead to liabilities being recognised, presented and disclosed as provisions when in fact they are liabilities of specific amounts owed to specific parties.
- (c) The intention of this Paper is to deal with common public sector transactions that arise from non-contractual arrangements. While the intention is to deal with transactions that would not ordinarily occur in the private sector, eg appropriations, there are some non-contractual arrangements that do exist in the private sector, eg the payment of fines. Under the approach proposed in paragraph 4.30, an entity may account for fines using the amortised cost approach in GRAP 104 by analogy. In the private sector, these transactions would be accounted for using the equivalent of GRAP 19 because the arrangement is not contractual. On this basis, it could be questioned why the

accounting treatment for these types of transactions should be different in the public and private sector.

Alternative approach – Apply GRAP 104 to all liabilities

4.36 While GRAP 104 is currently used to account for contractual liabilities that are settled in cash, the Board considered whether GRAP 104 could be used to account for all liabilities, both contractual and non-contractual, including those that may be uncertain in timing and amount. The implication of this alternative is that GRAP 19 would be withdrawn and GRAP 104 would be used to account for liabilities such as rehabilitation provisions and other liabilities of uncertain timing and amount.

4.37 In deliberating the merits of this approach, the Board concluded that while this approach may be attractive for its simplicity as one approach will be applied to all liabilities, it would result in a significant departure from the international standards. The Board also concluded that because of the inherent uncertainty associated with certain types of liabilities, they may need to be measured at fair value under GRAP 104. As these liabilities are often not traded on an active, liquid market, determining fair value may be relatively complex as entities would need to rely on estimation techniques.

Issue 4 – Accounting approach for non-contractual payables

Question 7

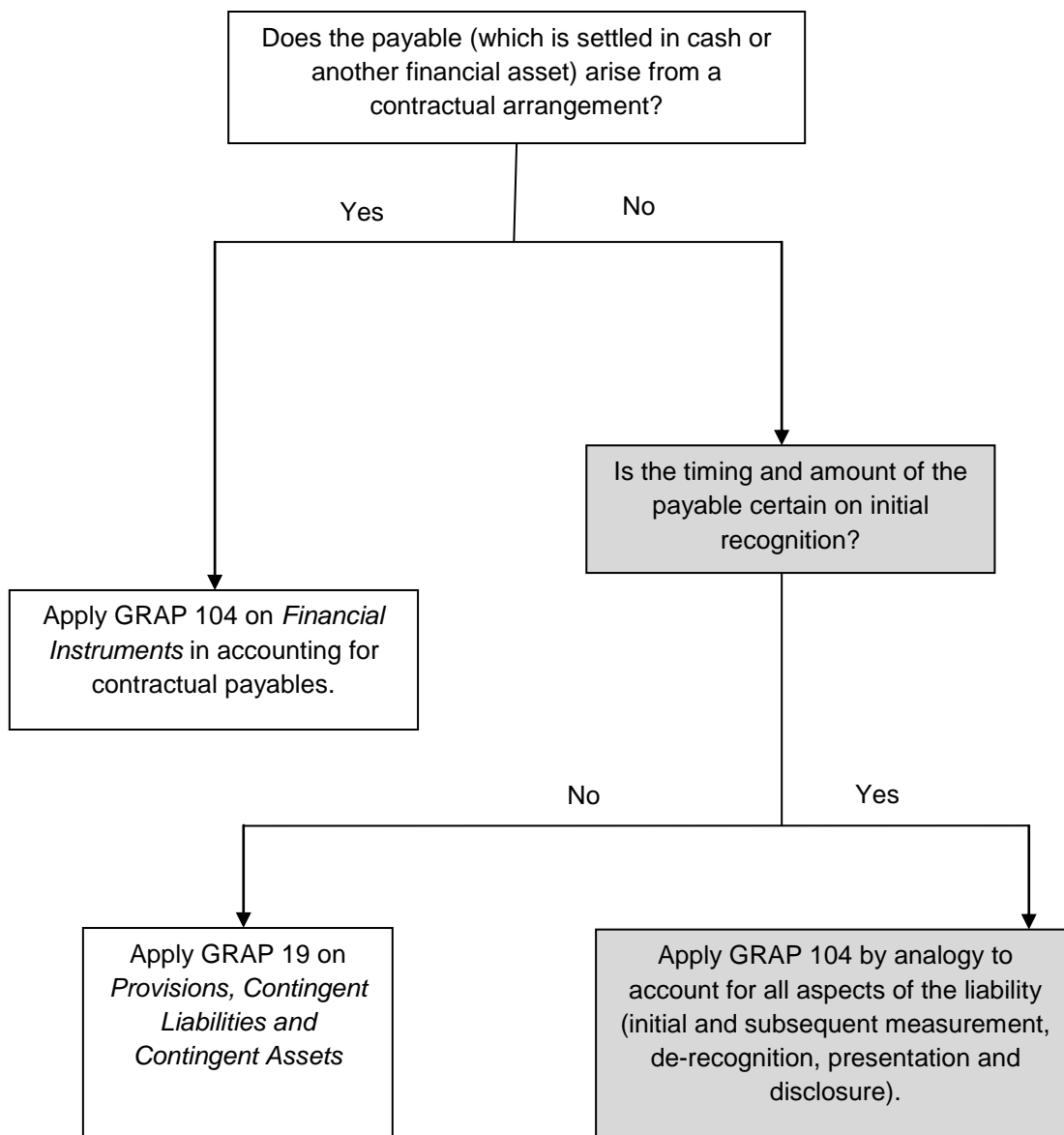
4.38 Based on the proposed approach outlined in paragraph 4.30, and the alternative approaches outlined in paragraphs 4.34 to 4.37, the Board would appreciate respondents' views on the following issues:

- Do you support the Board's preferred approach in 4.30 or do you support one of the alternative approaches outlined in paragraphs 4.34 to 4.37? Please provide reasons for your view.
- Do you believe that the same approach should be applied for both assets and liabilities? Please provide reasons for your view.
- In paragraph 4.33, the Board has concluded that the measurement basis applied for certain receivables and payables would be consistent, eliminating potential consolidation issues. Do you agree with this view? Please provide reasons for your view.

A revised Decision Tree B has been included at the end of this section outlining the proposed accounting.

4.39 Regardless of the approach selected, the Board is of the view that guidance is required for the accounting of non-contractual payables. Based on the comments received, the Board will assess the most appropriate form of the required. (see the Board's proposal for receivables in paragraph 3.40-3.48).

Revised Decision Tree B – Proposed requirements for payables



Receivables	ANNEXURE A – EXISTING REQUIREMENTS FOR THE RECOGNITION AND MEASUREMENT OF ASSETS THAT HAVE THE FEATURES OF FINANCIAL INSTRUMENTS							
	CONTRACTUAL				NON-CONTRACTUAL			
	Sales of goods and services, interest, royalties, other	Leases	Donor funding	Licences and similar fees (see notes below)	Licences and similar fees (see notes below)	Grants	Appropriations and other inter-governmental transfers	Taxes, fines and forfeitures
Initial recognition	GRAP 9 GRAP 104	GRAP 13	GRAP 23	GRAP 9 GRAP 23	GRAP 9 GRAP 23	GRAP 23	GRAP 23	GRAP 23
	<u>GRAP 9</u> Inflow of resources probable and those resources can be measured reliably. <u>GRAP 104</u> Trade date.	Finance lease: Commencement date of the lease. Operating lease: Asset used by lessee.	Demonstrate control over an asset Inflow of resources probable and those resources can be measured reliably.	<u>GRAP 23</u> Demonstrate control over an asset <u>GRAP 9 and 23</u> Inflow of resources probable and those resources can be measured reliably.	<u>GRAP 23</u> Demonstrate control over an asset <u>GRAP 9 and 23</u> Inflow of resources probable and those resources can be measured reliably.	Demonstrate control over an asset Inflow of resources probable and those resources can be measured reliably.	Demonstrate control over an asset Inflow of resources probable and those resources can be measured reliably.	Demonstrate control over an asset Inflow of resources probable and those resources can be measured reliably.
Initial measurement	GRAP 9 GRAP 104	GRAP 13	GRAP 23	GRAP 9 GRAP 23	GRAP 23	GRAP 23	GRAP 23	GRAP 23
	<u>GRAP 9</u> Fair value of the consideration received or receivable. <u>GRAP 104</u> Fair value of the asset, plus transaction costs (if measured at	Finance lease: Net investment in the lease (less transaction costs if not a manufacturer or trader lessor). Operating lease: Straight-lining of lease payments as	Fair value.	<u>GRAP 9</u> Fair value of the consideration received or receivable (transaction price). <u>GRAP 23</u> Fair value.	<u>GRAP 9</u> Fair value of the consideration received or receivable. <u>GRAP 23</u> Fair value.	Fair value.	Fair value.	Fair value.

	amortised cost or cost).	asset used.						
Subsequent measurement	GRAP 104	GRAP 104	GRAP 104	GRAP 104	Framework	Framework	Framework	Framework
	Amortised cost less impairment. Fair value (unlikely).	Amortised cost less impairment.	Amortised cost less impairment.	Amortised cost less impairment.	Accounting policy determined by entity using GRAP 3.	Accounting policy determined by entity using GRAP 3.	Accounting policy determined by entity using GRAP 3.	Accounting policy determined by entity using GRAP 3.
Derecognition	GRAP 104	GRAP 104	GRAP 104	GRAP 104	Framework	Framework	Framework	Framework
					Accounting policy determined by entity using GRAP 3.	Accounting policy determined by entity using GRAP 3.	Accounting policy determined by entity using GRAP 3.	Accounting policy determined by entity using GRAP 3.
Presentation	GRAP 104 GRAP 1	GRAP 13 GRAP 1	GRAP 104 GRAP 1	GRAP 104 GRAP 1	GRAP 1	GRAP 1	GRAP 1	GRAP 1
	<u>GRAP 104</u> To the extent applicable, paragraphs .84-.99. <u>GRAP 1</u> General presentation considerations.	<u>GRAP 1</u> General presentation considerations.	<u>GRAP 104</u> To the extent applicable, paragraphs .84-.99. <u>GRAP 1</u> General presentation considerations.	<u>GRAP 104</u> To the extent applicable, paragraphs .84-.99. <u>GRAP 1</u> General presentation considerations.	<u>GRAP 1</u> General presentation considerations.	<u>GRAP 1</u> General presentation considerations.	<u>GRAP 1</u> General presentation considerations.	<u>GRAP 1</u> General presentation considerations.

Disclosure	GRAP 104 GRAP 1	GRAP 104 GRAP 13 GRAP 1	GRAP 104 GRAP 23 GRAP 1	GRAP 104 GRAP 23 GRAP 1	GRAP 23 GRAP 1	GRAP 23 GRAP 1	GRAP 23 GRAP 1	GRAP 23 GRAP 1
	<u>GRAP 104</u> To the extent applicable, paragraphs .102-.132 <u>GRAP 1</u> Specific requirements in GRAP regarding the separate disclosure of exchange and non-exchange receivables. General disclosure considerations.	<u>GRAP 104</u> To the extent applicable, paragraphs .102-.132 <u>GRAP 13</u> Paragraphs .66 (finance leases) and .75 (operating leases). <u>GRAP 1</u> General considerations	<u>GRAP 104</u> To the extent applicable, paragraphs .102-.132 <u>GRAP 23</u> Paragraph.104-.105 <u>GRAP 1</u> Specific requirements in GRAP regarding the separate disclosure of exchange and non-exchange receivables. General disclosure considerations.	<u>GRAP 104</u> To the extent applicable, paragraphs .102-.132 <u>GRAP 23</u> Paragraph.104-.105 <u>GRAP 1</u> Specific requirements in GRAP regarding the separate disclosure of exchange and non-exchange receivables. General disclosure considerations.	<u>GRAP 23</u> Paragraph.104-.105 <u>GRAP 1</u> Specific requirements in GRAP regarding the separate disclosure of exchange and non-exchange receivables. General disclosure considerations.	<u>GRAP 23</u> Paragraph.104-.105 <u>GRAP 1</u> Specific requirements in GRAP regarding the separate disclosure of exchange and non-exchange receivables. General disclosure considerations.	<u>GRAP 23</u> Paragraph.104-.105 <u>GRAP 1</u> Specific requirements in GRAP regarding the separate disclosure of exchange and non-exchange receivables. General disclosure considerations.	<u>GRAP 23</u> Paragraph.104-.105 <u>GRAP 1</u> Specific requirements in GRAP regarding the separate disclosure of exchange and non-exchange receivables. General disclosure considerations.

Notes – Analysis of assets:

1. Licence fees can give rise to either exchange or non-exchange revenue, depending on the circumstances of the arrangement. As the Discussion Paper plans to explore whether such arrangements can in fact be contractual in nature, licence fees have been included under both contractual and non-contractual.

Payables	ANNEXURE B – EXISTING REQUIREMENTS FOR THE RECOGNITION AND MEASUREMENT OF LIABILITIES THAT HAVE THE FEATURES OF FINANCIAL INSTRUMENTS											
	CONTRACTUAL						NON-CONTRACTUAL					
	Payables	Leases	Grants	Licence fees	Social benefits	Performance obligations that give rise to other payables (see note 1 below)	Social benefits	Licence fees	Grants	Performance obligations that give rise to other payables	Appropriations and intergovernmental transfers	Taxes, fines, forfeitures
Initial recognition	GRAP 104	GRAP 13	GRAP 104	GRAP 104	GRAP 104 (See notes 2 and 3 below)	GRAP 104	GRAP 19 Framework	GRAP 19 Framework	GRAP 19 Framework	GRAP 19	GRAP 19 Framework	GRAP 19 Framework IAS 12 Income Taxes
	Trade date Obligation to pay, timing and amount certain.	Finance lease: Commencement of lease Operating lease: Use of asset or in accordance with agreement (eg advance payments)	“Trade date” Obligation to pay, timing and amount certain.	“Trade date” Obligation to pay, timing and amount certain.	“Trade date” Obligation to pay, timing and amount certain.	Conditions exist on resources received in a non-exchange revenue transaction.	No realistic alternative but to settle obligation, and reliable estimate can be made. Timing and amount certain.	No realistic alternative but to settle obligation, and reliable estimate can be made. Timing and amount certain.	No realistic alternative but to settle obligation, and reliable estimate can be made. Timing and amount certain.	Conditions exist on resources received in a non-exchange revenue transaction.	No realistic alternative but to settle obligation, and reliable estimate can be made. Timing and amount certain	<u>Fines and forfeitures</u> No realistic alternative but to settle obligation, and reliable estimate can be made. Timing and amount certain <u>Taxes</u> IAS 12.

Initial measurement	GRAP 104	GRAP 13	GRAP 104	GRAP 104	GRAP 104	GRAP 104	GRAP 19 Framework	GRAP 19 Framework	GRAP 19 Framework	GRAP 19 Framework	GRAP 19 Framework	GRAP 19 Framework IAS 12
	Fair value plus transaction costs (if subsequently measured at amortised cost).	Finance lease: Present value of future minimum lease payments. Operating lease: Straight-line basis.	Fair value plus transaction costs (if subsequently measured at amortised cost).	Fair value plus transaction costs (if subsequently measured at amortised cost).	Fair value plus transaction costs (if subsequently measured at amortised cost).	Fair value plus transaction costs (if subsequently measured at amortised cost).	Accounting policy formulated using GRAP 3. Most likely based on GRAP 19 – best estimate of the amount required to settle the obligation; amount specified in legislation.	Accounting policy formulated using GRAP 3. Most likely based on GRAP 19 – best estimate of the amount required to settle the obligation.	Accounting policy formulated using GRAP 3. Most likely based on GRAP 19 – best estimate of the amount required to settle the obligation.	Accounting policy formulated using GRAP 3. Most likely based on GRAP 19 – best estimate of the amount required to settle the obligation.	Accounting policy formulated using GRAP 3. Most likely based on GRAP 19 – best estimate of the amount required to settle the obligation; amount specified in legislation.	<u>Fines, forfeitures</u> Accounting policy formulated using GRAP 3. Most likely based on GRAP 19 – best estimate of the amount required to settle the obligation.
Subsequent measurement	GRAP 104	GRAP 13	GRAP 104	GRAP 104	GRAP 104	GRAP 104	GRAP 19 Framework	GRAP 19 Framework	GRAP 19 Framework	GRAP 19 Framework	GRAP 19 Framework	GRAP 19 Framework IAS 12
	Amortised cost.	Same as initial measurement.	Amortised cost.	Amortised cost.	Amortised cost.	Amortised cost.	Accounting policy formulated using GRAP 3.	Accounting policy formulated using GRAP 3.	Accounting policy formulated using GRAP 3.	Accounting policy formulated using GRAP 3.	Accounting policy formulated using GRAP 3.	<u>Fines, forfeitures</u> Accounting policy formulated using GRAP 3. <u>Tax</u>

												IAS 12
Derecognition	GRAP 104	GRAP 104	GRAP 104	GRAP 104	GRAP 104	GRAP 104	Framework	Framework	Framework	Framework	Framework	Framework
	Paragraphs .80-.83.	Paragraphs .80-.83.	Paragraphs .80-.83.	Paragraphs .80-.83.	Paragraphs .80-.83.	Paragraphs .80-.83.	Accounting policy formulated using GRAP 3.	Accounting policy formulated using GRAP 3.	Accounting policy formulated using GRAP 3.	Accounting policy formulated using GRAP 3.	Accounting policy formulated using GRAP 3.	<u>Fines, forfeitures</u> Accounting policy formulated using GRAP 3. <u>Tax</u> IAS 12
Presentation	GRAP 104 GRAP 1	GRAP 104 GRAP 1	GRAP 104 GRAP 1	GRAP 104 GRAP 1	GRAP 104 GRAP 1	GRAP 104 GRAP 1	GRAP 1 Framework	GRAP 1 Framework	GRAP 1 Framework	GRAP 1 Framework	GRAP 1 Framework	GRAP 1 Framework
	To the extent relevant, paragraphs .84-.99.	To the extent relevant, paragraphs .84-.99.	To the extent relevant, paragraphs .84-.99.	To the extent relevant, paragraphs .84-.99.	To the extent relevant, paragraphs .84-.99.	To the extent relevant, paragraphs .84-.99.	Accounting policy formulated using GRAP 3.	Accounting policy formulated using GRAP 3.	Accounting policy formulated using GRAP 3.	Accounting policy formulated using GRAP 3.	Accounting policy formulated using GRAP 3.	<u>Fines, forfeitures</u> Accounting policy formulated using GRAP 3. <u>Tax</u> IAS 12

Disclosure	GRAP 104 GRAP 1	GRAP 13 GRAP 104 GRAP 1	GRAP 104 GRAP 1	GRAP 104 GRAP 1	GRAP 104 GRAP 1	GRAP 104 GRAP 1	GRAP 1 Framework	GRAP 1 Framework	GRAP 1 Framework	GRAP 1 Framework	GRAP 1 Framework	GRAP 1 Framework
	To the extent applicable, paragraphs .100-.132	To the extent applicable, paragraphs .100-.132	To the extent applicable, paragraphs .100-.132	To the extent applicable, paragraphs .100-.132	To the extent applicable, paragraphs .100-.132	To the extent applicable, paragraphs .100-.132	Specific requirements in GRAP regarding the separate disclosure of exchange and non-exchange payables. General disclosure considerations.	Specific requirements in GRAP regarding the separate disclosure of exchange and non-exchange payables. General disclosure considerations.	Specific requirements in GRAP regarding the separate disclosure of exchange and non-exchange payables. General disclosure considerations.	Specific requirements in GRAP regarding the separate disclosure of exchange and non-exchange payables. General disclosure considerations.	Specific requirements in GRAP regarding the separate disclosure of exchange and non-exchange payables. General disclosure considerations.	Specific requirements in GRAP regarding the separate disclosure of exchange and non-exchange payables. General disclosure considerations.

Notes – Analysis of liabilities:

1. Performance obligations – In accordance with GRAP 23, performance obligations arise when an entity has received resources in a non-exchange transactions, and the use of those resources is subject to a condition. Initially, performance obligations are recognised and measured in GRAP 23 using the principles in GRAP 19. Subsequent to initial recognition, it may become clear that the entity has no alternative but to return the resources to the transferor. Where this is the case, and the return of resources is in the form of cash or another financial asset, the liability is a financial liability, or has the features of a financial liability.
2. Social benefits – It is the intention that the Discussion Paper explore whether social benefits, which arise out of legislation, can in fact have the characteristics of a contractual arrangement.
3. Social benefits – There is no prescriptive guidance on the treatment of social benefits in the existing Standards of GRAP. Consequently, there is a range of acceptable accounting treatments. The view articulated by the Secretariat is that an obligation for social benefits arises before they become “due and payable”. As a result, the nature of the obligation for social benefits will most likely evolve over time. The initial recognition of a social benefit obligation (although not specifically prescribed in existing Standards) would most likely take the



form of a provision, particularly if the timing and amount is uncertain. Where specific amounts become due and payable to beneficiaries, it is likely that at this point a payable, similar to a financial instrument, would be recognised.