



IGRAP 1

ACCOUNTING STANDARDS BOARD

**INTERPRETATIONS OF THE STANDARDS OF
GENERALLY RECOGNISED ACCOUNTING
PRACTICE**

**APPLYING THE PROBABILITY TEST ON INITIAL
RECOGNITION OF EXCHANGE REVENUE**

(IGRAP 1)

**Issued by the
Accounting Standards Board
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INTERPRETATION OF THE STANDARD OF GENERALLY RECOGNISED ACCOUNTING PRACTICE: APPLYING THE PROBABILITY TEST ON INITIAL RECOGNITION OF EXCHANGE REVENUE

Introduction

The Accounting Standards Board (Board) is required in terms of the Public Finance Management Act, Act No. 1 of 1999, as amended (PFMA), to determine generally recognised accounting practice referred to as Standards of Generally Recognised Accounting Practice (GRAP).

The Board must determine GRAP for:

- (a) departments (national and provincial);
- (b) public entities;
- (c) constitutional institutions;
- (d) municipalities and boards, commissions, companies, corporations, funds or other entities under the ownership control of a municipality; and
- (e) Parliament and the provincial legislatures.

The above are collectively referred to as “entities”.

The Board has approved the application of Statements of Generally Accepted Accounting Practice (GAAP), codified by the Accounting Practices Board (APB) and issued by the South African Institute of Chartered Accountants (SAICA) to be GRAP for:

- (a) government business enterprises (GBEs)(as defined in the PFMA);
- (b) trading entities (as defined in the PFMA);
- (c) any other entity, other than a municipality, whose ordinary shares, potential ordinary shares or debt are publicly traded on the capital markets; and
- (d) entities under the ownership control of any of these entities.

The Board believes that Statements of GAAP are relevant and applicable to financial statements prepared by all such entities including those under their ownership control.

Financial statements should be described as complying with Standards of GRAP only if they comply with all the requirements of each applicable Standard of GRAP and any related Interpretations of the Standards of GRAP.

All paragraphs in this Interpretation of the Standards of GRAP have equal authority. The status and authority of appendices are dealt with in the preamble to each appendix. This Interpretation of the Standards of GRAP should be read in the context of its objective, its basis for conclusions if applicable, the *Preface to Standards of GRAP*, the *Preface to the*



Interpretations of the Standards of GRAP and the Framework for the Preparation and Presentation of Financial Statements.

Standards of GRAP and Interpretations of Standards of GRAP should also be read in conjunction with any directives issued by the Board prescribing transitional provisions, as well as any regulations issued by the Minister of Finance regarding the effective dates of the Standards of GRAP, published in the Government Gazette.

Reference may be made to a Standard of GRAP that has not been issued at the time of issue of this Interpretation of the Standards of GRAP. This is done to avoid having to change the Standards already issued when a later Standard is subsequently issued. Paragraph .12 of the Standard of GRAP on *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Reference

The Standard of GRAP on *Revenue from Exchange Transactions* (GRAP 9).

Objective

- .01 Paragraph .03 of the Standard of GRAP on *Revenue from Exchange Transactions* states that revenue is recognised when it is probable that future economic benefits or service potential will flow to the entity and these benefits can be measured reliably.
- .02 This Interpretation of the Standards of GRAP provides guidance on how an entity applies the probability test on initial recognition of exchange revenue that arises on the provision of goods or services provided on credit in an exchange transaction where there is uncertainty that the revenue will eventually be collected, because discretion will be exercised subsequently.

Scope

- .03 This Interpretation of the Standards of GRAP applies only to the probability test on initial recognition of exchange revenue; it should not be applied by analogy to other types of transactions. Subsequent measurement of the associated assets and/or liabilities, presentation and disclosure requirements are not addressed.



- .04 This Interpretation of the Standards of GRAP does not deal with cash sales or payments received in advance of the provision of goods or services.

Issues

- .05 In the public sector, entities are required to provide goods or services in accordance with their legislative mandate. At the time of invoicing the customer, there may be uncertainty that the revenue will be collected. Nevertheless, entities often continue to provide the goods or services, despite non-payment by the recipient of the goods or services. However, entities are still required to collect the revenue due to them in terms of legislative requirements.
- .06 At present different practices are applied to the use of the probability test on initial recognition of exchange revenue. Some take into account the likelihood of not receiving all the revenue, having regard to the past payment history of recipients of the goods or services. Others estimate future losses on initial recognition. Yet others recognise the full amount of the revenue and subsequently recognise an impairment loss.
- .07 This Interpretation of the Standards of GRAP addresses the manner in which an entity applies the probability test on initial recognition of exchange revenue in accordance with the Standard of GRAP on *Revenue from Exchange Transactions*.

Consensus

- .08 An entity assesses the probability of each transaction on an individual basis when it occurs. When the probability of receiving revenue is assessed at initial recognition, entities shall not assess the probability on an overall level based on the payment history or on an estimate of future losses.
- .09 At the time of initial recognition it is inappropriate to assume that the collectability of amounts owing by individual recipients of goods or services will not occur, because the entity has an obligation to collect all revenue. A decision not to enforce these rights, is a subsequent event. Accordingly, the Board concluded that the full amount of revenue should be recognised at initial recognition
- .10 Assessing impairment is an event that takes place subsequent to initial recognition. Such impairment is thus reported as an expense.



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- .11 This approach on disclosure improves the information provided to users of the financial statements.

Transitional provisions

- .12 This Interpretation of the Standards of GRAP is applied prospectively.

Effective date

- .13 An entity shall apply this Interpretation of the Standards of GRAP for annual financial statements covering periods beginning on or after 1 April 2009.



Appendix

Illustrative example

This example accompanies, but is not part of, the Interpretation of the Standards of GRAP.

Example 1

Entity A provides public goods and services to private households. Entity A bills individual households on a monthly basis for goods provided and services rendered. Entity A calculates, based on past experience, that only about 90% of the revenues are collected. Entity A recognises the full amount of revenue based on the terms of the arrangement with each household, notwithstanding its knowledge based on past experience. Consideration should be given to whether there is objective evidence that an impairment loss has been incurred when making the impairment assessment for subsequent measurement of the receivables at the reporting date.



Basis for conclusions

Introduction

The basis for conclusions summarises the Accounting Standard Board's considerations in reaching consensus on the issues outlined in this Interpretation of the Standards of GRAP.

Background

- BC1. Different practices exist as to how to apply the probability test on initial recognition of exchange revenue in accordance with the Standard of GRAP on *Revenue from Exchange Transactions*.
- BC2. Entities have applied the following practices:
- (a) Entities have recognised revenue on a net basis by assessing the amount likely to be collected either on an historic experience basis, or on an estimate of future loss basis; or
 - (b) Entities recognise revenue on a gross basis at the amount of the transaction and a separate expense is recognised for any impairment of that amount.

Scope

- BC3. As any cash sale is both probable (as the economic benefits or service potential have flowed to the entity) and measurable (the fair value of the transaction is the price between a willing buyer and a willing seller in an arms length transaction), cash transactions (over-the-counter sales) are excluded from this Interpretation of the Standards of GRAP.
- BC4. Advance payments for the future provision of goods or services are also not included in this Interpretation, as there is no need to apply the probability test for the recognition of the revenue. The entity applies the principles in the Standard of GRAP on *Revenue from Exchange Transactions* to recognise the revenue related to these types of transactions.

Basis for consensus

- BC5. The Board considered the current practices of entities referred to in BC2.
- BC6. The Board concluded that the practice of recognising revenue on a net basis, after considering the probability of collection at initial recognition, is inappropriate for the reasons set out below.
- BC7. In terms of section 89 of the PFMA, the Board is required to set standards that promote transparency in and effective management of revenue, expenditure, assets and liabilities of the entities to which these standards apply. In setting Standards of GRAP, the Board considers any relevant factors including the legislative requirements to which entities must adhere.
- BC8. At the time of providing the goods or services, an entity has an obligation to collect all revenues in terms of their relevant legislation. As a result, entities are accountable for the full amount of revenue to be collected
- BC9. The Board considers that initial recognition of exchange revenue at the invoiced amount, without taking into account the possibilities of non-collection, other than where a specific situation exists and which anticipates the non-enforcement of the right to collect, improves the information provided to users and increases accountability.
- BC10. The Board concluded that it is inappropriate to base the probability test on events that occur after initial recognition. It is inappropriate to consider future loss events on initial recognition.

Transitional provisions

- BC11. Some amounts may relate to prior periods, and information to enable the entity to assess probability in prior periods may not be available. As a result, the Board believes prospective application is appropriate.