



Accounting Standards Board

ED 95

Responses due by 15 May 2012

**INVITATION TO COMMENT ON
PROPOSED AMENDMENTS TO THE
INTERPRETATION OF STANDARDS OF GRAP ON
*APPLYING THE PROBABILITY TEST ON INITIAL
RECOGNITION OF EXCHANGE REVENUE*
(IGRAP 1)**

(ED 95)



IGRAP 1

Commenting on this Exposure Draft

The Accounting Standards Board (the Board) seeks comment on the Exposure Draft proposing amendments to the Interpretation of Standards of Generally Recognised Accounting Practice on *Applying the Probability Test on Initial Recognition of Exchange Revenue* (IGRAP 1). Once approved by the Board, the revised Interpretation of the Standards of GRAP on *Applying the Probability Test on Initial Recognition of Revenue* will replace IGRAP 1 that was issued in 2009.

The proposals in this Exposure Draft may be modified in the light of comment received.

Comment should be submitted in writing so as to be received by **15 May 2012**. Email responses are preferred. Unless respondents to this Exposure Draft specifically request confidentiality, their comment is a matter of public record once the Interpretation to the Standards of GRAP have been amended and issued. Comment should be addressed to:

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INTRODUCTION

Standards of Generally Recognised Accounting Practice

The Accounting Standards Board (the 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, provincial and government components);
- (b) public entities;
- (c) trading entities (as defined in the PFMA);
- (d) constitutional institutions;
- (e) municipalities, municipal entities or any other entities under the ownership control of a municipality and boards, commissions, companies, corporations and funds; and
- (f) Parliament and the provincial legislatures.

The above are collectively referred to as “entities” in Standards of GRAP.

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

- (a) government business enterprises (as defined in the PFMA);
- (b) any other entity, other than a municipality, whose ordinary shares, potential ordinary shares or debt are publicly tradable on the capital markets; and
- (c) 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.

Section 89(1)(b) of the PFMA, requires the Board to prepare and publish directives and guidelines concerning the Standards of GRAP as set in paragraph 89(1)(a) of the PFMA. The *Preface to the Standards of GRAP* determines that directives will be used to set transitional provisions and transitional arrangements for the entities required to comply with Standards of GRAP. Directives issued by the Board in terms of section 89(1)(b) of the PFMA therefore have the same authority as the Standards of GRAP.

Directives should be read in conjunction with the relevant Standard(s) of GRAP, as well as the *Preface to the Directives*.



Background and purpose of this Exposure Draft

The Board approved the Interpretation of Standards of GRAP on *Applying the Probability Test on Initial Recognition of Exchange Revenue* (IGRAP 1) during 2009. IGRAP 1 provides guidance on how an entity applies the probability test on initial recognition of exchange revenue that arises on the provision of goods and services provided on credit where there is uncertainty that the revenue will eventually be collected.

With the Standard of GRAP on *Revenue from Non-exchange Transactions (Taxes and Transfers)* (GRAP 23) becoming effective on 1 April 2012, the Board agreed that the principles in IGRAP 1 should also be extended to non-exchange transactions. This is to ensure that the probability test on initial recognition of exchange and non-exchange revenue is applied consistently.

The purpose of this Exposure Draft is to outline amendments to IGRAP 1 that will expand its scope to the initial recognition of non-exchange revenue.

Due process and timetable

The due process followed by the Board in proposing amendments to an Interpretation of Standards of GRAP, is for the Board to receive comment on the proposals set out in this Exposure Draft from preparers, users, auditors, standard-setters and other parties with an interest in public sector financial reporting. Accordingly, all interested parties are invited to provide comment.

Upon the closure of the comment period, the Board will consider the comment received on the Exposure Draft and may modify the Interpretation of the Standards of Generally Recognised Accounting Practice: *Applying the Probability Test on Initial Recognition of Revenue* in the light of comment received before approving the amended Interpretation of Standards of GRAP.

Request for comment

Comment on this Exposure Draft is invited by **15 May 2012**. The Board requires that respondents express an overall opinion on whether the Exposure Draft is supported in general and to supplement this opinion with detailed comment, whether supportive or critical, on the principles in the Exposure Draft. Respondents are also invited to provide detailed comment identifying the specific paragraphs to which it relates, explaining the issue and suggesting alternative wording, with supporting reasoning, where this is appropriate. The basis for accepting or rejecting significant comment will be published on the ASB's website.

As with any other Exposure Draft, comment on any other matter contained in this Exposure Draft would also be welcomed. Comment is most helpful if reference is made to a specific paragraph or group of paragraphs.



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

**APPLYING THE PROBABILITY TEST ON INITIAL
RECOGNITION OF REVENUE
(IGRAP 1)(2011)**



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

Interpretations of Standards of Generally Recognised Accounting Practice

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, provincial and government components);
- (b) public entities;
- (c) trading entities (as defined in the PFMA);
- (d) constitutional institutions;
- (e) municipalities, municipal entities or any other entities under the ownership control of a municipality and boards, commissions, companies, corporations and funds; and
- (f) Parliament and the provincial legislatures.

The above are collectively referred to as “entities” in Standards of GRAP.

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

- (a) government business enterprises (as defined in the PFMA);
- (b) any other entity, other than a municipality, whose ordinary shares, potential ordinary shares or debt are publicly tradable on the capital markets; and
- (c) 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.



The Interpretation of Standards of GRAP on *Applying the Probability Test on Initial Recognition of Revenue* is set out in paragraphs .01 to .15. 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.



Interpretation of Standards of GRAP on Applying the Probability Test on Initial Recognition of Revenue

The proposed amendments to the existing Interpretation of the Standards of GRAP on *Applying the Probability Test on Initial Recognition of Exchange Revenue* (IGRAP 1) are outlined below. New text is underlined while deleted text is struck through.

Reference

- The Standard of GRAP on *Revenue from Exchange Transactions* (GRAP 9).
- The Standard of GRAP on *Revenue from Non-Exchange Transactions (Taxes and Transfers)* (GRAP 23).

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 A similar requirement is included in paragraph .29 of the Standard of GRAP on *Revenue from Non-Exchange Transactions (Taxes and Transfers)* (GRAP 23). GRAP 23 states that the inflow of resources from a non-exchange transaction shall be recognised as an asset when it is probable that future economic benefits or service potential associated with the asset will flow to the entity and the fair value of the asset can be measured reliably. An inflow of resources from a non-exchange transaction recognised as an asset shall be recognised as revenue, except to the extent that a liability is also recognised in respect of the same inflow.

~~.03~~ This Interpretation of the Standards of GRAP provides guidance on how an entity applies the probability test on initial recognition ~~where~~ of credit is extended for the settlement of goods or services provided through a revenue transaction where uncertainty exists about the entity's ability to collect such revenue based on past history or because discretion about collectability is exercised subsequently.

~~Exchange revenue that arises on the provision of goods and 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

~~.04~~ This Interpretation of the Standards of GRAP addresses the manner in which an entity applies the probability test on initial recognition of:

~~.03~~

(a) exchange revenue in accordance with the Standard of GRAP on *Revenue from Exchange Transactions*, and

(b) non-exchange revenue in accordance with the Standard of GRAP on *Revenue from Non-exchange Transactions (Taxes and Transfers)*.

~~This Interpretation of the Standards of GRAP only to the probability test on initial recognition of exchange and revenue; it should not be applied by analogy to other types of transactions.~~

.05 Subsequent measurement of the associated assets and/or liabilities, presentation and disclosure requirements are not addressed in this Interpretation of Standards of GRAP. Instead, entities should consider the requirements in the applicable Standards of GRAP for the appropriate accounting.

.06 This Interpretation of the Standards of GRAP does not deal with:

~~.04~~ (a) exchange or non-exchange transactions that are settled simultaneously in cash (i.e. cash sales) sales;

(b) advance receipts of exchange and non-exchange revenue or payments received in advance of the provision of goods or services; or

(c) exchange or non-exchange transactions where there is no intention to charge for all or some services. Examples include goods and services provided to indigent consumers or households or rebates deducted on the provision or acquisition of certain goods or services.

Issues

.07 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 ultimately will be collected. Nevertheless, entities often continue to provide the goods or services, despite non-payment by the recipient of the goods or services. Entities are required to collect the revenue due to them in terms of their legislative mandate.

~~.05~~

.08 Some entities are also required in terms of their legislative mandate to levy taxes, fines, licence fees and other types of non-exchange revenue. For example, a municipality is required in terms of the Property Rates Act to levy property rates on the



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

- ~~.09~~ At present different practices are applied when determining the probability on initial recognition of exchange revenue. Some take into account the likelihood of not receiving all the revenue, having regard to the past collection experience ~~payment history, and reduce the amounts initially recognised by the estimated future losses. of, for example, recipients of the goods or services. Others estimate future losses on initial recognition. Yet others~~ Others recognise the full amount on initial recognition 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

- ~~.10~~ Assessing and recognising impairment is an event that takes place subsequent to the initial recognition of revenue charged. ~~Such impairment is thus reported as an expense. An entity assesses the probability of collecting revenue of each transaction on an individual basis when accounts fall into arrear it occurs. Such an assessment should not be made on a portfolio basis at the time of initial recognition. 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 revenue should be recognised at initial recognition.
- ~~.11~~ The resulting disclosure of the subsequent impairment ~~This approach on disclosure improves the information provided to users of the financial statements.~~

Transitional provisions

Initial adoption of the Interpretation of Standards of GRAP

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



Amendments to the Interpretation of Standards of GRAP

- .13 Paragraphs .03, .04, .05, .06, .09 and .10, were amended and paragraphs .02 and .08 were added in the Interpretation of Standards of GRAP. An entity shall apply these amendments prospectively for annual financial periods beginning on or after [proposed as 1 April 2013]. To the extent that an entity has early adopted the Standard of GRAP on *Revenue from Non-exchange Transactions (Taxes and Transfers)* (GRAP 23) or considered GRAP 23 in developing an accounting policy for non-exchange revenue, the entity may adopt these amendments earlier with disclosure of the fact.

Effective Date

- .14 An entity shall apply this Interpretation of the Standards of GRAP for annual financial statements covering periods beginning on or after ~~1 April 2009~~ [proposed as 1 April 2013].

Withdrawal of the Interpretation of Standards of GRAP: Applying the Probability Test on Initial Recognition of Exchange Revenue

- .15 This Interpretation of Standards of GRAP supersedes the Interpretation of Standards of GRAP: *Applying the Probability Test on Initial Recognition of Exchange Revenue* issued in 2009.



Appendix: Illustrative examples

These ~~This~~ examples ~~accompanies~~, but are is not part of, the Interpretation of Standards of GRAP.

Example 1: Revenue from an exchange transaction

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

Example 2: Revenue from a non-exchange transaction

In terms of the Property Rates Act, Municipality XYZ levies property rates monthly on property owners. Municipality XYZ estimates that, based on past experience, 95% of the revenues are collected. Municipality XYZ should recognise the full amount of property rates levied in terms of its legislative mandate, notwithstanding its expectations of the collection of rates based on past experience. Assessing and recognising an impairment loss is a subsequent event.



Basis for conclusions

Introduction

The ~~B~~asis 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 arising from exchange and non-exchange transactions in accordance with the Standards of GRAP on Revenue from Exchange Transactions and Revenue from Non-exchange Transactions (Taxes and Transfers).~~
- 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

- BC1. This Interpretation of Standards of GRAP includes within its scope revenue arising from both exchange and non-exchange transactions. It provides guidance on how an entity applies the probability test on initial recognition of exchange and non-exchange revenue where entities are required to provide goods and services, or levy taxes, fines, licence fees or other types or non-exchange revenue in accordance with their legislative mandate where uncertainty exists about the entity's ability to collect such revenue based on past history or because a discretion is exercised subsequently.
- BC3. ~~As any cash sales are~~ is both probable (as the economic benefits or service potential have flowed to the entity) and measureable (the fair value of the transaction is the price between a willing buyer and a willing seller in an arm's length transaction), cash-transactions that are settled simultaneously in cash ~~(over the counter sales)~~ are excluded from this Interpretation of ~~the~~ Standards of
- BC2.



GRAP.

- ~~BC4.~~ BC3. Advance payments for the future provision of goods or services, or advance receipts of revenue, for example taxes received in advance of the taxable event, are also not included in this Interpretation of Standards of GRAP, as there is no need to apply the probability test for the recognition of the revenue. The entity applies the principles in the Standards of GRAP on Revenue from Exchange Transactions and Revenue from Non-exchange Transactions (Taxes and Transfers) to recognise the revenue related to these types of transactions.

Basis for concensus

- ~~BC5.~~ The Board considered the current practices of entities referred to in BC2.
- BC4.
- ~~BC6.~~ BC5. 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.~~ BC6. 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 applicable to the ~~to which entities must adhere.~~
- ~~BC8.~~ BC7. At the time of providing the goods or services, or when levying and initially recognising taxes, fines, licence fees or other types of non-exchange revenue, an entity has an obligation to collect all revenues in terms of the relevant legislation. As a result, entities are accountable for the full amount of revenue to be collected.
- ~~BC9.~~ BC8. The Board considers that the initial recognition of exchange revenue at the invoiced amount, and the subsequent assessment and recognition of any impairment and disclosure of such subsequent events 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

- ~~BC14.~~ 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
- BC9. believes prospective application is appropriate.