Accounting for adjustments to revenue

By Amanda Botha, Project manager at the Accounting Standards Board

Introduction

Various legislative and other regulatory processes (hereafter legislation or similar means) govern how an entity charges revenue. In many instances, processes are also in place for the entity or person that has been charged the revenue to appeal and/or object. These include:

(a) a process established by the entity that charged the revenue;

(b) specific legislation or similar means that establishes an appeal and/or an objection process; and/or

(c) another legal process.

In addition, the entity that charges the revenue may establish its own internal review processes to assess if the revenue was correctly charged in terms of the prescribed tariff, basis, percentage or formula as promulgated in legislation or similar means.

These processes are most prevalent in non-exchange revenue transactions such as property rate tax, fines or levies, but they may also exist for other types of revenue charged by entities.

The outcome of these processes may result in an adjustment to revenue already recognised by the entity. As these processes can take some time to complete, the outcome of the review, appeal and/or objection may not necessarily be completed within the same reporting period in which the revenue was initially recognised. In accounting for the adjustment to revenue, stakeholders questioned whether an adjustment to revenue should be treated as a change in an accounting estimate, or as a correction of an error. It was also questioned whether the accounting will be different if the revenue was recognised in a previous reporting period.

To address the concerns raised by stakeholders, the Board approved a proposed Interpretation of the Standards of GRAP on *Accounting for Adjustments to Revenue* to explain how the recognised revenue, including interest and penalties, should be adjusted following the outcome of a review, appeal and/or objection process.

Accounting for an adjustment to revenue as a correction of an error

Legislation or similar means allow an entity to levy revenue after the completion of a due process and/or the promulgation of the tariff, base, percentage or formula to be used when revenue is charged. Where an entity has not followed the required legislative due process to promulgate the tariff, base, percentage or formula prior to charging the revenue, the entity should account for the adjustment to the recognised revenue as a correction of an error. For example, where a municipality did not publish its valuation roll in the Government Gazette for public inspection for at least 30 days as required by the Property Rates Act, using property values in the valuation roll to charge property rate tax will constitute an error. Any adjustment to interest and penalties charged on the recognised revenue also comprises a correction of an error.

Where the entity charged revenue using an incorrect tariff, base, percentage or formula, the adjustment to the recognised revenue, including interest and penalties, should also be accounted for as a correction of an error.

In accordance with GRAP 3 *Accounting Policies, Changes in Accounting Estimates and Errors*, an error that occurred in the current reporting period, needs to be corrected before the financial statements are authorised for issue. If the error relates to a prior period, the error is corrected retrospectively by restating comparative information.

Accounting for an adjustment to revenue as a change in an accounting estimate

Following the outcome of a review, appeal and/or objection process, an adjustment to recognised revenue, including interest and penalties, is accounted for as an change in an accounting estimate if:

(a) changes occur in the circumstances that led to the recognition of the revenue; or

(b) as a result of new information that became available.

For example, a municipality followed the required legislative requirements to develop its valuation roll to charge property rate tax, and during the public consultation process, no objections were received from any property owner on the values reflected in the valuation roll. Following the implementation of the new valuation roll, the entity undertakes its own internal review process and physically inspects properties in a certain area to confirm their values. The municipality concludes that the values of a group of properties are overstated in the valuation roll. The adjustment to the value of the properties and the resultant property taxes are accounted for as a change in an accounting estimate following the new information that became available.

GRAP 3 requires that a change in an accounting estimate is accounted for prospectively in the period of the change if the change affects that period only, or the period of change and future periods if the change affects both. Thus, even though the adjustment to revenue relates to revenue recognised in a prior period, the adjustment will only be accounted for prospectively.

Refunds are part of adjustments to revenue

As refunds represent an overstatement of recognised revenue, refunds are part of adjustments to revenue. Refunds are therefore either accounted for as a change in an accounting estimate or a correction of an error as explained above.

Distinction between a correction or an error and a change in an accounting estimate

Management needs to apply judgement to determine whether an adjustment to revenue comprises a correction of an error, or a change in an accounting estimate.

When adjustments to revenue arise from new information that becomes known to the entity, the entity may consider the following to determine whether the adjustment comprises a correction of an error or a change in an accounting estimate:

(a) If information becomes known to the entity, but the entity could not reasonably have been expected to know of this information when the revenue was charged, the adjustment to revenue is likely to be a change in an accounting estimate.

(b) If information becomes known to the entity, and the entity could reasonably have been expected to know of the information, and/or that the information used was incorrect, the adjustment to revenue is likely to be the correction of an error.

Amendments to IGRAP 1 *Applying the Probability Test on Initial Recognition of Revenue*

The Board also proposes making amendments to IGRAP 1. These amendments indicate that an entity should consider other factors to assess the probability of the future economic benefits or service potential on initial recognition of revenue. These factors may include early settlement discounts granted by the entity, or rebates or similar reductions based on the satisfaction of certain criteria. Where the revenue charged in terms of legislation or similar means is subject to a legal or similar regulatory process of which the outcome may only be known on completion of the process, the proposed amendments to IGRAP 1 indicate that the entity may need to take this into consideration when assessing the future economic benefits or service potential on initial recognition.

Accessing the Exposure Draft

The proposed pronouncements on adjustments to revenue (ED 164 and ED 165) are available on the ASB's website at www.asb.co.za.

Comment on these pronouncements is due on 31 August 2018.