ACCOUNTING STANDARDS BOARD

INTERPRETATION OF THE STANDARDS OF GENERALLY RECOGNISED ACCOUNTING PRACTICE

APPLYING THE PROBABILITY TEST ON INITIAL RECOGNITION OF REVENUE

(IGRAP 1)

Issued by the
Accounting Standards Board

June 2012

IGRAP 1

APPLYING THE PROBABILITY TEST ON INITIAL RECOGNITION OF REVENUE

This Interpretation was originally issued by the Accounting Standards Board (the Board) in June 2012. Since then, it has been amended by:

- Consequential amendments from the amendments to GRAP 104 *Financial Instruments*, issued by the Board in April 2019.

Introduction

This pronouncement is set out in paragraphs .01 to .15. All paragraphs in this pronouncement have equal authority. The status and authority of appendices are dealt with in the preamble to each appendix. This pronouncement should be read in the context of its objective, its basis for conclusions and/or the basis for conclusions of its international equivalent, if applicable, the *Preface to the Standards of GRAP* and the *Framework for the Preparation and Presentation of Financial Statements*[1].

Standards of GRAP and Interpretations of the 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, published in the Government Gazette.

Directives should be read in conjunction with the applicable Standards of GRAP and Interpretations of the Standards of GRAP.

[1] In June 2017, the Board replaced the *Framework for the Preparation and Presentation of Financial Statements* with the *Conceptual Framework for General Purpose Financial Reporting*.

IGRAP 1

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

Reference

- GRAP 9 *Revenue from Exchange Transactions*
- GRAP 23 *Revenue from Non-exchange Transactions (Taxes and Transfers)*

Objective

.01 Paragraph .03 of the Standard of GRAP on *Revenue from Exchange Transactions* (GRAP 9) 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 .30 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. GRAP 23 clarifies that an inflow of resources is probable when the inflow is more likely than not to occur.

.03 This Interpretation provides guidance on how an entity applies the probability test on the initial recognition of revenue from an exchange or non-exchange transaction:

(a) where credit is extended and uncertainty exists about the entity's ability to collect such revenue based on past history or because discretion about collectability is exercised subsequently; and

(b) when other factors impact the inflow of future economic benefits or service potential to the entity.

Scope

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

(a) exchange revenue in accordance with GRAP 9; and

(b) non-exchange revenue in accordance with GRAP 23.

.04A The recognition of interest revenue is not within the scope of this Interpretation. Interest revenue is recognised in accordance with the Standards of GRAP on *Financial Instruments* (GRAP 104) and *Statutory Receivables.*

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

.06 This Interpretation does not deal with:

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

(b) advance receipts of exchange and non-exchange revenue; 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.

Issues

Collectability of revenue in assessing future economic benefits or service potential

.07 In the public sector, entities are required to provide goods or services and to levy taxes, fines, licence fees and other types of non-exchange revenue in accordance with their legislative mandate. At the time of invoicing, there may be uncertainty as to whether the revenue will ultimately be collected based on the entity's exposure to credit risk. Nevertheless, entities often continue to provide goods or services and levy taxes, fines, licence fees or other types of non-exchange revenue, despite non-payment as they are required in terms of their legislative mandate to undertake these functions and collect the revenue due to them. For example, a municipality is required in terms of the Property Rates Act to levy property rates on the property owner based on the value of the property. These rates are levied without considering the collectability thereof as any possible non-payment is a subsequent event.

.08 At present different practices are applied when determining the probability on initial recognition of revenue where there is uncertainty about the collectability of revenue. Some take into account the likelihood of not receiving all the revenue by considering the past collection experience, and reducing the amounts initially recognised by the estimated credit losses. Others recognise the full amount on initial recognition and subsequently recognise an impairment loss.

Other factors to consider in assessing future economic benefits or service potential

.08A Entities are also uncertain of the extent to which factors, other than the uncertainty about the collectability of revenue, should be considered when determining the probability of the inflow of future economic benefits or service potential on initial recognition of revenue. For example, in providing certain goods or services, or when charging non-exchange revenue, the amount of revenue charged may be reduced or otherwise modified under certain circumstances. These circumstances include, for example, where the entity grants early settlement discounts, rebates or similar reductions based on the satisfaction of certain criteria, or as a result of adjustments to revenue already recognised following the outcome of any review, appeal or objection process (see the Interpretation of the Standards of GRAP on *Accounting for Adjustments to Revenue*).

Consensus

.08B On initial recognition of revenue, an entity should consider the revenue it is entitled to, following its obligation to collect all revenue due to it in terms of legislation or similar means. In addition, an entity needs to consider other factors that will impact the probable inflow of future economic benefits or service potential based on past experience and current facts and circumstances that exist on initial recognition.

Collectability of revenue in assessing future economic benefits or service potential

.09 At the time of initial recognition of exchange and non-exchange revenue it is not appropriate to assume that revenue will not be collected as the entity has an obligation to collect all revenue and this would be contrary to normal business principles. Accordingly, the Board concluded that the full amount of exchange and non-exchange revenue should be recognised at the initial transaction date after considering other factors that may impact the inflow of future economic benefits or service potential to the entity (see paragraph .11A).

.10 Assessing and recognising impairment is an event that takes place subsequent to the initial recognition of revenue charged. An entity assesses the probability of collecting revenue when accounts fall into arrears. Such an assessment should not be made at the time of initial recognition.

.11 The disclosure of the subsequent impairment improves the information provided to users of the financial statements.

Other factors to consider in assessing future economic benefits or service potential

.11A In considering the revenue to which an entity is entitled, an entity considers other factors that impact the inflow of future economic benefits or service potential on initial recognition of revenue. An entity applies judgement based on past experience and current facts and circumstances.

Transitional provisions

Initial adoption of the Interpretation of the Standards of GRAP

.12 This Interpretation is applied prospectively.

Amendments to the Interpretation of the Standards of GRAP

.13 Paragraphs .03, .04, .05, .06, .08 and .10, were amended and paragraph .02 was added in this Interpretation. An entity shall apply these amendments prospectively for annual financial periods beginning on or after 1 April 2013. To the extent that an entity has early adopted 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

Initial adoption of the Standards of GRAP

.14 An entity shall apply this Interpretation for annual financial statements covering periods beginning on or after 1 April 2013.

Entities already applying Standards of GRAP

.14A Paragraphs .08A, .08B and .11A were added and paragraphs .02, .03, .06, .07, .08 and .09 were amended in this Interpretation. An entity shall apply these amendments prospectively for annual financial statements beginning on or after 1 April 2020. Earlier application is permitted.

.14B Paragraph .04A was added by the revision of GRAP 104 issued in April 2019. An entity shall apply these amendments for annual financial statements covering periods beginning on or after 1 April 2025. An entity shall apply these amendments retrospectively.

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

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

Appendix – Illustrative examples

This appendix is illustrative only and does not form part of this Interpretation. The purpose of this appendix is to illustrate the application of this Interpretation and to assist in clarifying its meaning.

Collectability of revenue in assessing future economic benefits or service potential

Example 1A – Revenue in 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, based on past experience of its credit risk exposure, that only about 90% of the revenues will be 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 1B – Revenue in a non-exchange transaction

As required by the Property Rates Act, Municipality XYZ levies property rates monthly on property owners. Municipality XYZ estimates that, based on past experience of its credit risk exposure, 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 the rates based on past experience.

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

Other factors to consider in assessing future economic benefits or service potential

Example 2

Local authorities are empowered as servicing authorities to issue road traffic infringement notices. When the local authority issues an infringement notice to an offender, the infringement notice indicates that the infringer is entitled to a 50% discount if the fine is paid not later than 28 days from the date of issue. In addition, an infringer can follow a legal or similar process to object to the traffic fine, which could result in a reduction of the fine. Where the offender provided incorrect information, it could also result in the fine becoming void.

On initial recognition of the revenue from traffic fines, the local authority makes an estimation of the number of infringers that will settle the fine within the specified time period of 28 days. The estimation of the probable inflow of revenue should also include a reasonable estimate of the number of traffic fines that could be reduced following the outcome of legal or other processes, as well as the number of fines that can become void as a result of incorrect information provided by the infringer on the infringement notice. Estimates made by the local authority are based on past experience and current facts and circumstances.

Basis for conclusions

Introduction

This basis for conclusions gives the Accounting Standard Board's (Board's) reasons for accepting or rejecting certain proposals related to applying the probability test on initial recognition of revenue. This basis for conclusions accompanies, but is not part of, this Interpretation.

Scope

BC1. This Interpretation 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 revenue where:

(a) it is required to provide goods and services, or levy taxes, fines, licence fees or other types of such goods and services, or non-exchange revenue in accordance with its legislative mandate and uncertainty exists about the entity's ability to collect such revenue based on the entity's exposure to credit risk; and

(b) other factors impact the inflow of future economic benefits or service potential to the entity.

BC2. As cash sales are both probable (since the economic benefits or service potential have already 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), transactions that are settled simultaneously in cash are excluded from this Interpretation.

BC3. Advance receipts of exchange and non-exchange revenue, for example the receipt of an upfront payment for water and electricity services to be provided to a customer, or taxes received in advance of the taxable event, are also not included in this Interpretation. This is because there is no need to apply the probability test for the recognition of the revenue. The entity applies the principles in GRAP 9 and GRAP 23 to recognise the revenue related to these types of transactions.

Basis for consensus

BC4. The Board concluded that the initial amount of revenue recognised by an entity should reflect the revenue that the entity is entitled to collect. In applying the probability test on initial recognition, the entity should consider its obligation to collect all revenue due in terms of legislation or similar means, and other factors that impact its entitlement to collect the revenue.

Collectability of revenue in assessing future economic benefits or service potential

BC5. The Board concluded that the practice of recognising revenue on a net basis, after considering the probability of collection based on credit risk at initial recognition, is inappropriate for the reasons set out below.

BC6. In terms of section 89 of the Public Finance Management Act, Act No. 1 of 1999, 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 entities.

BC7. Paragraph .21 in the Standard of GRAP on *Presentation of Financial Statements* allows an entity to depart from the principles in a Standard of GRAP if the regulatory framework requires such a departure. 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 applicable legislation. As legislation requires accountability over all revenue due, the Board concluded that entities should recognise the full amount of revenue to be collected and not only the revenue that is probable. This departure from the Standards is necessary to achieve the level of accountability required by the legal framework in South Africa.

BC8. The Board considers that the initial recognition of revenue at the invoiced amount, and the subsequent assessment and recognition of any impairment and disclosure of such subsequent events, improves the information provided to users and increases accountability.

Other factors to consider in assessing future economic benefits or service potential

BC8A. The use of estimates is an essential part of the accrual basis of accounting. On initial recognition of revenue, entities need to apply the probability test to recognise the revenue that it is entitled to collect in terms or legislation or similar means. Assessing the inflow of future economic benefits or service potential on initial recognition does not include assessing the probability of collection of revenue based on an entity's exposure to credit risk.

BC8B. The Board concluded that other factors, other than exposure to credit risk, that impact the inflow of future economic benefits or service potential to the entity, should be considered on initial recognition. These other factors include early settlement discounts, rebates or similar deductions or as a result of adjustments to revenue following the completion or a review, appeal or objection process. In assessing the impact of these other factors on the flow of future economic benefits or service potential, judgement needs to be applied based on past experience and current facts and circumstances. The entity will only recognise that portion of the revenue that it will more likely than not receive.

Transitional provisions

BC9. 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.