

mSCOA Project: Exchange and Non-Exchange transactions

Position papers do not have any legal status in its own right. Subject matters dealt with in position papers are identified for specific consideration and may be matters controversial in nature, accounting treatment become relevant in order to achieve consistencies in classification throughout the local government sector.

Position papers need to be read together with the Project Summary Document as updated periodically by National Treasury.

Position papers DO NOT replace any National Treasury guidelines, circulars, practice notes or implementation guidelines.

Position papers are prepared by the mSCOA Project Team based on information collected through the mSCOA Project Lifecycle. Consultation with interested parties may be necessary in concluding on subject matters.

Terminology applied in the position paper will be specifically defined for updating the Standard Terminology list as published on the National Treasury web as part of the mSCOA project documents.

Frequently asked questions received are used as part of the basis for research to cross reference to the specific queries for retaining the completeness of this source of information.

Conclusion to be formulated on the position taken by National Treasury after conducting consultation as may be defined by the mSCOA Technical Work Group, and supplemented by the views of the mSCOA Project Steering Committee.

Recommendations to the mSCOA Project Steering Committee may include appropriate reference to any National Treasury documentation requiring review following the outcome of the conclusion on the position paper.

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BACKGROUND

1. Municipalities receive revenue from various sources i.e., the provision of goods or services, property rates, fines and penalties, licences and permits and transfers and subsidies. The classification of these sources of revenue - between “Revenue from Exchange Transactions” guided by the Standards of GRAP 9 on Revenue from Exchange Transactions” and “Revenue from Non-exchange Transactions” guided by the Standards of GRAP 23 on Revenue from Non-exchange Transactions. The ASB further released the Standards of GRAP 109 on Statutory Receivables which is not yet applicable.
2. Prior to the implementation of mSCOA little emphasis had been given to drawing this distinction at the point of classifying the transaction for capturing within the financial application.
3. The distinction usually was made at the time of preparation of the financial statements. The Budget Reporting Tables and In-year Reporting Tables also did not require this classification.

THE PROBLEM STATEMENT

4. Municipalities have varying opinions on whether or not specifically “licences and permits” should be classified as “exchange or non-exchange revenue”.
5. In certain circumstances, the same type of revenue may take the form of either exchange or non-exchange transactions, depending on the circumstances and services that the municipality is required to undertake to earn the revenue, i.e., either through the rendering of a service or the execution of a legislative right to tax by the administration of a compliance function in terms of the set of legislation.
6. Municipalities are required to apply judgement as to whether revenue constitutes exchange or non-exchange revenue in terms of Standards of GRAP 9 and GRAP 23 in certain circumstances.
7. Requests were made through training interventions, consultation and the Frequently Asked Questions Database to standardise the classification of “licences and permits” to either “exchange or non-exchange revenue”.
8. This Position Paper serves to share the outcome of the above requests in the context of mSCOA specifically to Version 5.5 (potentially locked to become 6).

LEGISLATIVE AND ACCOUNTING STANDARDS

Legislation

9. Section 64 of the Municipal Finance Management Act, No 56 of 2003 (MFMA) states that the accounting officer is responsible for the management of revenue of the municipality. This includes amongst others:
10. The revenue due to the municipality is calculated on a monthly basis
11. The municipality has and maintains a management, accounting and information system which:
 - recognises revenue when it is earned;
 - accounts for debtors; and
 - accounts for receipts of revenue.

Standards of GRAP references

12. Paragraph 12 of Standards of GRAP 9 on Revenue from Exchange Transactions defines:

“**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.”
13. Paragraph 5 of the Standards of GRAP 23 on Revenue from Non-exchange Transactions defines:

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.
14. the Standards of ¹GRAP 108 on Statutory Receivables defines:

Paragraph 5: **Statutory receivables** are receivables that:

 - (a) arise from legislation, supporting regulations, or similar means; and
 - (b) require settlement by another entity in cash or another financial asset

Paragraph 4: Statutory receivables can arise from both exchange and non-exchange transactions. Where these receivables arise from exchange and non-exchange revenue transactions, an entity shall apply the recognition and initial measurement requirements of

¹ The Minister of Finance has not yet determined the effective date for the Standard of GRAP on Statutory Receivables (GRAP 108). Entities may consider GRAP 108 in developing an accounting policy for principle-agent arrangements.

the Standards of GRAP on Revenue from Exchange Transactions and Revenue from Non-exchange Transactions (Taxes and Transfers), as well as the requirements of this Standard.

ASB Frequently Asked Questions

15. 4.2 Should revenue received from license fees and similar transactions be accounted for as exchange or non-exchange revenue by the issuer?
16. Public sector entities frequently issue licenses to undertake certain activities or operate certain assets, e.g. motor vehicle, drivers', fishing, gambling and similar licenses. For purposes of the discussion that follows, the entity issuing the license is the issuer and the entity receiving the license is the license holder.
17. For the issuer of licenses, the consideration received can either be treated as exchange or non-exchange revenue. Whether the revenue is exchange or non-exchange in nature depends on the nature and circumstances of the transaction.
18. In formulating an appropriate accounting treatment, the following steps should be considered:
 - Whether the entity acts as an agent or a principal.
 - The definitions of exchange and non-exchange transactions.

Step 1: Agent or principal

An entity should firstly assess whether it acts as an agent or a principal in such arrangements. In making this assessment, it uses the principles in ²GRAP 109 on Accounting by Principles and Agents. 9 Revenue from Exchange Transactions.

When an entity acts as the principle and is the issuer of the license, it considers step 2 below.

Step 2: Exchange or non-exchange revenue

Where an issuer concludes that it acts as principal in the arrangement, it should consider the definitions of both exchange and non-exchange transactions, defined as follows in the Standards of GRAP:

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

² The Minister of Finance has not yet determined the effective date for the Standard of GRAP on Accounting by Principles and Agents (GRAP 109). Entities may consider GRAP 109 in developing an accounting policy for principle-agent arrangements.

value in exchange (i.e. non-exchange revenue), or gives value to another entity without directly receiving approximately equal value in exchange (i.e. non-exchange transactions such as social benefit transactions).”

In determining whether the revenue is exchange or non-exchange revenue, the following is important:

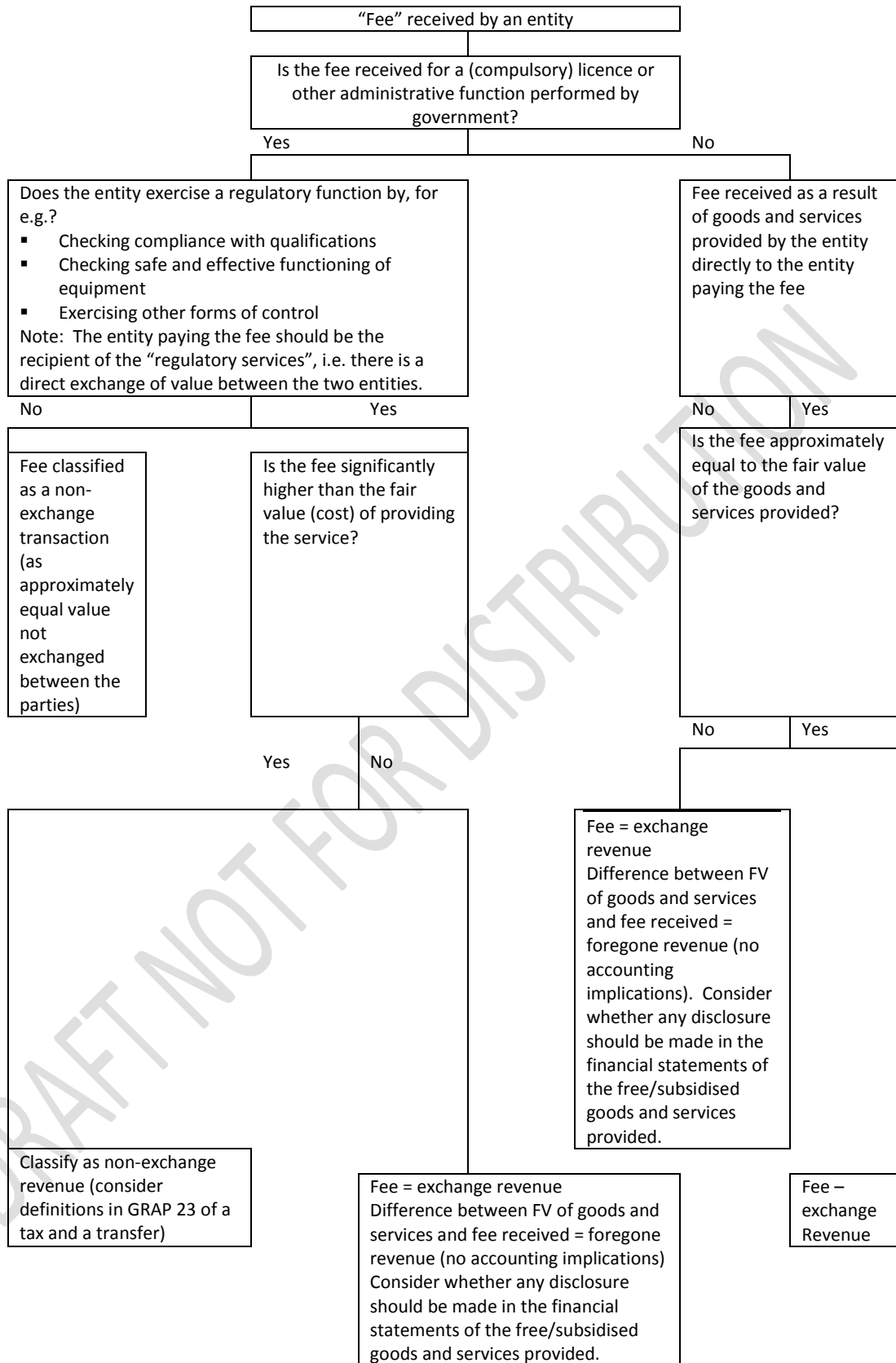
- Whether the issuer provides goods and services directly to the licence holder in return for the consideration received.
- The value of the goods and services provided in relation to the consideration received.

Consideration received by the issuer

The extent of the consideration received by the issuer for the goods and/or services provided may also vary from arrangement to arrangement. The issuer should therefore consider the value of the goods and/or services provided in relation to the consideration received in assessing whether the transaction results in exchange or non-exchange revenue, using the following basic principle (based on the definition of exchange and non-exchange transactions):

- Where the consideration received by the issuer is significantly greater than the fair value of the goods and/or services provided, the revenue could be non-exchange revenue as it may be tax or similar revenue (the issuer has received consideration and not provided approximately equal value in return).
- Where the consideration received by the issuer is less than the goods and/or services provided, the revenue could be exchange revenue. Any foregone revenue may be indicative of the provisions of a social benefit (the issuer has provided goods and/or services and has not received approximately equal value in return).

The following decision tree may be useful in classifying revenue received by issuers of licenses, particularly in relation to revenue from compulsory or legislated receipts:⁴



POSITION OF mSCOA

19. The following Revenue is regarded as Exchange Revenue:
 - Agency Services
 - Interest, Dividend and Rent on Land
 - Operational Revenue
 - Rental from Fixed Assets
 - Sales of Goods and Rendering of Services
 - Service Charges
 - Licences or Permits
20. The following Revenue is regarded as Non-Exchange Revenue
 - Fines, Penalties and Forfeits
 - Licences or Permits
 - Property Rates
 - Surcharges and Taxes
 - Transfers and Subsidies
21. The following revenue could be regarded as either Exchange or Non Exchange Revenue, management of the municipality would be required to document their judgement in this regard. (Refer to the decision tree above)
 - Licences or Permits

NATIONAL TREASURY DOCUMENTS TO BE REVISED FOLLOWING THE ADOPTION OF THIS POSITION PAPER

Standards of GRAP Implementation Guide – GRAP 23 on Revenue from Non-exchange Transactions

22. Section 4.3 Licence, Subscription and Similar Fees has reference. The guidance provided to assist in deciding on the correct accounting treatment need to be aligned to the latest Version of the ASB FAQ paragraph 4.2.

Budget Reporting Tables, In-year Reporting and Illustrated Financial Statements

23. The presentation of the current line item “Debt Impairment” used in the Budget Reporting Tables (as well as other returns as defined in Annexure A of Position Paper on Reporting), to be aligned to the proposals made in this Position Paper, amongst other tables, the following:
- A4: Budgeted Financial Performance (Revenue and Expenditure) – does not provide for a distinction between exchange and non-exchange revenue.
 - SA2: Matrix Financial Performance Budget (Revenue source/expenditure type and department) – does not provide for a distinction between exchange and non-exchange revenue.
 - SA25: Budgeted Monthly Revenue and Expenditure – does not provide for a distinction between exchange and non-exchange revenue.

CONCLUSION

24. This Position Paper confirms the dual classification of “licences and permits” based on judgement of management between “exchange and non-exchange revenue” as provided for in Version 5.5 of the mSCOA Tables
25. If further classification may be required subjected to the same principle of dual classification, consideration will be given based on motivations presented to National Treasury through the FAQ DB.
26. The municipalities audit file need to keep sufficient documentation and motivation for the decision made by management for purposes of retaining an audit trail in support of implementing the mSCOA Classification Framework.

RECOMMENDATION

27. The mSCOA Project Steering Committee to note:
- Version1 of this Position Paper on Exchange and Non-exchange Revenue was discussed and presented to the ICF at the 9 September 2015 meeting.
 - Content discussed and agree with the ASB by the OAG on 15 February 2016.
 - Comment period offered to the ASB Forum Members and invitation extended to all municipalities / provincial treasuries from beginning of March to 8 April 2016. Comments received up to 12 July 2016 considered in finalisation of the Position Paper.

- Position Paper to be recommended for publishing to the National Treasury Web.

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ANNEXURE A: COMMENTS AND QUERIES RECEIVED INFORMING THE PROBLEM STATEMENT

Reference / Date	From	Number	Query	Response
Letter/Email 7 April 2016	Jeanine Poggiolini ASB	1.	The Project Summary Document Still seems to only allow classification of certain items of revenue as either exchange or non-exchange. The flexibility proposed in the position paper does not seem to be reflected in the Project Summary Document.	The PSD is aligned to mSCOA Version 5.4, which only provides for licences and permits to be classified either as exchange or non-exchange. If any other requests are received through the FAQ DB additional classification will be considered. The Position Paper also only provide for Licences and Permits.
		2.	The FAQ quoted in the paper has also been updated and should be amended accordingly.	FAQ updated based on the April 2016 release.
Letter/Email 9 May 2016	Hilton Renald uMahlathuze	3.	Position Paper: It is noted that Version 5.4 of mSCOA does not have a Revenue Item for “Subscription Fees”. Although not an issue for this municipality currently this may be a flaw in Version 5.4 going forward.	The relevance of “Subscriptions Fees” in the context of local government need to be considered. If any requests are received for this classification following the release of the position paper an appropriate classification will be added in mSCOA moving forward.
		4.	It is recommended that to ensure a consistent approach throughout all municipalities, that a firm stance be taken on paragraph 9 i.e. that the decision tree has too many subjective questions, resulting in an inconsistent decision been made from one municipality to the next.	This argument has been the subject of discussion with the ASB. We need to allow management judgement in following the decision tree in finding the appropriate classification. The Standard of GRAP 109 on Statutory Receivables may result in the reconsideration of the classification provided for in Version 5.5 moving forward. [Pending

Reference / Date	From	Number	Query	Response
				implementation to be announced by the Minister of Finance).
		5.	Secondly besides the absence of “subscription fees”, version 5.4 caters for “Licences and Permits” both under Exchange and Non-exchange.	Subscription fees are not relevant to local government unless we receive different opinions. Licences and Permits are indeed subjected to dual classification within exchange and non-exchange depending on the judgment applied by management in following the decision tree. Ultimately if a proper compliance function is run by the municipality besides only the collection of licence and permit fees.
		6.	Thirdly, this municipality does not have an absolutely firm view for either exchange or non-exchange on these items, but would sway towards exchange due to in most cases additional responsibilities the municipality has in issuing licences and permits.	Comment noted.

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