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MuniMoney Matters

Navigating Contractual Receivables

This edition provides municipalities with guidance on the recording of transactions within the mSCOA, with a specific focus on contractual receivables and the resulting implications on output VAT for a municipality.

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From the Office of the Accountant-General

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1. Initial recognition of municipal debt

According to GRAP 104 on *Financial Instruments (revised 2019)* receivables are recognised when an entity becomes party to the contractual provisions of the instrument, e.g., when an entity provides goods and services on credit[1].

Receivables from contractual debt is recognised at fair value, plus transaction costs if subsequently measured at amortised cost[2]. For short-term receivables and payables, the fair value on initial recognition is the undiscounted transaction price if the initial credit period granted (i.e., the period between transaction date and the due date for payment) is consistent with terms used in the public sector, either through established practice or legislation (e.g. legislation, regulation or by-laws may indicate that a transaction should be settled in X no. of days and that no interest needs to be charged during this time).

As explained above, the full amount of revenue that the entity is entitled to is recognised at the transaction date[3].

The subsequent measurement consideration is discussed in **section 2** below. Assume for the purpose of this section that the receivables from the sale of electricity (for all customer base types) meet the requirements in GRAP 104 to be measured at amortised cost.

VAT implications

Most municipalities account for VAT on a payment basis. Where a municipality applies the payments basis method of accounting for VAT, it is only liable for VAT (to SARS) on actual payments made and actual payments received in respect of taxable supplies during the period.

A set of *m*SCOA accounts have been created to assist municipalities in tracking the potential amounts payable/receivable[4] to SARS. The table below summarises the process for the charging and receipt of VAT (i.e., output VAT transactions) on a payment basis:

Event	Process	*m*SCOA Account
Monthly billing **Example 1**	The VAT on the service charge is accrued [POS – current liability]	Liabilities: VAT Credit Output Accrual: Recognised
Receipt of payment from customers **Example 2**	A VAT output liability is recognised in line with the payments basis for VAT [POS – current liability]	Liabilities: Current Liabilities: Output VAT: Recognised
When the municipality completes the VAT 201 return for submission to SARS **Example 3**	At the end of the tax period all actual receipts in the tax period are transferred to the VAT Control account (Payable) and the municipality determines the total amount due to SARS	Liabilities: Current Liabilities: VAT Payable Control: Transfers

[1] GRAP 104 (2019) paragraph 3.1 and AG3.12 - AG3.13
[2] GRAP 104 (2019) Paragraph 5.1 - 5.3 and AG5.1 - AG5.11
[3] IGRAP 1 paragraph .08B - .09
[4] MFMA Circular No. 12 (Oct 2021)

Example 1 Recongition of electricity sales receivable : The billing cycle for January 2023 generated R46million in commercial conventional (single phase) electricity sales. VAT is calculated to be R6million (R46m x 15/115). On initial recognition, the fair value of the (undiscounted) receivable is R46million and is recognised as follows:

Debit	Trade and other receivables from exchange transactions, Trading Services, Electricity, Monthly Billing [a] [POS]	R46million
Credit	Revenue from exchange transactions, Service Charges, Electricity, Electricity Sales, Commercial Conventional (single phase) [b] [PER]	(R40million)
Credit	Current liabilities, VAT Credit Output Accrual, Recognised [c] [POS]	(R6million)

[a] *Monthly Billing – Long Code: IA-001-010-003-001-002*

[b] *Commercial Conventional (Single Phase) – Long Code: IR-002-006-001-008-001*

[c] *Recognised – Long Code: IL-001-009-002*

Impact of Example 1 on AFS:

PER	Revenue from exchange transactions	(R40million)
POS	Receivables from exchange transactions	R46million
	Current liabilities (VAT)	(R6million)

Example 2 Recognition of collections from sales of electricity: By the end of February 2023 the municipality received R37million in payments from its commercial conventional customers. VAT received is calculated to be R4,8million (R37m x 15/115)

Debit	Cash and Cash Equivalents, Cash at Bank: Deposits [a] [POS]	R37million
Credit	Trade and other receivables from transactions, Trading Services, Electricity, Collections [b] [POS]	(R37million)

[a] *Deposits – Long Code: IA-001-001-001-001-002*

[b] *Collections – Long Code: IA-001-010-003-001-005*

Debit	Current liabilities, VAT Credit Output Accrual, Transfers [c] [POS]	R4,8million
Credit	Current liabilities, Output VAT, Recognised [d] [POS]	(R4,8million)

[c] *Transfers – Long Code: IL-001-009-003*

[d] *Recognised – Long Code: IL-001-010-002*

Impact of Example 2 on AFS (cumulative):

PER	Revenue from exchange transactions	(R40million)
POS	Receivables from exchange transactions	R9million
	Cash and cash equivalents	R37million
	Current liabilities (VAT)*	(R6million)

**R1,2million in the accrual account and R4,8million in the VAT payable account*

Example 3 Recognition of VAT payable to SARS: At the end of the tax period the VAT received is transferred to the VAT payable control account for purposes of completing the VAT 201 return.

Debit	Current liabilities, Output VAT, Transfers [a] [POS]	R4,8million
Credit	Current liabilities, VAT Control - Payable, Transfers [b] [POS]	(R4,8million)

[a] *Transfers – Long Code: IL-001-010-003*
[b] *Transfers – Long Code: IL-001-008-002*

Impact of Example 3 on AFS (cumulative):

PER	Revenue from exchange transactions	(R40million)
POS	Receivables from exchange transactions	R9million
	Cash and cash equivalents	R37million
	Current liabilities (VAT)*	(R6million)

**R1,2million in the accrual account and R4,8million in the VAT control account*

2. Subsequent measurement of municipal debt

The subsequent measurement decision is dependent on the classification of the financial instrument by the municipality. This classification and measurement model of financial assets is determined by[5]:

- the entity's management model under which the financial assets are managed; and
- the contractual cash flow characteristics of the financial assets: solely payments of principal and interest (SPPI) test.

This assessment is judgmental and ensures that the measurement basis used for financial assets reflects the underlying characteristics of the instrument and the reasons why an entity holds an instrument.

Contractual cash flows meet the SPPI test when the principal amounts outstanding are consistent with a basic lending arrangement. In a basic lending arrangement, consideration for the time value of money and credit risk are typically the most significant elements of interest.

It is likely that receivables are measured at amortised cost because (a) entities (generally) hold receivables to collect the cash flows in accordance with the terms of the arrangement, and (b) the characteristics of the cash flows are likely consistent with a basic lending arrangement. This section assumes that the receivables from electricity sales are measured

[5] GRAP 104 (2019) paragraph 4.1

at amortised cost. Gains and losses that arise from the amortisation process are recognised in surplus or deficit[6].

VAT implications

Interest is regarded as a financial service and is therefore exempted for VAT purpose in terms of section 12 of the VAT Act.

Example 4 Interest on electricity sales using amortised cost: Using the same information from Example 1 above. Of the R46million billed in January 2023 in respect of commercial conventional (single phase) electricity, R2,5million was outstanding in March 2023. The municipality's policy is to charge interest of 10% on outstanding amounts. The charging of interest in the debtors' sub-system, and to the individual accounts of the customers is as follows (R2,5million x 10%/12): R20,833 for March 2023.

Debit	Trade and other receivables from exchange transactions, Trading Services, Electricity, Interest Charged [a] [POS]	R20,833
Credit	Revenue from exchange transactions, Interest Dividend and Rent on land, Interest, Receivables, Electricity [b] [PER]	(R20,833)

[a] *Interest Charged – Long Code: IA-001-010-003-001-003*
[b] *Interest – Long Code: IR-002-002-001-001-002*

Assume, on initial recognition the municipality estimated that this sub-category of customer usually settles their account within three months of the billing cycle. The effective interest rate for this category of debt is calculated as follows:

	February 2023	**March 2023**	**April 2023**
Amount owing	R2,500,000	R2,500,000	R2,520,833
Interest (10%)	R0	R20,833	R21,007
Expected future cash flow:			**R2,541,840**
Present value:	**R2,500,000**		
N:	**3months**		
I: *__6,66%__*			

This means that, from a GRAP 104 perspective the municipality would charge interest on the account as follows:

	February 2023	**March 2023**	**April 2023**
Amount owing	R2,500,000	R2,513,870	R2,527,816
Interest (7,32%)	R13,870	R13,947	R14,024
			R2,541,840

The total interest charged by the Municipality over the three-month period is R41,840

[6] GRAP 104 (2019) Paragraph 5.43

There is however a difference in how the amounts are recognised when comparing the billing system and the requirement of GRAP 104. From the above, it is evident that the difference on a monthly basis is not material. A further entry to align the financial system to GRAP 104 is not passed by the municipality (or illustrated here).

Impact of Example 4 on AFS – prior to receipt of payment from the municipality

PER	Revenue from exchange transactions (interest)	(R41,840)
POS	Receivables from exchange transactions*	R2,541,840

**Carrying value of receivables R2,500,000 plus interest R41,840*

3. Impairment of municipal debt

At each reporting date an entity should assess whether the credit risk of a financial asset has increased significantly since initial recognition. This credit risk assessment is based on the change in risk of default occurring over the expected life of the financial asset i.e., the change in default between reporting date and initial recognition. The assessment is not based on the change in the amount of credit losses.

To assist entities in the assessment of credit risk, GRAP 104 provides the following **practical expedients**:

- An entity may assume that the credit risk has not significantly increased if a financial instrument is determined to have **low credit risk**.
- A **rebuttable presumption** exists that credit risk has significantly increased if the contractual payments of a financial instrument are **more than 30 days past due.**

For receivables[7], entities are permitted to use a simplified approach to impairment. This approach requires entities to always measure the loss allowance on a lifetime expected losses (from initial recognition until derecognition) irrespective of the financial asset's credit risk. This means that an entity does not need to identify whether there have been significant increases in credit risk. The simplified approach makes no distinction between 12 month and lifetime expected credit losses[8].

An entity recognises in surplus or deficit, as an impairment gain or loss, the amount of the expected credit losses (or reversal) that is required to adjust the loss allowance at the reporting date to the amount that is required to be recognised in accordance with GRAP 104[9].

VAT implications

In section 1 above, it was demonstrated how municipalities raise an accrual for the VAT on electricity sales to customers. This accrual becomes a payable when the municipality collects the amounts owing from the customers. When a municipality assesses an expected credit loss on debtors' balances, it is recognizing that some or all of the amounts due from debtors

[7] The term "receivables" in GRAP 104 broadly refers to contractual arrangements where goods and services are provided by an entity to another party.
[8] GRAP 104 (2019) paragraph 5.17 and 5.18
[9] GRAP 104 (2019) paragraph 5.23

may not be collectible. Consequently, it may also need to adjust the VAT liability that was initially recognised on the sales that are now expected to be uncollectible.

Event	Process	*m*SCOA Account
Impairment of receivables **Example 5**	The VAT on debtors' balance assessed to be credit impaired is recognised in a separate account.	Liabilities: Output Tax: Provision for Doubtful Debt Impairment: Recognised

Example 5 Impairment of contractual receivables : At the end of the financial year (30 June 2023) the municipality assesses and determines that it's commercial conventional (single phase) electricity receivables should be impaired by R3million. The carrying value prior to impairment was R17million.

Debit Gains and losses, Impairment loss, Receivables from exchange transactions, Electricity [a] [PER] R2 608 696

Debit Output Tax: Provision for Doubtful Debt Impairment, Recognised [b] [POS] R391 304

Credit Receivables from exchange transactions, Trading services, Electricity, Impairment, Recognised [c] [POS] (R3,000,000)

[a] *Electricity – Long Code: IZ-005-007-001*

[b] *Recognised – Long Code: IL-001-011-002*

[c] *Impairment recognised – Long Code: IA-001-010-003-001-008-002*

Impact of Example 5 on AFS (cumulative):

PER	Surplus/deficit (Gains and losses)	R2 608 696
POS	Receivables from non-exchange transactions*	R14,000,000
	Current liabilities**	(R1 826 087)

**Receivable balance R17,000,000 less Impairment allowance R3,000,000*

***VAT output accrual R2 217 391 less Output tax impairment R391 304*

4. Write-off of municipal debt

A receivable is derecognised (in part or in its entirety) when[10]:

(a) the contractual cash flows have expired, are settled or waived;

(b) the entity transfers to another party substantially all of the risks and rewards of ownership of the financial asset; or

(c) the entity has retained significant risks and rewards, but transferred control to another party, and that party has the practical ability to sell the asset to an unrelated third party.

Gains and losses on the derecognition of financial assets are recognised in surplus or deficit[11].

VAT implications

In section 3 above, it was demonstrated how municipalities deal with the impact of impairment on the VAT accrual. When irrecoverable debt is written off, the Output tax accrual account must be reduced by the amount that was levied on the irrecoverable debt that is approved by Council to be written off. Any debt write-off will also have an impact on the impairment assessment (if the debtor was previously assessed as credit impaired). Care should be taken to reverse the amounts previously included in the impairment allowance account including the Output tax Provision for Doubtful Debt Impairment account.

Event	Process	*m*SCOA Account
Subsequent remeasurement of impairment **Example 5**	Any increase or decrease in the impairment figure would have an impact on the associated VAT.	Liabilities: Output Tax: Provision for Doubtful Debt Impairment: Transferred
Write-off of irrecoverable debt **Example 6**	The output VAT accrual account is reduced by the amount recognised on initial recognition of the sales transaction	VAT Credit Output Accrual, Transfers

[10] paragraph 6.1 - 6.15 and AG6.1 - AG6.14
[11] GRAP 104 (2019) paragraph 5.43

Example 6 Write-off of contractual debt: In addition to the impairment recognised on its commercial conventional (single phase) receivables at the end of the financial year (30 June 2023) the municipality requests and receives a Council Resolution to write-off individual accounts and amounts owing to the value of R750,000. These receivables had previously (on 30 June 2022) been fully impaired.

Debit	Expenditure, Irrecoverable debt written-off [a] [PER]	R637,600
Debit	Current liabilities, VAT Credit Output Accrual, Recognised [b] [POS]	R112,500
Credit	Receivables from exchange transactions, Trading services, Electricity, Debt write-off [c] [POS]	(R750,000)

[a] *Irrecoverable debts written-off – Long Code: IE-001*
[b] *Recognised – Long Code: IL-001-009-002*
[c] *Debt Write-off – Long Code: IA-001-010-003-001-006*

Debit	Receivables from exchange transactions, Trading services, Electricity, Impairment, Reversal [d] [POS]	R750,000
Credit	Output Tax: Provision for Doubtful Debt Impairment, Transfers [e] [POS]	(R112,500)
Credit	Gains and losses, Reversal of impairment loss, Receivables from exchange transactions, Electricity [f] [PER]	(R637,600)

[d] *Reversal - Long Code: IA-001-010-003-001-008-003*
[e] *Transfers – Long Code: IL-001-011-003*
[f] *Electricity – Long Code: IZ-006-007-001*

Impact of Example 6 on AFS:

PER	Surplus/deficit (Gains and losses)	R637,600
	Expenditure (Debt write-off)	(R637,600)
POS	Receivables from exchange transactions	Rnil
	Current liabilities*	RXX

**This balance reduced by R112,500 (in the VAT accrual and Output Tax provision for debt impairment), but assuming the account had amounts relating to other receivables there could be a closing balance*

Where to find additional information

GRAP Implementation Guides issued by the OAG → Open link

Standards of GRAP → Open link

mSCOA Circular on VAT → Open link

VAT guide for municipalities → Open link

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