Accounting Guideline

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Traffic Fines

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Note that this document is not part of the GRAP standard. The GRAP takes precedence while this guideline is used mainly to provide further explanations on the concepts already in the GRAP.

Contents

1. Introduction

A number of issues have been raised relating to the accounting treatment of traffic fines issued by municipalities using Standards of GRAP. This document outlines the principles that should be applied in accounting for traffic fines, and how they might be applied in certain circumstances. This guidance assumes that a municipality acts as principal in relation to the issuing of traffic fines. While this guidance is intended for municipalities, the principles may have relevance for other entities engaged in similar activities.

The guidance outlined in this document is an interim arrangement, and will need to be revised as more information becomes available about the practices of municipalities in issuing, collecting and accounting for traffic fines and the reliability of information available.

2. Types of traffic fines

In the municipal context, there are commonly two types of traffic fines that are issued:

- Fines issued in terms of the Administrative Adjudication of Road Traffic Offences Act (AARTO Act).
- Fines issued in terms of the Criminal Procedures Act.

Traffic fines are issued in terms of the AARTO Act by way of notices to offenders which specify the value of the fine that must be paid, along with any discount that can be applied if the fine is paid within a specific period of time.

Fines issued in terms of the Criminal Procedures Act are usually issued by way of notice to offenders, and can (a) indicate the value of the fine to be paid, and that certain reductions could be made to the value of the fine payable and how, or the circumstances under which, such reductions can be applied, or (b) indicate that the offender must appear in Court on a specified date (in these instances, the value of the fine may or may not be indicated but this is often only determined after a separate legal process).

3. Principles applicable to the recognition and measurement of traffic fines

This section of the guidance outlines the principles that need to be applied in accounting for traffic fines. As different requirements became effective in different reporting periods, this section also outlines when specific requirements became effective and what their impact may have been, or will be, in a particular reporting period.

Prior to 1 July 2012

Historically, municipalities accounted for traffic fines by applying the principles in the Standard of Generally Accepted Municipal Accounting Practice on *Revenue* (GAMAP 9). GAMAP 9 outlined the following principles in relation to the recognition and measurement of revenue from traffic fines:

> Paragraph .39: Revenue from the issuing of fines shall be recognised when:
>
> (a) it is probable that the economic benefits or service potential associated with the transaction will flow to the entity, and
>
> (b) the amount of the revenue can be measured reliably.
>
> Paragraph .41: An estimate should be made for the revenue amount collected from spot fines and summonses based on past experience of amounts collected. Where a reliable estimate cannot be made of revenue from summonses, the revenue from summonses should be recognised when the public prosecutor pays over to the entity the cash actually collected on summonses issued.

Principles to be applied from 1 July 2012

The Standard of GRAP on *Revenue from Non-Exchange Transactions (Taxes and Transfers)* (GRAP 23) was issued in February 2008 and became effective for municipalities on 1 July 2012. As traffic fines are non-exchange revenue transactions, the principles in GRAP 23 should have been used by municipalities to account for traffic fines from 1 July 2012. GRAP 23 outlines the following broad principles for the recognition of revenue from non-exchange transactions:

> Paragraph .43, "An inflow of resources from a non-exchange transaction recognised as an asset shall be recognised as revenue….".
>
> Paragraph .40 indicates that "An asset acquired through a non-exchange transaction shall initially be measured at its fair value at the date of acquisition."

In terms of GRAP 23, fines are classified as "Transfers". The following guidance is provided in GRAP 23 on the recognition and measurement of "transfers":

> Paragraph .78: "Transfers satisfy the definition of an asset when the entity controls the resources as a result of a past event and expects to receive future economic benefits or service potential from those resources. Transfers satisfy the criteria for recognition as an asset when it is probable that the inflow of resources will occur and their fair value can be reliably measured."
>
> Paragraph .79: "An entity obtains control of transferred resources either when the resources have been transferred to the entity, or the entity has an enforceable claim against the transferor. Many arrangements to transfer resources become binding on all parties before the transfer of resources takes place…."
>
> Paragraph .89: "…Assets arising from fines are measured at the best estimate of the inflow of resources to the entity."

New principle to be applied from 1 July 2013

In 2012, the ASB revised IGRAP 1 *Applying the Probability Test on the Initial Recognition of Revenue* to include revenue from non-exchange transactions. This amendment is applicable to municipalities from 1 July 2013. IGRAP 1 indicates that entities should not consider the probability of non-payment on the initial recognition of revenue. This should be considered as a subsequent event when assessing impairment.

Impact of GRAP 23 and IGRAP 1 on previous bases of accounting

When entities adopted GRAP 23 for the first time in the 2012/13 reporting period, they should have developed policies that resulted in traffic fines being recognised when the event that gives rise to enforceable claim occurs and a reliable measure of the receivable/revenue can be made.

GRAP 23 provides explicit guidance about the point at which revenue from traffic fines arises while GAMAP 9 was silent on this matter. GRAP 23 requires revenue to be measured based on the fair value of the receivable at acquisition, using the entity's best estimate of the inflow of resources to the entity. GAMAP 9 specified that traffic fines could be measured using an estimate based on past experience of amounts collected. GAMAP 9 also acknowledged that where a reliable estimate could not be made, then revenue could be recognised on the cash basis. There are clear differences between GAMAP 9 and GRAP 23 both on the point at which receivables and revenue from traffic fines are recognised, as well as how they should be measured.

<u>2012/13</u>: In measuring receivables and revenue from traffic fines in accordance with GRAP 23 in the 2012/13 reporting period, entities should have considered all relevant facts and circumstances. As the amendment to IGRAP 1 was only effective for municipalities from 1 July 2013, the probability of non-payment may have been included in the initial recognition and measurement of revenue from traffic fines in the 2012/13 reporting period. All other relevant factors should however have been considered in initially recognising and measuring receivables and revenue from traffic fines. Where entities did not consider all

other relevant factors as indicated in GRAP 23 in accounting for traffic fines in the 2012/13 reporting period, they should consider whether a correction of an error is necessary.

2013/14: The amendment to IGRAP 1 is effective from 1 July 2013 and should be applied prospectively. This means that if an entity did include the probability of non-payment in the initial recognition and measurement of revenue in 2012/13, then in 2013/14 it need not retrospectively restate the comparative information to exclude the probability of non-payment.

4. Application of principles

This section outlines how the principles in GRAP 23 and IGRAP 1 are applied in recognising and measuring receivables and revenues related to traffic fines. Where possible, the practical application is illustrated.

Does the transaction give rise to an asset?

For an entity to demonstrate that a non-exchange transaction gives rise to an asset, it needs to demonstrate that:

(a) It has control of the resource as a result of a past event; and

(b) Economic benefits or service potential are expected to flow to the entity.

Traffic fines result in amounts payable by offenders to the relevant authority. This means that the relevant authority issuing the fine (referred to as the "entity" in this document) has an enforceable claim against an offender to undertake specific actions, which in most instances for traffic fines means the payment of cash of a specific amount. An entity should therefore test whether this enforceable claim or right to collect cash (receivable) meets the definition of an asset.

Control of an asset as a result of a past event

Traffic fines are defined as economic benefits or service potential received or receivable by an entity as a consequence of the breach of laws or regulations. The past event that therefore gives rise to the receipt of economic benefits or service potential is the breach of a law or regulation.

Control of the traffic fine is demonstrated through the existence of an enforceable claim. A notice, summons or other document outlining the breach of the law is usually issued by the entity at the same time (or shortly after) the breach to the offender. This outlines the details of the enforceable claim that the relevant authority has against the offender.

Future economic benefits or service potential are expected to flow to the entity

The entity has a claim that is enforceable in law. An entity can explore various legal means and processes to enforce the payment of the fines. This means that there is a high expectation that future economic benefits or service potential will flow to the entity in future. (IGRAP 1 is discussed in paragraph 23 in the context of initial recognition).

When should the asset be recognised?

Where the definition of an asset is met, the entity should consider whether it should be recognised. The asset (receivable) should be recognised when it is probable that future economic benefits or service potential will flow to the entity and the value of the asset (in this case, fair value) can be measured reliably.

Probable that future economic benefits or service potential will flow to the entity

Paragraph 20 indicates that because a legally enforceable claim exists, there is a high expectation that economic benefits or service potential will result from the asset. The actual economic benefits or service potential received by entities in revenue transactions may however be low because of non-payment by offenders.

IGRAP 1 indicates that non-payment in exchange and non-exchange revenue transactions should be considered when assessing impairment rather than in the initial consideration of whether or not it is probable that economic benefits or service potential will flow to the entity. As public sector entities are required to collect all revenue due to them, IGRAP 1 ensures that appropriate accountability is exercised over this process.

An example of the practical effect of applying IGRAP 1 (ignoring other factors that might affect the measurement of the receivables) is as follows: If an entity issues traffic fines to the value of R 1 million in the 2013/14 reporting period, but it knows from past history that only 70% of offenders pay their outstanding fines, it will still recognise assets (receivables) and revenue of R 1 million as opposed to R700,000. In the 2012/13 reporting period, before the amendments to IGRAP 1 became effective, the entity may have recognised assets (receivables) and revenue of R700,000 i.t.o. the requirements in GRAP 23.

Reliable measure of the asset

To recognise an asset from a non-exchange transaction, an entity must be able to reliably determine its fair value[1]. The value of the fine that can be imposed on the offender is usually stipulated in legislation, regulation or equivalent, and will vary depending on the nature and severity of the offence. The amount due by a particular offender is usually indicated on the notice, summons or similar document issued. In these instances, the asset (receivable) can be measured reliably. Where the amount due by an offender is not specified, a separate legal process usually needs to be followed to determine the amount or other penalty due. In these instances, a reliable measure of the asset (receivable) may only be available upon completion of this process.

At what amount should the asset be recognised initially?

The asset should be recognised initially at fair value, which is the best estimate of the inflow of economic benefits (reading paragraphs .40 and .89 of GRAP 23 together).

The amount due by a particular offender should form the basis of the amount recognised initially as an asset (receivable) and as revenue. There are however other factors that need to be considered when determining the amount of the receivables and revenue that should be recognised initially. There are broadly four scenarios that may be encountered and discussed below.

Scenario 1

Where the amount due by a particular offender is specified on the notice, summons or equivalent document, reductions may be offered in certain instances. For example, fines issued in terms of the AARTO Act can be reduced by 50% if paid within a specified period of time. The offering of these reductions has the potential to reduce the amount that an entity is entitled to collect.

The entity will therefore need to estimate the likelihood of these discounts being taken up by offenders when measuring the asset (receivable) and amount of revenue that should be recognised. Any variations in the amount of reductions estimated are treated as a change in the estimated revenue and are accounted for as a change in accounting estimate in accordance with GRAP 3 *Accounting Policies, Changes in Estimates and Errors*. An entity should consider the disclosures in GRAP 1 *Presentation of Financial Statements* to ensure that relevant information is provided to users about how the assumptions applied in estimating revenue.

To illustrate the effect of this in a practical example: An entity issues traffic fines in terms of the AARTO Act worth R1 million in the 2013/14 reporting period. If an offender pays within 30 days, the value of the fine is reduced by 50%. From past experience, 25% of offenders take advantage of this reduction. Receivables and revenue to the value of R875,000 [R1,000,000 – (R1,000,000 X 25% X 50%0] are recognised initially. If after initial recognition, it becomes clear that more offenders have taken up the early payment reduction, say to 30%, then the receivables and revenue are reduced by a further R25,000 and accounted for as a change in estimate.

[1] GRAP 108 *Statutory Receivables*, although not yet effective, explains fair value in the context of statutory transactions.

Scenario 2

Where the amount due by a particular offender is specified on the notice, summons or equivalent document, the entity issuing the traffic fine may indicate that reductions are available, subject to further processes being undertaken. Where these processes are within the entity's discretion (i.e. it can decide on the reductions) then these should also be estimated when measuring the asset (receivable) and the amount of revenue to be recognised. Any variations in the amount of reductions estimated are treated as a change in the estimated revenue and are accounted for as a change in accounting estimate in accordance with GRAP 3. Relevant disclosures should be made on the assumptions used to estimate revenue and any other relevant information.

Scenario 3

Where the amount due by a particular offender is specified on the notice, summons or equivalent document, the entity issuing the traffic fine may indicate that reductions are available, subject to further processes being undertaken. Where these reductions are not within the entity's discretion, for example, they are subject to a further judicial process which is outside the entity's control, then these reductions are not considered in measuring the asset (receivable) on initial recognition. This is because of the high degree of uncertainty in estimating the likely outcome of this process. Once this separate process has been concluded, any reductions are accounted for as a change in estimated revenue and are accounted for as a change in accounting estimate. If an entity does have reliable information about reductions based on past history, then this information could be considered in the initial estimate. Relevant disclosures should be made on the assumptions used to estimate revenue and any other relevant information.

Scenario 4

Where the amount due by a particular offender is not specified on the notice, summons or equivalent document, it typically means that an additional judicial process needs to be followed. In these instances, an entity can only make a reliable estimate of the receivable and revenue once this process has been completed.

Other factors that may need to be considered when initially measuring the asset

34. There may be a number of other factors that may need to be considered by an entity in the initial measurement of revenue and receivables related to traffic fines. Examples of these include the following:

(a) For both the fines issued in terms of the AARTO Act and the Criminal Procedure Act, regardless of whether an amount is specified or not, an offender has the option to appear in Court and make the necessary legal representations.

(b) The legal validity of the fine issued, e.g. fines that may not be legally valid because the equipment used was not calibrated correctly, or the fine was not issued within the specified time frame.

In these instances, an entity should assess the impact on the initial measurement of the fine, and make appropriate adjustments based on reliable information. Relevant disclosures should be made on the assumptions used along with and any other relevant information.

At what amount should the asset be measured after initial recognition?

35. As traffic fines are statutory receivables, there is no explicit guidance on the subsequent measurement of these receivables for the 2013/14 reporting period. An entity should develop its own accounting policy for the subsequent measurement of these receivables using Directive 5 *Determining the GRAP Reporting Framework* and GRAP 3.