Western Cape Government
Provincial Treasury

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# Recognition of creditors on municipal financial records

## Background and Purpose

There has been inconsistency amongst municipalities on how and when they account for creditors and how they disclose such on their monthly and annual financial reports. This to a certain extent has resulted to PT receiving report with inconsistent recognition of creditors.

The purpose of this report is to provide guidance within PT as to what constitute a creditor or accounts payables and when should a transaction on acquiring of good or services be recognised as a creditor.

It is important to first define a liability together with other forms of liabilities before going into details on how and when creditors should be recognised for accounting purposes.

## Definitions

A **liability** is a present obligation of an entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits or service potential *(GRAP 19 paragraph 15)*.

**Payables** are then explained as **liabilities** to pay for goods or services that **have been received or supplied and have been invoiced or formally agreed** with the supplier (and include payments in respect of social benefits where formal agreements for specified amounts exist) *(GRAP 19 paragraph 16.)*.

**Accruals** are **liabilities** to pay for goods or services that have **been received or supplied but have not been paid, invoiced or formally agreed** with the supplier,
including amounts due to employees (for example, amounts relating to accrued vacation pay) ) *(GRAP 19 paragraph 16.)*.
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A **provision** is a **liability** where the timing or amount of the outflow of resources embodying economic benefits or service potential is uncertain *(GRAP 19 paragraph 15)*.

The Payables, Accrual and Provisions are all forms of liabilities that are disclosable on the financial statements. A municipality should therefore keep records of these liabilities separately on their financial records.

## Interpretation and analysis

Based on the definition of the Payables it is explicitly stated that the good and services must be received and invoiced or formally agreed with supplier for payables or creditors to be recognised. It should therefore be noted that before the invoice is received from the supplier, no payables or creditors can be recognised. It is therefore safe **to state that for accounting purposes only when an invoice for the good or services has been received by a municipality will a payable or creditor be raised.**

**If goods or services that were ordered are received but the supplier has not yet invoiced the municipality,** this indicates that there is a liability as the good have been received by the municipality or a service has been rendered, **but because no invoice is obtained this cannot be recognised as a creditor or payable**. **This will now be recognised as an accrual if a reporting period closes before the invoice is received.** The definition of accrual requires that goods or service are received but have not been paid, invoiced or formally agreed with the supplier.

**It should be noted that for both these forms of liability the goods or services has to be received by the municipality.** It there are no goods or services received by the municipality there is no liability as there is no present obligation.

For an example if a municipality has ordered refuse bins on 15 May 2012. At month end the municipality has not yet received the bins, the municipality cannot then recognise a creditor nor an accrual for the month of May as the bins were not received at May 2012 month end. Where the bins were received at 30 May 2012 the municipality had to do a good receipt on their respective systems and that would give rise to an accrual if no invoice has been received.

Had the invoice been received before or on the 30 May 2012, the creditor or payable should be raised. This would apply similarly if the May month was he year-end.

**This should then clarify that creditors cannot be raised on orders.** There was some confusion amongst municipalities as certain systems recognised creditors when the orders are made. E.g. SAMRAS had an option for municipalities to choose when to recognise the creditors: it was either when goods are ordered, or on good receipt or when invoiced. This has since been clarified with SAMRAS that it is only when good are received that a present obligation arises. Before that there is neither liability nor accrual to be recognised.

## Conclusion

As per GRAP 19 creditors should be raised on good and services that has been ordered, received and invoiced by suppliers but not yet paid for. If goods and services have been received but not yet invoiced these will be accruals. Creditors should not be raised on items ordered and not yet received. If such orders are significant, the municipality can disclose those as part of commitments but not recognise the transactions on their financial record.

Yours faithfully

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**DATE:**