

TREASURER'S DIRECTIONS

ACCOUNTING – INCOME

Section A5.1 : Overview

STATEMENT OF INTENT

Income shows the sources of cost recoveries, the extent to which costs are being recovered and the overall inflows of financial resources into an Agency. This Section explains what income is, when income should be recognised and how income is classified.

MAIN FEATURES

Section 38 of the *Financial Management Act* requires every Accountable Officer and every employee of an Agency to comply with the Treasurer's Directions.

Income

- Income is increases in economic benefits during the reporting period in the form of increases in assets or reductions in liabilities that result in an increase in equity, other than those relating to contributions from Government.

Recognition of Income

- An Agency is to recognise income that it controls.
- Income is to be recognised and recorded when an increase in economic benefits related to an increase in assets and/or a reduction in liabilities has arisen, and the increase in economic benefits can be reliably measured.

Classification of Income

- Income is to be classified according to its nature or type and is to be recorded under the income classes provided by the Standard Classifications.
- Income and expenses are not to be offset unless required or permitted by Treasurer's Directions or Australian accounting standards.

For authoritative instruction and guidance, reference should be made to related Treasurer's Directions and associated commentary, relevant Australian accounting standards and other authoritative interpretations.

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AUTHORITIES

Financial Management Act

REFERENCES

| | |
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| AAS 29 | Financial Reporting by Government Departments |
| AASB 101 | Presentation of Financial Statements |
| AASB 118 | Revenue |
| AASB 1004 | Contributions |
| | Framework for the Preparation and Presentation of Financial Statements |

Related Treasurer's Directions:

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| F2.2 | Framework – <i>Working for Outcomes</i> : Central Holding Authority |
| A1.3 | Accounting – Introduction : Standard Classification Codes |
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| C3.1 | Cash Management – Transaction Management : Receipting |

WHAT IS INCOME ?

A5.1.1

Income is increases in economic benefits during the reporting period in the form of increases in assets or reductions in liabilities, that result in an increase in equity, other than those relating to contributions from Government.

(i) Income encompasses both revenue and gains as shown below:

$$\boxed{\text{Income}} = \boxed{\text{Revenue}} + \boxed{\text{Gains}}$$

- Revenue arises in the course of the ordinary activities of an Agency (for example, output revenue).
- Gains represent other income that may, or may not, arise in the course of ordinary activities of an Agency.

(ii) Revenues are typically associated with the sale or delivery of goods and services and are generally represented by the creation of a receivable or inflow of cash. Examples of Agency revenues include:

- output revenue;
- revenue from the provision of goods and services;
- specific purpose payment (SPP) funding;
- rental revenue; and
- resources received free of charge.

(iii) Gains represent items that meet the definition of income, but are not revenue. Examples of Agency gains include:

- a profit on the disposal of an item of plant and equipment;
- income arising from liabilities assumed by Government; and
- certain unrealised gains resulting from increases in asset values.

(iv) An Agency may also manage, on behalf of the Government, the collection of certain income that it does not control. Such income is called Territory income and may include revenue as well as gains. Common Territory income includes:

- Australian Government general purpose funding;
- Territory taxes;
- certain regulatory fees and charges; and
- fines.

- (v) There are two essential characteristics of income:
- an increase in economic benefits; and
 - an increase in equity during the reporting period, other than that relating to contributions by Government.

A5.1.2 Increases in economic benefits occur in the form of increases in assets or reductions in liabilities.

- (i) Income in the form of inflows of cash or increases in receivables can arise from an Agency providing outputs, goods and services, disposing of assets or receiving grants. Transactions and other events, that give rise to an asset and a corresponding liability, are not income, for examples, loans received.
- (ii) Increases in economic benefits may also arise from a reduction in liabilities. For example, where an Agency liability is settled by another entity on behalf of an Agency, the Agency would record income as it represents a saving of Agency resources which otherwise would have been required to satisfy those obligations. In practice the assumption of Agency liabilities will primarily be made by Government and will be treated as a contribution by Government rather than income.
- (iii) Income arises once control over the economic benefits has been achieved. For example, revenues will not normally arise before the provision of goods or services by an Agency because the Agency will not have established a claim for payment against an external party (ie: revenue should be earned).
- (iv) Reference should be made to Treasurer's Directions Section C3.1 for requirements relating to receipting of monies.

A5.1.3 Income results in an increase in equity during the reporting period.

- (i) Income has the effect of increasing assets or reducing liabilities, which results in an increase in the equity (net assets) of an Agency. For example, an increase in assets (cash) resulting from raising debt does not constitute income, as there would have been an equivalent increase in liabilities (debt), and as a result, equity would remain unchanged.
- (ii) Certain increases in equity do not qualify as income, primarily those resulting from contributions by Government. Contributions by Government and other direct adjustments to equity are discussed in Treasurer's Directions Sections A4.1 and A4.2.
- (iii) Treasurer's Directions Sections A5.2, A5.3 and F2.2 provide further instruction and guidance in relation to Agency and Territory income and the recording of Territory items in the Central Holding Authority.

RECOGNITION OF INCOME

A5.1.4

Income is to be recognised and recorded in the books of an Agency when:

- an increase in economic benefits related to an increase in assets and/or a reduction in liabilities has arisen;
- the increase in economic benefits can be measured reliably; and
- the income is not recorded in the Central Holding Authority.

- (i) Recognition is the process of incorporating in an Agency's Balance Sheet or Operating Statement an item that meets specific definition and recognition criteria. Income is recognised when an amount is recorded in an Agency's Operating Statement. It is possible for an item to meet the definition criteria for income but not be recognised. This could be due to uncertainty as to whether there has been an increase in economic benefits occurring or due to an inability to reliably measure the income.
- (ii) In effect, the recognition of income occurs simultaneously with the recognition of an increase in assets (for example, cash received) or a decrease in liabilities (for example, a liability forgiven). In most cases, the increase in future economic benefits will be clearly evident and will be capable of measurement with a high degree of reliability.
- (iii) The point at which income is recognised in the financial statements depends on the type of transaction or event that gives rise to the income. For example, revenue from service delivery would not ordinarily be recognised until earned. Appendix A provides a comparison of revenue recognition for a simple sale transaction under cash and accrual accounting. Specific recognition points for different types of income are described in Treasurer's Directions Sections A5.2 and A5.3.
- (iv) Income will be specific to an Agency in that income of one Agency cannot at the same time also be income of another Agency. Income will therefore be recorded in the financial records of one Agency only.
- (v) Income controlled by an Agency can be used to assist the Agency in achieving its outcomes and therefore should be reported in the Agency's financial statements. Some income, such as taxes and certain regulatory fees and fines may be collected by an Agency on behalf of the Government. Such amounts will be recorded in the Central Holding Authority rather than being recorded in the Agency's financial statements. Treasurer's Directions Section F2.2 elaborates on the concept of the Central Holding Authority and items recorded by it.

A5.1.5 **Income is to be measured at the fair value of the consideration or contributions received or receivable.**

- (i) The amount of income arising from a transaction is usually determined by agreement between the Agency and the purchaser of goods/services or provider of funds. It is measured at the fair value of the consideration or contributions received or receivable taking into account such things as trade discounts and volume rebates.
- (ii) In most cases, the amount of income is clearly evident, for example, invoiced or agreed price for goods sold. However in some cases it may be necessary to estimate the applicable amount of income. For example, in accounting for service provision and construction contracts, the stage of contract completion may be utilised to provide a reliable estimate of income earned to date.
- (iii) Income will be recognised at the Goods and Services Tax (GST) exclusive amount. Additional instruction and guidance regarding GST policy may be found in Treasury GST Circulars.

CLASSIFICATION OF INCOME

A5.1.6 **Income is to be classified according to its nature or type and is to be recorded under the income classes provided by the Standard Classifications.**

A5.1.7 **Agencies are not to record items of income and expense as extraordinary items on the face of the Operating Statement or in the notes to the accounts.**

- (i) To ensure consistent classification across Agencies, the Standard Classifications provide minimum classification requirements for income. These classes are further described in Treasurer's Directions Sections A5.2 and A5.3 and include:
 - output revenue;
 - goods and services revenue;
 - taxes;
 - grants and subsidies;
 - royalties, rents and dividends;
 - other income; and
 - asset income.
- (ii) Items of income and expense are not to be presented as extraordinary items, either on the face of the Operating Statement, or in the notes to the accounts. However, material items of income or expense may be disclosed separately by nature and amount in the notes to the accounts.

A5.1.8

Income and expenses are not to be offset unless required or permitted by Treasurer's Directions or Australian accounting standards.

- (i) Offsetting means the reduction of income by an expense or vice versa in an Agency's Operating Statement so that only the net amount is recognised. Income and expenses may only be offset in certain situations where offsetting reflects the substance of the transaction, and offsetting is permitted by Treasurer's Directions or Australian accounting standards. Restrictions in relation to offsetting assets and liabilities also apply.
- (ii) Offsetting amounts is restricted as it can mislead users and reduce the ability of users of financial information to understand the transactions undertaken and to assess the financial position of an Agency. In this regard, offsetting income and expenses would not provide users with complete and accurate information in relation to total Agency income and expenses.
- (iii) Examples of situations where offsetting is allowed by Australian accounting standards include:
- the net proceeds (gain or loss) from the disposal of non-current assets are to be reported on a net basis in Agency financial statements (AASB 101);
 - revaluation increases and revaluation decreases related to items of property, plant and equipment are to be offset against one another within the same asset class (AASB 116); and
 - a financial asset and a financial liability may be offset where an Agency has a legally enforceable right to set-off the asset and the liability, and the Agency intends to exercise such a right or to settle simultaneously (AASB 132).
- (iv) In addition, certain adjustments and error corrections may be offset where offsetting better reflects the substance of the transactions. For example:
- payments received from another entity relating to a seconded staff member are able to be offset against Agency employee expenses, where the Agency receiving the payment continues to pay the employee's salary and related costs. Where the payment received exceeds actual expenses incurred, the excess would be recognised as income; and
 - where the invoiced purchase price of goods is subsequently reduced by the supplier due to a billing error, and a refund is provided by the supplier, the refund is able to be offset against the cost of the purchased goods.

RECOGNITION OF REVENUE – EXAMPLE

The diagram below shows the recognition points for a sale transaction under both the accrual and cash basis of accounting.

