

TREASURER'S DIRECTIONS

ACCOUNTING – ASSETS

Section A2.9 : Prepayments

STATEMENT OF INTENT

Accurate recording of prepayments allows costs to be apportioned over more than one reporting period rather than being recorded when paid. This Section explains the concept of prepayments and requirements relating to the recognition and classification of prepayments.

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.

Prepayments

- Prepayments are payments made in one reporting period, for goods or services that an Agency expects to receive or consume in future periods.

When are Prepayments Appropriate ?

- Payment prior to the receipt of goods and services is only to be made where:
 - it is a requirement of the procurement process; or
 - there is an identifiable benefit to the Territory.

Recognition of Prepayments

- A prepayment is to be recognised and recorded in the reporting period in which the payment is made in advance of receiving goods or services.

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

Framework for the Preparation and Presentation of Financial Statements

Related Treasurer's Directions:

A2.1 Accounting – Assets : Overview

A6.1 Accounting – Expenses : Overview

C3.2 Cash Management – Transaction Management : Payments

WHAT ARE PREPAYMENTS ?

A2.9.1

Prepayments are payments made in one reporting period, for goods or services that an Agency expects to receive or consume in future periods.

- (i) Payments made in advance of the receipt of goods or services are considered to be an asset until the goods or services are received or consumed. Prepayments are also known as prior payments. Expenses will be incurred as the goods or services are received or consumed and the prepayment (asset) reduced accordingly.
- (ii) Examples of prepayments include amounts paid in advance for:
 - rent of property, plant and equipment (including communication lines);
 - conference fees, software licences and subscriptions;
 - reciprocal grants and subsidies; and
 - contract payments where prior payment is stipulated as part of the contract.
- (iii) Treasurer's Directions Sections A2.1 and A6.1 provide instruction and guidance in relation to assets and expenses, while Treasurer's Directions Section C3.2 provides instruction and guidance in relation to payments.

WHEN ARE PREPAYMENTS APPROPRIATE ?

A2.9.2

Payment prior to the receipt of goods and services is only to be made where:

- it is a requirement of the procurement process; or
- there is an identifiable benefit to the Territory.

- (i) As a general rule payment will not be made in advance of the receipt of goods or services. However, payments in advance may occur in certain circumstances. Prepayments are considered to be appropriate where:
 - it is a requirement of the procurement process (for example, memberships, subscriptions and airline bookings); or
 - there is an identifiable benefit to the Territory.

- (ii) Other relevant factors in assessing the appropriateness of making a prepayment include:
- delivery of goods or services is assured;
 - value of the prepayment – additional care should be exercised as the value of the prepayment increases;
 - previous relationship with the supplier (for example, a history of prompt delivery and problem free dealings indicates that a high standard of service should continue);
 - supplier's creditworthiness and the likelihood of recovery in the event of failure by the supplier to deliver the goods or services; and
 - other identifiable benefit to the Territory.

RECOGNITION OF PREPAYMENTS

A2.9.3

A prepayment is to be recognised and recorded in the reporting period in which the payment is made in advance of receiving goods or services.

- (i) Recognising payments made in advance as a prepayment (asset) in the Balance Sheet indicates that the Agency expects to receive future benefits equivalent to the value of the prepayment. The receipt or consumption of the goods and services results in a reduction in the prepayment and a corresponding increase in expenses for that reporting period. At the end of a reporting period an Agency will need to:
- review significant expenses for prepayments; and
 - reassess existing prepayment balances and reduce them in whole or in part where goods or services have been received or consumed.
- (ii) In practice some payments for goods or services may be charged directly to expense accounts. In these cases, and where amounts are significant or material, it will be necessary to correctly account for the portion of the expense that relates to goods or services yet to be received or consumed. This will result in a reduction to the previously recognised expense and an increase in assets (prepayments).
- (iii) While there may be many situations where an Agency could recognise prepayments at the end of the reporting period, an Agency should focus on significant prepaid items. In this regard, an Agency will need to ensure that appropriate processes are in place to properly identify and record prepayments that are material individually or in aggregate.
- (iv) Appendix A provides examples of how to account for prepayments, while Treasurer's Directions Section A2.1 provides instruction and guidance on the classification of assets, including prepayments.

ACCOUNTING FOR PREPAYMENTS – EXAMPLES

Example 1

An Agency pays \$120,000 (GST exclusive) for an annual subscription on 1 January X2 and recognises a prepayment at that time.

Initial journal to recognise the annual subscription as a prepayment:

DR	Other Prepaid Expenses	<i>(Increase in Asset – Balance Sheet)</i>	\$120,000	
CR	Cash at Bank	<i>(Decrease in Asset – Balance Sheet)</i>		\$120,000

The monthly journal to recognise a reduction in the prepayment and recognition of an expense would be:

DR	Membership and Subscriptions Expense	<i>(Increase in Expense – Operating Statement)</i>	\$10,000	
CR	Other Prepaid Expenses	<i>(Decrease in Asset – Balance Sheet)</i>		\$10,000

Example 2

An Agency pays \$120,000 (GST exclusive) for software licence and support services for six months in advance on 1 April X2. This transaction was initially (and incorrectly) fully recorded as an expense in the month in which the payment was made.

Initial journal to record six months licence and support services as an expense:

DR	Licensing Charges Expense	<i>(Increase in Expense – Operating Statement)</i>	\$120,000	
CR	Cash at Bank	<i>(Decrease in Asset – Balance Sheet)</i>		\$120,000

The following journal is processed to correctly recognise the prepayment, along with a reduction in expenses:

DR	Other Prepaid Expenses	<i>(Increase in Asset – Balance Sheet)</i>	\$120,000	
CR	Licensing Charges Expense	<i>(Decrease in Expense – Operating Statement)</i>		\$120,000

The monthly journal to recognise a reduction in a prepayment and recognition of an expense would be:

DR	Licensing Charges Expense	<i>(Increase in Expense – Operating Statement)</i>	\$20,000	
CR	Other Prepaid Expenses	<i>(Decrease in Asset – Balance Sheet)</i>		\$20,000