TREASURER'S DIRECTIONS

ACCOUNTING – EQUITY

Section A4.1 : Overview

STATEMENT OF INTENT

The Government establishes and invests resources in Agencies to enable the delivery of outputs to the community. This Section explains the concepts relating to equity and provides requirements relating to the recognition and classification of equity.

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.

Equity

- Equity is the residual interest in the assets of an Agency after deduction of all the Agency's liabilities.

Recognition of Equity

- The recognition criteria for assets and liabilities provide the criteria for the recognition of equity.
- Equity is only to be adjusted in certain circumstances.

Classification of Equity

- Items of equity are to be recorded according to the classes provided by the Standard Classifications.

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.

CONTENTS

AUTHORITIES

Financial Management Act

REFERENCES

AAS 29	Financial Reporting by Government Departments
AASB 101	Presentation of Financial Statements
UIG 1038	Contributions by Owners Made to Wholly Owned Public Sector Entities
	Framework for the Preparation and Presentation of Financial Statements

Related Treasurer's Directions:

A1.1	Accounting – Introduction : Accrual Accounting
A2.1	Accounting – Assets : Overview
A2.4	Accounting – Assets : Revaluation
A3.1	Accounting – Liabilities : Overview
A4.2	Accounting – Equity : Owner Actions

WHAT IS EQUITY ?

A4.1.1

> **Equity is the residual interest in the assets of an Agency after deduction of all the Agency's liabilities.**

(i) The Government is the owner of Agencies on behalf of the Territory and the value of this ownership interest is represented by equity. In practice, the Territory's ownership interest in Agencies is recorded in the Central Holding Authority. Equity in an Agency includes:

- Accumulated Funds - operating surpluses or deficits that accumulate over time;
- Reserves - such as the Asset Revaluation Reserve which arises from the revaluation of non-current assets; and
- Capital - contributions by Government (equity injections) less distributions to Government (equity withdrawals). Also known as Contributed Capital.

(ii) Accumulated funds comprise the following:

- net surplus or deficit as reported in the Operating Statement for the current reporting period;
- accumulated surplus or deficit brought forward from previous reporting periods; and
- direct adjustments to accumulated funds made in accordance with Treasurer's Directions or Australian accounting standards.

(iii) The balance of accumulated funds is determined through the operating results of an Agency (income less expenses). Accumulated funds are increased by the excess of income over expenses and are decreased by the excess of expenses over income. The balance of accumulated funds may also be adjusted in limited circumstances, but only where allowed by Treasurer's Directions or Australian accounting standards.

(iv) Reserves represent:

- amounts allocated from an Agency's net operating results that may or may not be for a specific purpose;
- adjustments relating to the revaluation of assets; and
- other direct adjustments made in accordance with Treasurer's Directions or Australian accounting standards.

(v) Capital or contributed capital records the Government's direct ownership interest entities that it controls. As owner, the Government is interested in maintaining an appropriate level of investment in Agencies to ensure they are capable of delivering services (for example, outputs). The Government will consider the nature and mix of assets and liabilities in each Agency and may adjust these assets and liabilities as required. For example, the Government through an administrative rearrangement may alter the number and structure of Territory Agencies, and in so doing alter the capital recorded in some or all of these entities.

(vi) An increase in the Government's investment in an Agency is referred to as a contribution by Government (acting as owner). An example of a contribution by Government is a capital appropriation to an Agency for the purchase of a new asset. A decrease in the Government's investment in an Agency is referred to as a distribution to Government. An example of a distribution to Government is the transfer of a function or asset from an Agency to the Government. Treasurer's Directions Section A4.2 and UIG Interpretation 1038 provide further instruction and guidance in relation to contributions by and distributions to Government.

(vii) There are three characteristics of equity:

- the rights attached to equity rank after liabilities as a claim to the assets of an Agency;
- equity bears the results of operations and the consequences of other events affecting the Agency; and
- equity is the net position or residual interest.

(viii) Equity cannot be specified independently, unlike assets and liabilities, as it is the net position or residual interest. Another term used for equity is net assets. The relationship between equity and an Agency's assets and liabilities is shown in the following equation:

$$\boxed{\text{Equity (Net Assets)} = \text{Assets} - \text{Liabilities}}$$

(ix) The amount of equity recognised in an Agency's Balance Sheet will therefore be dependent on the underlying measurement of Agency assets and liabilities. Where an Agency's liabilities exceed its assets, no amount would be recognised as equity, rather a deficiency of assets over liabilities would be recognised in the Balance Sheet. Concepts relating to assets and liabilities are explained in Treasurer's Directions Sections A2.1 and A3.1.

RECOGNITION OF EQUITY

A4.1.2 **The criteria for the recognition of assets and liabilities provide the criteria for the recognition of equity.**

(i) As equity is the residual interest in the assets of an Agency after deduction of its liabilities, the recognition criteria for assets and liabilities are the basis for the recognition of equity.

A4.1.3 **Equity is only to be adjusted:**

- **for the net surplus or deficit reported in the Operating Statement;**
- **as a result of contributions by or distributions to Government;**
- **for transfers to or from reserves;**
- **for revaluation increments and decrements; or**
- **as required or permitted in Treasurer's Directions or Australian accounting standards.**

(i) As the residual interest in an Agency, equity bears the results of the Agency's operations and reflects the impact of these operations on the Agency's assets and liabilities.

(ii) As owner, the Government may choose to increase or decrease its ownership interest in an Agency.

(iii) The Asset Revaluation Reserve represents the net movement in the value of assets resulting from the revaluation of assets. Treasurer's Directions Section A2.4 provides further instruction and guidance relating to the revaluation of non-current assets.

(iv) Directly adjusting income and expense items to equity reduces a user's ability to assess the true performance of an Agency. However, in certain situations Treasurer's Directions or Australian accounting standards may require or permit a direct adjustment to equity. For example:

- where an Agency changes accounting policies on the initial adoption of an Australian accounting standard, transitional provisions may allow an income or expense item to be excluded from the operating results and recognised as a direct adjustment to accumulated funds; and
- errors relating to prior financial years that are discovered in the current financial year are to be accounted for retrospectively by adjusting accumulated funds.

Additional instruction and guidance in relation to accounting policy changes and prior year errors may be found in Treasurer's Directions Section A1.1.

CLASSIFICATION OF EQUITY

A4.1.4 **Items of equity are to be classified according to their nature and, as a minimum, under the classes provided by the Standard Classifications.**

(i) To assist users of financial statements equity is classified according to its nature. For the majority of Agencies the nature of equity is determined by reference to its source. For example, capital contributions are differentiated from accumulated funds and reserves.

(ii) Agency equity is classified into:

- Accumulated Funds - the accumulated operating results of the Agency;
- Reserves - such as the Asset Revaluation Reserve; and
- Capital – representing the Government's ownership interest in the Agency.