TREASURER'S DIRECTIONS

ACCOUNTING – EXPENSES

Section A6.1 : Overview

STATEMENT OF INTENT

Expense information is important to Agency management as it shows outflows of goods and services, the extent to which costs are incurred and the types of costs incurred. This Section explains what expenses are, when expenses should be recognised and how expenses should be 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.

Expenses

- Expenses are decreases in economic benefits during the reporting period in the form of reductions in assets or increases in liabilities that result in a decrease in equity, other than those relating to distributions to Government.

Recognition of Expenses

- Expenses are to be recognised when a decrease in economic benefits related to a reduction in assets and/or an increase in liabilities has arisen, and the decrease in economic benefits can be measured reliably.

Classification of Expenses

- Expenses are to be classified according to their nature or type and, are to be recorded according to the classes provided by the Standard Classifications.
- Revenue 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

AAS 29	Financial Reporting by Government Departments
AASB 101	Presentation of Financial Statements
	Framework for the Preparation and Presentation of Financial Statements

Related Treasurer's Directions:

F2.2	Framework – Working for Outcomes : Central Holding Authority
A1.3	Accounting – Introduction : Standard Classification Codes
A4.1	Accounting – Equity : Overview
A4.2	Accounting – Equity : Owner Actions
A6.2	Accounting – Expenses : Employee Benefits
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A6.4	Accounting – Expenses : Grants and Subsidies

WHAT ARE EXPENSES?

A6.1.1 | **Expenses are decreases in economic benefits during the reporting period in the form of reductions in assets or increases in liabilities that result in a decrease in equity, other than those relating to distributions to Government.**

(i) Expenses encompass both expenses from ordinary activities and losses as shown below:

Expenses	=	Expenses from ordinary activities	+	Losses

- Expenses from ordinary Agency activities include costs associated with purchasing goods and services, paying salaries and wages, and certain non-cash expenses such as depreciation.
- Losses represent other expenses that may, or may not arise in the course of ordinary activities of an Agency.

(ii) Expenses from ordinary activities relate to costs incurred by an Agency other than losses and can include both cash and non-cash items. Under accrual accounting, the full cost of Agency outputs includes both cash and non-cash expenses. Agency expenses include:

- employee expenses, such as salaries and wages;
- purchases of goods and services;
- depreciation and amortisation;
- repairs and maintenance; and
- property management.

(iii) Losses represent other items that meet the definition of an expense that may or may not arise in the course of ordinary activities. Examples of Agency losses include:

- a loss on the disposal of an item of plant and equipment;
- a loss incurred in writing down obsolete inventory; and
- certain unrealised losses resulting from reductions in asset values.

(iv) There are two essential characteristics of expenses:

- a decrease in economic benefits; and
- a decrease in equity other than that relating to distributions to Government.

A6.1.2 **Decreases in economic benefits occur in the form of reductions in assets or increases in liabilities.**

(i) Most expenses result from economic benefits being consumed or expiring during the reporting period. For instance, an Agency may incur an expense for the purchase of goods and services. If the item is paid for immediately there will be a decrease in an asset (cash). If there is a delay in payment there will be an increase in a liability (accounts payable).

A6.1.3 **Expenses result in a decrease in equity, other than those relating to distributions to Government.**

(i) Expenses have the effect of reducing assets or increasing liabilities, resulting in a decrease in the equity of an Agency. However, not all reductions in assets or increases in liabilities constitute an expense. For example, the raising of debt would increase liabilities (debt) and increase assets (cash), consequently not affecting equity and not giving rise to an expense.

(ii) In addition, decreases in equity resulting from distributions to Government (acting as owner) do not constitute an expense. Distributions to Government and other direct adjustments to equity are discussed in Treasurer's Directions Sections A4.1 and A4.2.

(iii) Detailed instruction and guidance in relation to specific types of expenses may also be found in Treasurer's Directions Sections A6.2 to A6.4.

RECOGNITION OF EXPENSES

A6.1.4

> Expenses are to be recognised and recorded in the books of an Agency when:
>
> - a decrease in economic benefits related to a reduction in assets and/or an increase in liabilities has arisen;
> - the decrease in economic benefits can be measured reliably; and
> - the expense 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. An expense 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 an expense but not be recognised. This could be due to uncertainty as to whether there has been a decrease in economic benefits during the period or due to an inability to reliably measure the expense.

(ii) In effect, the recognition of expenses occurs simultaneously with the recognition of an increase in liabilities (for example, accounts payable), or a decrease in assets (for example, cash paid or depreciation of equipment).

(iii) It is also necessary that the decrease in economic benefits be able to be measured reliably for an expense to be recognised. In most cases, the amount of the expense will be clearly evident and will be capable of measurement with a high degree of reliability. For example, the purchase price of goods can readily be obtained from the invoice, purchase order or supplier's quoted price. However, there may be some cases that will be subject to estimation. For example, the cost of electricity used since last billing date could be measured reliably based on prior periods electricity usage.

(iv) Expenses will be recognised:

- at the GST-exclusive cost if an input tax credit entitlement exists; or
- at the GST-inclusive cost if there is no entitlement to input tax credits.

Additional instruction and guidance regarding GST policy may be found in Treasury GST Circulars.

(v) The point at which an expense is recognised is dependent on the nature of the transaction or other event that gives rise to the expense. Where economic benefits acquired by an Agency are consumed immediately or soon after acquisition (for example, consumables), the expense would qualify for recognition in the reporting period in which the purchase or acquisition occurs. Where economic benefits are expected to be consumed over several reporting periods (for example, depreciable assets), expenses should be allocated systematically to the reporting periods during which the economic benefits are expected to be consumed.

(vi) An expense for the purchase of goods and services will typically be recognised on receipt of the specified goods or services. This contrasts to the situation that occurs in a cash accounting environment where an item of expenditure is only recognised when a cash payment is made. Appendix A provides a comparison of the recognition of expenses for a simple purchase transaction under cash and accrual accounting.

(vii) An expense will be specific to an Agency in that an expense of one Agency cannot at the same time also be an expense of another Agency. Each expense will therefore be recorded in the financial records of one Agency only.

(viii) An Agency will only recognise expenses that it controls. In rare cases, Agencies may incur Territory expenses that relate to items that are paid by an Agency on behalf of the Government. As the Agency has no control over the payment of these amounts, they will be recorded in the Central Holding Authority rather than being recorded in an Agency's Operating Statement. Treasurer's Directions Section F2.2 elaborates on the concept of the Central Holding Authority and items recorded by it.

CLASSIFICATION OF EXPENSES

A6.1.5 Expenses are to be classified according to their nature or type and, as a minimum, are to be recorded under the expense classes provided by the Standard Classifications.

A6.1.6 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) An Agency providing services will typically classify expenses according to their nature, such as employee expenses or depreciation. However, to ensure consistent classification across Agencies, the Standard Classifications provide the minimum classification requirements for expenses. These classes are further described in Treasurer's Directions Sections A6.2 to A6.4 and include:

- employee expenses;
- general expenses; and
- grant and subsidy expenses.

(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 and expense may be disclosed separately by nature and amount in the notes to the accounts.

A6.1.7 **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 an expense by income 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.

APPENDIX A

RECOGNITION OF EXPENSES – EXAMPLE

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