TREASURER'S DIRECTIONS

ACCOUNTING – INTRODUCTION

Section A1.1 : Accrual Accounting

STATEMENT OF INTENT

Accrual accounting is one of the key elements of the Working for Outcomes framework. This Section explains the accrual accounting concept and provides a summary of the five accrual elements and the application of Australian accounting standards.

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.

Accrual Accounting

- Accrual accounting is the accounting basis where assets, liabilities, equity, income and expenses are recognised in the reporting periods to which they relate, regardless of when cash is received or paid.

Elements of Accrual Accounting

- The elements of accrual accounting are assets, liabilities, equity, income and expenses.

Recording Transactions under Accrual Accounting

- Agencies are to record financial data on an accrual basis using double entry accounting and prepare financial statements using the accrual accounting basis.
- For the purpose of applying Australian accounting standards, all Agencies and Government Business Divisions are classified as not-for-profit entities.

Accounting Pronouncements and Accounting Policies

- Agencies are to comply with the requirements of relevant Australian accounting standards and other accounting pronouncements included in these and related Treasurer's Directions Sections.
- Agencies are to establish appropriate accounting policies, and are to consistently apply these policies from one reporting period to the next.

Changes in Estimates and Accounting for Errors

- Unless impracticable, Agencies are to correct errors that occurred in prior financial years retrospectively in the first reporting period after their discovery.

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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Appendix A — Accrual and Cash Accounting – Comparison

Appendix B — Elements of Accrual Accounting

AUTHORITIES

Financial Management Act

REFERENCES

AAS 29 — Financial Reporting by Government Departments

AASB 101 — Presentation of Financial Statements

AASB 108 — Accounting Policies, Changes in Accounting Estimates and Errors

Framework for the Preparation and Presentation of Financial Statements

Related Treasurer's Directions:

F2.1 — Framework – *Working for Outcomes :* Overview

A2.1 — Accounting – Assets : Overview

A3.1 — Accounting – Liabilities : Overview

A4.1 — Accounting – Equity : Overview

A5.1 — Accounting – Income : Overview

A6.1 — Accounting – Expenses : Overview

WHAT IS ACCRUAL ACCOUNTING ?

A1.1.1

Accrual accounting is the accounting basis where assets, liabilities, equity, income and expenses are recognised in the reporting periods to which they relate, regardless of when cash is received or paid.

(i) Accrual accounting is one of the key elements of the *Working for Outcomes* framework. Accrual accounting facilitates the focus on agency outputs and performance by providing financial information on the full cost of outputs. Treasurer's Directions Section F2.1 provides further instruction and guidance in relation to *Working for Outcomes.*

(ii) Accrual accounting records all transactions that arise from an Agency's operations. Under accrual accounting, transactions are recorded in the period to which they relate, even though no cash may have been received or paid. In contrast, under cash accounting an Agency only records a transaction when cash is received or paid. In addition, accrual accounting takes into account transactions where no cash is exchanged, such as transactions involving the creation of obligations to pay (payables), or rights to receive cash at future dates (receivables), and transactions relating to the cost of using assets in the production of outputs (depreciation).

(iii) Appendix A provides a comparison between accrual and cash accounting.

ELEMENTS OF ACCRUAL ACCOUNTING

A1.1.2

The elements of accrual accounting are:

- **assets;**
- **liabilities;**
- **equity;**
- **income; and**
- **expenses.**

(i) Accrual accounting identifies assets, liabilities, equity, income and expenses to highlight an Agency's economic condition and financial performance having regard to its control over resources, financial structure and capacity for change. A summary of each of these elements is provided below, while the Accounting Series of Treasurer's Directions explains each of these elements in more detail.

(ii) Assets are reported in the Balance Sheet and provide information on the resources deployed in the delivery of outputs, by an Agency. Examples of Agency assets include:

- cash;
- receivables;
- inventories;
- prepayments; and
- property, plant and equipment.

(iii) Liabilities represent debts or amounts owing by an Agency and are also reported in the Balance Sheet. Examples of Agency liabilities include:

- payables;
- accrued expenses;
- employee benefit liabilities; and
- other liabilities.

(iv) Equity is the residual interest of the Government in the net assets (assets minus liabilities) of an Agency and is reported in the Balance Sheet and in greater detail the Statement of Changes in Equity. Equity includes:

- accumulated funds;
- reserves; and
- capital.

(v) Income encompasses both revenue (for example, revenue from the delivery of outputs) and gains (for example, a profit resulting from the disposal of an item of plant and equipment). Income is reported in the Operating Statement and provides information on inflows of resources to an Agency. Examples of Agency income include:

- output revenue;
- sales of goods or services; and
- grants and subsidies.

(vi) Expenses relate to costs incurred by an Agency (including losses) and are reported in the Operating Statement. Agency expenses include:

- salaries and wages;
- purchases of goods and services;
- repairs and maintenance; and
- depreciation.

(vii) Appendix B presents the relationship between the accrual elements in an equation and aligns each element to the Balance Sheet or the Operating Statement.

RECORDING TRANSACTIONS UNDER ACCRUAL ACCOUNTING

A1.1.3

Agencies are to :

- **record financial data on an accrual basis using double entry accounting; and**
- **prepare financial statements using the accrual accounting basis.**

(i) Double entry accounting is the process by which every relevant financial transaction or event is recorded using two entries, a debit entry and an off-setting credit entry. For instance, the journal to record the purchase of consultancy services by an Agency is a debit to the relevant expense account and a credit to the payables account representing the obligation to pay the consultant.

(ii) 'Debit' and 'credit' are accounting terms used to describe changes in account balances. At any point of time, the sum of all the debit entries in an Agency's ledger is equal to the sum of all the credit entries in the ledger.

(iii) When recording information in an Agency's financial systems, Agencies should remain aware of the 'materiality' concept. Information is material if its omission, misstatement or non-disclosure would adversely affect decisions made by the users of the financial reports.

(iv) In deciding whether the information is material, consideration will be given to the following:

- nature of the item (for example, 'cash at bank' is considered to be material by nature);
- amount of the item (for example, an amount of less than 5% of the relevant asset or liability class may be considered to be immaterial); and
- amount of other items of the same or similar nature in aggregate as well as individually.

A1.1.4 **For the purpose of applying Australian accounting standards, all Agencies and Government Business Divisions are classified as not-for-profit entities.**

A1.1.5 **The classification of Government Business Divisions as not-for-profit entities for the purpose of applying Australian accounting standards, does not change the Government's intention that Government Business Divisions are to operate in a commercial manner.**

(i) Certain Australian accounting standards include specific requirements and exemptions relevant to not-for-profit entities. Australian accounting standards define a not-for-profit entity as one whose principal objective is not the generation of profit, and accordingly, it would be rare for General Government entities to be classified as for-profit.

(ii) A review of Territory Agencies and Government Business Divisions (GBDs) has indicated that all Agencies and GBDs are in substance not-for-profit entities. This review took account of:

- the intentions of Government;
- the applicable legislative and governance frameworks;
- the degree and nature of Government funding;
- the targeted financial performance of the entity; and
- other entity specific factors.

(iii) The classification of GBDs as not-for-profit entities for the purposes of applying Australian accounting standards does not change Government's intention that GBDs operate in a commercial manner, nor does it remove the requirement for GBDs to continue to improve operating efficiencies and reduce business costs. Additional information in relation to GBD commercial practices may be found in the Government Business Division Manual.

ACCOUNTING PRONOUNCEMENTS AND ACCOUNTING POLICIES

A1.1.6 **Agencies are to comply with the requirements of relevant Australian accounting standards and other accounting pronouncements included in these and related Treasurer's Directions Sections.**

A1.1.7 **Agencies are to comply with requirements of relevant Australian accounting standards and other pronouncements that are not included in Treasurer's Directions Sections following advice from Treasury.**

(i) Requirements in relevant Australian accounting standards and other accounting pronouncements are, as far as possible, provided in these and other relevant Treasurer's Directions Sections and related Policy Briefs. Agency compliance with Treasurer's Directions is required under the *Financial Management Act* and assists in ensuring accounting and financial management policies are consistently applied across Agencies.

(ii) In certain situations the *Financial Management Act,* Treasurer's Directions and Policy Briefs may also require Agencies to comply with requirements additional to those included in relevant Australian accounting standards.

(iii) Accounting pronouncements include:

- Australian accounting standards (AAS's and AASB's);
- Urgent Issues Group (UIG) Interpretations as shown in AASB 1048;
- the Framework for the Preparation and Presentation of Financial Statements; and
- other authoritative pronouncements of the Australian Accounting Standards Board.

A1.1.8

Subject to these and related Treasurer's Directions, relevant Australian accounting standards and other accounting pronouncements, an Agency is to establish appropriate accounting policies.

(i) Consistent with instruction and guidance provided by the Treasurer's Directions, associated Policy Briefs and relevant Australian accounting standards, Agencies need to establish and maintain appropriate accounting policies. These policies will be specific to the Agency's circumstances, whilst remaining consistent with the *Working for Outcomes* framework and in compliance with the Treasurer's Directions.

(ii) Relevance and reliability are recognised as the primary qualitative characteristics that financial information should possess. Accordingly, the concepts of relevance and reliability are central to the selection and development of accounting policies.

(iii) Relevant financial information assists users in making and evaluating decisions about the allocation of scarce resources. It assists users in making predictions about future situations and in forming expectations, or it plays a confirmatory role in respect of past evaluations. Financial information may be relevant because of its nature, its nature and magnitude, or because of its magnitude in relation to its nature.

(iv) Reliable financial information faithfully conveys to users the underlying transactions and other events that have occurred. For financial information to be reliable it needs to be complete, free from bias (that is, neutral) and free from undue error.

(v) For financial information to be both relevant and reliable, it is necessary that the substance of the underlying transactions or events is reported. Prudent judgement is required to select accounting policies that ensure financial information is both relevant and reliable.

A1.1.9

Agencies are to apply accounting policies consistently from one reporting period to the next, and are not to change accounting policies unless:

- **required or permitted to do so by Treasurer's Directions or Australian accounting standards;**
- **requirements contained in the Treasurer's Directions change and a corresponding change in an accounting policy is required; or**
- **such a change would result in more reliable and relevant information being presented in an Agency's financial report.**

(i) Accounting polices should be consistently applied for similar transactions, events and conditions to enable financial information to be comparable over time. Comparable information enables users to identify trends in an Agency's financial information. In addition to comparability, financial information needs to be presented in financial reports in the most understandable manner having regard to the users of the financial information.

(ii) While comparability and understandability imply that recognition, measurement and presentation of financial information needs to be carried out in a consistent manner, consistency should not sacrifice the relevance and reliability of financial information.

A1.1.10 **Unless a new or amended Treasurer's Direction or Australian accounting standard requires otherwise, Agencies are to account for accounting policy changes retrospectively by restating comparative financial information, and adjusting accumulated funds (or other applicable equity class).**

A1.1.11 **Where it is impractical to account for accounting policy changes retrospectively, an Agency may apply the new accounting policy to the earliest period for which the retrospective application is practicable.**

(i) New or amended Treasurer's Directions and/or Australian accounting standards may include transitional provisions that require the initial application of certain accounting policy changes to be accounted for in a particular way. Where no such transitional provisions are provided, accounting policy changes, including voluntary changes, require retrospective application, with adjustments made to accumulated funds (or other applicable equity class). Each Agency should have regard to the materiality of adjustments prior to restating financial information.

(ii) The retrospective application of a new or amended accounting policy requires the accounting policy to be applied to prior period information are far back as is practicable. However, it is recognised that it will not always be practical for an Agency to retrospectively apply a new or amended accounting policy to multiple prior periods. In these situations, each Agency should have regard to the specific requirements included in AASB 108, and the definition of 'impracticable' contained therein. Treasury should be consulted where a voluntary change in accounting policy is likely to have material impact on Agency financial statements.

CHANGES IN ESTIMATES AND ACCOUNTING FOR ERRORS

A1.1.12

Agencies are to account for changes in accounting estimates prospectively by:

- **recognising the adjustments as an income or expense in the financial year in which the estimate is revised (and future financial years were relevant); and**
- **adjusting the carrying amount of the related asset, liability or equity item in the financial year in which the estimate is revised (where applicable).**

(i) Reliable estimates are used to measure certain items included in Agency financial statements. For example, estimates may be used to measure:

- bad and doubtful debts;
- inventory obsolescence; and
- certain employee benefit liabilities.

(ii) Estimates may need to be revised if changes occur in the information or circumstances upon which the estimate was based. Agencies should note that revisions to estimates are accounted for prospectively from the date of change in the estimate. By nature, changes to accounting estimates do not relate to prior periods and are not treated as error corrections.

A1.1.13

Unless impracticable, Agencies are to correct errors that occurred in prior financial years retrospectively in the first reporting period after their discovery by restating:

- **comparative financial information for errors that occurred in the prior year; or**
- **comparative year opening balances of assets, liabilities and equity for errors that occurred before the previous financial year.**

A1.1.14

Agencies are to correct errors that occur and are detected in the current financial year by correcting the financial records of the current financial year.

(i) Errors are omissions or misstatements in one or more financial years that can arise in relation to the recognition, measurement and/or presentation and disclosure of assets, liabilities, equity, income and expenses. Errors include those resulting from mathematical mistakes, system errors, oversights, misinterpretations of available facts, mistakes in applying accounting policies and fraud.

(ii) Errors relating to prior financial years that are discovered in the current year are to be accounted for retrospectively by restating comparative financial information and adjusting accumulated funds. Accordingly, the correction for prior year errors is excluded from the operating result for the year in which the error is discovered.

(iii) It is recognised that it will not always be practical for an Agency to retrospectively account for prior year errors, particularly those that impact multiple prior periods. In these situations, each Agency should correct prior year errors to the extent practicable, and have regard to the specific requirements included in AASB 108, including the definition of 'impracticable' contained therein.

(iv) In certain situations, Agencies will discover errors that have occurred and are detected in the current financial year. Such errors are required to be corrected in the financial records of the current financial year. Accumulated funds will not be adjusted for errors related to the current financial year.

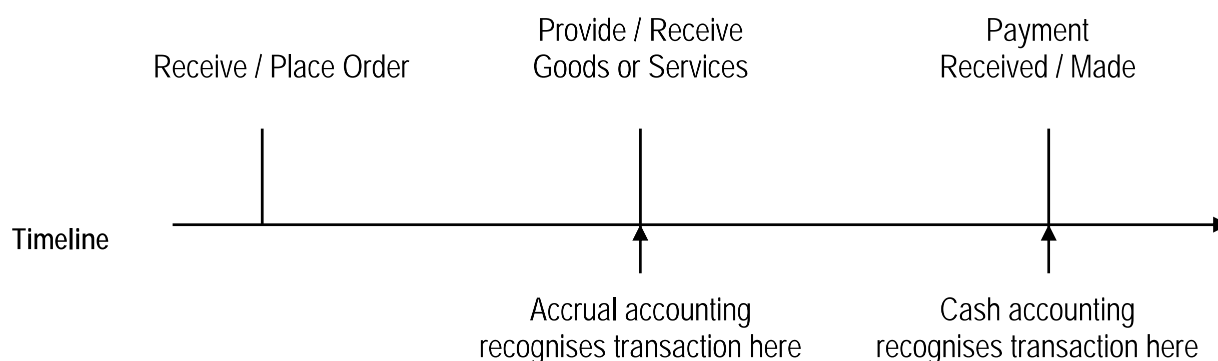
(v) Agencies should remain aware of the administrative effort associated with identifying and correcting prior period errors, particularly those occurring over several financial years. In this regard, it is only material prior period errors that would ordinarily be subject to adjustment.

APPENDIX A

ACCRUAL AND CASH ACCOUNTING – COMPARISON

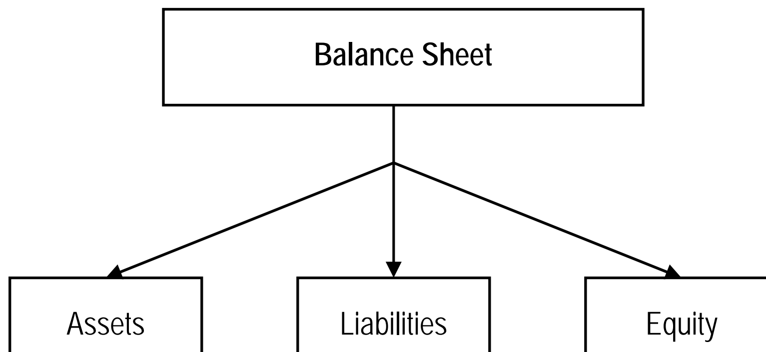
		Accrual Accounting	Cash Accounting
(i)	Recognition	Recognition of transactions or other events in the reporting period in which they occur, irrespective of whether cash has been received or paid.	Recognition of the financial effects of transactions or other events only when cash is received or paid.
(ii)	Focus	It is more comprehensive and focuses on total resources, not just cash. It provides information about assets, liabilities, equity, income and expenses, and changes in them.	It focuses on cash and does not provide information about assets, liabilities, equity, income and expenses.
(iii)	Measure of financial performance	The focus on total resources provides a better and more comprehensive measure of financial performance and facilitates resource allocation.	The emphasis on cash provides a narrow assessment of financial performance.

The figure below shows the different points of recognition of a transaction under accrual and cash accounting:



APPENDIX B

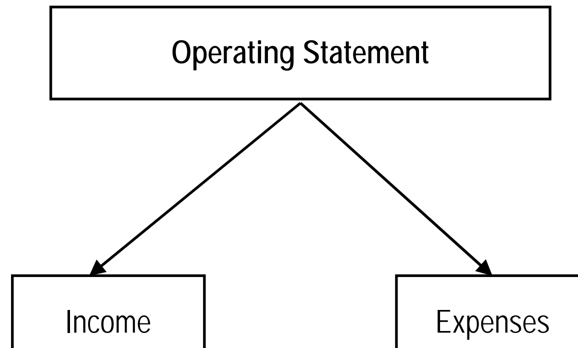
ELEMENTS OF ACCRUAL ACCOUNTING



Assets = Liabilities + Equity

OR

Equity = Net Assets



Operating Surplus / Deficit = Income – Expenses

Operating Result = Operating Surplus/Deficit

The Operating Result impacts Equity