TREASURER'S DIRECTIONS

ACCOUNTING – LIABILITIES

Section A3.1 : Overview

STATEMENT OF INTENT

Complete and accurate liability information allows an Agency to be fully aware of its financial obligations. This Section explains what liabilities are, when liabilities should be recognised and how they should be classified. The concept of commitments is also discussed.

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.

Liabilities

- Liabilities are present obligations of an Agency that arise from past events, the settlement of which is expected to result in an outflow of resources embodying economic benefits.
- Commitments are not liabilities but are intentions to give up resources embodying economic benefits.

Recognition of Liabilities

- Liabilities are to be recognized and recorded in the books of an Agency only when:
  - it is probable that an outflow of resources embodying economic benefits will be required; and
  - the amount of the liability can be measured reliably

Classification of Liabilities

- Liabilities are to be recorded according to the categories and classes provided by the Standard Classifications.
- Assets and liabilities 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.

CONTENTS

AUTHORITIES

Financial Management Act

REFERENCES

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
A3.2	Accounting – Liabilities : Accounts Payable and Accrued Expenses
A3.3	Accounting – Liabilities : Provisions
A3.4	Accounting – Liabilities : Employee Benefits
A3.6	Accounting – Liabilities : Leases
A3.7	Accounting – Liabilities : Contingent Liabilities

WHAT ARE LIABILITIES?

A3.1.1 **Liabilities are present obligations of an Agency that arise from past events, the settlement of which is expected to result in an outflow of resources embodying economic benefits.**

(i) Liabilities represent debts or amounts owing by an Agency to other entities that are due or payable. Liabilities may also be termed financial obligations. Other entities can include:

- private sector entities (also external entities) such as companies, businesses, employees and individuals;
- Northern Territory Government entities (internal entities) such as other Agencies, Government Business Divisions, and Government Owned Corporations; and
- other Government entities (external entities) such as Commonwealth, State and local Government entities.

(ii) Examples of Agency liabilities include:

- payables, for example amounts owed by an Agency for goods and services received;
- accrued expenses, for example electricity used but not yet invoiced at the end of a period;
- employee benefit liabilities which are amounts payable to employees as a result of rendering services;
- borrowings and advances; and
- finance lease liabilities.

(iii) There are three essential characteristics of a liability:

- existence of a present obligation to other entities;
- a requirement to give up resources embodying economic benefits at some future time; and
- previous occurrence of a transaction or event that created the liability.

A3.1.2 **Present obligations are duties or responsibilities on an Agency to act or perform in a certain way with little or no discretion to avoid settlement of the obligations.**

(i) Most obligations are legally enforceable in that they stem from legally binding contracts or are imposed by Government statutes. These transactions are generally non-cancellable, or not cancellable without penalty. For example, a contract for the purchase of specialised equipment. Obligations can also include those imposed by notions of equity or fairness and by custom or usual business practices. For example, a formal Government announcement that the Treasurer has approved ex-gratia payments to eligible natural disaster victims.

(ii) It is important to distinguish between present obligations and future commitments. Commitments are discussed later in these Directions.

A3.1.3 **The settlement of a present obligation usually involves the Agency giving up resources embodying economic benefits.**

(i) In a majority of cases, the settlement of a present obligation by an Agency would involve a cash payment to a supplier. Other ways to settle a financial obligation include:

- an electronic or ledger transfer;
- transfer of a non-cash asset;
- provision of services; or
- conversion of the obligation to equity.

A3.1.4 **The transaction or event giving rise to the liability must have occurred.**

(i) To give rise to a liability, the transaction or event creating the present obligation must have occurred. In addition, the transaction or event must give rise to an expectation that the Agency will have to give up resources at some future time. In certain situations, entering a contract or agreement may not be sufficient to give rise to a present obligation. The contract or agreement may require another event to occur or condition to be fulfilled before a present obligation arises. For example, an Agency may enter into a contract with a supplier for the purchase of goods or services. Entering into the contract does not give rise to a present obligation, rather the event is the receipt of the contracted goods or services by the Agency.

(ii) Appendix A outlines the stages in a number of transactions highlighting past events giving rise to a present obligation.

RECOGNITION OF LIABILITIES

A3.1.5

Liabilities are to be recognised and recorded in the books of an Agency only when:

- **it is probable that an outflow of resources embodying economic benefits will be required;**
- **the amount of the liability can be measured reliably; and**
- **the liability 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. It is possible for an item to meet the definition of a liability but not be recognised as such. This could be due to uncertainty as to the possibility of an outflow of economic benefits being required, or due to an inability to reliably measure the liability. A provision or contingent liability will be recognised instead.

(ii) The chances of an outflow of economic benefits being required needs to be more likely rather than less likely. If at the time the liability occurs, it is not considered probable that economic benefits will be required to be sacrificed by the Agency at some future time, it will not qualify for recognition as a liability. For example, obligations resulting from the provision of guarantees will not be recognised as a liability if it is not possible to establish at reporting date that a future sacrifice of economic benefits will be required. In addition, such a liability must be able to be measured reliably.

(iii) Information regarding potential financial obligations and non-recognised liabilities, where significant, may still be required to be presented in an Agency's financial report. However, this information would be disclosed in the notes to the financial statements as a contingent liability and would not be recognised in the financial statements themselves.

(iv) The Liability Decision Tree in Appendix B assists in distinguishing between liabilities, provisions and contingent liabilities.

(v) Liabilities will be specific to an Agency in that an Agency liability cannot at the same time also be the liability of another Agency. A liability will therefore be recorded in the financial records of one Agency only. In addition, some liabilities, such as superannuation and long service leave will be recorded in the Central Holding Authority rather than being recorded by Agencies. Treasurer's Directions Section F2.2 elaborates on the concept of the Central Holding Authority and items recorded by it.

A3.1.6

The amount recorded as a liability represents the monetary expression of the expected outflow of resources embodying economic benefits.

(i) The basis used to measure liabilities can vary. For the majority of liabilities, the amounts to be paid can be clearly determined based on invoices, contracted amounts and agreed charges. Some liabilities, however, may need to be estimated based on:

- quoted prices or purchase order amounts;
- invoices or bills from previous periods for ongoing charges (for example, electricity costs); or
- previous contracted amounts.

(ii) Agencies should note that the use of estimates does not of itself undermine reliable measurement. This is especially the case with regard to measuring provisions, where the exact amount or timing of the future expenditure may be uncertain.

(iii) Liabilities are recognised inclusive of the amount of Goods and Services Tax (GST). This is because the total amount of the transaction as represented by the invoiced or contracted price is the amount that will be paid by an Agency. Additional instruction and guidance regarding GST policy may be found in Treasury GST Circulars.

(iv) Reference should be made to Treasurer's Directions Sections A3.2 to A3.7 for instruction and guidance relating to recognition and measurement of specific types of liabilities.

CLASSIFICATION OF LIABILITIES

A3.1.7

> Liabilities are to be classified according to their nature or type and, as a minimum, are to be recorded under the current and non-current categories and liability classes provided by the Standard Classifications.

(i) Classification of liabilities on the basis of their nature or type may be made according to one or more of the following factors:

- source;
- liquidity;
- extent of security or guarantee;
- expected timing of settlement; and
- any conditions attached.

A3.1.8

> Current liabilities are liabilities that:
>
> - are due or expected to be settled within 12 months of reporting date;
> - the Agency is unable to defer settlement for at least 12 months; and
> - are held primarily for trading purposes.

(i) Current liabilities may include the following items:

- payables;

- accrued expenses;
- employee benefit liabilities;
- borrowings and advances; and
- finance lease liabilities.

(ii) Some liabilities such as trade payables and some accrued expenses will always be classified as current liabilities, even though they may be due to be settled in more than 12 months time.

A3.1.9 **Non-current liabilities are all liabilities other than current liabilities.**

(i) Non-current liabilities are liabilities that are not payable or expected to be settled within the next 12 months from the reporting date and include items such as long term borrowings and finance lease arrangements.

A3.1.10 **Assets and liabilities are not to be offset unless required or permitted by Treasurer's Directions or Australian accounting standards.**

(i) Offsetting means the reduction of a liability by an asset or vice versa in an Agency's Balance Sheet so that only the net amount is recognised. Assets and liabilities 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 income and expenses 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 assets and liabilities would not provide users with complete and accurate information in relation to total assets and liabilities held by the Agency. Measuring assets net of valuation adjustments, such as allowances for doubtful debts, or obsolescence, is not offsetting.

(iii) Examples of situations where offsetting is allowed 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).

COMMITMENTS

A3.1.11 **Commitments are not liabilities but are intentions to give up resources embodying economic benefits.**

(i) Commitments are potential obligations to other entities that may become liabilities if and when performance under existing contracts, agreements or legislation occurs. Commitments may be evidenced by agreements (such as a contract to construct a capital item or a purchase order), or undertakings (such as a promise to provide disaster relief) to make future payments to other entities.

(ii) The point at which a commitment becomes a liability is generally when the intention to give up resources embodying economic benefits becomes a present obligation. For example, an Agency's decision to acquire assets in the future does not, of itself, create a present obligation. In this situation, a liability would normally arise when the Agency has received the asset and is obliged to pay for it. Further examples are provided at Appendix A to assist in distinguishing commitments from liabilities.

A3.1.12 **Commitments are not to be recognised in the Balance Sheet.**

A3.1.13 **Agencies are to ensure that complete and accurate information on material commitments is available for financial reporting purposes.**

(i) As commitments are not liabilities, they are not recognised in the Balance Sheet. However, note disclosure of certain material commitments is required for:

- capital expenditure commitments;
- other expenditure commitments (except commitments for the supply for inventories); and
- lease commitments.

(ii) Complete and accurate information on material commitments will facilitate financial reporting and will assist Agency managers with cash forecasting and management.

APPENDIX A

DISTINCTION BETWEEN COMMITMENTS AND LIABILITIES – EXAMPLES

The following examples aim to assist in distinguishing between commitments and liabilities. Each transaction noted below has been segregated into several stages highlighting classification (as a commitment or a liability) and the required accounting treatment.

Example 1 – Ordering Office Furniture or Equipment

Stage	Need identified	Quotes obtained	Order placed	Order accepted	Goods delivered per order	Payment made
Classification Treatment	 No recognition No disclosure	 No recognition No disclosure	Commitment Note disclosure* No recognition	Commitment Note disclosure* No recognition	Liability Recognition	Liability extinguished

Example 2 – Placing a Contract Out to Tender

Stage	Decision to tender	Tender advertised	Contract accepted and signed	Contract work commenced	Contract work completed	Payment made
Classification Treatment	 No recognition No disclosure	 No recognition No disclosure	Commitment Note disclosure* No recognition	Liability for work performed (Recognition) Commitment for unperformed portion (Note disclosure)*	Liability Recognition	Liability extinguished

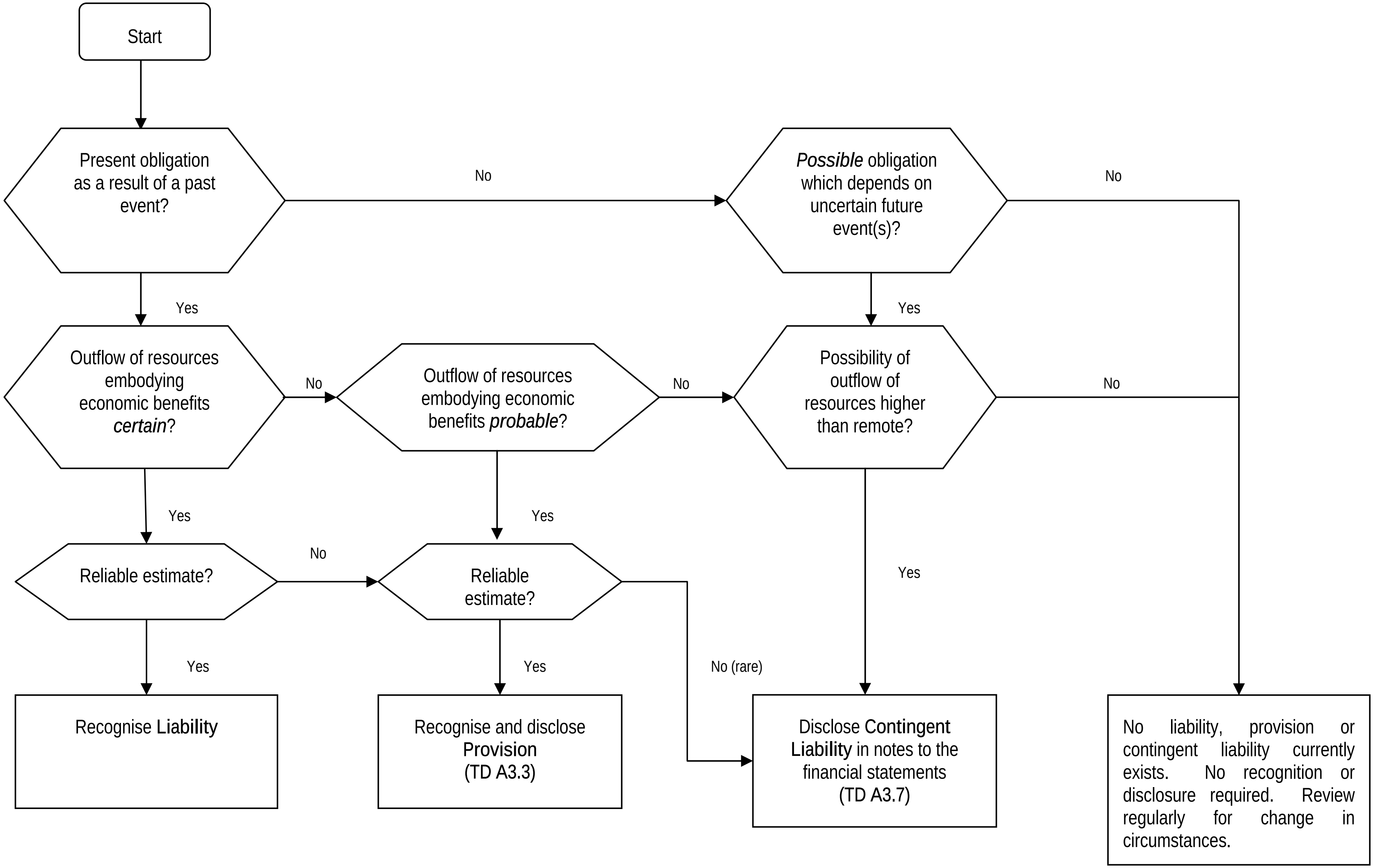
Example 3 – Payment of Non-reciprocal Grants#

Stage	Eligibility criteria set by Government	Application received	Decision made in favour of applicant	Applicant accepts grant conditions	Payment made
Classification Treatment	 No recognition No disclosure	 No recognition No disclosure	Commitment Note Disclosure* No recognition	Liability Recognition	Liability extinguished

* Material commitments only.

The accounting treatment for grants will be determined based on an assessment of the nature and substance of each grant agreement (or class of similar grant agreements).

APPENDIX B: Liability Decision Tree



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