TREASURER'S DIRECTIONS

ACCOUNTING – LIABILITIES

Section A3.2 : Accounts Payable and Accrued Expenses

STATEMENT OF INTENT

Complete and accurate information on accounts payable and accrued expenses enables users of financial statements to assess an Agency's ability to pay its debts when they fall due. This Section explains the concepts and requirements in relation to accounts payable and accrued expenses.

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.

Accounts Payable

- Accounts payable are liabilities to pay for goods or services that have been received and have been invoiced or formally agreed with the supplier.
- Accounts payable are to be recognised and recorded in the books of an Agency at fair value when goods or services have been received and invoiced.

Accrued Expenses

- Accrued expenses are liabilities to pay for goods or services that have been received or supplied but have not been invoiced or formally agreed with the supplier.
- An accrued expense is to be recognised and recorded in the books of an Agency at fair value where goods or services that have been received or supplied but have not been invoiced or formally agreed with the supplier.

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 132	Financial Instruments: Disclosure and Presentation
AASB 137	Provisions, Contingent Liabilities and Contingent Assets
AASB 139	Financial Instruments: Recognition and Measurement

Related Treasurer's Directions:

A3.1	Accounting – Liabilities : Overview
A3.3	Accounting – Liabilities : Provisions
C3.2	Cash Management – Transaction Management : Payments

ACCOUNTS PAYABLE

A3.2.1 **Accounts payable are liabilities to pay for goods or services that have been received and have been invoiced or formally agreed with the supplier.**

(i) Accounts payable (also known as creditors) are amounts owed by an Agency to other entities for goods or services received prior to the end of the reporting period. These obligations are reported as financial liabilities in the Balance Sheet.

(ii) Information reported on accounts payable allows users of financial statements to assess the quantum of an Agency's debts and its ability to pay these debts as and when they fall due. Such information also allows Agency management to monitor and control these outstanding obligations more effectively.

(iii) Treasurer's Directions Section A3.1 provides further instruction and guidance relating to the definition, recognition and classification of liabilities.

A3.2.2 **Accounts payable are to be recognised and recorded in the books of an Agency at fair value when goods or services have been received and invoiced.**

(i) Under accrual accounting, a liability in relation to the purchase of goods or services is recognised when it is probable that an outflow of resources embodying economic benefits will be required in the future to settle the obligation, and the value of the liability can be measured reliably. However, a liability would not be raised where the goods or services have already been paid for (paid in advance).

(ii) Recognition of accounts payable will normally occur when the goods or services are invoiced and received by an Agency. It is at this point that it is probable that the Agency will have to make payments to the supplier, and in most cases the amount of goods or services is stated in an invoice (that is, the amount can be measured reliably). Accounts payable will initially be recorded at fair value (invoice amount), while such liabilities will subsequently be measured at amortised cost, which equates to cost (for example, invoice amount less any part payment made).

(iii) The purchase of goods or services on credit allows an Agency to delay payment for the goods or services for some specific length of time as agreed by the supplier. Regardless, a liability would still be recognised when the goods or services have been received and invoiced by an Agency, rather than when cash payments are made. Examples showing how to account for accounts payable are provided at Appendix A.

(iv) Subsequent cash payments made to the supplier will reduce the previously recognised liability. Settlement of a liability may also occur as a result of: transfers of assets other than cash; the provision of services by the Agency; and/or the replacement of the liability with another liability. Additional instruction and guidance in relation to payments, including requirements in relation to the Territory's 30 day payment policy may be found in Treasurer's Directions Section C3.2.

(v) Documentation, typically an invoice, should be available to support the value recorded as accounts payable. For an invoice, statement or agreement to be recognised as accounts payable it must:

- have been received by the last day for collation of accounts payable;
- be for goods or services received during the reporting period; and
- be unpaid at the end of the reporting period.

(vi) Accounts payable 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 information and guidance regarding GST policy may be found in Treasury GST Circulars.

(vii) In some cases an Agency may receive trade discounts on goods or services purchased from a supplier. A trade discount is a reduction provided to an Agency from the normal list price and is used to determine the actual invoice price charged to an Agency. In this situation, only the net amount of an invoice is recognised as accounts payable. This is in contrast to discounts offered by suppliers for early payment which will only be accounted for when an Agency actually takes advantage of such discounts.

(viii) In addition, an Agency may receive credit notes from a supplier that adjust previous purchase transactions, for example, for overpaid invoices or damaged goods. The balance of outstanding accounts payable should reflect the actual obligation after allowing for these adjustments.

ACCRUED EXPENSES

A3.2.3 **Accrued expenses are liabilities to pay for goods or services that have been received or supplied but have not been invoiced or formally agreed with the supplier.**

(i) Accrued expenses represent unpaid amounts for goods or services received during the reporting period which have not yet been invoiced or formally agreed. This is usually due to a difference between the supplier's billing cycle and an Agency's reporting cycle. Liabilities of this type are likely to arise in relation to utility services, such as telephone and electricity costs. Other examples of accrued expenses include:

- lease or rent charges for properties;
- information technology charges (such as desktop services and mainframe charges); and
- accrued salaries and wages.

(ii) Accrued expenses are reported in the Balance Sheet as current liabilities.

A3.2.4 **An accrued expense is to be recognised and recorded in the books of an Agency at fair value when goods or services have been received or supplied but have not been invoiced or formally agreed with the supplier.**

(i) While there will be numerous situations where an Agency may raise accrued expenses at the end of the reporting period, it is recommended that Agencies focus on significant expense items. In this regard, an Agency will need to ensure that appropriate processes are in place to properly identify and record accrued expenses that are material individually or in aggregate.

(ii) An Agency should exercise care in ensuring that accrued expenses recognised in the financial statements do not duplicate what has already been raised in accounts payable. Particular attention will therefore need to be made to invoices received close to the end of the reporting period.

(iii) Unlike accounts payable, accrued expenses are recognised exclusive of the amount of Goods and Services Tax (GST) as GST relating to the transaction is recognised at the earlier of arrival of a tax invoice or payment of cash. Additional information and guidance regarding GST policy may be found in Treasury GST Circulars.

(iv) It will often be necessary to estimate the amount or cost of an accrued expense by taking into account past and existing usage and historic information. For example, an Agency is charged $240 per month for each of the 1000 desktop computers it utilises. Assuming that the Agency has not received an invoice for desktop use for the last month and the number of desktop computers has remained static, the estimated monthly accrued expense would be $240,000 (1 month x $240 x 1000 desktop computers).

(v) Although certain liabilities and some accrued expenses can only be measured using a degree of estimation, such obligations would continue to be recognised as liabilities unless a reliable estimate is not possible. Provisions are examples of liabilities of uncertain timing or amount. Treasurer's Directions Section A3.3 provides further instruction and guidance in relation to provisions.

(vi) Examples of how to estimate and account for accrued expenses are provided at Appendix B.

APPENDIX A

ACCOUNTING FOR ACCOUNTS PAYABLE – EXAMPLES

Example 1 – Purchase of Consumable Office Supplies

On 1 June an Agency purchased consumable office supplies for $8,800 (including $800 GST). The supplies are not regarded as inventory. The office supplies and associated invoice was received on 20 June and the payment terms allowed 30 days credit. No liability is raised on 1 June as this only represents a commitment by the Agency. The journal entry to recognise an expense and a liability on 20 June is as follows:

DR	Office Requisites and Stationery Expense	*(Increase in Expenses – Operating Statement)*	$8,000	
DR	GST Owing/Paid	*(Increase in Assets – Balance Sheet)*	$800	
CR	Accounts Payable	*(Increase in Liabilities – Balance Sheet)*		$8,800

On payment, the journal entry would be:

DR	Accounts Payable	*(Decrease in Liabilities – Balance Sheet)*	$8,800	
CR	Cash at Bank	*(Decrease in Assets – Balance Sheet)*		$8,800

Example 2 – Purchase of Services

An Agency hired a consulting firm to conduct a research project. Fees are payable when the work is completed. On 30 April, the project is completed and the Agency received an invoice totalling $55,000 (including $5,000 GST) for services delivered. The journal entry to recognise an expense and a liability on 30 April is as follows:

DR	Consultants Fees Expense	*(Increase in Expenses – Operating Statement)*	$50,000	
DR	GST Owing/Paid	*(Increase in Assets – Balance Sheet)*	$5,000	
CR	Accounts Payable	*(Increase in Liabilities – Balance Sheet)*		$55,000

On payment, the journal entry would be:

DR	Accounts Payable	*(Decrease in Liabilities – Balance Sheet)*	$55,000	
CR	Cash at Bank	*(Decrease in Assets – Balance Sheet)*		$55,000

APPENDIX B

ACCOUNTING FOR ACCRUED EXPENSES – EXAMPLES

Example 1 – Accrued Telephone Expenses

An Agency is billed for telephone usage on the 15th day of each month. The invoice for telephone services for the period from 15 June to 14 July is due on 15 July. At the end of June telephone expenses relating to the period from 15 June to 30 June will need to be estimated and recorded in the accounts as accrued expenses.

Review of previous monthly invoices provides an average monthly bill of $60,000 (excluding GST).

Estimated telephone expense for a month		$60,000
Estimated telephone expense from 15 - 30 June	=	$60,000 x 16 days/30 days
Accrued Telephone Expenses	=	$32,000

On 30 June the following journal entry would be processed:

DR	Telecommunications Expense	*(Increase in Expenses – Operating Statement)*	$32,000	
CR	Accrued Expenses	*(Increase in Liabilities – Balance Sheet)*		$32,000

Where the above journal is not reversed in the next reporting period, the following journal entry would be processed on receipt of an invoice for $44,000 (including $4,000 GST):

DR	Telecommunications Expense	*(Increase in Expenses – Operating Statement)*	$8,000	
DR	GST Owing/Paid	*(Increase in Assets – Balance Sheet)*	$4,000	
DR	Accrued Expenses	*(Decrease in Liabilities – Balance Sheet)*	$32,000	
CR	Accounts Payable	*(Increase in Liabilities – Balance Sheet)*		$44,000

On payment, the journal entry would be:

DR	Accounts Payable	*(Decrease in Liabilities – Balance Sheet)*	$44,000	
CR	Cash at Bank	*(Decrease in Assets – Balance Sheet)*		$44,000

APPENDIX B (continued)

Example 2 – Accrued Electricity Expenses

An Agency has incurred costs for electricity usage prior to 30 June but has not yet received an invoice for these electricity costs. Journal entries are required to recognise an expense and a liability to reflect electricity usage for the period from the last billing date up to reporting date (in this case 30 June). The amount recorded would be an estimate that could be based on prior usage patterns. If the Agency's previous electricity bill for a 3 month period was $30,000 (excluding GST) and 2 months have elapsed since the last bill, the following journal entry would be processed:

DR	Power Expense	*(Increase in Expenses – Operating Statement)*	$20,000	
CR	Accrued Expense	*(Increase in Liabilities – Balance Sheet)*		$20,000

Where the above journal is not reversed in the next period, the following journal entry would be processed on receipt of an invoice for $44,000 (including $4,000 GST) for 3 months of electricity use:

DR	Power Expense	*(Increase in Expenses – Operating Statement)*	$20,000	
DR	GST Owing/Paid	*(Increase in Assets – Balance Sheet)*	$4,000	
DR	Accrued Expense	*(Decrease in Liabilities – Balance Sheet)*	$20,000	
CR	Accounts Payable	*(Increase in Liabilities – Balance Sheet)*		$44,000

On payment, the journal entry would be:

DR	Accounts Payable	*(Decrease in Liabilities – Balance Sheet)*	$44,000	
CR	Cash at Bank	*(Decrease in Assets – Balance Sheet)*		$44,000