Appendix D Transitional Notes

With the implementation of accrual accounting, entities will be required to account for economic events specific to their entities on:

a) an accrual accounting basis and
b) an appropriations basis.

Accrual Accounting

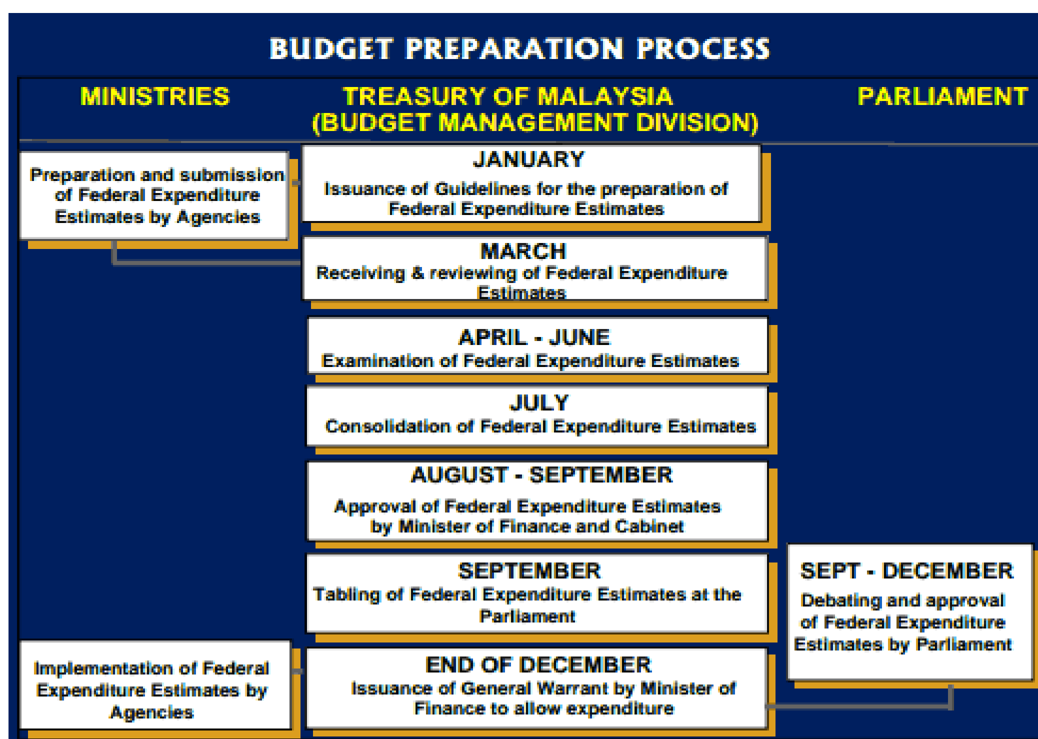
Accrual accounting recognizes transactions when the underlying economic event occurs, not just when cash is received or paid. In accrual accounting, transactions are classified as assets, liabilities, equity, revenues or expenses.

The objective of accrual accounting is to ensure that events that affect an entity's financial statements are recorded in the periods in which they occur, rather than in the periods in which the entity uses its appropriation. Accrual accounting means recognizing revenue when earned (rather than when cash is received) and recognizing expenses when incurred (rather than just when paid). Over the long run, trends in expenses and revenues, since they reflect the underlying economic consequences of operating decisions for a time period are generally more meaningful than trends in payments and cash receipts or charges to an appropriation.

The accrual basis provides users with information about matters such as the resources controlled by the entity, the cost of its operations and other information useful in assessing its financial position and changes in it over a particular time period, and in assessing whether a particular entity is operating economically and/or efficiently.

Accounting for Appropriations

An appropriation is an authority of Parliament to pay money out of the Consolidated Fund. The budget formulation process is as per below:



Appendix D Transitional Notes (continued)

As seen from the above diagram, the ministries will prepare and submit estimation of Federal Expenditure by agencies. The Finance Authority and Cabinet will review and examine the Federal Expenditure estimates. Federal Expenditure estimates that have been approved by the Finance Authority and the Cabinet will be tabled at the Parliament. The Parliament will then debate and approve the Federal Expenditure estimates deemed appropriate. A general warrant will be issued by the Finance Authority to allow expenditure by ministries.

An appropriation is required before funds can be spent by the entities. The expense appropriated must not exceed the approved limits authorized by a Supply Act or authorized by law in accordance with Article 102 of the Federal Constitution. The sums appropriated shall be accounted in the Consolidated Fund.

According to Financial Procedure Act 1957, public trust fund do not require appropriation as no budget was prepared and approval from parliament is not required. Management of public trust funds is governed by a trustee committee.

If in respect of any financial year it is found:

- that the amount appropriated by the Supply Act is insufficient, or that a need has arisen for expenditure for which no amount has been appropriated by the Supply Act; or
- that any moneys have been expended in excess of the amount (if any) appropriated by the Supply Act,

a supplementary estimate showing the sums required or spent shall be laid before the parliament and the purposes of any such expenditure shall be included in a Supply Bill.

Every warrant issued for the service of any financial year shall lapse and cease to have any effect at the close of one calendar month following the financial year. Payment for work performed, goods received, and services rendered or any other contractual arrangement prior to the end of the financial year authorized under the warrant shall be made during the one calendar month following the financial year. The expense should be properly chargeable to the accounts of that year also.

As a general rule, transactions are recorded against an appropriation on ‘cash basis’. However, there are certain expenditures which are not charged to an appropriation until a payment is required e.g. various allowance or provision accounts currently set up by entities such as employee benefit costs for accrued vacation pay, severance pay, etc.

Currently, accounting for the use of appropriations provides the Finance Authority with control over most expenditures of FGOM, for both amount and purpose. However, it does not give a complete financial picture of FGOM since it lacks information on assets and some liabilities and skews information on program costs. For example, if an entity purchases a building, the entity will record the full expenditure against a particular appropriation in the year acquired notwithstanding that the building will provide benefits over a number of years.

The Statement of Budget Performance is prepared in accordance to MPSAS 24 –Presentation of budget information in financial statement, on the appropriations basis with a comparison of the budget and actual amounts, as required by the Federal Constitution. Please refer to Chapter 4 – Presentation of Financial Statement for further illustration.

Appendix D Transitional Notes (continued)

Identifying Key Differences between Accrual Accounting and Accounting for Appropriations

In order to understand the primary differences between accrual accounting and accounting for the use of appropriations, terminology becomes increasingly important. It is necessary to distinguish between certain terms, to ensure that all users are consistent when describing a transaction, preparing a journal entry or providing rationale for various accounting treatments.

Expenditures versus Expenses

Expenditures may be cash outlays for capital assets (capital expenditures) or cash outlays for operating purposes (operating expenditures). A capital expenditure, for example the purchase of a vehicle, generally does not immediately result in an expense, although expenses will follow later as the asset is consumed and depreciation or amortization expenses are accrued. An operating expenditure may follow an expense.

Expenses, as per Accrual Accounting Policies, are defined as 'decreases in economic benefits or service potential during the reporting period in the form of outflows or consumption of assets or incurrence of liabilities that result in decreases in net assets/ equity, other than those relating to distributions to owners.'

To further clarify the difference, expenditure refers to the acquisition of a good or service whereas an expense refers to the use of the good or service acquired. For example, the acquisition cost of a tangible capital asset would be an expenditure and the amortization of the cost of that asset would be an expense in the statement of financial performance for the period. Conceptually, the cost of an asset is deferred and recognized as an amortization expense over the period when the assets are used in delivering government programs.

Revenues versus Receipts

Revenues, from an accrual accounting perspective, are defined as 'the gross inflow of economic benefits or service potential during the reporting period when those inflows result in an increase in net assets/ equity, other than increases relating to contributions from owners.' Revenues should be accounted for in the period in which the transactions or events occurred that gave rise to the revenues. For example, user fees should be recorded in the period the goods or services are provided, sales and excise taxes should be recorded in the period when the sales are made, and transfer payments for shared cost agreements should be recorded in the period the costs are incurred. Items not practicably measured until cash is received would be accounted for at that time. Accounting for all of government's revenues ensures that related financial assets are accounted for in the period they are created.

Revenue earned which is not yet collected in the year would be accounts receivable. Receipts refer to moneys received, whether through cash, cheque or by electronic transfer of funds.