



8.0 ACCOUNTING FOR RECURRENT EXPENDITURE

8.1 Introduction

This chapter covers the following:

- a. Applicable Terms
- b. Applicable Standard
- c. Types of Expenses
- d. Recognition, Measurement and Disclosure

8.2 Applicable Terms

Expenses: is an outflow of cash or other valuable assets from one entity to another. Because expenses are such an important indicator of an entity's operations, there are specific accounting rules on expense recognition.

In migrating from IPSAS cash basis to accrual, due care must be taken in the identification, presentation, measurement and disclosure of relevant recurrent expenditure.

An entity should present, either on the face of the statement of financial performance or in the notes to the statement of financial performance, an analysis of expenses using a classification based on either nature of expenses or their function within the entity, as appropriate.

Recurrent Expenditures: It refers to payment made by Government for all purposes except capital costs. In other words, they are recurring spending on items that are consumed and only last for a limited period of time. For example: wages and salaries, expenditure on consumables, interest payment, drugs.

Transfers (Aid, Grants and Donations)

Government Transfers (Aid, Grants and Donations) are transfers of money from a government to an individual, an organization or another government for which the government making the transfer does not:

- a. receive any goods or services directly in return, as would occur in a purchase/sale transaction;
- b. expect to be repaid in the future, as would be expected in a loan; or
- c. expect a financial return, as would be expected in an investment.

While this definition specifically mentions “transfers of money” it can also be applied to non-cash transfers. The major characteristic of these transfers is that they are non-reciprocal, in the sense that the government does not receive equal value in exchange directly from the transferee.

For the purpose of this Manual Recurrent Expenditures are used interchangeable with Expenses.

Classification of Expenses:

Nature of Expense Method – Under this method, expenses are aggregated in the statement of financial performance according to their nature, and are not reallocated among various functions within the entity. This method is simple to apply in many smaller entities because no allocations of operating expenses between functional classifications are necessary.

Examples:

- a. Salaries & Wages
- b. Allowances & Social Contribution
- c. Social Benefits
- d. Overhead Cost
- e. Grants & Contributions
- f. Subsidies
- g. Depreciation Charges
- h. Amortization Charges
- i. Bad Debts Charges

Functional Method of Expense – It classifies expenses according to the program or purpose for which they were made. This presentation often provides more relevant information to users than the classification of expenses by nature, although the allocation of expenses to functions can be arbitrary and involves considerable judgment.

Examples:

- a. General Public Service
- b. Education
- c. Defence
- d. Public Order and Safety
- e. Economic Affairs

Entities classifying expenses by function should disclose additional information on the nature of expenses, including depreciation and amortization expense, salaries and employee benefits, and finance costs.

8.3 Recognition, Measurement & Disclosure

Recognition

The full accrual basis recognizes expenses when service potential or future economic benefits are consumed or otherwise diminished. For example, the costs of assets that embody future economic benefits or service potential are deferred on acquisition and are allocated to the periods in which they are used. For grants, the recognition criteria would be when the eligibility criteria have been met and the amounts can be estimated reliably.

General Recognition

Transfers

Government transfers should be recognized in financial statements as expenditures in the period that the events giving rise to the transfer occurred, as long as:

- a. The transfer is authorized;
- b. Eligibility criteria, if any, have been met by the recipient; and
- c. A reasonable estimate of the amount can be made.

Types of Transfers

- a. Entitlements
- b. Transfers under Shared Cost Agreements
- c. Grants

Entitlements

Entitlements are defined as “transfers that a government must make if the recipient meets specified eligibility criteria. Such transfers are non-discretionary in the sense that both:

- a. “who” is eligible to receive the transfer; and
- b. “how much” is transferred

Transfers under Shared Cost Agreements

Transfers under shared cost agreements are defined as reimbursement of eligible expenditures pursuant to an agreement between the transferring government and the recipient.

Recognition criteria for Shared Cost Agreements

Transfers under shared cost agreements should be recognized when the recipient incurs eligible expenditures because, under the agreement, the entity must reimburse the recipient for the specified percentage of those eligible expenditures.

Liabilities should be recognized by the transferring entity at the end of the accounting period for the estimated, unpaid portion of incurred eligible expenditures owed to recipients pursuant to a shared cost agreement.

Grants

Grants are “transfers that are made at the discretion of an entity.

The entity making the transfer has discretion in deciding whether or not to make a transfer, the conditions to be complied with, if any, how much will be transferred and to whom.

Grants include such transfers as: cultural grants, scholarships, research grants and regional development grants. In most cases, recipients have to apply for the money or meet some eligibility criteria; however, in contrast to entitlements, applying or meeting eligibility criteria does not guarantee that the recipient will receive the money.

The entity still has discretion to decide whether or not to make the transfer.

As long as the grant is discretionary, the entity has no obligation and therefore no expense is incurred in the financial statements at the time the application is made.

Recognition Criteria for Grants

Liabilities should be recognized by the transferring entity for any unpaid, authorized grants at the end of the accounting period for which recipients have met eligibility criteria, if any, prior to the end of that period.

Tax Expenditures

Governments use the tax system to meet their economic, social or other goals in two different ways:

- a. As a primary vehicle to raise revenue; and
- b. As a way of giving particular incentives or promoting particular behaviour among taxpayers.

In some situations, for example, an entity gives tax exemptions to provide incentives to invest in particular areas. They also commonly utilize measures other than exemptions, such as allowances, tax rate reductions, tax credits or tax exempt status. These measures are referred to as tax expenditures

because they reduce the tax bills of those who receive them and are therefore analogous to subsidies, which involve direct expenditures.

Employee Benefits

These are treated under Accounting for Employee Benefits (Chapter 9)

Borrowing Costs

Borrowing Costs are interest and other expenses incurred by an entity in connection with the borrowing of funds. Recognition, Measurement and Disclosure of Borrowing Costs can be seen in details in Chapter 10.