TR Circular No 3/2003

The Treasury Dept.
The Mall,
Floriana

5th March 2003

To : Directors of Corporate Services,
Directors of Finance and Administration,
Directors, and other Accounting Officers

GOVERNMENT ACCRUAL ACCOUNTING:
PROCEDURES FOR THE MANAGEMENT OF PREPAYMENTS, ACCRUALS AND CAPITAL COMMITMENTS

In line with Government policy regarding the introduction of Accrual Accounting, Treasury is committed to ensure that the implementation process of the accounting methodology is gradually rolled out in accordance with the government financial strategic objectives as defined by the Ministry of Finance.

The circular on fixed asset management (inventory) issued in November 1999 (MF 14/99) and that relating to Debtors and Creditors issued in October 2001 (MF 10/2001) by the Permanent Secretary, Ministry of Finance were the first of a serious of changes forming part of the Accrual Accounting Programme.

The procedures herein represent another step in the direction of the change that shall bring about much more meaningful information for decision-making, understanding of government financial position and also better long-term financial planning which is necessary today and for the foreseeable challenges ahead.

The main purpose of these procedures is to enable Ministries and Departments to manage and maintain appropriate control of the Prepayments, Accruals and Capital Commitments which have a direct bearing on the financial budgets as much as on the Cash Flow projections undertaken by all.

These procedures are in many ways also an extension to the last circular of Debtors and Creditors Control wherein reference was made to Accruals and Prepayments. Indeed, these procedures should enable a better understanding and demarcation of each category as distinct from Debtors and Creditors.

With regards to Capital Commitments, these are necessary as a step towards the identification of fixed asset commitments and multi-year financial and budgetary planning.

Furthermore, the procedures are intended as guidelines to:

- Standardise the categories of expenditure and revenue as detailed in the Malta Government Accounting Standards (MGAS) launched in 2002. (MGAS's may be found at www. gov.mt under Accrual Accounting in Government)
- Facilitate the working procedures for all in maintaining record of Prepayments, Accruals and Capital Commitments
- Facilitate the process of information gathering necessary for the preparation of departmental, Ministry and Government-wide financial and management reporting

The exercise contemplated in the attached procedures and guidelines, leading to the Notification requested in section 4, needs to be completed on a quarterly basis. The first submission shall be for period ending March 2003. All submissions are to be made both as a hard and a soft copy. Soft copies are to be sent, to the Treasury Department, through any of the following e-mail accounts:

Internet Account:	Accrual.Accounting@gov.mt	OR
Team-ware E-mail A/C:	Accrual Accounting at MOF	

To enable the understanding of these procedures by all those who are, or will be, engaged in their implementation, a series of Information Sessions will be carried out in conjunction with the Ministry of Finance in the coming weeks.

For this purpose you are kindly requested to respond to requests made by the Ministry of Finance for the nomination of responsible officials within your Ministry or Department.

Finally, I would like to stress the need for the full support and commitment from all directors responsible, particularly, Directors of Corporate Services and Directors of Finance and Administration, who are directly responsible to ensure that these procedures are implemented effectively and submissions are forthcoming on time.

Noel Camilleri
Accountant General

PREPAYMENTS, ACCRUALS AND CAPITAL COMMITMENTS

1. Definitions

1.1 Prepayments (Prepaid Expenditure)

Prepayments are payments in advance, made for goods and/or services still to be delivered and/or rendered at the end of the financial period[1]. They must not be charged to the statement of financial performance[2] since they do not relate to the revenue earned in the period.

1.2 Accruals (Accrued Expenditure)

These relate to costs for goods and services used in a particular period for which no invoice or bill is received by the end of a financial period[1]. The charge to the statement of financial performance[2] must always be the expenditure incurred for the period, not just the invoices received. The amount of accruals at the end of the financial period[1] is to be included with the expenses for the financial year. However the amount of accruals is not included in the creditors' ledger since to become a creditor, the department must receive a bill or invoice.

1.3 Deferred income

Deferred income is that proportion of money received or receivable which relates to goods and services to be supplied after the end of the accounting period. Deferred income arises irrespective of whether an invoice, bill or notice for payment is issued or not, and irrespective of whether money is received or not.

1.4 Accrued income

Accrued income refers to income due to the department for goods provided/services rendered during the financial period[1] for which no bill, invoice or notice for payment is issued by the department by the end of the financial period[1]. This amount is not included with the debtors' figure since to become a debtor, the department must issue a bill, invoice or notice for payment.

1.5 Capital Commitments

A capital commitment is a foreseeable fixed asset expenditure that, at reporting date,:

a) has been ordered or contracted for but has not yet been delivered, or

b) has been authorised by the responsible authority but has not yet been ordered or contracted.

[1] Government financial period is equal to a calendar year i.e. January to December
[2] Statement of financial performance is equivalent to Income and Expenditure account or Profit and Loss account

1.6 Prudence principle

In applying these concepts, consideration must be given, in particular, to the prudence principle. Prudence means that one must take into the statement of financial performance[2] potential losses, but one cannot take potential gains. Consequently in case of uncertainty, departments must not underestimate expenditure and/or overestimate revenue.

2. Management of prepayments, accruals and capital commitments

2.1 Valuation (Annex 1)

2.1.1 Prepayments, accruals, deferred income and accrued income are to be consistently measured at a realistic and prudent estimate in accordance to the following guidelines:

- Prepayments are to be calculated on the last invoice paid
- Accruals are to be calculated on the last invoice received or any other relevant documentation available
- Deferred income is to be calculated on the last receipt issued
- Accrued income is to be calculated on the amount outstanding

2.1.2 When a foreseeable fixed asset expenditure has been ordered or contracted for but has not yet been delivered, the value of capital commitment to be taken, is that shown on the Local Purchase Order or Letter of Acceptance. On the other hand, when the fixed asset expenditure has been authorised but has not yet been ordered or contracted, a realistic estimate in accordance to current market valuations is to be taken. This may be done through a quotation or a tendering process.

Under all circumstances recognition is to be made to other factors which may influence such valuations.

2.2 Treatment of multiple scenarios and procedures (Annex 2 & 3)

2.2.1 Prepayments (Annex 2 - A)

Prepayments must include recurrent expenditure on goods and/or services that until the end of a financial period[1] have been;

a) invoiced and paid but not received, and

b) payments in advance not invoiced and not received.

The above instances include advance payments, deposits for future services or products and prepaid contractual services.

2.2.2 Accruals (Annex 2 - B)

Recurrent expenditure on goods and/or services that have been received and consumed but which have not been invoiced till the end of a financial period[1], is to be included with accruals.

2.2.3 Deferred Income (Annex 3 - A)

According to Malta Government Accounting Standard 9 (MGAS 9), revenue earned from the rendering of services, sale of goods, interest, royalties and dividends is to be accounted for on the accrual basis.

In addition according to MGAS 18, revenue receivable from final withholding tax, duties, levies and excises on imported goods, licenses, registration and permit fees is to be classified as revenue when payment becomes due.

Therefore only payments received in advance from the above two types of revenue (Category A) are to be included with deferred income.

2.2.4 Accrued Income (Annex 3 – A & B)

MGAS 18 also states that revenue receivable from provisional tax, capital gains, settlement tax, income tax, social security contributions and value added tax payments due by taxpayers is to be classified as revenue when the payment becomes due or when the money is received, whichever is the earlier.

Accrued income is to consist of revenue generated during a financial period[1] from these types of revenue (Category B) and from Category A (para. 2.2.3) for which;

a) no bill, invoice or notice for payment was issued, and

b) no payment was received till end of period.

2.2.5 Capital Commitments (Annex 2 – E)

Foreseeable fixed asset expenditure prior to delivery stage that has been authorised by the responsible authority but has not yet been ordered or contracted is to be reported as a capital commitment.

2.2.6 Other types of expenditure (Annex 2)

Other categories of expenditure, as outlined in Annex 2C and 2D, do not require any disclosure as regards this circular. However, these have been outlined as they have an impact on the disclosure of creditors and inventory.

2.2.7 Other types of revenue (Annex 3)

Revenue falling under Category C as specified in Annex 3 do not require any disclosure as regards this circular.

3. Notification to Accountant General

A quarterly analysis of prepayments, accruals, deferred income, accrued income and capital commitments is to be submitted to the Accountant General both electronically and as a printed document, using attached Excel templates (Annex 4) provided by this Office, within ten working days of the following month of each quarter. For instance, Quarter 1 within the first ten working days of April.

4. Responsibilities

4.1 Responsibility of Heads of Department

The Heads of Departments are to ensure that:

(a) A suitable officer within the Department is responsible for calculating the amount of prepayments, accruals, deferred income and accrued income and for estimating the amount of capital commitments.

(b) The Accountant General is to be notified on his request of all prepayments, accruals, deferred income, accrued income and capital commitments belonging to each department.

(c) In the absence of a head of department or his acting, the next highest Officer in the Department is to assume the responsibilities as defined under this section.

4.2 Responsibility of Directors Corporate Services and Directors Finance & Administration

The Directors Corporate Services and the Directors Finance & Administration have the responsibility to ensure that all Heads of Department falling under the responsibility of their respective Ministry comply with the procedures as stipulated in this circular. It is their responsibility to ensure that the information regarding prepayments, accruals, deferred income, accrued income and capital commitments is to be furnished as defined in this circular within the stipulated time frame.

4.3 Responsibility of Accountant General

The Accountant General is to ensure that Heads of Departments including Directors Corporate Services and Directors Finance & Administration comply with these procedures, and that information regarding prepayments, accruals, deferred income, accrued income and capital commitments is received in a timely manner.

Annex 1

<u>Clarification by examples</u>

Assuming that the financial period[1] ends on 31 December 2001

<u>1. Prepayments</u>

A department has paid insurance premiums as follows:

01 January 2001, Lm 420 for period of three months to 31 March 2001.

01 April 2001, Lm 840 for period of six months to 30 September 2001.

01 October 2001, Lm 840 for period of six months to 31 March 2002.

The October payment of Lm 840 covers period October 2001 to March 2002. The amount to be accounted for in the statement of financial performance[1] relates to the number of months falling within the financial period[1] i.e., three months. For a period of 12 months the cost of insurance is Lm 1,680, representing the figure to be shown in the statement of financial performance[2]. As at 31 December 2001 the prepaid amount will be Lm 420, being the amount paid in advance for the period 1 January to 31 March 2002.

<u>2. Accruals</u>

A department is being charged rent at the rate of Lm 2,000 per year. It is payable at the end of each quarter of the year for the three months' tenancy that has just expired. The tenancy commenced on 1 January 2001. The rent was paid for 2001 on 31 March, 3 July and 2 October and on 4 January 2002.

During the year ended 31 December 2001 the rent expense account will show a figure of Lm 1,500. Therefore the rent expense figure of Lm1,500 must be increased by Lm 500 accrued expense to represent the annual chargeable rent. This is the amount to be shown in the statement of financial performance[2]. The Lm 500 represents the accrued rent for the period 1 October to 31 December 2001.

<u>3. Deferred Income</u>

A department's warehouse is larger than is required. Part of it is rented to a third party for Lm 400 per annum. For the year ended 31 December 2001 the department received the following cheques:

2 January 2001, for three months to 31 March 2001	Lm 100
3 April 2001, for three months to 30 June 2001	Lm 100
30 June 2001, for three months to 30 September 2001	Lm 100
5 October 2001, for three months to 31 December 2001	Lm 100
29 December 2001, for three months to 31 March 2002	Lm 100

The amount of rent receivable to be shown in the statement of financial performance[2] for 2001 is that earned for the twelve months, i.e. Lm 400. Therefore the rent receivable account, showing a figure of

Lm 500, must be debited with a balance carried forward to the following year amounting to Lm 100 payment received in advance, for the period 1 January to 31 March 2002 (deferred income).

<u>4. Accrued Income</u>

On 1 January 2001 a department deposited Lm 10,000 in a bank account that earns 5% simple interest every six months on 31 March and 30 September. The interest received in 2001 was as follows:

31 March 2001,	Lm 125
30 September 2001,	Lm 250

The interest earned in the three months to 31 December 2001 was received on 31 March 2002. The interest receivable account showed a credit figure of Lm 375 while the interest actually earned in 2001 amounted to Lm 500. Therefore the accrued income that is to be added to the interest received amount as at 31 December 2001 amounted to Lm 125, representing interest for the period 1 October to 31 December 2001 not yet received.

<u>5. Capital Commitment</u>

A department has issued a tender document for the purchase of new premises and office furniture. As at the end of the financial period[1] the tender was not adjudicated. From the tender documents submitted it transpired that the cost of the new premises and new office furniture would be in the region of Lm 70,000. In this case the department would have a capital commitment of Lm 70,000 (authorised but not yet ordered) as at the end of the financial period[1] which is to be specified and declared in the quarterly submission. If the tender had been adjudicated but the goods were not yet delivered by the end of the financial period[1], the department would have a capital commitment of Lm 70,000 (contracted but not yet delivered).

Expenditure Categories & Disclosure **Annex 2**

	Purchase Type & Status at End of Financial Period[1]					Reporting Requirements				
	Type of exp.	**Stage**	**Received**	**Invoiced**	**Payment**	**Creditor**	**Prepaid expenditure**	**Accrued expenditure**	**Capital commitment**	**Inventory (Fixed Asset)**
A	Recurrent	Payment made	*no*	*yes*	*yes*		**3**			
	Recurrent	Payment made	*no*	*no*	*yes*		**3**			
B	Recurrent	Goods Received	*yes*	*no*	*no*			**3**		
C	Both*	Invoice Received	*yes*	*yes*	*no*	**3**				
	Fixed Asset	Goods Received	*yes*	*no*	*no*	**3**				**3**
D	Fixed Asset	Payment made	*yes*	*yes*	*yes*					**3**
E	Fixed Asset	LPO / LA	*no*	*no*	*no*				**3**	

Note - A fixed asset expenditure is the purchase of non-trading business assets that have a useful life that is not normally less than 3 years and its cost is not less than Lm 50 as per Ministry of Finance circular 14/99.

* Recurrent and fixed asset expenditure.

Revenue Categories & Disclosure

Revenue Category	Revenue Status at End of Financial Period[1]			Reporting Requirements			No Reporting is needed
	Due in Fin. Period	Invoice/bill Issued	Payment Received	Deferred Income	Accrued Income	Debtors	
A	*no*	*no*	*yes*	3			
	no	*yes*	*yes*	3			
	yes	*no*	*no*		3		
	yes	*yes*	*no*			3	
	yes	*yes*	*yes*				3
	no	*no*	*no*				3
	yes	*no*	*yes*				3
B	*yes*	*no*	*no*		3		
	yes	*yes*	*no*			3	
	yes	*yes*	*yes*				3
	no	*no*	*yes*				3
	no	*yes*	*yes*				3
	no	*no*	*no*				3
	yes	*no*	*yes*				3
C	*yes*	*yes*	*yes*				3
	yes	*no*	*no*				3
	yes	*yes*	*no*				3
	no	*no*	*yes*				3
	no	*yes*	*yes*				3
	no	*no*	*no*				3
	yes	*no*	*yes*				3

Revenue receivable from the rendering of services, sale of goods, interest, royalties and dividends should be classified as revenue on an accruals basis. Final withholding tax, duties, levies and excises on imported goods, licenses, registration and permit fees should be classified as revenue when it becomes due.
MGAS 9 & MGAS 18 Par.49, 55, 60

Revenue receivable from provisional tax, capital gains, settlement tax, income tax, social security contributions and value added tax payments due by taxpayers should be classified as revenue when the payment becomes due or when the money is received, whichever is the earlier.
MGAS 18 Par. 43, 45, 47, 53, 57

Other sources of revenue such as fines, stamp duty, interest on overdue amounts due to Government in respect of non-exchange transactions and other fees should be classified as revenue when payment is received.
MGAS 18 Par.62

Category A

Final withholding tax
Duties
Levies
Excises
Licenses
Registration fees
Permit fees
Rendering of services
Sale of goods
Interest receivable on
government-owned assets
Royalties
Dividends

Category B

Provisional tax
Capital gains tax
Settlement tax
Income tax
Soc. sec. contributions
Value added tax

Category C

Other revenue such as:
Fines
Stamp duty
Interest receivable on
overdue amounts
due to the entity

Annex 4

Tables

Table 1: Analysis of Prepayments

Prepayments (Prepaid Expenditure)

Department | **Quarter Ending Month**

(refer to **Annex 2 A)**

Description	Amount Prepaid Lm
Personal Emoluments	
Utilities	
Materials & Supplies	
Repairs & Upkeep	
Rent payable	
International memberships	
Office Services	
Transport	
Travel	
Information Services	
Contractual Services	
Professional Services	
Training	
Hospitality	
Incidental Expenses	
Special Expenditure	
Programmes and Iniatives	
Contributions to Government	
Capital Projects	
Below-the-line	
Other expenditure	
Total Prepaid Expenses	

Note - Fixed assets related expenditure must not be included with the above.

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Table 2: Analysis of Accruals

Accruals (Accrued Expenditure)

Department | **Quarter Ending Month**

(refer to **Annex 2 B)**

Description	Amount Accrued Lm
Personal Emoluments	
Utilities	
Materials & Supplies	
Repairs & Upkeep	
Rent payable	
International memberships	
Office Services	
Transport	
Travel	
Information Services	
Contractual Services	
Professional Services	
Training	
Hospitality	
Incidental Expenses	
Special Expenditure	
Programmes and Iniatives	
Contributions to Government	
Capital Projects	
Below-the-line	
Other expenditure	
Total Accrued Expenses	

Note - Fixed assets related expenditure must not be included with the above.

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Table 3: Analysis of Deferred Income

Deferred Income

Department | **Quarter Ending Month**

Description *(Applicable to Revenue Category A only - refer to Annex 3)*	**Amount Deferred Lm**
Taxes (0101 - 0191)	
Licences & Fees (0201 - 0269)	
Fees of Offices (0301 - 0349)	
Receipts from goods & services (0401 - 0499)	
Receipts from activities (0501 - 0525)	
Rent receivable (0611 - 0618)	
Interest & Dividends received (0601, 0621 - 0639, 0681 - 0696, 0904)	
Revenue from Below-the-line accounts	
Other revenue	
Total Deferred Income	

Note - Numbers in brackets refer to account numbers as per chart of accounts

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The following are the types of revenue falling under Category A:
Final withholding tax
Duties
Levies
Excises
Licences
Registration fees
Permit fees
Rendering of services
Sale of goods
Interest receivable on government-owned assets
Royalties
Dividends

Other revenue categories are not subject to deferred income

Table 4: Analysis of Accrued Income

Accrued Income

Department | **Quarter Ending Month**

Description *(Applicable to Revenue Category A & B only - refer to Annex 3)*	**Amount Accrued Lm**
Taxes (0101 - 0191)	
Licences & Fees (0201 - 0269)	
Fees of Offices (0301 - 0349)	
Receipts from goods & services (0401 - 0499)	
Receipts from activities (0501 - 0525)	
Rent receivable (0611 - 0618)	
Interest & Dividends received (0601, 0621 - 0639, 0681 - 0696, 0904)	
Revenue from Below-the-line accounts	
Other revenue	
Total Accrued Income	

Note - Numbers in brackets refer to account numbers as per chart of accounts

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The following are the types of revenue falling under Category A and B:

Final withholding tax
Duties
Levies
Excises
Licences
Registration fees
Permit fees
Rendering of services
Sale of goods
Interest receivable on government-owned assets
Royalties
Dividends

Provisional tax
Capital gains tax
Settlement tax
Income tax
Social security contributions
Value added tax

Other revenue categories are not subject to accrued income

Table 5: Analysis of Capital Commitments

Capital Commitments*1

Department

Quarter Ending Month

Account / Project Code	Narration / Description of Foreseeable Fixed Asset Expenditure	Category (1 - 9)*2	Ordered (O) / Authorised (A)	Value Lm	Year of Realisation
	Total Capital Commitments				

*1 A capital commitment is a foreseeable fixed asset expenditure, which could arise either from recurrent and/or capital accounts, that at reporting date it
a) has been ordered or contracted for but has not yet been delivered, or
b) has been authorised by the responsible authority but has not yet been ordered or contracted.
*2 Categories (1-9) are the main fixed asset categories as outlined in circular MOF 14/99.

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