

This accounting policy paper is based on IPSAS 1 Presentation of Financial Statements and the Conceptual Framework for General Purpose Reporting by Public Sector Entities, as adopted by the Treasury of the Republic of Cyprus.

Expenses from Exchange Transactions

IPSAS Project Team; Despina Stavrou
(by Despina Stavrou)
The Treasury of the Republic of Cyprus

Date: 15 January 2018

TABLE OF CONTENTS

1. INTRODUCTION.....	2
1.1 Expenses	2
1.2 Objectives.....	2
1.3 Scope.....	2
1.4 Definitions.....	4
1.5 Types of Expenses	5
2. RECOGNITION.....	6
3. MEASUREMENT	8
4. CUT-OFF PROCEDURES.....	9
4.1 Accrued Expenses.....	10
4.2 Deferred Expenses / Prepayments.....	10
5. DISCLOSURES	11
6. TRANSITIONAL PROVISIONS.....	11
7. EFFECTIVE DATE.....	11
8. REFERENCES	11
9. APPENDIX	12

1. INTRODUCTION

1.1 EXPENSES

Expense¹ is decreases in the net financial position of the entity, other than decreases arising from ownership distributions.

Expense arise from exchange and non-exchange transactions, other events such as unrealized increases and decreases in the value of assets and liabilities, and the consumption of assets through depreciation and erosion of service potential and ability to generate economic benefits through impairments. Expense may arise from individual transactions or groups of transactions.

An analysis of expenses classified by nature is provided on the face of the Statement of Financial Performance (as per Accounting Policy on Presentation of Financial Statements).

1.2 OBJECTIVES

The objective of this accounting policy is to propose the accounting treatment and disclosure of expenses arising from exchange transactions, giving further guidance regarding their cut-off points at the end of the reporting period. The aim of this policy is to provide technical accounting guidance for the preparation of financial statements regarding *expenses from exchange transactions*, so as to enable the financial statements to give a true and fair view of the financial performance and financial position of the entity. The aforementioned policy is prepared following guidance from all relevant International Public Sector Accounting Standards (IPSASs).

1.3 SCOPE

This accounting policy applies to the accounting treatment of all expenses in the financial statements of the government of the Republic of Cyprus and its consolidated entities. However, where specific types/categories of expenses are dealt with directly in another standard, the rules indicated in that specific standard shall apply (e.g. for the depreciation

¹ *Definition of Expense as per the “Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities”.*

expense of PPE see Accounting Policy for Property, Plant and Equipment, for inventory see Accounting Policy for Inventories, for employee benefits see Accounting Policy for Employee Benefits etc).

1.4 DEFINITIONS

Accrual basis – a basis of accounting under which transactions and other events are recognised when they occur (and not only when cash or its equivalent is received or paid). Therefore, the transactions and events are recorded in the accounting records and recognised in the financial statements of the periods to which they relate. The elements recognised under accrual accounting are assets, liabilities, net assets/equity, revenue, and expenses.

Deferred outflow is an outflow of service potential or economic benefit provided to another entity or party to use in a specified future reporting period that results from a non-exchange transaction and decreases net assets.

Expense is decreases in the net financial position of the entity, other than decreases arising from ownership distributions.

Exchange transactions are transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value to another entity in exchange.

Fair value - the amount for which an asset could be exchanged, or a liability settled, between knowledgeable willing parties in an arm's length transaction.

A **liability** is a present obligation of the entity for an outflow of resources that results from a past event.

Material - omissions or misstatements of items are material if they could, individually or collectively, influence the decisions or assessments of users made on the basis of the financial statements. Materiality depends on the nature and size of the omission or misstatement judged in the surrounding circumstances. The nature or size of the item, or a combination of both, could be the determining factor.

Non-exchange transactions – Transactions that are not exchange transactions. In a non-exchange transaction, an entity either receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange.

Reporting date - the date of the last day of the reporting period to which the financial statements relate.

1.5 TYPES OF EXPENSES

Public sector entities may incur expenses from exchange and non-exchange transactions.

Exchange transactions:

Transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value to another entity in exchange.

Non-exchange transactions:

Transactions in which an entity receives value from another entity without directly giving approximately equal value in exchange.

Examples of expenses from exchange transactions (exchange expenses) the public sector entities may report include, but are not limited to, the following:

- cost of services (e.g. consulting)
- cost of goods
- travel expenses
- repairs and maintenance
- overheads/indirect costs
- interest expense/borrowing costs
- general operating and other direct costs

Besides exchange expenses, public sector entities incur expenses from non-exchange transactions (non-exchange expenses), such as social benefits, grants to other public sector entities (grants to municipalities, universities), grants to individuals, grants to non-public sector entities. Social Benefits and Grants and Other Transfer payments are dealt with in other accounting policies.

In distinguishing between exchange and non-exchange transactions, the substance rather than the form of the transaction should be considered.

2. RECOGNITION

Expenses are recognised when a decrease in future economic benefits or service potential related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably. This means, in effect, that recognition of expenses occurs simultaneously with the recognition of an increase in liabilities or a decrease in assets.

1. Under IPSASs, no specific standard prescribes the accounting and disclosure of expenses. The accounting for this area arises from the fundamental principle of accrual basis accounting. As per IPSAS 1 (Presentation of Financial Statements), under the accrual basis, expenses are recognised when the transaction or event causing the expense occurs. The recognition of the expense is therefore not linked to when cash or its equivalent is received or paid, budgetary commitment is raised or invoice is received. An expense can result from a transaction that does not have to involve an outflow of cash. So under this basis of accounting, the transactions and other events are recognised in the financial statements of the periods to which they relate.
2. Expenses are recognised in line with the overreaching principles of accrual basis accounting, and according to the specific requirements of individual IPSAS standards.
3. Expenses from exchange transactions arising from the purchase of goods and services are recognised when the supplies/services are **delivered and accepted** by the entity. Furthermore, at the reporting date expenses related to the service delivered during the period for which an invoice has not yet been received or accepted shall be estimated based on supporting evidence and recognised in the statement of financial performance.
4. An entity may incur an expense for a period before any invoice is received. Since the service/good has been delivered, a corresponding liability (an accrual) and an expense should be recognised. Conversely, an entity may pay in advance for a service/good, long before delivery is made. In these cases, a prepayment shall be recognised as an asset in the statement of financial position, and the expense *shall* not be recognised until delivery is received and accepted.

5. Expenses such as overheads, cost of goods/services, employee benefits and depreciation result in the consumption of assets (e.g. cash, inventory and property, plant and equipment), or the increase in a liability (e.g. a payables account). Expenses also result if a liability is recognised for a provision, or when the value of an asset is reduced due to impairment (as per Accounting Policies “Provisions, Contingent Assets and Contingent Liabilities” and “Impairment of Assets”).
6. Where expense recognition is linked to the increase in a liability, the criteria for recognition of a liability are relevant. A key issue with respect to this is whether or not a present obligation exists due to a past event (as per Accounting Policy “Provisions, Contingent Assets and Contingent Liabilities”).
7. In certain situations, a key issue shall be whether goods received should be capitalized and an asset recognised or whether an expense should be recognised instead. In those situations, the definition and recognition criteria for assets are relevant, since expense recognition will result if those criteria are not met and an asset is not recognised. Finally, some situations may result in the recognition of an expense because an asset already in existence has decreased in value. For example, this is relevant to depreciation of PPE, amortization of intangible assets and impairment of assets (see relevant Accounting Policies for Property Plant and Equipment, Intangible Assets etc).

3. MEASUREMENT

Expenses shall be measured at the fair value of the consideration paid, or payable, taking into account for example the amount of any trade discounts and volume rebates granted to the public-sector entity.

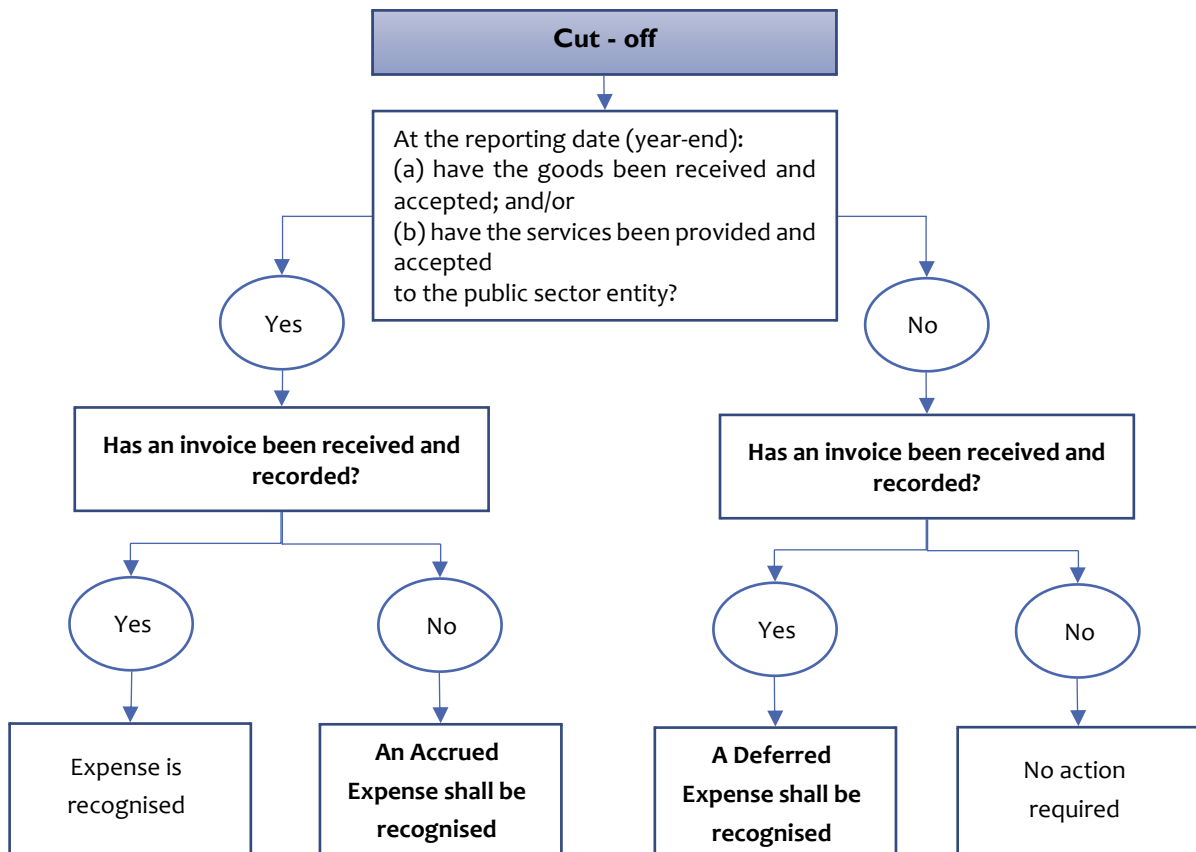
Generally, the fair value of the consideration paid, or payable, corresponds to the amount of the invoice.

When an agreement/contract exists between the supplier and the entity, the expense amount incurred on a transaction may indicate the fair value of the consideration paid or payable.

Where the payment of the expense is deferred, the fair value of the consideration is less than the nominal amount of cash payable. In this case the nominal amount shall be used, since the impact of discounting is considered immaterial.

4. CUT-OFF PROCEDURES

Transactions and events shall be recorded in the accounting records and recognised in the financial statements of the periods to which they relate.



At year-end, if no invoice has been received but the service has been performed or the supplies delivered, the amount to be recognised shall be estimated reliably. This estimate shall be based on different supporting information, such as the approved budget dedicated to the project, the purchase order, the stage of completion of the service, the contract/aggreement between the supplier and the entity, the invoice received after the year-end, etc (see paragraph 4.1).

Similarly, if at the end of the year the invoice has been received and recorded in the accounting records of the entity but the service has not been performed or the goods have not been delivered, a deferred expense shall be recognised (see paragraph 4.2).

4.1 ACCRUED EXPENSES

Accrued expenses are expenses that have been incurred but not yet paid. Examples of expenses that are commonly accrued include interest on borrowings for which no payment has yet been made and services received for which no supplier invoice has yet been received.

Under accrual-based accounting, accrued expenses must be recognised in the accounting period in which they are incurred rather than in following period(s) in which they are paid.

4.2 DEFERRED EXPENSES / PREPAYMENTS

Deferred expenses/prepayments are expenses that are paid in advance but have not yet been incurred. Examples of deferred expenses include insurance premiums paid before the start of the insured period, and rent paid in advance.

Expenses must be recorded in the accounting period in which they relate. Therefore, deferred expenses/ prepayments shall not be shown as expenses in the accounting period in which they are paid. They shall be recognised as expenses in subsequent accounting period(s), when the services relating to the prepaid expense have been performed.

(see illustrative examples, Appendix)

5. DISCLOSURES

Public sector entities shall disclose:

- The accounting policies adopted for the recognition of expenses
- On the face of the statement of financial performance an analysis of expenses using a classification based on the nature of expenses. Further detail of expenses may be included within the notes to the financial statements, including specific disclosure requirements of individual accounting policies. Expenses shall be reported separately and shall not be offset, unless required or permitted by an accounting policy.

6. TRANSITIONAL PROVISIONS

No transitional exemptions are provided for the adoption of this Accounting Policy.

7. EFFECTIVE DATE

The rules mentioned above shall be effective for annual financial statements covering periods beginning on or after 1 January 2023.

8. REFERENCES

This accounting policy is based on the following:

IPSAS 1 Presentation of Financial Statements

IPSAS 33 First-Time Adoption of Accrual Basis IPSASs

The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities

9. APPENDIX

Illustrative examples – Exchange Transactions: Measurement / Cut - Off

1. Purchase of goods/services

On 24/12/20X0, *goods/services have been delivered and the invoice has been received* from the supplier. Since the expense has been incurred in the reporting period, the invoice must be recognised in the Statement of Financial Performance for year 20X0. No accrued expense or prepayment is recognised in this example.

2. Purchase of a service that has not been invoiced before the year-end:

At 31/12/20X0 *a service has been delivered but no invoice has yet been received*. This is an accrued expense since it has been incurred within the reporting period. The expense must be recognised in the Statement of Financial Performance for year 20X0, with the corresponding Payable recognised on the liabilities side of the Statement of Financial Position.

3. Purchase of goods (not PPE or inventory):

This example is very rare in practice, since it assumes that the entity accepted the invoice even though the goods had not been delivered before the year-end.

On 24/12/20X0, *an invoice is received* from a supplier and recorded in a creditors' account on the liabilities side of the Statement of Financial Position. On 31/12/20X0 the *goods have not yet been delivered* and therefore the invoice must not be recognised as an expense in the Statement of Financial Performance for year 20X0. Instead, it will be recognised as an expense in the subsequent accounting period (20X1), when the goods will be delivered and accepted.

For the year 20X0, this amount must be treated as a **deferred expense** and it must be included in a Prepayments account in the assets side of the Statement of Financial Position.

4. Rent expense - correct allocation between the reporting periods

In October 20X0 the entity *receives a rent invoice for the following three months* (November 20X0 to January 20X1). The invoice is recorded in year 20X0, however a part of it represents an expense that relates to the year 20X1. By 31 December 20X0 the entity has obviously benefited from only two months' rent in year 20X0. So only the rent for November and December should be recognised in the Statement of Financial Performance of year 20X0. The **rent for January 20X1** must be included as an asset (under **Prepayments**) in the Statement of Financial Position for year 20X0.