



SUBJECT: ACCRUAL ACCOUNTING

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1-10-00 PURPOSE AND APPLICABILITY

- A. An effective accrual accounting system involves more than the accrual of costs and expenditures and the production of periodic statements of financial condition. Properly structured, the accounts should produce current information consistent with budget and PPBS classifications. If these classifications are not consistent with an agency's organizational structure, the periodic or cumulative costs and expenditures systematically accrued in accounts by organizational components can be distributed by statistical techniques or other acceptable methods to the classifications as needed for analysis and budget purposes.
- B. This chapter provides a general definition and guidance in the application of accrual accounting within the Department. Further guidance is provided in subsequent chapters of this manual devoted to specific areas of accounting. Accrual operating procedures appear in Chapter 3-60.
- C. To prescribe a standard application of accrual accounting to fit the varied needs of all organizations within the Department is not feasible. Applicable systems must be designed to fit the circumstances and requirements of each organization or a component thereof. Since a major objective of accrual accounting is to provide management officials with essential and reliable information for use in achieving efficient and economical operations, management's advice and cooperation must be obtained in establishing the accounting structure and internal reporting system.
- D. The policies and procedures defined and explained herein will apply to all agencies within the Department and to all affiliated Government organizations supported by the Department. Agencies and other HHS affiliated organizations will implement the instructions contained herein which are applicable to their operations. Any significant deviations from the policies or accrual

accounting procedures prescribed in this manual will be cleared in advance with the Deputy Assistant Secretary, Finance.

1-10-10 POLICY

- A. In the area of grants and contracts with non-profit institutions, it is considered that the Government is in partnership with the grantee or contractor. No changes will be required in a grantee's or contractor's system of accounting as a result of the collection of data required by this instruction if the system otherwise meets the requirements of the grant/contract and of the awarding Agency. However, grantees and contractors may be requested to provide periodic information which does not normally appear in their regular reporting.
- B. Financial data relative to obligations and disbursements which are currently being recorded will continue to be so handled.
- C. Accruals will be recorded at the Common Accounting Number (CAN) level.
- D. Data collection techniques will, where possible, serve management needs as well as financial requirements responsive to Department and Central Financial Agencies' reporting needs.
- E. Reliability of data will be commensurate with the expenditure of resources necessary to secure that reliability. The convention of materiality will be applied so as to exclude the need for refinement on small items unless otherwise required by this manual. Materiality, however, will not be limited to relative measures but will also be measured in absolute amounts. Prudent business judgment relative to possible misinterpretation will serve as a guide.
- F. Direct monthly reporting by grantees and contractors for accrual purposes will be obtained only when statistical techniques such as correlation, regression procedures and sampling are inappropriate or will not provide valid and reliable data under the standards of paragraph E above.

- G. Techniques for obtaining accrual data based on program logic will be revalidated periodically by statistical procedures. Arbitrary prorations will not be employed for more than a calendar quarter without being adjusted to actual figures where available.

1-10-20 GENERAL

- A. Accrual accounting will be on a monthly basis. Good management depends on current factual information concerning financial operations for purposes of planning and control. Accrual accounting meets this requirement by reflecting in the records and reports events as they occur from a Time or Period standpoint.
- B. Accrual accounting produces Accrued Costs and Accrued Expenditures related to goods and services used without regard to WHEN ordered, delivered, or paid.
- C. Accrual accounting provides current financial control over expenditures, revenues, assets and liabilities, and produces information about resources available for use in later fiscal years.
- D. A properly designed accrual accounting system thus provides information with respect to the status of:
 - S OBLIGATIONS, i.e., value of goods and services ordered
 - S ACCRUED EXPENDITURES, i.e., value of goods and services received actually or constructively. (1-10-30F)
 - S DISBURSEMENTS, i.e., payments for goods and services
 - S COSTS, i.e., goods and other resources used (consumed)
- E. Accrual accounting does not require a change in the method of appropriating funds because accrued costs are reconciled with obligations incurred, with accrued expenditures, and with disbursements.
- F. It is not a question of obligation accounting versus accrual accounting; information produced by both methods is necessary - but for different purposes.

- G. Obligation accounting produces information necessary for:
 - 1. Controlling the dollar amounts of goods and services ordered against appropriations, apportionments, and allotments.
 - 2. Reporting to Congress in the budget submission the dollar amounts of goods and services ordered, or to be ordered according to "object classes" such as personal services, travel, supplies and materials, etc.
 - 3. As a by-product, showing dollar amounts disbursed for goods and services regardless of when ordered, delivered, or used.
- H. Accrual accounting, properly integrated with obligation and appropriation accounting, provides:
 - 1. All the information produced by obligation accounting plus,
 - 2. Accrued costs and expenditures for management's use in planning, controlling and appraising the efficiency of operations.
 - 3. Financial control over assets and liabilities.
 - 4. Information for determining accrued costs as a basis for fee establishment or for reimbursement for services.
 - 5. Accrued cost information for more valid comparisons of actual and planned financial performance.
 - 6. All the information necessary for cost budgets, including goods and services received and resources available for future use.
- I. An accrual accounting system, properly integrated with accounts for appropriations and obligations provides information for a complete picture of the financial results of operations.

1-10-30 DEFINITIVE STATEMENTS

A. General

The concept of "accrued expenditures" should be clearly differentiated from that of "cost" or "applied cost."

These latter two terms, in place of referring to the time of receipt of service or material, refer to the time of use or consumption of the service or material. Thus, an accrued expenditure for the acquisition of an inventory item becomes an applied cost at a later date, when the item is withdrawn for use. In the case of materials and services provided through working funds, the applied costs become accrued expenditures of the appropriation for which the work is performed as well as the working fund and at the same time accrued revenues of the working fund. Cost (applied cost) records will continue to be maintained where essential for performance evaluations as related to project schedule or technical reporting systems. The following definitions are more specific and are presented to provide greater penetration of the subject than was afforded in the preceding treatment.

B. Accrued Expenditures

1. Accrued expenditures are the aggregate dollar amount of financial transactions occurring during an accounting period which either (a) require the concurrent or subsequent disbursement of funds or (b) result in the application of funds previously advanced to others. Such transactions consist of (a) goods and services whether received actually or constructively (1-10-30F), (b) services performed by employees, contractors, grantees, lessors and other payees, (c) amounts becoming owed under programs for which no current service or performance is required (such as annuities, insurance claims, other benefit payments and a few types of grants), (d) program-type loans (as distinct from current advances), and (e) liquidation of previously unfunded liabilities. Expenditures accrue without regard to when the payment takes place and thus include, for any period, all disbursements made in payment of goods and services received during the period as well as any amounts unpaid for such services at the end of the period.
2. Expressed in accounting terms, accrued expenditures are those transactions which result in reduction in the Government's equity in net fund assets (other than refunds of receipts). The credit side of such entries will always be to fund-type assets such as cash or advances or to funded liabilities such as accounts payable or accrued liabilities, the latter being liabilities not yet due and payable. While

accrued expenditures are frequently simultaneously accrued costs or accrued expenses, they are not always such and, contrari-wise, accrued costs and expenses are not always accrued expenditures. See subparagraph D below for the definition of accrued costs and expenses.

3. In those cases where Congress has permitted liabilities to be accrued without being charged to the balance of an appropriation, a fund, or a contract authorization, the liability is considered "unfunded" and no accrued expenditure is recorded or reported until the time that the liability becomes funded, although an accrued non-fund cost would be recorded. The most common example of such an accrual is the earning of employee annual leave, which, except in the case of working capital or other revolving funds, is not funded, i.e., chargeable to an appropriation or other fund until taken or until payable upon termination of employment.

C. Accrued Revenues

Accrued revenues earned during a given period are a source of funds and result from (1) services performed by the Government, (2) goods and other tangible property delivered to purchasers or their agents, including sales of fixed assets, and (3) amounts becoming owed to the government for which no current performance by the Government is required. Examples of revenues are charges for hospital services, fines and forfeitures levied, interest accruing on loans, and premiums earned on Government-operated insurance programs. Revenue from gifts to the United States will be recorded on a cash basis. The term "revenue" is also used by the Treasury Department to include collections of program-type loans. In the Umbrella system, such collections are classified as receipts.

D. Accrued (Applied) Costs or Expenses

1. The meaning of the word "costs" lies in the context of its use. When used to describe the use or consumption of goods or services, the term Applied Costs is synonymous with the terms Accrued Costs and Accrued Expenses but not with Accrued Expenditures. In Bureau of the Budget Circular A-11, the following definition is given:

"For operating programs, costs will represent the value of resources consumed or used."

2. In this manual, the above definition will be intended whenever the terms Applied or Accrued Costs are used. When the word costs is used without a modifying adjective its meaning will have to be determined from the context.
3. For most operating purposes, costs are synonymous with current expenses and are the value of goods and services actually used or consumed during the current period.
4. Examples of accrued costs or expenses are salaries, taxes, depreciation, materials issued, and interest charges. These costs accrue and are recognized in a specific period even though payment for them was made in a prior period (Depreciation) or will be made in a future period (Salaries earned but not paid at the end of the month or other period).

E. Advances and Prepaid Expenses

1. Advance payments, including prepaid expenses (costs), are assets and are, from the Treasury's viewpoint, treated as cash; they are neither accrued expenditures nor costs. They develop into such accruals only as the value represented by the advance is earned by the payee, at which time the advance outstanding or the prepaid expense is reduced and the accrued expenditures and costs are recognized. If an advance is neither earned by the payee nor returned, it becomes an accrued expenditure and cost when its uncollectibility is determined, at which time it should be recognized in the accounts.
2. Prepaid expenses are rare in Government, since generally the Government does not prepay rent and does not carry insurance, the two areas where prepayments most frequently occur in private industry. The criterion of materiality will generally likewise preclude the treatment of subscriptions to publications and reporting services as prepaid expenses. See Section 1-10-30G for the accounting treatment for deferred charges where benefits or services have been received by the Government (and hence are not prepaid expenses) but it is desired to spread the cost over subsequent periods benefitting from the expenditure.

F. Constructive Receipt

1. Constructive receipt of goods or other tangible property, rather than physical receipt or the passing of legal title, is the measure of the accrual in certain cases. When a contractor provides goods to the Government which he holds himself available to sell to others, the accrual occurs when physical delivery by the contractor and receipt by the Government take place or title passes (that is, when goods are either delivered to the Government or to a carrier acting on behalf of the Government). However, when a contractor manufactures or fabricates goods or equipment to the Government's specifications, constructive receipt occurs in each accounting period when the contractor earns a portion of the contract price, and the accrual takes place as the work is performed. Formal acceptance of the work by the Government is not a test in such case.
2. The accrual basis, among other things, measures what is owed between the parties, whether or not it is "due and payable", as soon as it becomes owed. In general, the Government does not owe on its obligations until performance takes place on the part of the other party; it does not owe on goods and equipment of a type sold generally until physical delivery has been made. However, once performance occurs, the Government owes for special fabrication even though it has not yet been billed.

G. Deferred Charges

1. Deferred charges are expenditures which benefit future fiscal periods and must, therefore, be accounted for as non-cash assets until applied to costs. They differ from prepaid expenses, paragraph E above, in that services have been rendered by the payees in the case of deferred charges while in the case of prepaid expenses they have not.
2. Deferred charges are accrued expenditures when incurred, similar to the acquisition of inventory or fixed assets, but do not become accrued costs until amortized. Examples of deferred charges are leasehold improvements, the cost of which is to be

amortized over the life of the lease and premiums on bonds purchased which are amortized by charges against interest income as earned.

H. Disbursements

Disbursements are checks issued or cash paid, net of refunds. Note that disbursements are not the same thing as expenditures. Also, note that disbursements include funds used to make advance payments.

I. Liabilities not Previously Recorded

Liabilities which are normally funded will be recorded as accrued expenditures and reported promptly, even if they cause the recorded obligations to exceed available funds. The concept of accrued expenditures must not be modified, nor disclosure prevented by the failure to record obligations larger in total than the amounts of available funds. Necessary corrective and reporting actions will be taken whenever such a violation of law has occurred (see Chapter 2-10-90). See paragraph K below for unfunded liabilities.

J. Subgrantees and Subcontractors

Where a grantee, a contractor, or even another Government agency (to which there is an obligation or an advance payment) performs through a subgrantee, subcontractor, or other party, it is necessary to determine the timing of such performance - generally following the same rules as if the principal had performed directly. For instance, in a grant requiring specific performance according to Government specifications, the grantee's earnings, and therefore the Government's accrued expenditures, will be measurable, at least in part, by the amounts of the subgrantees' costs, including a pro-rata share of overhead, in a given period.

K. Unfunded Liabilities

In those cases where Congress has permitted liabilities to accrue without being charged as an obligation to the balance of an appropriation, a fund, or a contract authorization, the liability is considered "unfunded" and no obligation or accrued expenditure is recorded or reported until the time that the liability becomes funded.

Non-funded costs are, however, to be considered as applied costs at the time the unfunded liability is accrued. Accrued annual leave earned is a principal example. However, for some appropriations/funds specifically authorized by law, annual leave is recorded as a funded liability and reported as obligations incurred, as an accrued expenditure, and as applied cost at the time leave is earned.