THABO MOFUTSANYANA District Municipality

CONTINGENT LIABILITIES POLICY

THABO MOFUTSANYANA DISTRICT MUNICIPALITY	
Subject: Contingent Liability Policy	Policy No:
Directorate: Finance	Council Item No:
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ABBREVIATIONS

MFMA	Municipal Finance Management Act, No. 56 of 2003
GRAP	Generally Recognised Accounting Practice
AFS	Annual Financial Statement
TMDM	Thabo Mofutsanyana District Municipality

TERMINOLOGY AND DEFINITIONS

Constructive obligation – is an obligation that derives from an entity's actions where:

a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and
b) as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

Contingent asset – is a possible asset that arises from past events, and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.

Contingent liability is:

a) a possible obligation that arises from past events, and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or
b) a present obligation that arises from past events but is not recognised because:
   i. it is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; or
   ii. the amount of the obligation cannot be measured with sufficient reliability.

Executory contracts – are contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent.

Financial guarantee contract – is a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.

Legal obligation – is an obligation that derives from:

a) a contract (through its explicit or implicit terms);
b) legislation; or
c) other operation of law.

Liabilities – are present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits or service potential.

Loan commitment – is a firm commitment to provide credit under pre-specified terms and conditions.

Management – comprises those persons responsible for planning, directing and controlling the activities of the entity, including those charged with the governance of the entity in accordance with legislation, in instances where they are required to perform such functions.

Obligating event – is an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation.

Provision – is a liability of uncertain timing or amount.

SECTION 1: LEGISLATIVE REQUIREMENTS

The Municipal Finance Management Act, No. 56 of 2003 [MFMA] in Chapter 12 provides guidance on the preparation of financial statements, other allocations and other compulsory disclosures.

SECTION 2: OBJECTIVE

The objective of this policy is to define the responsibilities and prescribe the accounting treatment and presentation that Thabo Mofutsanyana District Municipality to comply with in terms of the MFMA and GRAP Standard 1 and GRAP Standard 19 in respect of contingent liability.

The policy document addresses the following areas:

- The Accounting policy with respect to contingent liability
- Guidance on the identification and accounting treatment of events after reporting date
- Guidance on the disclosure requirements of events after reporting date.

SECTION 3: ACCOUNTING POLICY

The GRAP 19 Standard requires that certain information be disclosed about contingent liabilities and contingent assets in the notes to the financial statements to enable users of the AFS to understand their nature, timing and amount.

SECTION 4: GUIDING PRINCIPLES

This policy supports the following principles:

- To secure the sound and sustainable management of the financial affairs of municipalities and other institutions in the local sphere of government;

- To establish treasury norms and standards for the local sphere of government;

- Ensuring transparency, accountability and appropriate lines of responsibility in the fiscal and financial affairs of municipalities and municipal entities;

- The management of the municipality’s revenues, expenditures, assets and liabilities and the handling of their financial dealings.

Paragraph 33, 35, 36 and 37 of GRAP19 dealing with the recognition of a contingent liability states the following:

- In the extremely rare case where no reliable estimate can be made, a liability exists that cannot be recognised. That liability is disclosed as a contingent liability (see paragraph .101 of standard of GRAP 19)

- A contingent liability is disclosed, as required by paragraph .101 of standard of GRAP 19, unless the possibility of an outflow of resources embodying economic benefits or service potential is remote.

- Where an entity is jointly and severally liable for an obligation, the part of the obligation that is expected to be met by other parties is treated as a contingent liability. For example, in the case of joint venture debt, that part of the obligation that is to be met by other joint venture participants is treated as a contingent liability. The entity recognises a provision for the part of the obligation for which an outflow of resources embodying economic benefits or service potential is probable, except in the rare circumstances where no reliable estimate can be made.

- Contingent liabilities may develop in a way not initially expected. Therefore, they are assessed continually to determine whether an outflow of resources embodying economic benefits or service potential has become probable. If it becomes probable that an outflow of future economic benefits or service potential will be required for an item previously dealt with as a contingent liability, a provision is recognised in the financial statements of the period in which the change in probability occurs, except in the extremely rare circumstances where no reliable estimate can be made. For example, a municipality may have breached an environmental law but it remains unclear whether any damage was caused to the environment. Where, subsequently, it becomes clear that damage was caused and remediation will be required, the entity would recognise a provision because an outflow of economic benefits is now probable.

SECTION 5: IDENTIFICATION AND ACCOUNTING TREATMENT OF CONTINGENT LIABILITY

TMDM prepares and presents financial statements under the accrual basis of accounting and therefore shall apply the GRAP 19 Standard in the accounting for, and disclosure of, contingent liability.

A liability is a present obligation arising from past events, the settlement of which is expected to result in an outflow on resources embodying economic benefits or service potential.

There are two types of obligations:

- A legal obligation is an obligation that derives from a contract (through its explicit or implicit terms, legislation or other operation of law).

- A constructive obligation is an obligation that derives from an entity's actions that have created a valid expectation on the part of other parties that it will discharge those responsibilities. This valid expectation could arise as a result of an established pattern of past practice, published policies or sufficiently specific current statement indicating that the entity will accept certain responsibilities.

To understand a contingent liability it is important to first understand the concept of a liability. In an accrual environment, a liability is recognised when it is either ***virtually certain*** or ***probable (more likely than not)*** that the entity has a present obligation, the settlement of which will require an outflow of economic benefits or service potential from the entity. A contingent liability is disclosed when it is ***possible*** that economic benefits will flow from the entity, or when an outflow of economic benefits or service potential is probable but cannot be measured reliably.

This concept is illustrated in the table below:

Liabilities	Outflow of economic benefits/service potential		
	Probable (more likely than not)	**Possible**	**Remote**
Reliable estimate	Liability *(consider including in the note on provisions)*	Contingent liability (disclose)	Contingent liability (*do nothing*)
Not reliable estimate	Contingent liability (disclose)	Contingent liability (disclose)	Contingent liability (*do nothing)*

SECTION 6: GENERAL DISCLOSURE REQUIREMENTS OF CONTINGENT LIABILITY

Unless the possibility of any outflow in settlement is remote, an entity shall disclose for each class of contingent liability at the reporting date a brief description of the nature of the contingent liability and, where practicable:

a) an estimate of its financial effect, measured under paragraphs .43 to .59 of standard of GRAP 19;
b) an indication of the uncertainties relating to the amount or timing of any outflow; and
c) the possibility of any reimbursement.

Litigation claims

The amount that must be disclosed in the disclosure note to the annual financial statements of the Municipality is the estimated settlement value of claims instituted against the Municipality as at 30 June. The claim will only be settled when either the court decides that the Municipality is liable or the Municipality accepts the liability, both of which are unknown. Civil claims against the Municipality that have **not** been settled (by a court order or mutually between the parties) must be included in **contingent liabilities**.

Claims are normally overstated. The amount disclosed is not necessarily the claim amount, but rather the amount determined as the most likely amount that the court will settle on. "Most likely" must be determined by a qualified legal person (such as a lawyer) or from Municipal history.

Where final settlement was reached and payment was made

These payments will be expensed against the vote. Where final settlement was reached but payment is outstanding as at 30 June it represents a provision and should be disclosed as such in a disclosure note.

SECTION 7: SHORT TITLE

This Policy is the Contingent Liability Policy of the Thabo Mofutsanyane District Municipality.

SECTION 8: IMPLEMENTATION

This Policy has been approved by Thabo Mofutsanyane District Municipality in terms of resolution……………………dated……………………and comes into effect from……………………