



Fezile Dabi

District Municipality

Provisions, Contingencies and Accruals Policy

DEFINITIONS:

Accrual: accounts that represent liabilities and non-cash-based assets of the municipality emanating from the application of accrual-based accounting.

Contingent asset: a possible asset that arises from past events, whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events beyond the control of the municipality

Contingent liability: a possible obligation depending on whether some uncertain future event occurs, or a present obligation but payment is not probable or the amount cannot be measured reliably

Liability: present obligation as a result of past events settlement is expected to result in an outflow of resources (payment)

Obligating event: an event that creates a legal or constructive obligation, resulting in an municipality having no realistic alternative but to settle the obligation

Probable: likely to happen or to be true

Provision: a liability of uncertain timing or amount.

Restructurings: a termination of a line of business, closure of business locations, changes in management structure or fundamental re-organization.

1. OBJECTIVES

- a) To ensure that appropriate recognition criteria and measurement bases are applied to provisions, contingencies and accruals.
- b) To ensure that appropriate, sufficient information regarding provisions and accruals is disclosed in the notes to the financial statements relating to provisions, contingencies and accruals of the municipality to enable users to understand their nature, timing and amount.
- c) To ensure that provisions, contingencies and accruals are dealt with correctly in the financial statements.

2. LEGISLATIVE CONTEXT

Section (62)(1) of Municipal Finance Management Act, 56 of 2003 (MFMA) stipulates that the accounting officer of a municipality is responsible for managing the financial administration of the municipality, and must for this purpose take all reasonable steps to ensure:

- a) *that the resources of the municipality are used effectively, efficiently, economically and transparently;*
- b) *that full and proper records of the financial affairs of the municipality are kept;*
- c) *that the municipality has and maintains effective, efficient and transparent systems-*
 - i. *of financial and risk management and internal control; and*
 - ii. *of internal audit complying with and operating in accordance with any prescribed norms and standards;*
- d) *that irregular and fruitless and wasteful expenditure and other losses are prevented;*
- e) *that expenditure is in accordance with the operational policies of the municipality; and*
- f) *that disciplinary or, when appropriate, criminal proceedings, are instituted against any official of the municipality who has allegedly committed an act of financial misconduct or an offence in terms of Chapter 15.*

3. POLICY PRINCIPLES

- a) Provision should be recognized only when there is a liability i.e. a present obligation resulting from past events.
- b) Accruals should be reported as part of trade and other payables in the financial statements, whereas provisions must be reported separately in the statement of financial position.
- c) The municipality shall raise a provision in the financial statements in the period in which the outflow of resources becomes probable.
- d) Contingent liabilities shall not be recognized as liabilities and contingent assets as assets in the financial statements rather shall be disclosed in the notes to the financial statements.
- e) Contingent liabilities and contingent assets shall be reviewed continuously to determine if the outflow of resources have become probable.
- f) The Chief Financial Officer must be informed of any material contingency that may arise during the course of the business of the municipality (e.g. pending labour disputes, unsettled orders, etc.).
- g) The Chief Financial Officer shall, at financial year end, perform an assessment to identify any material contingencies so as to ensure the completeness, relevance and accuracy of the contingencies that must be recorded and reported at financial year end.

4. RECOGNITION AND MEASUREMENT

4.1 Provisions

Provisions shall be measured at the amount (best estimate) that the municipality would rationally pay to settle the obligation or to transfer it to a third party at the reporting date.

Such best estimate should take into account any risks and uncertainties related to the outflows and any reimbursements due from external parties. Gains from the disposal of assets shall not be included in the measurement of a provision.

Where the effect of time value of money is material, the measurement of provision shall be the present value of the expenditures required to settle the obligation.

Provisions shall be reviewed at least once at the end of every reporting period and shall be adjusted to the current best estimate. Changes in the measurement of the liability resulting from either a change in estimated timing or amount of the outflow of resources, or a change in the discount rate shall result in an adjustment to the liability already recognised.

Provisions shall be recognized in the accounting records of the municipality only if the following conditions are evident:

- a) a present obligation (legal or constructive) has arisen as a result of a past event
- b) payment is probable ('more likely than not'), and
- c) the amount can be estimated reliably.

The amount recognized as a provision shall be the best estimate of the expenditure required to settle the present obligation at the balance sheet date, that is, the amount that the municipality would rationally pay to settle the obligation at the balance sheet date or to transfer it to a third party.

The following shall be used as the basis to estimate the amount for provision to be recognized:

- a) Provisions for one-off events (e.g. settlement of lawsuit) are measured at the most likely amount.
- b) Provisions for large populations of events (e.g. refunds of consumer deposits) shall be measured at a probability-weighted expected value.

Both measurements shall be at discounted present value that reflects the current market assessments of the time value of money and the risks specific to the liability.

In reaching its best estimate, the municipality shall take into account the risks and uncertainties that surround the underlying events.

If some or all of the expenditure required to settle a provision is expected to be reimbursed by another party (e.g. a contractor contracted to do work for the municipality), the reimbursement shall be recognized as a separate asset, and not as a reduction of the required provision, when, and only when, it is virtually certain that reimbursement will be received if the municipality settles the obligation. The amount recognized should not exceed the amount of the provision.

Should it happen that the municipality will not be liable for costs if the third party fails to pay, then neither the provision nor the reimbursement should be recognized by the municipality in respect of those costs.

Provisions shall be reviewed and adjusted at the end of each financial year and if an outflow is no longer probable, provision is reversed.

4.2 Accruals

In terms of this policy, accruals are:

- i. **Obligations** to pay for goods or services that have been received or supplied but have not been paid, invoiced or formally agreed with the supplier, including amounts due to employees (for example, amounts relating to accrued vacation pay). These obligations shall be recorded as liabilities in the financial statements of the municipality. In the event that goods or services have not been invoiced as at the end of the reporting period, the municipality shall recognise accruals based on the most recent quotation of the supplier / service provider or estimates of the official order issued to the supplier / order for such goods and / or services.
- ii. **Rights** to receive income for services rendered that have been supplied to customers / consumers but have not been billed/invoiced at the end of the financial year. Estimates of consumption for services rendered between the last reading date and the reporting date shall be recorded as an accrual. Adjustments to provisional estimates of consumption shall be made in the invoicing period in which meters are read. This type of accrual shall be recorded as assets in the financial statements of the municipality.

Accruals shall be recognized in the accounting records of the municipality only if the following conditions are evident:

- a) a present obligation / right (legal or constructive) has arisen as a result of a past event
- b) payment / receipt is probable ('more likely than not'), and
- c) the amount can be estimated reliably.

5. USE OF PROVISION

A provision shall only be used as originally intended. Any unused amounts shall be reversed and not be utilized for other purposes and if provisions are no longer required they shall be reversed.

Setting off expenditure against a provision that was originally recognized for another purpose would conceal the impact of two different events, and therefore setting-off is not permitted.

6. CONTINGENCIES

6.1 Contingent Liabilities

The municipality shall not recognize contingent liabilities, but shall disclose such contingent liabilities in the notes to the financial statements to the extent that:

- a possible obligation exists, depending on whether some uncertain future event occurs, or
- a present obligation exists, but payment is not probable or the amount cannot be measured reliably

The municipality shall keep an internal register of provisions, which shall be reconciled to the General Ledger at least at the end of the financial year. The register shall contain the following information as a minimum:

- a description of the contingency;
- the officer responsible for the management and settlement of the contingency;
- the value, if the value can be measured reliably;
- the way in which it arose, for example its source; and
- action taken relating to the Contingency, for example action to minimise loss.

6.2 Contingent Assets

A 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 municipality.

A contingent asset shall not be recognised in the financial statements of the municipality, but shall be disclosed where an inflow of economic benefits or service potential is probable.

However, when the realisation of income is virtually certain, then the related asset is not a contingent asset and in this case an asset must be recognised in the financial statements.

7. RETENTION FEES

In relation to major works, goods or services procured by the municipality, a retention fee up to the maximum of 10% of the contract price, excluding VAT shall be withheld at the discretion of the Accounting Officer.

However, the condition of retention withholding should be communicated with the service provider / supplier concerned prior to commencement of the project, this fact must also be specifically disclosed in the Service Level Agreement (SLA) to be entered into with the service provider / supplier concerned.

The following minimum information must be specifically communicated to the service provider / supplier in relation to retention fees and disclosed in the SLA:

- a) The actual retention fee as a percentage of the total project costs (up to a maximum of 10%);
- b) Reasons for retention of a certain portion of the contracted amount;
- c) Conditions under which retentions may be released / paid over to the supplier / service provider;
- d) The timing that must lapse before conditions relating to retention can be revisited and verified prior to releasing of retention fee; and
- e) Procedures that must be followed by the service provider / supplier to claim retention fee when it becomes due.

In relation to projects that are funded through conditional grants, when reporting on such conditional grant spending, the municipality must report on the total value of the invoice due (including any retentions). Should it happen that in relation to conditional grant funding, the municipality applies for a roll-over of funds, any retention fees must not be included as part of unspent funds for which the rollover is applied for since that based on the foregoing policy provision, it is accepted that retentions forms part of the total invoice due and payable, the only difference is the timing of the payment.

8. GUARANTEES FOR CAPITAL PROJECTS

For all turnkey capital projects (i.e. projects that are started from the scratch and handed over to the municipality as completed product) a 50% guarantee based on the total contract value shall be required from the appointed contractor.

For all other capital projects that are in excess of R 5 million, a 10% guarantee based on the total contract value shall be required from the appointed contractor.

The following minimum information must be specifically communicated to the service provider / supplier in relation to guarantees and disclosed in the SLA:

- a) The actual amount of guarantee as a percentage of the total project costs (up to a maximum of 50% for turnkey capital projects and 10% for any other capital projects);
- b) Reasons for guarantee required;
- c) Conditions under which guarantees may be lifted;
- d) The timing that must lapse before conditions relating to guarantees can be revisited and verified prior to lifting of such guarantee requirements; and
- e) Procedures that must be followed by the service provider / supplier to withdraw the guarantee when the conditions thereof are no longer applicable.

9. DISCLOSURES

9.1 Provisions

The municipality shall disclose in the notes to the financial statements, reconciliation for each class of provision that will include the following:

- opening balance
- additions
- used (amounts charged against the provision)
- unused amounts reversed
- unwinding of the discount, or changes in discount rate
- closing balance

The municipality shall disclose the following for each class of provision:

- A brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits or service potential.
- An indication of the uncertainties about the amount or timing of those outflows. Where necessary to provide adequate information, an municipality shall disclose the major assumptions made concerning future events.

- The amount of any expected reimbursement, stating the amount of any asset that has been recognized for that expected reimbursement.

9.2 Contingencies

The municipality shall disclose in the notes to the financial statements the following in relation to each contingent liability:

- a description of the contingency;
- the value, if the value can be measured reliably;
- the way in which it arose, for example its source; and
- action taken relating to the Contingency, for example action to minimise loss.

9.3 Guarantees and Retentions

The guarantees and retentions must be disclosed as part of the disclosure of the asset affected in the notes to the financial statements with the following minimum information:

- a) a description of the guarantee / retention signed by the appointed contractor;
- b) the value, if the value can be measured reliably (e.g. 50% of the project value);
- c) the way in which it arose, for example its source; and
- d) action taken (*where applicable*) relating to the guarantees / retentions, for example action to minimise loss.

10. REVIEW AND APPROVAL

This policy and underlying strategies will be reviewed at least annually, or as necessary, to ensure its continued application and relevance.