Section 10 – Liabilities

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Liabilities

10.1 Overview

Liabilities are future dispositions of assets that the entity is presently obligated to make to other entities as a result of past transactions or events. Paragraphs 60 to 64 of the Australian Accounting Standards Board (AASB) *Framework for the Preparation and Presentation of Financial Statements* define liability as a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow of resources embodying economic benefits. This means that liabilities are amounts the local government will need to pay for (outflow of economic benefits) as the result of a transaction with another entity (result of past events).

A liability should be recorded if the two following criteria are met:

a) it is probable (ie. more likely than not) that the liability will be settled sometime in the future; and

b) the amount of settlement can be reliably measured.

'Reliably measured' means measured without undue bias or error. In most cases, even when a liability cannot be measured precisely, it will still be possible to make a fair estimate of the amount of the liability and if this estimation is free from known bias or error it will be considered reliable for the purposes of the accounting standards.

☐ 10.1.1 Classification of Liabilities

Liabilities are to be apportioned between current and non-current on the principles set out in AASB 101.69 – that is, on the basis of whether they are expected to be paid within 12 months. Current liabilities are liabilities that will be paid or are expected to be paid within the 12 months after the reporting period ends. All other liabilities are non current liabilities.

AASB 101.69(d) is to be interpreted as relating to *Trade and Other Payables and Borrowings*, but not *Provisions* which are subject to AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* and AASB 119 *Employee Benefits*.

☐ 10.1.2 Deciding the Disclosures to be Made

The concept of Materiality provides guidance to the level of disclosures to be made. The description OTHER is only used where the amount is not material, otherwise an appropriate description must be shown.

Paragraphs 29 and 30 of the *Framework for the Preparation and Presentation of Financial Statements* provide a general statement of the concept of materiality, and this is expanded in an Australian context by AASB 1031 *Materiality* and AASB 1031.9 specific to the application of materiality.

AASB 1031.15 suggests a rebuttable presumption of non-materiality where an amount is less than 5% of the base amount, and a rebuttable presumption of materiality where an amount is in excess of 10% of the base amount. AASB 1031 also includes commentary at paragraphs 14 and 17 — 19 directly relating to the assessment of materiality for not-for-profit entities.

The paragraphs in the Framework and AASB 1031 should be carefully reviewed and considered when determining the appropriate level of disclosure of the following items. In particular, attention should be given to disclosure of items that indicate significant variations from the previous years.

Subject to the above comments, the following may be used as a guide for assessing materiality:

- For the purposes of assessment of materiality of liabilities items, the *"base amount"* is considered to be the total liabilities grouping.
- Where any individual payable type exceeds 10% of the base amount, separate disclosure is appropriate.
- Where any individual payable type is less than 5% of the base amount, separate disclosure is unlikely to be appropriate.

10.2 Current Liabilities

The following are examples of descriptions for current liabilities, i.e. obligations that are usually due within 12 months after the end of the reporting period.

☐ 10.2.1 Payables

Account payables are liabilities for unpaid goods or services that have been received or supplied and invoiced or formally agreed with the supplier. Examples are amounts due to suppliers for stores, materials and utilities.

☐ 10.2.2 Accrued Expenses

Accruals are liabilities to pay for goods or services that have been received or supplied but have not been paid, invoiced or formally agreed with the supplier at the end of the reporting period. Amounts that traditionally meet this definition include accrued interest payable and accrued rental payable.

At the end of the reporting period, an analysis of all goods and services received during the period is made and a credit for accrued liabilities booked for any obligations of the local government not already recorded. The corresponding debit entry would be made against the related goods and services account. The journal would be reversed at the beginning of the next period.

Example:

Assume the local government has rental expenses of approximately $20,000 prior to 30 June and invoices are received in the subsequent period and have not been processed prior to the period end accounting cut-off, the journal entries will be as follows:

To record period end accruals (period 1)

	$	$
DR Rental Expense (Income Statement)	20,000	
CR Accrued Expenses (Balance Sheet)		20,000

On 1 July reverse above journal

DR Accrued Expenses (Balance Sheet)	20,000	
CR Rental Expense (Income Statement)		20,000

To record receipt of invoices (period 2)

DR Rental Expense (Income Statement)	20,000	
CR Payables (Balance Sheet)		20,000

☐ 10.2.3 Payment Received In Advance

This refers to amounts paid to the local government for the supply of goods and/or services to the payer which would be refunded if the works and/or services were not performed and includes credit balances held in the Sundry Debtors ledger, but does not include contributions such as rates, grants, fees and charges paid in advance. Amounts paid for private works prior to commencement of works is an example of payment received in advance.

AASB 1004.60(e) *Contributions* requires rates, grants, service charges, and other non-reciprocal fees and charges received in advance to be disclosed as normal revenue in the year of receipt with no take up of liability, the amount and nature of which need to be disclosed by way of notes in the financial statements.

☐ 10.2.4 Bonds, Deposits & Retentions

Bonds, deposits and retentions are funds that a local government has no control over and should be placed in trust funds and not brought in as municipal funds.

Provisions

Provisions are only recognised when the local government has a present legal or constructive obligation[1] as a result of past events ie. it is probable (more likely than not) that an outflow of resources will be required to settle the obligations; and the amount can be reliably estimated.

Provisions can be distinguished from other liabilities such as trade payables and accruals because there is uncertainty about the timing or amount of the future expenditure required in settlement. Provisions are not recognised for future operating losses.

☐ 10.2.5 Provisions for Employee Entitlements (Current)

Employee entitlements are all forms of consideration given by an entity in exchange for services rendered by its employees. Short term provision for entitlements could include annual leave, sick leave and long service leave.

Annual leave is calculated as a ‘pro-rate entitlement’, that is the undiscounted amount expected to be paid.

Sick leave can be identified as vesting and non-vesting. Vesting sick leave occurs where a local government has entered into an industrial agreement to pay a proportion of untaken sick leave on termination, and is regarded as not being "due" until termination occurs. It is therefore recognised as a provision (which may be a current or non-current liability) and calculated in the same way as annual leave.

Sick leave in local governments is usually non-vesting. Provision for non-vesting sick leave is only necessary where it is expected that the sick leave taken in the future will exceed the benefits accumulated. For example, when an employee transfers to another local government with a large unused sick leave entitlement and falls seriously ill shortly after commencing with the new employer.

☐ 10.2.6 Short-Term Borrowings

Borrowings are classified as current liabilities when they are short-term in nature and due to be settled within 12 months after the reporting date. e.g. Bank Overdraft.

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[1] As defined under AASB 137(10), see Glossary.

Bank Overdraft is where the amounts drawn from the local government's working account have exceeded deposits. It should be disclosed separately as a short-term borrowing as opposed to a current portion of a long-term borrowing. It would also require disclosure in a note on "*Short-Term Borrowings*".

10.3 Non-Current Liabilities

The following are examples of descriptions for liabilities due more than 12 months.

☐ 10.3.1 Provision for Employee Entitlements (Non-Current)

This item relates only to long-term employee benefits, principally Long Service Leave. These liabilities are calculated as the present value of the expected future cash outflows required to settle the obligation that exists at reporting date.

☐ 10.3.2 Long-Term Borrowings

If a local government expects, and has the discretion, to refinance or roll over a loan for at least 12 months after the reporting date under an existing loan facility, it classifies the loan as *non-current*, even if it would otherwise be due within a shorter period. However, when refinancing or rolling over the loan is not at the discretion of the local government (for example, there is no agreement to refinance), the potential to refinance is not considered and the loan is classified as current.

☐ 10.3.3 Other Provisions

It is important that each local government examine its operations to identify and recognise all legal and constructive obligations arising from past events. Where the timing or amount of future cash outflows is uncertain, these are recognised as provisions.

These must be recognised at the *best estimate of the future cash outflows*[2]. Examples of other provisions include *Insurance Losses and Onerous contracts*[3].

[2] AASB 137.36 – The appendix to AASB 137 provides a number of examples of the application of the Standard.
[3] If an entity has an onerous contract (the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it), the present obligation under the contract should be recognised as a provision.

10.4 Debt Management

Debt management can be viewed as both an indicator of financial performance and as a financing opportunity.

The Western Australian Treasury Corporation (WATC) debt assessment criteria may provide useful guidance to local governments on debt management.