

COMMITMENTS POLICY

ABBREVIATIONS

MFMA	Municipal Finance Management Act
GRAP	Generally Recognised Accounting Practice
AFS	Annual Financial Statements

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1. LEGISLATIVE REQUIREMENTS

Municipal Finance Management Act

The Municipal Finance Management Act [MFMA] in Chapter 12 provides guidance on the preparation of financial statements, other allocations and other compulsory disclosures.

2. OBJECTIVE

The objective of this policy is to define the responsibilities of Tswelopele Local Municipality in terms of the MFMA with respect to the identification and disclosure of both approved and contracted for and approved but not yet contracted for commitments in the annual financial statements [AFS]. The policy document addresses the following areas:

- ◆ The definition of a commitment
- ◆ The definition of Approved and Contracted for commitments, Approved but not yet Contracted for commitments, Capital Expenditure and Current Expenditure.
- ◆ The Accounting policy with respect to commitments
- ◆ Guidance on the identification and accounting treatment of commitments
- ◆ Guidance on the disclosure requirements of commitments.

3. TERMINOLOGY AND DEFINITIONS

A **commitment** represents goods/services that have been approved and/or contracted for, but where delivery has not taken place at the reporting date. A commitment arises when a decision has been made to incur a liability. A commitment converts to a liability when that intention becomes a present obligation or basically when the delivery of the contracted goods/services has taken place.

Capital commitments arise when the municipality has entered into a contract on or before the end of the financial year to incur expenditure over subsequent accounting periods relating to construction of infrastructure, the purchase of major items of property, plant and equipment or significant consultancy.

Operational commitments arise when the municipality has ordered goods/services in the normal course of business but for which no delivery has taken place at the reporting date.

Approved and contracted for commitment is where the expenditure has been approved and the contract has been awarded at the reporting date.

Approved and not yet contracted for commitment is where the expenditure has been approved but the contract has not yet been awarded or is awaiting finalization at the reporting date.

Capital expenditure is expenditure incurred to purchase, upgrade or construct physical assets such as buildings for which there will be a long-term benefit. Long-term relates to a period of longer than one year.

Current / Operational expenditure is the purchase of goods and services for which there will be a short-term benefit and incurred in the normal course of business. Short-term relates to a period less than one year.

4. ACCOUNTING POLICY

Commitments are not recognised in the Statement of Financial Position and Statement of Financial Performance but are included in the disclosure notes of the annual financial statements.

The disclosures of commitments entered into before the reporting date shall be done in the financial statements as required by the following standards of GRAP:

- [1] GRAP 1 on Presentation of Financial Statements which requires disclosure of unrecognised contractual commitments [GRAP1:124];
- [2] GRAP 13 on Leases which requires disclosure of the future minimum lease payments;
- [3] GRAP 17 on Property, plant and equipment which requires disclosure of contractual commitments for the acquisition on property, plant and equipment [GRAP 17:80[c]; and
- [4] GRAP 31 on Intangible assets which requires the disclosure of contractual commitments for the acquisition of intangible assets [GRAP 31:120 [d].

Section 122 [3] of the MFMA states that:

Both annual financial statements and consolidated annual financial statements must be prepared in accordance with generally recognised accounting practice prescribed in terms of section 91[1] [b] of the Public Finance Management Act.

5. IDENTIFICATION AND ACCOUNTING TREATMENT OF COMMITMENTS

To determine whether a commitment exists at the reporting date the following are the guiding principles:

- ◆ Commitments represent goods/services that have been ordered, but for which no delivery has taken place at the reporting date. These amounts are not recognised in

the Statement of Financial Position as a liability or as expenditure in the Statement of Financial Performance, but are, however, disclosed as part of the disclosure notes.

- ◆ Items are classified as commitments where the Municipality commits itself to future transactions that will normally result in outflow of resources.
- ◆ Contracts that are entered into before the reporting date, but for which goods and services have not been received are disclosed in the commitments disclosure note to the financial statements.
- ◆ Material contracts entered into after the reporting date, but prior to the approval of the financial statements must be disclosed under subsequent events and in the report of the Accounting Officer.
- ◆ Other commitments for which disclosure is necessary to achieve a fair presentation should be disclosed in a note if both the following criteria are met.
- ◆ Contracts should be non-cancellable or only cancellable at significant cost [for example, contracts for computer or building maintenance services]; and
- ◆ Contracts should relate to something other than the routine business of the entity – therefore salary commitments relating to employment contracts or social security benefit commitments are excluded.

The transaction cycle to demonstrate at which stage commitments will be disclosed in the AFS can be represented in a tabular form as below:

Contracts exceeding R200,000 are obtained through a competitive bidding process.

Stage	Decision to put contract to tender	Contract accepted and signed	Contract work commences		Payment made
Classification	No recognition / No disclosure	Commitment	Liability for work performed	Commitment for unperformed work	Settles the liability

Purchases of property, plant and equipment that are less than R200,000 are done through the quotation process. The items are purchases are done against the approved annual budget.

Stage	Need has been identified	Quotes Sourced	Order placed	Order accepted	Goods delivered & accepted	Payment made
Classification	No recognition / No disclosure	No recognition / No disclosure	Commitment	Commitment	Liability	Settles the liability

The above cycle is also applicable to Operational commitments.

6. GENERAL DISCLOSURE REQUIREMENTS OF COMMITMENTS

6.1 Notes to the financial statements

As a minimum, the following should be disclosed in the notes to the financial statements for commitments:

- [1] A distinction should be made between capital and operational commitments.
- [2] The aggregate amount of capital and operational expenditure approved and contracted for at the reporting date, to the extent that the amount has not been recorded in the financial statements.
- [3] If a commitment is for a period longer than a year, it should be stated in the note.

To ensure that there is no duplication, lease commitments are disclosed under a separate note.

6.2 Contract / commitments register

A capital contract register/ commitments register shall be maintained by the municipality. The register will detail the following information which is essential for the calculation of commitments:

- ◆ The period of the tender awarded
- ◆ Original contract amount
- ◆ Amounts already paid pertaining to that tender/contract
- ◆ Amounts for which invoices have been received and which are therefore included in accruals should be deducted.

In respect of current / operational contracts

- ◆ Commitments loaded on the procurement system of which Goods Received Notes have not been raised.

Required disclosure note for Current and Capital Commitments

Already contracted for but not provided for

Capital expenditure

Current Expenditure

Note yet contracted for and authorized by accounting officer

Capital expenditure
Current Expenditure

Operating Lease – as lessee

Minimum lease payments due

- ◆ Within one year
- ◆ In second to fifth year inclusive
- ◆ Later than five years

Operating lease – as lessor

Minimum lease payments due

- ◆ Within one year
- ◆ In second to fifth year inclusive
- ◆ Later than five years