16.3 Contingent Liabilities

Policy Statement

It is the policy of the Province of Nova Scotia (Province) to record and/or disclose contingent liabilities on an accrual basis in accordance with Canadian public sector accounting standards (PSAS).

Definitions

CONTIGENT LIABILITIES

Contingent liabilities are potential obligations arising from existing conditions that may result in the future sacrifice of economic benefits depending on the outcome of a future event. The uncertainty will eventually be resolved when one or more future events not wholly within the government's control occurs or fails to occur. Resolution of the uncertainty at a future date will confirm the incurrence or non-incurrence of a liability.

Contingent liabilities are distinct from liabilities in that there is a degree of uncertainty as to whether a present obligation to sacrifice economic benefits exists at the financial statement date.

Policy Objective

The objective of this policy is to ensure contingent liabilities are appropriately, consistently, and accurately identified, accounted for, and disclosed in the Province's consolidated financial statements. Accounting for and disclosure of contingent liabilities is useful because they indicate possible claims on the economic resources of the Province and their potential risks and exposure on the government's financial position and results.

Application

This policy applies to all contingent liabilities of the Province's departments, agencies, boards, and commissions of the General Revenue Fund (hereinafter referred to as "departments").

Organizations outside of the General Revenue Fund but within the Government Reporting Entity are encouraged to adopt a policy that allows for the accurate and consistent reporting of contingent liabilities relating to external parties and complies with the entity's generally accepted accounting framework. These organizations are responsible for disclosing their contingent liabilities to the Government Accounting Division as part of the year-end consolidation reporting requirements.

Policy Directives

A contingent liability is identified, recorded, and disclosed based on the accounting standards and guidelines contained within PSAS. In applying this policy, departments are to identify all contingent liabilities under their area of responsibility.

Contingent liabilities are present at the financial statement date when there is an existing condition or situation (past event) that indicates the Province may have a potential liability. An outstanding loan guarantee, indemnity, or ongoing legal case are primary examples of existing conditions to consider for contingent liabilities. A future event must also be expected to occur that will resolve the uncertainty (likelihood) and determine whether the Province is obligated to settle the potential liability in the form of sacrificing economic benefits. The occurrence or non-occurrence of the future event cannot be wholly within the control of the Province (e.g., lawsuit settlement or loan default) in order to confirm whether a contingent liability exists or not.

RECOGNITION

Departments are to record a contingent liability when:

a) a future event will likely confirm that a liability has been incurred at the date of the financial statements; and

b) the amount can be reasonably estimated.

In determining whether a liability exists at the financial statement date, an assessment of the likelihood of adverse outcome (future event occurring or not occurring) must be made.

DERECOGNITION

Derecognition of a contingent liability should only occur if the likelihood of the future confirming event becomes unlikely and if there is a reasonable expectation that this status will not change in the near future. The accrued contingent liability should be derecognized and accounted for in the current period and not considered as a prior period adjustment. Derecognition should not occur as a result of the likelihood of the contingent liability changing to undeterminable.

DISCLOSURE

Risks and exposures, including contingent liabilities, are important in assessing the government's financial position and results. The existence of a contingent liability at the financial reporting date should be disclosed in the notes to the financial statements when:

a) the occurrence of the confirming future event is likely, but the amount of the liability cannot be reasonably estimated.

b) the occurrence of the confirming future event is likely and an accrual has been made, but there exists an exposure to liability in excess of the amount accrued on the books; or

c) the occurrence of the confirming future event is not determinable.

Information regarding contingent liabilities, including descriptions of their nature and extent, should be considered for disclosure in notes or schedules to the Province's financial statements. Relevance of such information to the decision-making process arguably outweighs the inherent uncertainty.

YEAR-END REPORTING

At the end of each fiscal year, departments must submit to Government Accounting a summary of their loan guarantees and contingent liabilities. To ensure the completeness, existence, and accuracy of their reported contingent liabilities and loan guarantees, departments should, among other things:

- Search for potential claims by regularly reviewing and following up on media releases and orders in council.
- Communicate regularly with program staff to determine if any new agreements with loan guarantees have been signed and to assess the risk of default at year-end.

Departments must submit annually, in the format prescribed by Government Accounting, a detailed listing of contingent liabilities, including loan guarantees and lawsuits. To ensure the completeness and accuracy of the schedule, departments must also complete, sign, and submit the Contingencies & Commitments (C&C) Checklist, as developed by Government Accounting.

Policy Guidelines

LIKELIHOOD OF FUTURE EVENT/ADVERSE OUTCOME

a) **Likely** – Assessed at greater than 70 per cent chance of adverse outcome.

b) **Unlikely** – Assessed at less than 30 per cent chance of adverse outcome.

c) **Unable to assess** – not determinable or insufficient information to assess the likelihood of adverse outcome.

ESTIMATE OF POTENTIAL LIABILITY

This amount represents the best estimate of potential loss to the Province based on all the information that is available prior to the completion of the financial statements. The supporting information should include discussions with Legal Services and consideration of precedents, probability analysis, and reports from independent experts. The information should also be supplemented with experience in similar transactions by those responsible for making these estimates.

In the case of a **lawsuit**, an estimate of the potential liability should include an assessment of the damages, legal costs of the plaintiff, and interest that may be awarded by the court as part of the lawsuit settlement. However, the Province's own legal costs and other professional and administrative costs related to defending the claim should be excluded from the estimate. If the contingent liability from litigation is covered by a counterclaim or insurance, the recovery may be netted against the liability if the probability of recovery is likely.

For **loan guarantees**, an estimate of potential liability related to a provision for loss should take into account the principal amount outstanding, accrued and unpaid interest if it is guaranteed, and amounts recoverable from the borrower and from the sale of assets pledged as security. The provision for losses on loan guarantees should be determined using the best estimates available in light of past events, current conditions, and taking into account all circumstances known at the date of the completion of the financial statements. In estimating the provision for losses, different techniques may be required. For individual loan guarantees, the provision could be based on the current circumstances of the individual borrowers. For guarantee programs consisting of a large number of similar loans, the provision could be based on historical experience or on economic conditions facing that group of borrowers.

Regardless of the estimation technique used, a range of potential amounts may be developed. When a particular amount within this range appears more reasonable than any other, that amount should be used. However, when no amounts within the range appears to be a better estimate than any other, the minimum amount in the range should be used.

RECOGNITION

The contingent liability should be recognized, as an expense and liability, only when it can be determined that the future adverse event (potential settlement of lawsuit) is likely (greater than 70 per cent) to confirm loss **and** the amount can be reasonably estimated. If there is insufficient or inconsistent evidence on which to base a decision as to the outcome of a contingent liability, one or both of the conditions set out above for accrual recognition may not be met. Accrual in these circumstances would be inappropriate.

In other cases when the likelihood of future event is assessed at between 30 per cent and 70 per cent, or not determinable (unable to assess), and for which a potential liability has been estimated, no accrual of the contingent liability is required. Rather in these cases, only note disclosure to the financial statements is required. Also, when contingent liabilities are assessed as unlikely (less than 30 per cent) to confirm future loss, no accrual, disclosure, or any other accounting treatment is required.

Recognition of a contingent liability should be maintained until it is resolved or otherwise extinguished, or until the probability of the occurrence of the future confirming event is determined to be unlikely at the financial statement date. The likelihood of the future confirming event occurring and the estimate of future loss should be continually assessed (at least annually at year-end). When a change in an estimate of the amount of a contingent liability is required, the adjustment would be accounted for as an operating expense in the current period and not considered as a prior period adjustment.

Note: Where more than one department is named in a claim, departments are to report an estimate of their share of the contingent liability. The estimated portion of the potential liability should be allocated between the departments based on advice from legal counsel and senior management. Government Accounting and Treasury Board Office should be consulted in these situations, as well as, but certainly not limited to, the following scenarios:

- where the magnitude of the estimated liability is so significant that its inclusion as an expense and liability risks revealing the estimate of the potential liability, which could have an adverse effect on the outcome of the contingency, or

- where the claim relates to decisions of government that have potential impact across many departments.

A decision tree is included in Appendix 16-B to assist in the application of these guidelines.

Accountability

DEPARTMENTS & FINANCIAL ADVISORY SERVICES UNITS

Departmental staff and Financial Advisory Services Units serving the departments are responsible for:

- implementing and complying with this policy
- documenting and updating their process, including roles and responsibilities of departmental staff, to comply with this policy
- maintaining a list of all contingent liabilities and determining their proper accounting treatment under the terms of this policy
- consulting with Legal Services staff, as necessary, to confirm likelihood of adverse outcome and estimation of potential liabilities
- preparing their annual contingent liabilities schedules at year-end for Government Accounting and thoroughly analyzing and reviewing them prior to submission to ensure all liabilities were accounted for and disclosed
- responding to Government Accounting inquiries regarding contingent liabilities
- providing the Office of the Auditor General with the evidence requested for the audit of contingent liabilities

GOVERNMENT ACCOUNTING DIVISION

Government Accounting is responsible for:

- distributing the contingent liabilities template and C&C Checklist to departments for year-end reporting purposes
- communicating the contingent liabilities reporting threshold to departments at year-end
- compiling a list of all contingent liabilities for the GRF
- compiling a list of all contingent liabilities for the consolidated GRE by reference to the financial statements and worksheet packages of the governmental units, government business enterprises, and government partnership arrangements
- reviewing contingent liabilities schedules submitted by departments for significant and unexpected differences
- liaising with departments and the Office of the Auditor General, as needed

- assisting departments in documenting and updating their processes to comply with this policy
- monitoring the application of this policy
- periodically updating this policy in consultation with departments

Monitoring

Financial Advisory Services Units serving the departments are responsible for monitoring the implementation and compliance of this policy. Government Accounting is responsible for monitoring the application, performance, and effectiveness of this policy. Government Accounting is also responsible for providing the necessary guidance and training to each department in regards to this policy.

References

Public Sector Accounting Standards:
PS 3200 Liabilities
PS 3300 Contingent Liabilities
PS 3310 Loan Guarantees

Appendix

16-B Decision Tree – Contingent Liabilities

Enquiries

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Appendix 16-B

Contingent Liabilities - Decision Tree