CAPITAL COMMITMENTS

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Learning objectives

- Define capital commitments
- Differentiate it to other liabilities
- Identify the applicable GRAP standards
- Accounting treatment
- How NT disclosure checklist gets performed
- Basic calculations
- Account for the effect of retentions
- Audit risks

Capital commitments definition and other liabilities

Capital commitment arises 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 item of property, plant and equipment.

Payables, arise when the goods and services have been invoiced or formally agreed with the supplier; and

Accruals, arise when the goods and services have been received but have not been invoiced or formally agreed with the supplier, including amounts due to employees. Although the amount or timing may need to be estimated, there is much less uncertainty involved

Capital commitments GRAP standard

Questions are frequently asked about whether the Standards of GRAP include a universal requirement to disclose commitments.

The answer is **no** – there is no universal requirement.

GRAP 1 refers to the disclosure of unrecognised contractual commitments in paragraph .124(d)(i).

The paragraph needs to be read in the context of the requirements of the other Standards to disclose commitments.

Capital commitments – AFS treatment

Commitments are not recognized as liabilities in the financial statements,

However, the GRAP standards listed in the next slides require them to be disclosed in the notes to annual financial statements.

Standards of GRAP that require the disclosure of commitments are:

- Operating leases (see GRAP 13)
- The purchase, construction, development, or repair and maintenance of investment property (see GRAP 16).
- The acquisition of property, plant and equipment (see GRAP 17.86(b))
- The acquisition of intangible assets (see GRAP 31.123(d)).
- The acquisition, maintenance and restoration of heritage assets (see GRAP 103).

Extracts from NT disclosure checklist

		Response	GRAP Ref	Comments
	d) the amount of contractual commitments for the acquisition of intangible assets?	☐Yes ☐No	31.123(d)	Click or tap here to enter text.

	c) the amount of contractual commitments for the acquisition, maintenance and restoration of heritage assets; and	☐Yes ☐No	103.91(c)	Click or tap here to enter text.

	b) the amount of contractual commitments for the acquisition of property, plant and equipment?	☐Yes ☐No	17.86(b)	Click or tap here to enter text.

Capital commitments basic calculations

Example: assets under contraction contracts

A municipality enters into an agreement with a Contractor for the construction of a local road, as approved in the municipal infrastructure grants. The contract was signed by both delegated parties on 13 January 2025. The Contractor is expected to hand over the road to the municipality on 12 January 2028 (36 months contract). The contract value was R10 000 000.

Year end is 30 June 2025

Contract in place, and a capital project, therefore, disclosure should be made in terms GRAP 17.86(b).

Assume all amounts are exclusive of VAT.

Scenario 1 – No retention

Based on the available documents which confines to the municipal expenditure policy (such as, progress report and site inspection were met)

Invoice 011 dated, 31 March 2025 for R500 000

Invoice 022 dated, 18 June 2025 for R1 800 000

Due to financial constraints, the municipality was only able to settle the first invoice by 30 June 2025. R500 000 was paid on 30 April 2025

Capital commitments calculation

Contract amount **R10 000 000**

Less a portion that no longer meets the definition of commitments as at 30 June 2025:

> Invoice 011 – Amount was recognized as a liability on invoice date. Amount became a payable (current liability – no longer a commitment), and later got settled. (R500 000)

> Invoice 022 – Amount was recognized as a liability on invoice date. Amount became a payable (current liability – no longer a commitment (R1 800 000)

Balance – representing commitments **R7 700 000**

Extract from the AFS of the municipality

	2025	2024
1. Commitments		
> Property, plant and equipment	7,700,000.00	0.00
Note: The above amounts are exclusive of VAT		

Scenario 1 - Journals

31 March 2025		
Dr WIP (roads)	R500 000	
Cr Payables (current liabilities)		R500 000
Expenditure payable recognised as WIP (or something similar)		
30 April 2025		
Dr Payables (current liabilities)	R500 000	
Cr Bank		R500 000
Payment of a Road Contractor		
18 June 2025		
Dr WIP (roads)	R1 800 000	
Cr Payables (current liabilities)		R1 800 000
Expenditure payable recognised as WIP (or something similar)		

Scenario 2 – with retentions

Based on the available documents which confines to the municipal expenditure policy (such as, approved completion certificates, progress report, etc. were met)

Invoice 011 dated, 31 March 2025 for R500 000

Invoice 022 dated, 18 June 2025 for R1 800 000

Due to financial constraints, the municipality was only able to settle the first invoice by 30 June 2025.

Based on the signed contract, 5% of the payments are withheld as a retention. The withheld funds would be released after 12 months from completion date, therefore, due on 13 January 2029.

Definition of retention

- mSCOA Definition: Usually an amount of money held back by the municipality to ensure that the contractor works properly. This retention money is due to the contractor as the work is completed, but will not be paid out. This is to ensure that contractors correct any defective work. Normally half of the retention money is paid to the contractor when the project is delivered (or the engineer issues the Certificate of Completion) and the other half is paid within 14 days after the end of the defects liability period.

Accounting treatment of retentions

From the definition we noted that the retention amount is due to the Contractor. But was not paid since the Municipality is still waiting for the defect period to lapse or the Contractor to rectify the defects.

No longer a commitment, **but a trade payable.**

Look for classification (current or non-current liability) – Consider the period when the retention is due at year-end.

The municipality should document the correct treatment on its accounting policy, and have it adopted by the Council for easy reference by an independent person like auditors. Relevant clause included on the SLA with the Contractor

Capital commitments calculation

Contract amount **R10 000 000**

Less a portion that no longer meets the definition of commitments as at 30 June 2025:

> Invoice 011 – Amount was recognized as a liability on invoice date. Amount became a payable (**non-current liability*** – no longer a commitment), and later got settled. (R500 000)

> Invoice 022 – Amount was recognized as a liability on invoice date. Amount became a payable (current liability – no longer a commitment (R1 800 000)

Balance – representing commitments **R7 700 000**

Scenario 2 - Journals

31 March 2025		
Dr WIP (roads)	R500 000	
Cr Payables (current liabilities) (500k* 95%)		R475 000
Cr Retention (non-current liabilities) (R500k*5%)		R25 000
Expenditure payable recognised as WIP (or something similar). Retentions due after 12 months, therefore, classified as non-current		
30 April 2025		
Dr Payables (current liabilities)	R475 000	
Cr Bank		R475 000
Payment of a Road Contractor net of retentions		
18 June 2025		
Dr WIP (roads)	R1 800 000	
Cr Payables (current liabilities) (1 800k*95%)		R1 710 000
Cr Retention (non-current liabilities)		R110 000
Expenditure payable recognised as WIP (or something similar). Retentions due after 12 months, therefore, classified as non-current		

Extract from the AFS of the municipality – No change for both scenarios

	2025	2024
1. Commitments		
> Property, plant and equipment	7,700,000.00	0.00
Note: The above amounts are exclusive of VAT		

Common errors from auditor perspective

- NT disclosure checklist not completed – leading to omission of required commitments. The focus should not only be about capital commitments. See slide 6 for the full list. (Completeness risk)
- Inclusion of any other operational commitments that are not required by GRAP. (Valuation risk)
- Awarded contracts from the bid register that meets the definition of commitments not included in the commitments register. (Completeness risk)
- Incorrect calculations (not treating retention as a separate liability or other formular errors). (Valuation risk)
- Retention incorrect classification. Due after 12 months but treated as current liability. (Classification risk)
- Rates-based contracts generally do not lead to commitments, unless the order has been issued and relates to items required for disclosure. But you can also add a narrations about these underneath the commitments note.

MCAI is a call away for other possible technical discussions.

Thank You