

Contingent Liabilities

Contingent liabilities are **possible obligations that may become liabilities** (e.g. lawsuits, contaminated sites) in the future. The defining characteristics of contingent liabilities are:

- 1) There must be an existing condition or situation the outcome of which is uncertain; and
- 2) An expected future event will resolve the uncertainty.

Is the municipality currently involved in a situation where the outcome of the situation is unknown, but an unfavourable outcome could result in a requirement for the municipality to make future cash payments to resolve the situation?

If so, then a contingent liability exists. The municipality then has to determine whether the municipality must record the contingent liability in the financial statements or disclose the existence of the contingent liability in the notes to the financial statements. To make that determination, the municipality must answer the following questions

Is the probability that the expected future event will confirm that a liability exists:

| | Yes | No |
|---|--------------------------|--------------------------|
| Likely (probability is high) Legal counsel advises that you should settle the lawsuit with the litigant because they have a strong case. | <input type="checkbox"/> | <input type="checkbox"/> |
| Unlikely (probability is slight) Legal counsel views a lawsuit to be frivolous and has no basis in law. | <input type="checkbox"/> | <input type="checkbox"/> |
| Not Determinable Legal counsel views a lawsuit as possibly being settled in favour of either party. | <input type="checkbox"/> | <input type="checkbox"/> |

The second question involves whether a determination can be made of the amount involved.

Can the amount involved be reasonably estimated? Yes No

Based on the municipality's answers above, a contingent liability should be:

1. Recorded in the financial statements when:
 - it is likely that the future event will confirm the existence of a liability; and
 - the amount of the liability can be reasonably estimated.
2. Disclosed in the notes to the financial statements when:
 - the occurrence of confirming event is likely but the amount cannot be reasonably estimated;
 - there is exposure for an additional liability in excess of the amount presently recorded; or
 - the outcome of the future event is not determinable.

The following chart indicates the financial reporting requirements for each situation.

| Probability of the Confirming Future Event | Amount of the Liability Can Be Reasonably Estimated | Amount of the Liability Cannot Be Reasonably Estimated |
|---|--|---|
| Likely | Accrue in the F/S | Disclose the situation in the notes |
| Not Determinable | Disclose the situation & amount in the notes | Disclose the situation in the notes |
| Unlikely | No action required | No action required |