

NDLAMBE MUNICIPALITY



IMPAIRMENT OF ACCOUNTS RECEIVABLE POLICY

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POLICY FOR THE IMPAIRMENT OF ACCOUNTS RECEIVABLES

(1) PURPOSES OF POLICY

The purpose of the policy is to provide guidelines for the impairment calculation of accounts receivable.

The effective management of debtors include, amongst others, the following processes:

- Implementation/ maintenance of the appropriate Information and Communication Technology (ICT) Systems and Business Processes;
- Accurate Billing;
- Customer Care and Accounts enquiry management;
- Effective and timeous Credit Control;
- Impairment of Debtors (Provision for Doubtful Debtors);

(2) OBJECTIVE OF THE POLICY

To ensure that the debtors disclosed in the annual financial statements are stated at amounts that are deemed to be collectable

(3) DEFINITIONS

For the purposes of this policy the following definitions are applicable:

“Debt” - means an amount owing to the Municipality;

“Debtor” – means a person who owes the Municipality money for rates/services rendered;

“Accounting Officer” – the Municipal Manager appointed;

“Council” – means the council of the Municipality;

“Municipality” – means the Ndlambe Municipality.

“Impairment loss” – GRAP 104 - means the difference between the asset’s carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset’s original effective interest rate (i.e. the effective interest rate computed at initial recognition).

“The effective interest method” - is a method of calculating the amortised cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, an entity shall estimate cash flows considering all contractual terms of the financial instrument.

(4) **BACKGROUND FROM GRAP STANDARDS**

In terms of GRAP 104 - *An entity shall assess at the end of each reporting period whether there is any objective evidence that a financial asset or group of financial assets is impaired.*

GRAP 104 defines objective evidence that a financial asset or group of assets is impaired to include observable data that comes to the attention of the holder of the asset about the following loss events:

- (a) significant financial difficulty of the issuer or obligor;
- (b) a breach of contract, such as a default or delinquency in interest or principal payments;
- (c) the lender, for economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the lender would not otherwise consider;
- (d) it is probable that the borrower will enter sequestration or other financial reorganisation;
- (e) the disappearance of an active market for that financial asset because of financial difficulties; or
- (f) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including:
 - (i) adverse changes in the payment status of borrowers in the group (e.g. an increased number of delayed payments); or
 - (ii) national or local economic conditions that correlate with defaults on the assets in the group (e.g. an increase in the unemployment rate in the geographical area of the borrowers, or adverse changes in market conditions that affect the borrowers in the group)

(5) **IMPAIRMENT OF DEBTORS NOT RAISED BY/ LOWERED BY**

National Treasury suggested approach in calculating debtor's impairment:

Advice on system changes on the Financial system to comply with GRAP with regard to provision for doubtful debts.

A report from the system should supply suitable information regarding the following:

- Ageing of each debtor
- Active / inactive account
- Tenants' / owners' account
- Debtor type: Residential, Business, Indigent, Government, etc.

Calculation of Impairment of Debtors

Impairment of debtors (Provision for doubtful debts) will be calculated as follows:
Refer to the Munsoft Ageing Report on the Consumer Debtor module with the following columns with headings and factors:

(a) Column Heading: Status Risk Score

Referring to an active and inactive debtors account

Factors applied as follows:

Inactive debtors account status equals to a factor of 2 due to the chances of collecting the debt from an inactive account is less than collecting from an active account.

Active debtors account status equals to a factor of 0 due to the chances of collecting from an active account holder is higher than from an inactive account holder.

Status Risk Indicator	Status Risk Score
Active	0
Inactive	2

(b) Column Heading: Type Risk Score

Referring to an owner or occupier account

Factors applied as follows:

Occupier debtors account type equals to a factor of 2 due to the lesser chance to collect the amount owed

Owner debtors account type equals to a factor of 0 due to the higher chance of collecting the debt e.g. when the owner sells the property debt should be settled before the Municipality issues the rates clearance certificate

Type Risk Indicator	Type Risk Score
Owner	0
Occupier	2

(c) Column Heading: Account Type Risk Score

Referring to the category and electricity distribution licence area of the property eg Government, Business Municipal Licence area and Business Eskom Licence area etc.

Factors applied as follows:

NT GROUP CODE	Type Risk Indicator	Type Risk Score
2201	National: Agriculture Forestry and Fisheries	0
2214	National: Home Affairs	0
2215	National: Human Settlements	0
2218	National: Justice and Constitutional Development	0
2224	National: Police	0
2228	National: Rural Development and Land Reform	0
2250	Provincial: Agriculture	0
2251	Provincial: Education	0
2252	Provincial: Health	0
2253	Provincial: Housing and Local Government	0
2255	Provincial: Other Departments	0
2256	Provincial: Public Works Roads and Transport	0
2257	Provincial: Social Development	0
2290	RSA	0
2301	Businesses: Municipal Licensed Area	1
2302	Businesses: Eskom Licensed Area	2
2303	Industrial: Municipal Licensed Area	1
2304	Industrial: Eskom Licensed Area	2
2310	Other: Eskom Licensed Area	2
2311	Business - Mun Licensed Area No Meters	2
2312	Agriculture (FARM) - Eskom Licensed Area	2
2313	Mun owned prop – Mun Licensed Area	0
2314	Mun Owned prop – Eskom Licensed Area	0
2315	PSI – Mun Licensed Area	1
2316	PSI – Eskom Licensed Area	2
2317	Church-Mun Licensed Area	1
2319	PSI – Mun Licensed Area No Meter	2
2321	Industrial: Municipal Licensed Area No Meter	2
2323	Mun Owned prop – Mun Licensed Area No Meter	0

2325	Church-Mun Licensed Area No Meter	2
2401	Households: Non-indigents - Municipal Licensed Area	1
2402	Households: Non-indigents - Eskom Licensed Area	2
2403	Households: Indigents - Municipal Licensed Area	2
2404	Households: Indigents - Eskom Licensed Area	2
2405	Households Staff - Municipal Licenced Area	1
2406	Households Staff - Eskom Licenced Area	2
2407	Households Councillors - Municipal Licenced Area	0
2408	Households Councillors - Eskom Licenced Area	0
2409	Households: Non-indigents - Mun Licensed Area No Meters	2
2411	Households: Indigents - Mun Licensed Area No Meters	2

(d) Column Heading: Total Type Risk

The Total Type Risk is the sum of Status risk score, Type Risk Score and Account Type Risk Score

(e) Column Heading: Ageing from 30 days to 180+ days

The impairment payment risk factors is based on the ageing of the consumers account. The longer outstanding the higher the risk factor.

Up to 30 Day Factor	60 Day Factor	90 Day Factor	120 Day Factor	150 Day Factor	180+ Day Factor
0	0.5	0.5	0.75	0.75	3.7

(f) Column Heading: Total Payment Risk

The Total Payment Risk is the sum of the ageing factors from 30 days to 180+ Days

(g) Column Heading: Provision Factor

The Provision factor is calculated by multiplying the TOTAL TYPE RISK with the TOTAL PAYMENT RISK, 10 being the highest tolerated risk. Therefore if the total is more than 10, then it impairs the full outstanding amount (100%) of the consumer due to the identified risk factors.

A provision factor <10 represents insufficient factors to suggest that the entire outstanding amount is impaired. The Provision factor is then multiplied by 10 to achieve a score out of a 100 deemed the *Factor*. This then allows for the

calculation of a pro-rata doubtful debts determination on this score out of 100 (ie % doubtful debts) E.g. if the provision factor is 3.75 the impairment percentage will be 37.50% of the service balance.

EXAMPLE A :

Debtor A – Amount outstanding R1 200.00

Let us assume the consumer scored the following for each report:

A) Type risk = (Status Risk + Type Risk + Acc Type Risk)
Type Risk = (2 + 2 + 1.25)
Type Risk = 5.25

B) Payment Risk = (30days + 60days + 90days + 120days + 150days + 180+days)
Payment Risk = (0.0 + 0.5 + 0.5 + 0.75 + 0.75 + 3.7)
Payment Risk = 6.2

C) Provision Factor = Type Risk x Payment Risk
Provision Factor = 5.25 x 6.2
Provision Factor = 32.55

The Provision factor is greater than 10, the entire debtor's amount is considered to be impaired. The provision for impairment relating to this debtor amounts to R1 200.00.

EXAMPLE B :

Debtor B – Amount outstanding R1 200.00

Let us assume the consumer scored the following for each report:

D) Type risk = (Status Risk + Type Risk + Acc Type Risk)
Type Risk = (0 + 0 + 1)
Type Risk = 1

E) Payment Risk = (30days + 60days + 90days + 120days + 150days + 180+days)
Payment Risk = (0.0 + 0.5 + 0.0 + 0.0 + 0.75 + 3.7)
Payment Risk = 4.95

F) Provision Factor = Type Risk x Payment Risk

$$\begin{aligned}\text{Provision Factor} &= 1.0 \times 4.95 \\ \text{Provision Factor} &= 4.95\end{aligned}$$

The Provision factor is less than 10, therefore a portion of the outstanding debt is considered doubtful. The provision factor is multiplied by 10 to achieve an impairment rate factor of 49.5%. This is the % of debt that is considered uncollectable based on the risk factors identified. The provision for impairment relating to this debtor amounts to R1 200.00 x 49.5% = R594.00. Future cashflow (FcF) expected is therefore R 606.00

Note - the calculation is not finalised here as the discounting of the future cashflow still needs to be determined.

(h) Present value of future cashflows

The measurement of the impairment loss should however take into account the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition).

In order to adhere to GRAP 104, we need to determine 2 variables necessary for determination of the PV of future cashflows – being the discount rate and the estimated collection period.

The following 2 elements must be considered –

- i) The assets' original effective interest rate**
This is considered to be the interest charged on outstanding debt at the municipal rate of prime + 1% as this is the contractual rate for late payment on the financial instrument and discounts future cashflows to the carrying value.
- ii) The risk dependent period affecting the collection**
In keeping with the model devised by National Treasury the estimate future collection period (Ave days) is extended by the risk affected rating (RR) according to the following table –

Total Risk Factor		Increase in future collection period (RR)
0 - 19.99	Probably not impaired	100%
> 20 - 39.99	Increase expected number of days outstanding with 20%	120%
>= 40 - 59.99	Increase expected number of days outstanding with 40%	140%
>= 60 - 79.99	Increase expected number of days outstanding with 60%	160%
>=80 - 99.99	Increase expected number of days outstanding with 80%	180%
100	100% of debtor amount	

The estimated future collection period in turn is determined by reference to the current outstanding weighted average debtors' days.(Ave days)
To obtain the final discount period (DiscP), the Ave days are multiplied by the RR.(Ave days x RR = DiscP)

Final calculation –

In order to obtain the discounted future cashflows the following is calculated:

Discounted Future cashflow (DiscFcF)= $FcF / (1 + (DiscP/365 * Discount\ rate))$

The difference between the FcF and the DiscFcF is then considered as additional impairment as the carrying value of the debtor is adjusted downwards to reflect only the DiscFcF.

Lets considered the same examples as above -

EXAMPLE A :

Debtor A – Amount outstanding R1 200.00

Let us assume the consumer scored the following for each report:

A) Type risk = (Status Risk + Type Risk + Acc Type Risk)
Type Risk = (2 + 2 + 1.25)
Type Risk = 5.25

B) Payment Risk = (30days + 60days + 90days + 120days + 150days + 180+days)
Payment Risk = (0.0 + 0.5 + 0.5 + 0.75 + 0.75 + 3.7)
Payment Risk = 6.2

C) Provision Factor = Type Risk x Payment Risk
 Provision Factor = 5.25 x 6.2
 Provision Factor = 32.55

The Provision factor is greater than 10, the entire debtor's amount is considered to be impaired. The provision for impairment relating to this debtor amounts to R1 200.00. No further calculation is necessary as the amount is 100% impaired, hence the FcF will be R nil.

EXAMPLE B :

Debtor B – Amount outstanding R1 200.00

Let us assume the consumer scored the following for each report:

D) Type risk = (Status Risk + Type Risk + Acc Type Risk)
 Type Risk = (0 + 0 + 1)
 Type Risk = 1

E) Payment Risk = (30days + 60days + 90days + 120days + 150days + 180+days)
 Payment Risk = (0.0 + 0.5 + 0.0 + 0.0 + 0.75 + 3.7)
 Payment Risk = 4.95

F) Provision Factor = Type Risk x Payment Risk
 Provision Factor = 1.0 x 4.95
 Provision Factor = 4.95

The Provision factor is less than 10, therefore a portion of the outstanding debt is considered doubtful. The provision factor is multiplied by 10 to achieve an impairment rate factor of 49.5%. This is the % of debt that is considered uncollectable based on the risk factors identified. The provision for impairment relating to this debtor amounts to R1 200.00 x 49.5% = R594.00. Future cashflow (FcF) expected is therefore R 606.00

Lets consider the aging of the current debt as follows –

Ave days	15	45	75	105	135	180
Total	0-30 days	30-60 days	60-90 days	90-120 days	120-150 days	180+ Day Factor
1 200	-	200	-	-	400	600
Multiplied						
171 000	-	9 000	-	-	54 000	108 000

Weighted days 142.5 =171000/1200

Based on the above the Ave Days is 142.5 days.
The discount Period (DiscP) is determined by Ave days x RR

$$(142.5 \times 140\%) = 199.5 \text{ days (DiscP)}$$

The DiscFcF is calculated as follow –

Assume prime rate is 9%

$$\text{DiscFcF} = \text{FcF} / (1 + (\text{DiscP}/365 * \text{Discount rate}))$$

$$R606.00 / (1 + (199.5/365 * 0.10))$$

$$\text{DiscFcF} = R 574.59$$

$$\text{Total impairment} - R1 200.00 - R574.59 = R625.41$$

(6) RECOGNITION OF IMPAIRMENT LOSS

In terms of GRAP 104 the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. The carrying amount of the asset shall be reduced either directly or through the use of an allowance account. The amount of the loss (excl. VAT) shall be recognised in surplus or deficit, with the VAT portion being written off against the VAT provision account.

(7) REVERSAL OF IMPAIRMENT LOSS

In terms of GRAP 104 - If, in a subsequent period, the amount of the impairment loss decreases, and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss shall be reversed either directly or by adjusting an allowance account. The reversal shall not result in a carrying amount of the financial asset that exceeds what the amortised cost would have been had the impairment not been recognised at the date the impairment is reversed. The amount of the reversal (excl VAT) shall be recognised in surplus or deficit, with the VAT portion being reversed from the VAT provision account.

(8) RESPONSIBILITY / ACCOUNTABILITY

The Council has the overall responsibility for adopting and approving the Provision for Bad Debts Policy.