MSUNDUZI MUNICIPALITY

CITY OF CHOICE

PIETERMARITZBURG
MSUNDUZI

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The Msunduzi Municipality

IMPAIRMENT POLICY

Draft 2021/2022

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1. DEFINITIONS

In this policy, unless the context indicates otherwise, the word or expression has the following meaning:

1.1 **“Accounting Officer”** The Municipal Manager appointed in terms of Section 82(1)(a) or (b) of the Municipal Structures Act, 1998 (Act No. 117 of 1998).

1.2 **"Account Holder”** includes a customer/consumer and refers to any occupier of any premises to which Council has agreed to supply or is actually supplying services, or if there is no occupier, then the owner of the premises and includes any debtor of the municipality.

1.3 **“Chief Financial Officer”** refers to the person so designated in terms of Section 75(2)(a) of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) or any person duly authorised to act on behalf of such person.

1.4 **“Council”** refers to The Msunduzi Municipality and its successors in law and includes the Council of that municipality or its Executive Committee or any other body acting by virtue of any power delegated to it in terms of legislation, as well as any official to whom the Executive Committee has delegated any powers and duties with regard to this policy.

1.5 **“Financial year”** refers to the period starting from 1 July in a year to 30 June the next year.

1.6 **“GRAP”** means Generally Recognized Accounting Practices.

1.7 **“Impaired”** means the carrying amount exceeds its recoverable amount.

1.8 **“MFMA”** means Municipal Finance Management Act 56 of 2003.

1.9 **“Municipality”** when referred to as:

(a) a corporate body, means a municipality as described in Section 2 of the Municipal Systems Act, 2000 (Act No. 32 of 2000).
(b) a geographic area means a municipal area determined in terms of the Local Government Municipal Demarcation Act, 1998 (Act No. 27 of 1998).

1.10 **“Municipal Manager”** means the person appointed as Municipal Manager in terms of Section 82 of the Local Government Municipal Structures Act, 1998, (Act No. 117 of 1998) and includes any person acting in that position or to whom authority has been delegated.

1.11 **“Receivable”** means any amount due, owing and payable by a customer in respect of a municipal account not paid on the due date.

1.12 **“Reporting date”** means 30 June of each year.

2. PURPOSE OF THE POLICY

2.1 The purpose of this policy is to provide a framework for methodology for the impairment of receivables in line with applicable accounting standards;

2.2 To ensure that sufficient allowance is made for the impairment of receivables in the financial statements;

2.3 To ensure that receivables disclosed in the financial statements are stated at amounts that are deemed collectable; and

2.4 To promote transparency as required by sections 215 and 216 of the Constitution when dealing with receivables and debt.

2.5 This policy must be supported by Standard Operating Procedures on Impairment, which must be reviewed at least annually by management.

3. SCOPE OF POLICY

3.1 The methodology is applicable to all receivables subsequently measured at amortized cost.

3.2 This includes the following line items as disclosed on the statement of financial position:

3.2.1 Consumer receivables;

3.2.2 Receivables from exchange transactions; and

3.2.3 Receivables from non-exchange transactions.

4. APPLICABLE ACCOUNTING STANDARDS

4.1 **GRAP 104** Financial Instruments sets out the requirements and guidelines for the impairment of financial assets subsequently carried at amortised cost.

4.2 **GRAP 104.46** "All financial assets measured at amortised cost, or cost, are subject to an impairment review in accordance with paragraphs .57 to 64."

4.3 **GRAP 104.57** "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. If any such evidence exists, the entity shall apply paragraphs .61 to .63 (for financial assets carried at amortised cost) and paragraph .64 (for financial assets carried at cost) to determine the amount of any impairment loss."

4.4 **GRAP 104.58** "A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a loss event) and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated."

4.5 **GRAP 104.61** "If there is objective evidence that an impairment loss on financial assets measured at amortised cost has been incurred, the amount of the loss is measured as 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 carrying amount of the asset shall be reduced either directly or through the use of an allowance account. The amount of the loss shall be recognised in surplus or deficit."

4.6 **GRAP 104.62** "An entity first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant (see paragraph .58). If an entity determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment."

5. <u>METHODOLOGY</u>

5.1 Timing of Assessment

5.1.1 The Municipality will assess at the end of each financial year, whether there is objective evidence, that a receivable account or group of receivable accounts is impaired.

5.2 Evidence of Impairment

5.2.1 The following accounts are specifically excluded from impairment testing:

5.2.1.1 Receivable accounts with a combined credit balance at reporting date;

5.2.2.2 Receivable accounts where the combined balance at reporting date is zero;

5.2.2.3 Receivable accounts where the Msunduzi Municipality is the account holder;

5.2.2.4 Receivable accounts where the Government, State Owned Entities and Other Municipalities is the account holder; and

5.2.2.5 Receivable accounts that have no balance outstanding greater than 30 days at reporting date as these accounts are considered not to be past due.

5.2.2 Any one of the following events is considered to provide objective evidence that a receivable account or group of receivable accounts, other than those accounts referred to in (5.2.1) above, could be impaired:

5.2.2.1 Receivables that have been placed under or applied for liquidation or sequestration;

5.2.2.2 Accounts handed over to debt collectors and/or power of attorney;

5.2.2.3 All accounts indicated as in-active accounts on the system;

5.2.2.4 When a formal arrangement is made on arrears debt;

5.2.2.5 All accounts with balances outstanding 90 days and longer as these accounts are considered to be past due.

5.3 Calculation and Recognition of Impairment Loss

5.3.1 The impairment loss is calculated as the difference between the carrying-value at reporting date less the present value of expected future cash flows.

5.3.2 The impairment loss is recognised in the statement of financial performance as:

5.3.2.1 an impairment loss where there's an increase in the impairment balance at reporting date compared to the balance on the comparative reporting date; or

5.3.2.2 as a reversal of impairment loss where there's a decrease in the impairment balance at reporting date compared to the balance on the comparative reporting date.

5.3.3 The impairment is recognised in the statement of financial position as either a credit (increase) or debit (decrease) to the impairment allowance account compared to the balance at the comparative reporting date.

5.4 Individually Significant Receivables

5.4.1 Consumer receivables with a total balance outstanding at reporting date in excess of **R1 000 000,00** is considered material and will be assessed individually for evidence of impairment. Management must maintain evidence of determination of recoverability or impairment for these receivables.

5.4.2 Where a debtor is both Indigent with a balance in excess of R1000 000 at reporting date, the Indigent status prevails in the calculation of impairment.

5.5 Risk Categories

5.5.1 All receivables are categorised into one of three risk categories. These categories are:

5.5.1.1 High risk category;

5.5.1.2 Medium risk category; and

5.5.1.3 Low risk category.

5.5.2 The allocation of receivables into the different risk categories are reviewed at every point of impairment determination per the management standard operating procedures.

5.5.3 **Consumer Receivables**

5.5.3.1 The following consumer receivables are specifically identified as being **high risk** due to their nature:

- Accounts with balances of 90 days and more.

5.5.3.2 The following receivables are specifically identified as being **low risk** receivables due to their nature and past payment history:

- Accounts with current and 30 days outstanding balance.

5.5.3.3 The following receivables are specifically identified as being **medium risk** receivables due to their nature and past payment history:

- Accounts with balances of 31 to 90 days only.

5.5.4 **Receivables from Exchange Transactions and Receivables from Non-Exchange Transactions**

5.5.4.1 The categorisation of receivables from exchange and non-exchange transactions inline with three risk categories will be similar to consumer receivables, as defined above in 5.5.3.

5.5.5 **Summary of risk groups for consumer and other receivables**

High risk	Medium risk	Low risk
Accounts that are outstanding for more than 90 days. **Indigent Accounts that are outstanding for more than 31 days**	Accounts with balances 31 to 90 days	Accounts with 30 days and current balances

5.5.5 The total income from consumers for the reporting period include:

- Property Tax;
- Refuse;
- Sewerage;
- Water;
- Electricity;
- Interest; and
- Sundry Charges.

5.5.6 The total income from receivables from exchange and non-exchange transactions include:

- Agency services;
- Licences and permits;
- Operational revenue;
- Rental of facilities and equipment;
- Rendering of services;
- Sale of goods;
- Fines, penalties and forfeits; and
- Other transfers

6. <u>DISCOUNT RATE</u>

6.1 The rate used to discount future cash flows will be the rate as per the approved tariff register (i.e. the interest rate)

6.2 The discount rate is adjusted with a premium per risk category. The following is taken into account in determining the premium:

6.2.1 The history of bad debts written off;

6.2.2 Effectiveness of the debt collection processes; and

6.3 Based on the above risk factors identified the discount rate is adjusted with the following premium:

Risk category	Premium adjustment
High risk	1.25%
Medium risk	1%
Low risk	Not applicable as debts are not considered impaired recoverable within normal payment terms

6.4 The risk factors and premium adjustment will be reviewed annually by management.

7. EXPECTED FUTURE CASH FLOWS

Group	Expected future cash flow
1. Indigent receivables	Accounts marked as indigent do not expect any re-payment and is therefore included at 100% of balance owing in the allowance calculation with the exception of indigent customers with only balances of 30 days and less.
2. High risk consumer receivables	Recoverability will be **42%** as per managements past experience with this category of debtors
3. Medium risk consumer receivables.	Recoverability will be **80%** as per managements past experience with this category of debtors.
4. Low risk consumer receivables	Fully recoverable

8. PRESENT VALUE OF EXPECTED FUTURE CASH FLOWS

8.1 The present value of expected future cash flows is calculated by discounting the expected future cash flows by the discount rate.

9. REVIEW OF METHODOLOGY

9.1 In terms of section 17(1)(e) of the MFMA polices must be reviewed on an annual basis and the reviewed policy tabled to Council for approval as part of the budget process.