Metsimaholo Municipality

DEBT IMPAIRMENT METHODOLOGY AND APPROACH

Reviewed for 2022/2023 Financial Year

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1. Background

The Municipal Finance Management Act, Act 56 of 2003 states that the municipality must manage its revenue by ensuring a proper system of internal control exists in respect of debtors and revenue.

Furthermore, the Standard of Generally Recognised Accounting Practice (GRAP 104) - Financial Instruments paragraph 46 states: "Subsequent measurement of financial assets - All financial assets measured at amortised cost, or cost, are subject to an impairment review in accordance with paragraphs .57 to .64."

The municipality must budget for realistic anticipated revenue less an acceptable provision for impairment.

The policy aims to ensure that debtors are disclosed in the annual financial statements at the amounts deemed to be collectable.

By adopting this policy clear guidelines are set on the treatment of the impairment of debtors.

2. Objective

The objectives of this methodology are to:

- Ensure that any outstanding debt with an indicator of impairment be assessed to determine the possibility of recovering such debt.
- Ensure that where it is evident that a debt cannot be recovered such debt be procedurally regarded as irrecoverable.
- Ensure that the Council of the municipality makes enough provision for impairments in their budget.
- Ensure that the impairment loss is recognised in surplus and deficit when there is objective evidence that it is impaired.
- Ensure that impairment is measured as the difference between the receivables carrying amount and the present value of estimated future cash flows discounted at the effective interest rate, computed at initial recognition.

3. Legislative framework

Municipal Systems Act, Act 32 of 2000.

- Municipal Finance Management Act, Act 56 of 2003.
- Standards of Generally Recognised Accounting Practice (GRAP).

4. Application to categories of debtors

This methodology will be applicable to the following categories of debtors:

- Consumer Debtors
    - Electricity
    - Water
    - Sewerage
    - Refuse
- Traffic Fines
- Rates
- Sundry Debtors
- Sale of Stands

5. Impairment approach excluding traffic fines

Receivables relating to the above categories are stated at cost less provision for impairment.

5.1. Step 1 – Identify receivables with no impairment indicator

The following accounts are specifically excluded from impairment testing:

- Receivable accounts with credit balance at reporting date;
- Receivable accounts where the balance at reporting date is zero;
- Receivable accounts where the Municipality is the owner; and
- Receivable accounts that have no balance outstanding longer than 30 days at reporting date as these accounts are considered not to be past due.

5.2. Step 2 – Identify and assess receivables that are significant

- When completed step one above identify all accounts where the total balance outstanding is above R 150 000 from all the remaining accounts on the consumer age analysis;
- These accounts must then be assessed individually;
- For each of these accounts determine their recoverability separately by considering the following indicators listed below. This would inform management that no payment can be expected from these accounts.
    - Is the account marked as inactive?
    - Has the account been handed over for debt collection?
    - Is the customer being liquidated/sequestrated?
    - Has the customer made any payments in the last 60 days before year end?
    - Has the customer made any payments after year end?
- If any of the significant receivables were found to be fully recoverable then copy and paste these accounts back onto the receivable age analysis. These receivables now must be assessed with the remaining group of receivables.

5.3. Step 3 – Identify all receivables with the following indicators of impairment

Any one of the following events is considered to provide objective evidence that a receivable account or group of receivable accounts could be impaired.

- All receivables placed under or applied for liquidation or sequestration
- Where the last payment date by the customer was before 1 May of the reporting period, thus 61 days before the reporting date.
- Accounts handed over to debt collectors and or to attorneys for collection;
- Receivables with balances indicated as in-active accounts on the system;
- Defaulting on a formal arrangement pertaining to arrear debt not paid;
- Receivables that have been formally presented to the CFO or Mayoral Committee or Council for write off; and
- All accounts with balances outstanding 90 days and longer as these accounts are past due

5.4. Step 4 – Allocate debtors to risk categories

For each account identified as being individually assessed, determine their recoverability separately by considering the past payment trend of the receivable. The past payment trend will be used to allocate receivables in to the following categories:

i) High – H

Customers with a payment trend of below 59% are considered as being high risk

ii) Medium – M

Customers with a payment trend of between 60% and 79% are considered as being medium risk

iii) Low – L

Customers with a payment trend of above 80% are considered as being low risk

Information to be used to obtain the payment trend:

The payment trend is calculated monthly by the manager revenue. Obtain these calculations from him and update calculations.

5.5. Step 5 – Determine the discount rate

The discount rate is set as the prime lending rate at reporting date, and can be obtained from the Reserve Bank website at reporting date.

https://www.resbank.co.za/Research/Rates/Pages/CurrentMarketRates.aspx

The prime rate is adjusted with a premium per risk category. The following is considered in determining the premium:

1. The economic conditions of the population in the municipal district;
2. History of bad debts written off;
3. Effectiveness of the debt collection processes;
4. Social problems in the rural community;
5. High unemployment rate in the municipal district.

Based on the above risk factors identified the risk-free rate is adjusted with the following premium

Risk category	Premium adjustment
High risk	1.25%
Medium risk	0.75%
Low risk	0.25%

The risk factors and premium adjustment to the prime-rate are reviewed annually by management.

5.6. Step – 6 Determine the expected future cash flows

The expected future cash flows are based on management's past experiences with the different debtor groups.

The expected future cash flows can be summarised as follows:

Group	Expected future cash flow
1. Accounts with no payment received in the last six months	No payment expected
2. Indigent receivables	Accounts marked as indigent do not expect any re-payment and is therefore included at 100% in the allowance calculation
3. Inactive accounts	No payment expected
4. Accounts marked as bad debts	No payment expected
5. Accounts with balances only in current, 30 days and/or 60 days	Fully recoverable
6. High risk consumer receivables	Based on percentage of the high-risk receivable's. Use the balance as per the age analysis report BP 136 after allowing for items 1-4 above as per May of the current financial year. Adjust the balance with receipts in June excluding June billing.
7. Medium risk consumer receivables	Based on percentage of the medium risk receivable's. Use the balance as per the age analysis report BP 136 after allowing for items 1-4 above as per May of the current financial year. Adjust the balance with receipts in June excluding June billing.
8. Low risk consumer receivables	Based on percentage of the low risk receivable's. Use the balance as per the age analysis report BP 136 after allowing for items 1-4 above as per May of the current financial year. Adjust the balance with receipts in June excluding June billing.
9. High risk sundry receivables	Based on percentage of the high-risk receivable's. Use the balance as per the age analysis report BP 136 after allowing for items 1-4 above as per May of the current financial year. Adjust the balance with receipts in June excluding June billing.
10. Medium risk sundry receivables	Based on percentage of the medium risk receivable's. Use the balance as per the age analysis report BP 136 after allowing for items 1-4 above as per May of the current financial year. Adjust the balance with receipts in June excluding June billing.
11. Low risk sundry receivables	Based on percentage of the medium risk receivable's. Use the balance as per the age analysis report BP 136 after allowing for items 1-4 above as per May of the current financial year. Adjust the balance with receipts in June excluding June billing.

5.7. Step 7 – Calculate the expected repayment term

The expected repayment term for high, medium and low risk receivables is calculated per risk category as follows:

5.7.1. Step 7.1 Determine the average receivable balance for the reporting period

The average receivable balance for the current period is calculated as follows:
Total outstanding receivable balance as reporting date **plus** the total receivable balance as per the prior year annual financial statements (AFS) closing balance **divided** by two.

5.7.2. Step 7.2 Determine expected payment term

The expected payment term is calculated as follows:

The total average outstanding receivable balance as per 5.7.1 above divided by the total average receipts from consumers for the reporting period multiplied by 365 days.

The following information must be obtained to perform expected payment term calculation:

- Prior year closing balance of debtors as per audited AFS;
- Current year balance as age analysis report BP136;
- Actual receipts – obtain calculations from the manager revenue.

5.7.3. Step – 7.3 Determine the Present Value (PV) of the expected cash flows

The PV of the expected future cash flows are determined by discounting the total due per receivable based on the discount rate per risk category as calculated in step 6 above .

PV Calculation:

The present value of expected future cash flows are calculated using the present value formula in excel

- **Rate:** This is the discount rate as per methodology divided by 365 to get a daily rate
- **Total number of payments (Nper):** This is the expected term as calculated in step 7 above
- **Payment made (pmt):** This is zero
- **Future value (fv)**: This is the expected future cash flow as calculated in step 6 above
- **Type**: This is nil as payment is expected at the end of the month

5.8. Step 8 – Calculate and recognise impairment loss

1. Calculations are done utilising the relevant excel tool implemented for this purpose.

2. Calculate the impairment loss as the difference between the total balance outstanding as at reporting date and the present value of expected future cash flows as calculated above

3. Review the list to ensure that none of the amounts calculated in the impairment loss column is in negative

4. Calculate the movement in the provision by deducting the current year calculated provision from the provision made in the prior year

Description	Amount
Current year calculation	(XXX)
Prior year provision	(XX)
Difference	(X)

5. Prepare a journal to account for the movement as calculated above

5.1. If current year provision is lower than prior year provision the journal required is

5.1.1. DT Statement of financial position
5.1.2. CT Statement of financial performance

5.2. If the current year provision is higher than the prior year provision the journal required is:

5.2.1. DT Statement of financial performance
5.2.2. CT Statement of financial position

Age Analysis after impairment				
90+ Days	**60 Days**	**30 Days**	**Current**	**Total Due**
39 030 512,70	3 187 994,56	7 986 995,95	14 321 484,22	64 526 987,43
696 791,46	10 250,72	6 405,88	19 961,79	733 409,85
-	-	-	-	-
25 469 699,38	482 222,84	478 949,17	3 027 910,05	29 458 781,44
-	-	-	-	-
-	-	-	-	-
16 366 834,59	857 751,36	1 293 790,25	1 476 658,83	19 995 035,04
2 685 736,88	55 882,54	61 937,60	62 016,62	2 865 573,63
5 471 698,88	264 282,32	342 371,20	493 637,42	6 571 989,83
810 274,03	19 250,05	17 255,04	38 254,03	885 033,15
15 254 161,77	788 642,75	1 099 197,51	1 524 661,17	18 666 663,19
504 389,91	2 302,84	29 454,74	185 102,20	721 249,70
11 394 491,13	1 899 778,01	4 436 426,45	14 298 884,67	32 029 580,26
1 399 073,48	23 024,10	47 820,74	59 772,77	1 529 691,08
119 083 664,22	**7 591 382,09**	**15 800 604,51**	**35 508 343,77**	**177 983 994,59**

6. Impairment Traffic Fines

Traffic fines are recognised as debtor net of fines paid and withdrawn less allowance for impairment.

6.1. Impairment approach

- Traffic fines are grouped based on their general characteristic that when the National Road Traffic Act is violated the person is issued a fine.
- Outstanding fines older than 2 years are written off. The write off is done in terms of circular 2 of 2006 issued by the Director of public prosecutions of the Free State. Council approval must be obtained for these write offs.
- A past payment history of the last 5 years is calculated at each reporting date.
- The municipality anticipates receiving some fines in the following year, this percentage is determined at each reporting date based on the last 3 years payment history on warrant payments resulting from small amounts of monies that are received from concluded warrant cases and other outstanding fines. History of three years are used because outstanding cases over 2 years are written off.

6.2. Step 1 – Impairment calculation

Calculations are done utilising the relevant excel tool implemented for this purpose

6.2.1. Step 1.2 – Grouping of traffic fines

- Obtain (S341) report - Monthly Breakdown Analysis Report from the traffic department. This report gives a breakdown of the following:
    - Number of cases per month with breakdown as follows:
        - Admission of guilt (AOG)
        - Spot Fines
        - Warrants
        - Cases Finalised
            - Paid
            - Withdrawn
        - Outstanding cases

- Obtain summary report (?) - for outstanding cases from the traffic department. This report gives a breakdown of the following and reconciles with outstanding cases as report above:
    - Number of cases per month outstanding as follows:
        - 341 Hand Written
        - 341 Camera
        - G54 Summons
        - S56 Summons
        - Warrants
        - Monthly Totals

- The above reports are summarised in excel

METSIMAHOLO LOCAL MUNICIPALITY 31.20.11.2

Finalized & Paid Summary

From: 2016/07/01 To: 2017/06/30

Month	Cases		AOG		Spot Fine		Warrant		Finalized		Paid		Withdrawn		Paid Spot Fine		Paid AOG		Paid Warrant		Outstanding	
201607	2740	975 780	95	36 900	2644	938 680	1	200	345	106 200	280	80 650	65	25 550	276	79 600	4	1 050	0	0	2 395	869 580
201608	5471	2 104 130	1420	563 950	3921	1 494 030	130	46 150	503	164 800	330	98 350	173	66 450	248	76 050	58	16 150	24	6 150	4 968	1 939 330
201609	861	300 000	455	153 750	150	50 050	256	96 200	234	73 800	197	60 000	37	13 800	14	3 450	143	44 600	40	11 950	627	226 200
201610	1352	468 100	372	132 700	258	75 850	722	259 550	406	130 300	317	100 500	89	29 800	20	5 000	206	64 250	91	31 250	946	337 800
201611	2433	854 650	469	151 850	839	297 650	1125	405 150	638	202 850	520	156 300	118	46 550	33	10 400	400	120 950	87	24 950	1 795	651 800
201612	6403	2 583 180	346	109 800	5382	2 223 330	675	250 050	429	136 280	361	114 730	68	21 550	49	17 980	286	86 950	26	9 800	5 974	2 446 900
201701	3481	1 302 960	1235	442 330	1903	739 480	343	121 150	558	165 410	508	147 360	50	18 050	136	46 830	357	97 030	15	3 500	2 923	1 137 550
201702	3062	1 093 250	567	179 090	2007	742 610	488	171 550	425	122 120	385	108 720	40	13 400	37	13 280	320	87 790	28	7 650	2 637	971 130
201703	5 958	2 379 000	606	192 970	4681	1 928 880	671	257 150	585	185 170	545	171 420	40	13 750	140	44 930	386	119 390	19	7 100	5 373	2 193 830
201704	5 380	2 225 460	1110	404 830	4098	1 760 780	172	59 850	364	106 760	342	98 160	22	8 600	38	10 180	301	87 330	3	650	5 016	2 118 700
201705	2645	978 100	1122	406 750	1523	571 350	0	0	182	55 700	171	51 200	11	4 500	23	7 550	148	43 650	0	0	2 463	922 400
201706	2951	1 083 530	937	338 550	2014	744 980	0	0	48	16 050	48	16 050	0	0	3	300	45	15 750	0	0	2 903	1 067 480
					0																	
Total	**42 737**	**16 348 140**	**8734**	**3 113 470**	**29420**	**11 567 670**	**4583**	**1 667 000**	**4717**	**1 465 440**	**4004**	**1 203 440**	**713**	**262 000**	**1017**	**315 550**	**2654**	**784 890**	**333**	**103 000**	**38 020**	**14 882 700**
									0,1104													
				16 348 140	**0**									**1 465 440**						**14 882 700**		
																						31.20.11.1

Metsimaholo Local Municipality **Outstanding Cases** 2017/06/30 15:50:56

Report From: 2016/07/01 To: 2017/06/30 Court: ALL

	341 Hand Written		341 Camera		G54 Summons		S56 Summons		First Information of Crime		Warrants		**Monthly Totals**			
Month	Qty	Amount	Qty	Amount	Qty	Amount	Qty	Amount	Qty	Amount	Qty	Amount	**Qty**	**Amount**		
201607	991	314 850	1 312	518 680	87	34 350	4	1 500			1	200	**2 395**	**869 580**	0	
201608	451	143 000	3 069	1 215 630	1 290	518 950	69	27 450			89	34 300	**4 968**	**1 939 330**	0	
201609	106	34 850	28	11 050	86	23 650	220	83 100			187	73 550	**627**	**226 200**	0	
201610	234	69 350					158	64 650			554	203 800	**946**	**337 800**	0	
201611	293	95 050	503	189 500			55	24 150			944	343 100	**1 795**	**651 800**	0	
201612	153	51 450	5 179	2 153 900			53	20 400			589	221 150	**5 974**	**2 446 900**	0	
201701	150	47 000	1 613	644 650	325	132 000	541	208 850			294	105 050	**2 923**	**1 137 550**	0	
201702	162	53 900	1 808	675 430			240	87 750			427	154 050	**2 637**	**971 130**	0	
201703	164	55 200	4 373	1 828 100			211	70 330			625	240 200	**5 373**	**2 193 830**	0	
201704	310	92 950	3 751	1 657 650			795	312 300			160	55 800	**5 016**	**2 118 700**	0	
201705	253	82 450	1 246	481 050			964	358 900					**2 463**	**922 400**	0	
201706	177	57 080	1 835	687 600			891	322 800					**2 903**	**1 067 480**	0	
																0
Totals	3 444	1 097 130	24 717	10 063 240	1 788	708 950	4 201	1 582 180	0	0	3 870	1 431 200	**38 020**	**14 882 700**	0	

6.2.2. Step 1.3 – Calculation of payment history based on past five-year information

The average percentage payment is calculated by taking the total actual amount paid per year over the past five years, divided by the total number of cases issued over the past five years less cases withdrawn. The percentage calculated is then used to determine the impairment amount for the reporting period.

6.2.3. Step 1.4 – Calculation debt impairment

From the above average payment calculation, the provision for impairment is calculated. Example: If the calculated average payment history is calculated to be 15%, then the impairment calculation will be equal to 75% of the total outstanding fines as at the specific reporting date.

6.2.4. Step 1.5 Calculation - Amount of debtors to be written off

Determine the recoverable amount:

- Traffic fines debtor as per report S341 for Prior year
- Less expected payment as per average payment % history as per 6.2.3 above
- Multiply the expected recoverable percentage as discussed below

The average payment of outstanding warrants over the past five financial is calculated by taking the total amount for warrants paid over the past five financial years divided by the total outstanding warrants over the past five financial years.

The expected average recoverable amount is based on the average payment of warrants outstanding.

Example:

Traffic fines as per report S341 (Prior year)	17 495 835,00
Less 15 % paid eventually	-2 624 375,25
Sub-total	14 871 459,75
7% recoverable	1 041 002,18

Amount of debtors to be written off

- Traffic fines debtor for financial year - 2 years prior
- Pluss the traffic fines movement for the prior financial year
- Less the recoverable amount as calculated above
- Equals the amount to be written back

The traffic fines movement for the prior financial year is determined by taking the outstanding traffic fines as per the prior year plus the recoverable amount for traffic fines for the prior year less the outstanding debtors for the financial year 2 years prior.
Example:

Traffic fines debtor for prior year 2	13 586 533,00
Traffic fines debtor movement for prior year	4 105 792,00
Total = Traffic fines debtor @ prior year	17 692 325,00
Less 7% recoverable as per calculation	-1 041 002,18
Amount to be written back	16 651 322,82

6.2.5. Step 1.5 Journals to be processed in the system

Prepare a journal to account for the movements as calculated above

Accounting for outstanding traffic fines

1.1. If current year provision is lower than prior year provision the journal required is

1.1.1. DT Statement of financial position
1.1.2. CT Statement of financial performance

1.2. If the current year provision is higher than the prior year provision the journal required is:

1.2.1. DT Statement of financial performance
1.2.2. CT Statement of financial position

1.3. Bad debts written off:

1.3.1. CT Amount to be written back (debtor) Statement of financial position
1.3.2. DT Statement of financial performance (bad debt written of)

6.3. Implementation and Review

This methodology shall be implemented ~~once~~ after annual review in line with the prescribed Accounting Standard and approved by management ~~council and it shall be reviewed on annual basis as part of budget processed.~~