METHODOLOGY FOR THE IMPAIRMENT OF RECEIVABLES POLICY

UNCHANGED

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PURPOSE

The purpose of this document is:

- To set out a methodology for the impairment of receivables in line with the applicable accounting standards;
- To ensure that sufficient allowance is made for the impairment of receivables in the financial statements;
- Ensure that receivables disclosed in the financial statements are stated at amounts that are deemed collectable; and
- To promote transparency as required by sections 215 and 216 of the Constitution when dealing with receivables and debt.

SCOPE

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

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

- Consumer receivables;
- Receivables from exchange transactions; and
- Receivables from non-exchange transactions.

DEFINITIONS AND ABBREVIATIONS

"CFO" means chief financial officer

"Financial year" means the period 1 July of one year to 30 June of the following year (both days included)

"GRAP" means generally recognised accounting practices

"MFMA" means Municipal Finance Management Act, Act 56 of 2003

"Municipality" means Steve Tshwete Local Municipality

"Reporting date" means 30 June of each year

APPLICABLE ACCOUNTING STANDARDS

GRAP 104 financial instruments sets out the requirements and guidelines for the impairment of financial assets subsequently carried at amortised cost.

GRAP 104.46 "*All financial assets measured at amortised cost, or cost, are subject to an impairment review…"*

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. "

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."*

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."*

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."*

METHODOLOGY

1. Timing of Assessment

The municipality will assess at the end of each reporting date whether there is objective evidence that a receivable account or group of receivable accounts is impaired.

2. Evidence of Impairment

The following accounts are specifically excluded from impairment testing:

- Receivable accounts with a combined credit balance at reporting date;
- Receivable accounts where the combined 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.

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

- A receivables that have been placed under or applied for liquidation or sequestration;
- Where the last payment date by the customer was before 1 May of each year;
- Accounts handed over to debt collectors and/or power of attorney;
- All accounts indicated as in-active accounts on the system;
- When a formal arrangement is made on arrears debt;
- When accounts have been formally presented to the CFO of mayoral committee for write off; and
- All accounts with balances outstanding 90 days and longer as these accounts are considered to be past due

3. Calculation and Recognition of Impairment Loss

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

The impairment loss is recognised in the statement of financial performance in the following accounts

Account Number	Account Description	Line item on statement of financial position
3500-WWSR-550829	Prov Bad Debt	Impairment loss / Reversal of impairment loss
3500-WWSR-547829	Prov Bad Debt	
3500-WWSR-546829	Prov Bad Debt	
3500-WMRR-422829	Prov Bad Debt	
3500-WMRR-420829	Prov Bad Debt	
3500-TWWD-567829	Prov Bad Debt	
3500-TWWD-566829	Prov Bad Debt	
3500-TWWD-560829	Prov Bad Debt	
3500-EXMC-100829	Prov Bad Debt	
3500-EDER-700829	Prov Bad Debt	

Account Number	Account Description	Line item on statement of financial position
3500-BTBT-170829	Prov Bad Debt	

The impairment is recognised in the statement of financial position in the allowance accounts:

Account Number	Account Description	Line item on statement of financial position
995040	BS Debt Impairment : Consumers	Consumer receivables
995055	BS Debt Impairment : Sundry Debt	Receivables from exchange transactions

4. **Individually Significant Receivables**

Consumer receivables with a total balance outstanding at reporting date over R150 000 is considered material and will be assessed individually for evidence of impairment.

For sundry receivables management will assess on an annual basis which accounts are considered to be individually material. These accounts will be assessed individually for evidence of impairment.

5. **Risk Categories**

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

- High risk category;
- Medium risk category; and
- Low risk category.

The allocation of receivables into the different risk categories are reviewed annually.

5.1. **Consumer receivables**

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

- Approved indigents;
- Tenant accounts; and
- Non-active accounts

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

- Government receivables, excluding government schools

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

- All accounts with prepaid electricity meters; and
- Government school receivables

The remainder of the consumer receivables are classified as medium risk receivables.

All other receivables are divided into the three risk categories based on management's knowledge of these receivables.

Summary of risk groups for consumer receivables

High risk	Medium risk	Low risk
Approved indigents	Remainder of consumer receivable accounts	Government receivables, excluding government schools
Tenant accounts		
Non-active accounts		

5.2. **Sundry receivables**

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

- Motor vehicle accidents;
- Library books;
- Bursary costs;
- Closed accounts;
- Marked to be written off; and
- Handed over accounts

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

- Main service contributions;
- Relocation costs; and
- Kanhym & Samancor

The following receivables are individually assessed

- Medical aid

The remainder of the sundry receivables are classified as medium risk receivables.

All other receivables are divided into the three risk categories based on management's knowledge of these receivables.

Summary of risk groups for consumer receivables

High risk	Medium risk	Low risk
Motor vehicle accidents	Remainder of sundry receivable accounts	Main service contributions
Library books		
Bursary costs		Reallocation costs
Closed accounts		
Marked to be written off		Kanhym & Samancor
Handed over accounts		

6. DISCOUNT RATE

The discount rate is set as the yield of the R157 South African government bond as at the reporting date. The actual yield on the R157 bond is sourced from the RMB Global Markets website at reporting date.

http://www.rmb.co.za/globalmarkets/rates_historicalRates.asp?product=Bonds&instrument=R157&rateDisplay=R157#topMenu

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

- The economic conditions of the population in the municipal district;
- History of bad debts written off;
- Effectiveness of the debt collection processes;
- The vast rural area that the municipality covers and the rural population have high social problems;
- 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 risk free rate are reviewed annually by management.

7. EXPECTED REPAYMENT TERM

One expected repayment term is calculated for high, medium and low risk receivables. The expected repayment term is calculated as the receivables' days at reporting date.

The average receivables balance for the reporting period is calculated as follows:

The balance due per age analysis include both debit and credit balances

The total income from consumers for the reporting period include:

- Property tax;
- Refuse;
- Sewerage;
- Water;
- Electricity;
- Interest; and
- Less income foregone

8. EXPECTED FUTURE CASH FLOWS

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

Group	Expected future cash flow
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 May balance after billing recovered before June billing
7. Medium risk consumer receivables	Based on percentage of the medium risk receivable's May balance after billing recovered before June billing
8. Low risk consumer receivables	Based on percentage of the low risk receivable's May balance after billing recovered before June billing
9. High risk sundry receivables	Based on the percentage of the high risk receivables June balance recovered before July billing
10. Medium risk sundry receivables	Based on the percentage of the medium risk receivables June balance recovered before July billing
11. Low risk sundry receivables	Based on the percentage of the low risk receivables June balance recovered before July billing

All payments received in July after the reporting date are added to the above calculated expected further cash flows before impairment is calculated.

9. PRESENT VALUE OF EXPECTED FUTURE CASH FLOWS

The present value of expected future cash flows is calculated using the present value formula in MSExcel. The data for input in the formula is the obtained from point 6, 7 and 8 above.

REVIEW OF METHODOLOGY

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.

Section	Chief Financial Officer
Current review date	
Previous review date	

APPROVAL AND IMPLEMENTATION OF METHODOLOGY

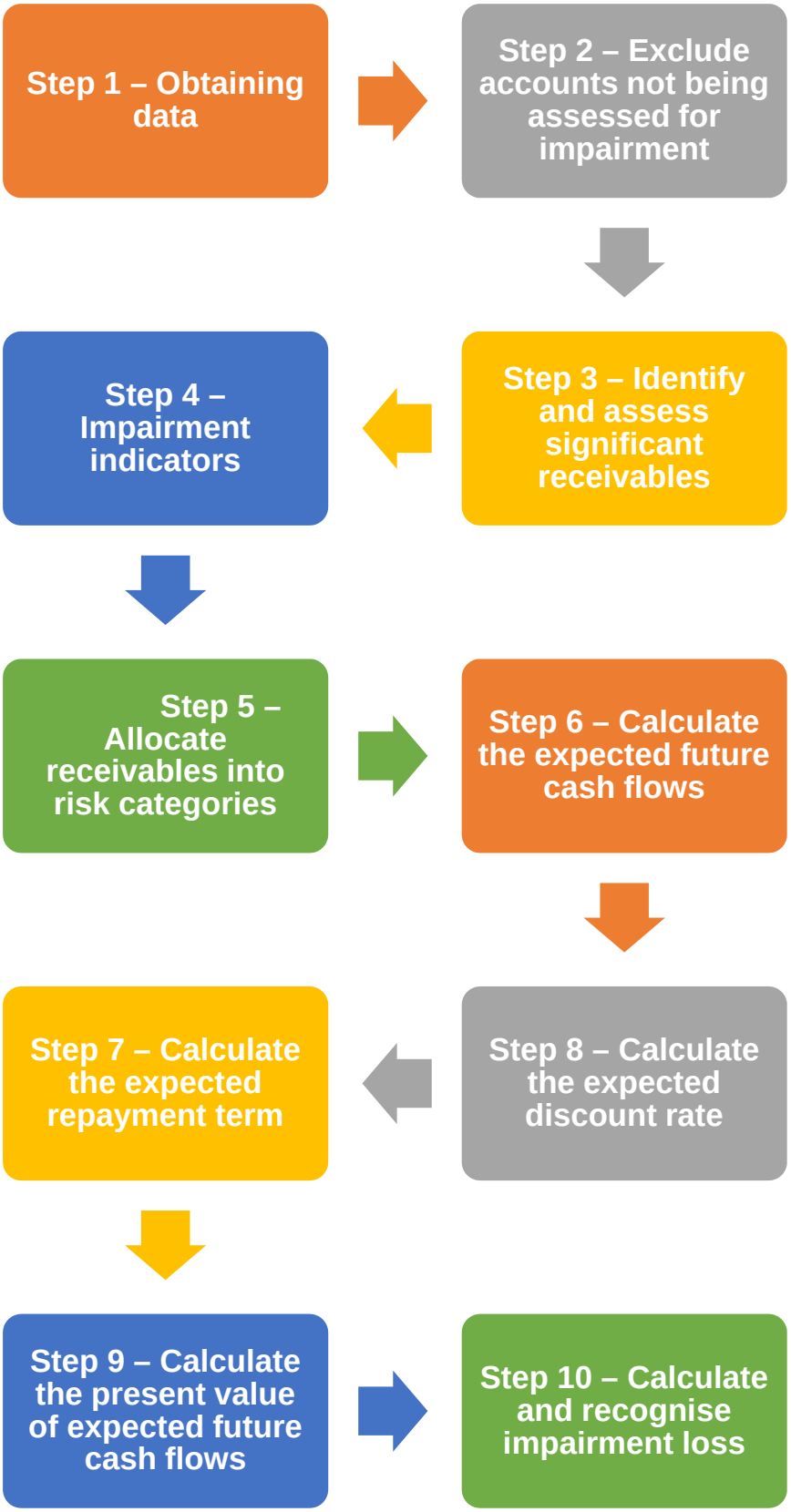
This methodology shall be implemented once approved by council.

Section	Chief Financial Officer
Approval date by Council	

SOURCE

- GRAP 104 financial instruments issued October 2009
- GRAP 104 application guide issued October 2009
- National Treasury Accounting Guidelines GRAP 104 financial instruments

APPENDIX A - WORK PROCEDURES – CONSUMER RECEIVABLES



Step 1 – <u>Obtaining data</u>

1. Obtain the consumer receivables age analysis as at reporting date:

    1.1. Subtotal all accounts with debit balances in the column with the heading Tot Outst and agree this subtotal to account 995011 consumers.
    1.2. Subtotal all the accounts with credit balances at reporting date and agree this subtotal to account 991041 consumers paid in advance town.
    1.3. Follow up and resolve any differences identified.

2. Obtain the following detail for each receivables reflecting on the consumer age analysis at reporting date:

    2.1. Last payment date (date of payments made on or before reporting date)
    2.2. Amount paid at last payment date
    2.3. Subsequent payment date (date of payments made after reporting date but before next billing date in July)
    2.4. Amount of subsequent payment
    2.5. Last date pre-paid electricity was bought
    2.6. Loan amount
    2.7. Hand over indicator
    2.8. Owner or tenant indicator
    2.9. Indicator if account has prepaid electricity meter or not
    2.10. Indicator if status is active or not active

3. Obtain prior year financial statements. From the financial statements obtain prior year balance on consumer general ledger account 995011 and consumers paid in advance town general ledger account 991041.

4. Obtain the total amount for service charges income and interest income on consumer accounts for the reporting period under review, remember to subtract income forgone:

    4.1. Sale of electricity
    4.2. Sales of water
    4.3. Sewerage charges
    4.4. Refuse removal
    4.5. Property tax
    4.6. Interest

5. Obtain the following additional data in one file, estate accounts should be excluded from this data:

    5.1. Total balance outstanding per consumer just after the May billings were levied.

5.2. Total balance outstanding per consumer in June, the day just before the levies for June was levied.
5.3. Obtain all receipts from the day the May billings were levied to day just before June billings were levied.

5.4. Ensure the file obtained include the following as n minimum:

5.4.1. Account number
5.4.2. Indicator if status is active or not active
5.4.3. Owner or tenant indicator
5.4.4. TarDesc
5.4.5. Indicator if the account is an estate account or not

Step 2 – <u>Exclude accounts not being assessed for impairment</u>

1. Save the consumer age analysis with the file name for example: STLM - Provision for impairment – 30 June 20??

2. From the file saved, identify all of the following accounts and delete them from the age analysis":

2.1. All accounts with zero or credit balances in column Tot Outst
2.2. All accounts in Owner column indicated as STEVE TSHWETE LOCAL MUNICIPALITY
2.3. All accounts where there is no balance outstanding over 30 days

Step 3 – <u>Identify and assess significant receivables</u>

1. From the remaining account on the consumer age analysis identify all accounts where the total balance outstanding is above R150 000.

2. Cut and save these accounts on a new tab for individual assessment.

3. For each account determine their recoverability separately by taking into account the following:

3.1. Is the account marked as inactive?
3.2. Has the account been handed over for debt collection?
3.3. Is the customer being liquidated / sequestrated?
3.4. Has the customer made any payments in the last 60 days before year end?
3.5. Has the customer made any payments after year end?

Step 4 – <u>Impairment indicators</u>

1. 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 receivable no has to be assessed with the remaining group of receivables.

2. Per receivable account determine if any of these indicators exist by indicating a Yes if they exist and a No if they do not exist:

   2.1. Is the account in liquidation/sequestration – this will be yes if the hand over indicator is a 20
   2.2. Was the last payment date from the receivable before 1 May – this will be Yes if the last payment date is before 1 May
   2.3. Has the receivable been handed over for debt collection – this would be Yes if the hand over indicator is either 55, 66 of 77
   2.4. Has the receivable account been marked as inactive on the system – this will be Yes if the status indicators is a 9
   2.5. Does the account have an arrangement for payment at reporting date – this will be Yes if the receivable has a loan amount
   2.6. Has the receivable account been marked as bad debts - this will be Yes if the hand over indicator is 99
   2.7. Does the receivable have any balances outstanding 90days and over - this will be Yes if there are any debit amounts in the columns Tot 90days, Tot 120days, Tot 150days and/or Tot 180days

3. Identify each individual receivable account for which with recoverable amount should be calculated. This will be all the receivables where the answer to any of the above indicators were Yes.

Step 5 – <u>Allocate receivables into risk categories</u>

1. Allocate receivables into the risk categories as per the methodology by inserting a column and indicating the risk category as follows:

   1.1. High – H
   1.2. Medium – M
   1.3. Low – L

2. Risk categories are determined in the following order:

   2.1. Non-active accounts – high risk – status indicated as a 9
   2.2. Indigent accounts – high risk - TarDesc indicated as Indigent 100%
   2.3. Government accounts, excluding government schools – high risk - TarDesc indicated as:
      2.3.1. Gov Duets
      2.3.2. Gov Business
      2.3.3. Gov Residential
      2.3.4. Gov Vacant Res
   2.4. Government school accounts – medium risk – TarDesc indicated as Gov Schools
   2.5. Tenant accounts – high risk – Owner indicated as 0
   2.6. Remainder of accounts – medium risk – this is all accounts not specifically included in point (a) to (e) above

Step 6.1 – <u>Calculate the expected future cash flows for specific risk receivables</u>

1. For all accounts where no indicator of impairment was identified the expected future cash flows are equal to the balance outstanding at reporting date.

2. The expected future cash flow for receivable accounts with some specific indicators (list below) are considered to be zero or, if a subsequent payment was received the subsequent payment is considered to be the expected future cash flow. These indicators are:

    2.1. All accounts where no payment has been received in the last 6 month. This will be:
        2.1.1. All account with a last payment date of 0000/00/00 and
        2.1.2. All accounts where the last payment date is before 1 January of the reporting year
    2.2. All accounts in TarDesc column indicated as INDIGENT 100%
    2.3. All accounts in Status column with an indicator of 9
    2.4. All accounts with a Hand over indicator of 99

3. Identify all the remaining accounts for which no expected future cash flow has been determined in point 1 or 2 above and follow step 6.2.

Step 6.2 – <u>Calculate the expected future cash flows for risk categories</u>

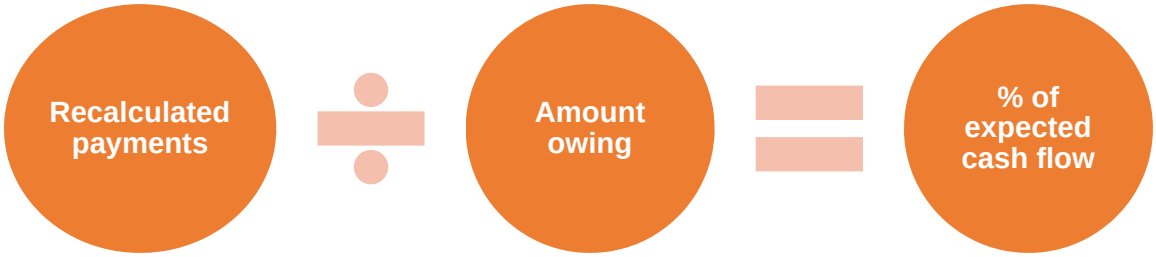
1. Take the data obtained in Step 1 point 5.

2. From the data received recalculate the payments received to ensure that payments received is not more than the amount owing. This is done in order to eliminate prepayments (where consumer pay more than the balance due).

3. Add a column and allocate the risk categories (H, M or L) per methodology. Risk categories will be allocated in the following order:

    3.1. Non-active accounts
    3.2. Indigents
    3.3. Government, excluding schools - they are low risk regardless if they are tenants
    3.4. Government schools - they are medium risk regardless if they are tenants
    3.5. Tenants
    3.6. Remainder of accounts

4. Calculate the expected payment term per risk category as:



5. Round the % of expected cash flow to the nearest 10%.

Step 7 – <u>Calculate the expected repayment term</u>

1. Calculated the receivables days as per the methodology.

2. Round the receivables' days to the nearest day.

3. If the receivables days is lower than 30days, then use 30days in the calculation as the expected payment term.

4. Use this receivables months as the expected repayment term for all consumer receivables.

Step 8 – <u>Calculate the expected discount rate</u>

1. The discount rate per risk category is obtained from the methodology.

Step 9 – <u>Calculate the present value of expected future cash flows</u>

1. For the following receivable accounts the present value of expected future cash flows are equal to the expected future cash flow calculated in step 6:

    1.1. All accounts where no indicator of impairment was identified is the balance outstanding at reporting date
    1.2. All accounts with arrangements
    1.3. All accounts where there are only amount in column Tot 30days and/or Tot 60days
    1.4. All accounts where no payment has been received in the last 6 month
    1.5. All accounts in owner column indicated as INDIGENT 100%
    1.6. All accounts in status column with an indicator of 9
    1.7. All accounts with a hand over indicator of 99

2. For the remaining receivables categorised between the risk categories 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 in order to get a daily rate
Total number of payments (Nper): This is the expected term as calculated in step 7 above and is in days
Payment made (pmt): This is zero
Future value (fv): This is the expected future cash flow as calculated in step 6 (4) (d) above
Type: This is nil as payment is expected at the end of the month

3. Calculate the total present value of expected future cash flows by adding all the individual calculations.

4. Check the total present value of expected future cash flows to ensure that the calculated amount is not higher than the balance outstanding at year end.

Step 10 – <u>Calculate and recognise impairment loss</u>

1. 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:

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

3. 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)

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

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

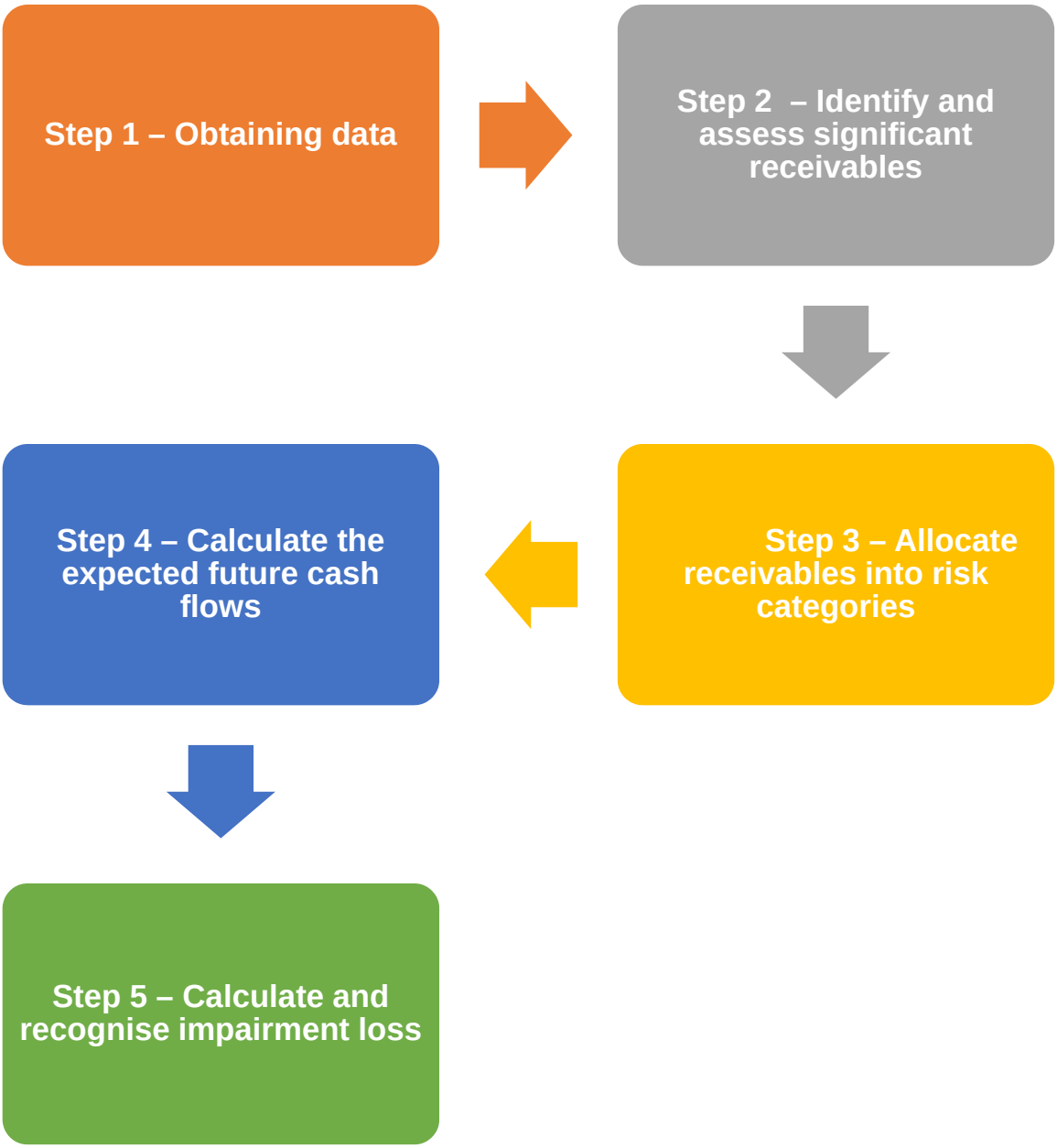
      4.1.1. DT Statement of financial position

4.1.2. CT Statement of financial performance

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

4.2.1. DT Statement of financial performance
4.2.2. CT Statement of financial position

APPENDIX B - WORK PROCEDURES – SUNDRY RECEIVABLES



Step 1 – Obtaining data

1. Obtain a list of sundry receivables as at reporting date.

2. Obtain payments received, per sundry receivable between 30 June and 31 July.

Step 2 – Identify and assess significant receivables individual

1. For each account identified as being individual assessed, determine their recoverability separately by taking into account the past payment trend of the receivable.

Step 3 – Allocate receivables into risk categories

1. Allocate accounts not being individually assessed into the risk categories as per the methodology by inserting a column and indicating the risk category as follows:

   1.1. High – H
   1.2. Medium – M
   1.3. Low – L

Step 4 – Calculate the expected future cash flows

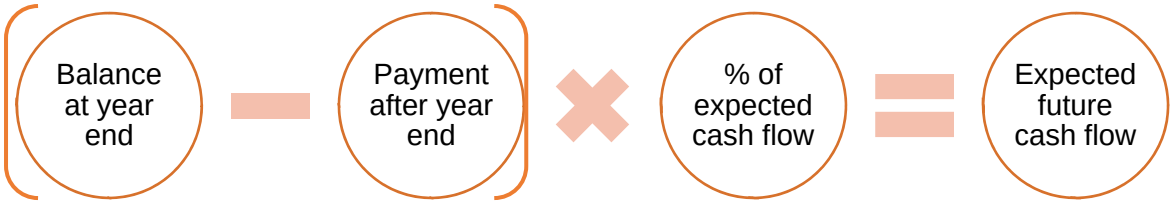
1. Based on past experiences and knowledge of the municipality the expected future cash flows for High and Low risk sundry receivables can be summarised as follows:

Risk category	Expected future cash flow
High risk	0%
Low risk	100%

2. Take the data obtained in Step 1 and calculate the % of expected future cash flows for medium risk sundry receivables as follows:

3. Round the % of expected cash flow to the nearest 10%.

4. Calculate the expected future cash flow as follows:



Step 5 – Calculate and recognise impairment loss

1. Calculate the impairment loss as:

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

3. 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)

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

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

   4.1.1. DT Statement of financial position
   4.1.2. CT Statement of financial performance

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

   4.2.1. DT Statement of financial performance
   4.2.2. CT Statement of financial position