

PROVISION FOR DOUBTFULL DEBT AND DEBT WRITE-OFF



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| PROVISION FOR DOUBTFUL DEBT AND DEBT WRITE-OFF |
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Contents

| | |
|---|---|
| 1. Definitions | 3 |
| 1.1. A financial asset is: | 3 |
| 2. Application and Scope..... | 3 |
| 3. Objectives of Policy..... | 3 |
| 4. Introduction | 3 |
| 5. Impairment of Debtors..... | 4 |
| 5.1. Consumer Debtors..... | 5 |
| 1.1. Sundry Debtors..... | 5 |
| 6. Write-Off of Doubtful Debtors..... | 5 |
| 6.1. Amounts equal to or lower than amounts delegated to the Chief Financial Officer by Council from time to time:- | 5 |
| 6.2. Amounts Exceeding the CFO's Delegated Authority:-..... | 6 |
| 6.3. Application of Prescription Act:- | 7 |
| 6.4. Specific Debt-Write-Off Incentives:-..... | 7 |

Initial: _____

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|---|
| PROVISION FOR DOUBTFUL DEBT AND DEBT WRITE-OFF |
|---|

1. Definitions

1.1. A financial asset is:

- (a) cash;
- (b) a residual interest of another entity; or
- (c) a contractual right to:
 - (i) receive cash or another financial asset from another entity; or
 - (ii) exchange financial assets or financial liabilities with another entity under conditions that are potentially favorable to the entity.

2. Application and Scope

The Provision for Doubtful Debt and Debt Write-Off Policy is applicable to the Govan Mbeki Municipality.

The policy, as amended, will be effective as from 1 July of every year.

3. Objectives of Policy

- To ensure that debtors disclosed in the Annual Financial Statements are stated at amounts that is deemed to be collectable.
- To ensure that uncollectable debt is written off within guidelines of existing policies and applicable legislation.

4. Introduction

Debtors for Govan Mbeki Municipality meet the definition of financial instrument based on GRAP 104, therefore the policy has been developed in terms of the standard and applicable laws and regulations.

AS disclosed in the annual financial statement of the municipality, the debtors have been classified as 'financial instrument at amortised cost'

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

- Implementation / maintenance of the appropriate 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).
- Write-Off of Uncollectable Debtors.

This policy provides guidelines on the treatment of the Impairment and Write-Off of Debtors.

Initial: _____

5. Impairment of Debtors

Consumer debtors, long term receivables and other debtors are stated at cost less a provision for bad debts. The provision is made on an individual basis or, based on expected cash flows.

Future cash flows in a group of debtors that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group.

Debtors are 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 from the debtors that can be reliably estimated. It may not be possible to identify a single, discrete event that caused the impairment, since it may have been the combined effect of several events that did so.

GRAP 104 has specific principles for calculating impairment of financial assets. For assets carried at amortised cost (Loans and trade receivables) the impairment calculation involves a comparison between the carrying value and the net present value of the expected cash flows discounted by the original effective rate.

Most municipalities incur credit losses (Bad Debts) from time to time. The extent of credit losses varies widely depending on the credit standing of customers and the municipality's specific credit control practices. When debtors are impaired by credit losses the municipality records the impairment in a separate account (e.g. bad debts or debtors written off) rather than directly reducing the carrying amount of the asset, it shall disclose a reconciliation of changes in that account during the period for each class of debtors.

Municipality deals with credit losses through its requirements on impairment. The approach is often referred to as an "incurred loss" model. Under this approach, impairments are recognized only on the basis of once or more "loss events" that have occurred after initial recognition. Loss events are also referred to as objective evidence of impairment. An event is a loss event if there is a correlation between the event and deterioration in the expected cash flows (amount and/or timing) from the receivables.

At each reporting date, receivables are reviewed for any objective evidence of impairment.

Objective evidence of impairment includes:-

- Information indicating that the debtor is in significant financial difficulty.
- Breach of contract, e.g. a debtor not paying by the due date.
- Information indicating that it is probable the debtor will become insolvent or similar
- Downgrade in credit rating

When evidence of impairment is identified, the amount of impairment is the difference between (i) the carrying value of the receivables; and (ii) the present value of the expected future cash flows discounted at the original effected interest rate.

Initial: _____

Standard always requires a collective or portfolio approach to impairment assessment:-

- An initial, individual review is required for items that are individually significant.
- In the collective assessment, items are grouped on the basis of common credit risk characteristics
- Items are removed from the collective assessment once information becomes available that specifically identifies losses on individual items
- Any individual items that are reviewed and found not to be impaired are then also included in the collective assessment.

Individual classes of loans and receivable are assessed for impairment using the following methodologies:

5.1. Consumer Debtors

Consumer debtors are evaluated at each reporting date and impaired as follows:-

| Category of Debtors | Percentage of Debt regarded as Collectable | Percentage of Debt Provided for as Irrecoverable (i.e. Impairment Percentage) |
|--|--|---|
| Credit Balances | Zero | Zero |
| In-Active Accounts | Zero | 100% |
| Handed-Over Accounts to Panel of Debt Collectors, Legal Handed-Over & Clearance Handed-Over (Debt Outside Section 118 of LG:Systems Act) | Zero | 100% |
| Approved Indigents | Zero | 100% |
| Pending Indigents | Zero | 100% |
| Disconnection of Services in Excess of More than 7 times During Preceding 12 Months | Zero | 100% |
| Debt Ageing 150+ Days | Average Payment Collection Rate Over Preceding 12 Months | 100% Less Average Payment Collection Rate Over Preceding 12 Months |
| Debt Ageing Less Than 150 Days | 100% | Zero |

5.2. Sundry Debtors

Sundry debtors are those Suspense Control Accounts classified as financial instruments with debit balances as at year-end. Sundry debtors are assessed individually for impairment to ensure that no objective evidence exists that these debtors are irrecoverable.

6. Write-Off of Doubtful Debtors

Where debts are identified as being irrecoverable (in periods subsequent to debtors being impaired), the process of write-off will be treated as follows:

6.1. Amounts equal to or lower than amounts delegated to the Chief Financial Officer by Council from time to time:-

The Revenue Manager identifies irrecoverable debtors within the delegated powers of the CFO, must prepare a report for the attention of the CFO detailing the nature of

Initial: _____

the underlying debt, conditions that led to the debt being identified as being irrecoverable, details of credit controls and debt collection processes followed to recover the debt and confirmation that all available avenues to recover the debt have been exhausted and that further actions would be fruitless and not cost effective.

The report of the Revenue Manager must be scrutinized by the Deputy Director: Revenue Management and his/her recommendation must be documented in the report.

The final report containing the recommendations of both the Revenue Manager as well as the Deputy Director: Revenue Management must be presented to the Chief Financial Officer (CFO) for consideration.

Requests approved by the CFO will be processed against the relevant debtors account and reflects as debits against Bad Debt in the General Ledger.

Reconciliation of the Provision for Doubtful debtors Account must be prepared annually by the Deputy Director: Revenue Management and retained for audit purposes.

6.2. Amounts Exceeding the CFO's Delegated Authority:-

The process for the consideration of write-offs of debts in respect of amounts in excess of Chief Financial Officer delegated authority must be dealt with as follows:

The Revenue Manager identifies irrecoverable debtors in excess of the delegated powers of the CFO, must prepare a report for the attention of the CFO detailing the nature of the underlying debt, conditions that led to the debt being identified as being irrecoverable, details of credit controls and debt collection processes followed to recover the debt and confirmation that all available avenues to recover the debt have been exhausted and that further actions would be fruitless and not cost effective.

The report of the Revenue Manager must be scrutinized by the Deputy Director: Revenue Management and his/her recommendation must be documented in the report.

The final report containing the recommendations of both the Revenue Manager as well as the Deputy Director: Revenue Management must be presented to the Chief Financial Officer for consideration.

If approved by the CFO, a formal report must be submitted to the Finance Portfolio Committee, Mayoral Committee and Council for consideration.

Approvals granted by council must be processed against the relevant debtors account and reflected as debit against Bad Debt in the General Ledger.

Reconciliation of the Provision for Doubtful debtors Account must be prepared annually by the Deputy Director: Revenue Management and retained for audit purposes.

Initial: _____

6.3. Application of Prescription Act:-

The provision of Prescription Act will apply to all services debt, excluding assessment rates. Applications and/or claims for prescription from debtors will only be assessed if no formal credit control or legal actions have been instituted during prescription debt period of three (3) years.

The Revenue Manager will assess application in terms of prescribed requirements. If in compliance with Prescription Act, approval may be granted to write-off prescribed portion of debt.

Approvals granted must be processed against the relevant debtors account and reflected as debit against Bad Debt in the General Ledger.

Reconciliation of the Provision for Doubtful debtors Account must be prepared annually by the Deputy Director: Revenue Management and retained for audit purposes.

6.4. Specific Debt-Write-Off Incentives:-

Deputy Director: Revenue Management to identify and investigate specific uncollectable debt categories. Report with full details as to the reasons for categorized debt write-off to be submitted to Council for approval.

Approvals granted must be processed against the relevant debtors account and reflected as debit against Bad Debt Provision in the General Ledger.

Signed by the Municipal Manager as per resolution _____:

Municipal Manager

Date

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