Fezile Dabi

District Municipality

Debt Impairment and Debt Write-Off Policy

DEFINITIONS:

For the purpose of this policy, the following terms have the meanings attributed below:

Definitions:

Bad Debt: - is an amount owed by a debtor that is unlikely to be paid

Bad Debt Write-off: - a process of writing-off irrecoverable debt owed by a debtor after exhausting all avenue available to the municipality to effectively collect the debt.

Contract: - In this policy, contract or contractual refers to an agreement, written or verbal, between the municipality and any person(s) that has clear economic consequences that the parties have little, if any, discretion to avoid, usually because the agreement is enforceable by law.

Debt impairment: decrease in an asset's net carrying value that exceeds the future undisclosed cash flow that should be generated.

SECTION 1: OBJECTIVES

a) To outline the municipality's policy on the principles, procedure and accounting requirements and treatment for recognition, measurement, presentation and disclosure of receivables (debtors).

b) To provide for improvement on the municipality's receivables accounts and financial records by writing-off debts that are not possible to recover.

SECTION 2: LEGISLATIVE CONTEXT

In terms of section 64(12)(e)(f) and (g) respectively of Municipal Finance Management Act, 56 of 2003 (MFMA), the Accounting Officer of a municipality must take all reasonable steps to ensure: -

a) that the municipal municipality has and maintains a management, accounting and information system which recognises revenue when it is earned; accounts for debtors; and accounts for receipts of revenue;

b) that the municipal municipality has and maintains a system of internal control in respect of debtors and revenue, as may be prescribed; and

c) that all revenue received by the municipal municipality, including revenue received by any collecting agent on its behalf, is reconciled at least on a weekly basis.

Furthermore, section 96 of Municipal Systems Act provides that a municipality must collect all money that is due and payable to it, subject to this Act and any other applicable legislation; and for this purpose, must adopt, maintain and implement a credit control and debt collection policy which is consistent with its tariff policies and complies with the provisions of this Act.

SECTION 3: SCOPE OF THE POLICY

This policy is applicable to receivables that came about from the provisions of legislation or an equivalent means, such as regulations, by-laws or other document issues in terms of legislation, such as council decisions (statutory receivables), as well as receivables that arise from contractual arrangements entered into (financial instruments).

SECTION 3: POLICY PRINCIPLES

The following principles shall be considered and serve as a guideline in the process to determine impairment and eventually write-off of debt / receivable:

a) A number of internal and external factors relevant to a receivable or groups of receivables must be considered when performing an impairment assessment.
b) When the future cash flows of receivables are estimated, both the amount of cash flows that will be received in future, as well as their expected timing must be considered.
c) If the cash flows are only likely to be received some time in the future, then the effect of time of value for money must be considered where the effect of time value of money is material. The estimated future cash flows must then be discounted using a risk-free rate of interest and if applicable, adjust this rate for any risk specific to the receivable.
d) Where it is necessary to discount the expected cash flows of a receivable or group of receivables in determining whether it is impaired, the initial effect of that discounting as well as the unwinding of that interest over time, must be included in the amount of impairment loss recognised or as an adjustment to the impairment loss respectively.
e) Where a receivable or group of receivables is impaired, the municipality will continue to accrue for any normal interest or other charges due to the municipality were this is in accordance with the applicable legislation, regulation or council decision or policy.
f) Before any debt can eventually be written-off, all the applicable actions, including legal action where appropriate, should have been fully exhausted.
g) Despite annual impairment provisions that must be assessed for debts, a debt must have been in arrears for (3) three or more years and all avenues have been exhausted by the municipality to collect the outstanding debt. Moreover, in cases of natural persons, a debt may be written-off when a debtor has passed away and the deceased estate is insolvent.
h) Debt may also be written-off if, for any other reason, the Council deems just and appropriate to warrant a write-off.
i) No blanket write-off shall be applied for any debt owed to the municipality, each debt will be assessed individually and on the basis of the merits of each individual case, a decision will then be arrived at as to whether a write-off of debt is considered or not.

SECTION 5: PRINCILES, PROCEDURES AND METHODOLOGY FOR IMPAIRMENT OF DEBTORS (RECEIVABLES)

5.1 Principles for assessment of impairment provision and uncollectibility of debt

a) In order to determine the impairment provision, an assessment should be conducted annually at reporting date (i.e June), to determine whether there is any indication that a receivable or group of receivables has been impaired.

b) A receivable (debtor) or group of receivables (debtors) shall be considered to be impaired in there is an objective evidence of impairment as a result of one or more loss events that occurred after the initial recognition of the receivable / receivables and that the loss event has an impact on the estimated future cash flows of the receivable or group of receivables that can be reliably estimated.

c) A receivable shall be assessed for impairment individually when such receivable is individually significant and alternatively receivables shall be assessed as a group.

d) Where no objective evidence of impairment exist for individually assessed receivable or group of receivables, the municipality shall include a receivable or receivables in a group of other financial assets with similar credit risk characteristics and collectively assess them for impairment.

e) Receivable(s) that are individually assessed for impairment and for which an impairment loss is recognised is(are) not included in the collective assessment of impairment.

5.2 Methodology for calculating impairment provision and uncollectible debts:

a) The assessment of debt impairment for receivables, either individually assessed or assessed as a group, shall be done taking into account the assumptions and according to the methodology as outlined below:

First Step:

In determining the impairment provision, the receivables shall firstly be categorised and information relating to the following observable factors or events shall be accumulated, considered and evaluated in order to assess collectability of a receivable or groups of receivables:

(i) Significant financial difficulty of the debtors;

(ii) A breach of agreement, such as default on delinquency in interest or principal payments;

(iii) The municipality, for economic or legal reasons relating to the debtor’s financial difficulty, granting the debtor a concession that the municipality would not consider;

(iv) It is possible that the debtor will enter sequestration or other financial reorganisations;

(v) Observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of receivables since the initial recognition of those receivable(s); although the decrease cannot yet be identified with the individual receivable in the group, including:

- Adverse changes in the payment status of the debtor in the group (e.g an increased number of delayed payments) or;
- National or local economic conditions that correlated with defaults on the receivables in the group (e.g adverse changes in market conditions that affect the debtors in a group).

(vi) In some cases, the above observable data or events required to estimate the amount of impairment loss on a financial asset may be limited or no longer fully relevant to current circumstances, e.g when a debtor is in financial difficulties and there is limited available historical data relating to similar debtors. In such cases, the municipality shall use it experience judgment to estimate the amount of any impairment loss. Similarly, the municipality shall use its experienced judgement to adjust observable data for a group of receivables to reflect the current circumstances.

Second Step:

Based on the observable factors above, the municipality shall calculate the provision for impairment or uncollectibility of a debt by considering the cash shortfalls it would incur in various default scenarios for prescribed future periods using the following formula:

A x B = C

Where:-

A = Default rate (expressed in a percentage form);
B = Gross Carrying Amount of Receivable(s); and
C = Impairment Provision.

Any previously recognised impairment provision must be revised when the expected timing or similar amount of the cash flow to be collected changes.

Third Step:

Determine the estimated future cash flows of receivable(s) using the following formula:

A – B = C

Where:-

A = Gross Carrying Amount of Receivable(s)

B = Impairment provision, and

C = Estimated future cash flows of Receivable(s)

SECTION 4: PROCEDURES FOR WRITE-OFF OF UNCOLLECTIBLE DEBT / RECEIVABLE

4.1 Debt Write-off

a) Debts will be written off only when the recovery procedures have proven unsuccessful and further action is either not cost effective or highly unlikely to succeed.

b) The decision to write off individual debts should include consideration of the cost of recovery action versus the amount of the debt being pursued.

c) The Chief Financial Officer will recommend, in writing, to the Accounting Officer debts to be written off and such recommendation(s) shall be accompanied by all the necessary supporting documentation.

d) The Accounting Officer shall review the listed accounts for write-off, together with recommendations and other supporting documents and compile a comprehensive report to be tabled to council to recommend write-off after being satisfied that the recovery procedures have been complied with and that all reasonable attempts to recover debt have been exhausted.

4.2 Authority to Write-Off Debts

a) The Accounting Officer shall table to council a comprehensive written report recommending write-off of debts.

b) Only the Council of shall have the authority to approve the final write-off of debt, regardless of the rand value.

4.3 Administration and Management

a) The Chief Financial Officer shall maintain a register of debts that have been written off which shall be available for audit purposes. The register will record the details of each debt written-off, the council resolutions that approved the write off and any subsequent action to reinstate and recover debt.

b) In order to prevent unauthorized bad debts journal entries, access to both the cash receipt function and the bad debts recording function on the financial system are to be restricted with no journal adjustments to take place on the debtors' module without specific approval by the Chief Financial Officer or his / her delegate.

c) In order to provide further assurance of the validity of the accounting information of the debtors accounts, an independent reconciliation between approved adjustments and actual adjustment shall be performed every time after approval and processing of Bad Debts Write-Off journals entries.

d) A Chief Financial Officer shall ensure that bad debts are written off in a timely manner after approval by the council.

e) The Chief Financial Officer shall ensure that the General Ledger Accounts Balances are reconciled on a monthly basis to the Subsidiary Debtors Ledgers.

SECTION 6: POTENTIAL RISK OF NON-COMPLIANCE

a) The Chief Financial Officer shall ensure that there are controls in place at all times in order to deal with the following possible risks against debtors' accounts and writing-off of debt:

   (i) Recovery of debtors with insignificant account balances, where costs of recovery including manpower, postage and collection agent fees outweigh any possible benefit that could be obtained in return;
   (ii) Unauthorised access to Debtors accounts which may give effect to unauthorised write-off of bad debts;
   (iii) Lack of proper internal controls systems and segregation of duties. e.g An official who has access to both cash and accounts receivable may take cash and could hide the fact by false bad debt journals;
   (iv) Failure to provide for debt impairment or failure to write-off of uncollectible debts after approval by the council could result in overstatement of debtors an ultimately affect the fair presentation of the municipality's financial statements.

SECTION 7: REPORTING

a) All debt impairment provisions and actually written-off / uncollectible debt during the financial year must be reported at all appropriate levels as part of internal reporting and must be reported on and disclosed in the Annual Financial Statement in accordance with the applicable accounting standards.

b) Impairment losses or any applicable reversals thereof must be recognised and disclosed in the Annual Financial Statements in accordance with the applicable accounting standards

c) A report of all uncollectible debts written-off shall be submitted by the Chief Financial Officer to the Accounting Officer immediately after approval by the council.

SECTION 8: REVIEW AND APPROVAL

This policy and underlying strategies will be reviewed at least annually, or as necessary, to ensure its continued application and relevance.