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DRAFT IMPAIRMENT OF DEBTORS
AND
WRITE-OFF POLICY 2018

INDEX

DRAFT IMPAIRMENT OF DEBTORS AND WRITE-OFF POLICY 2018

1. INTRODUCTION

To ensure that households consumers with no or lower income are not denied a reasonable basic service and that the Municipality is not financially burdened with non-payment of the basic services. Council approved policies on property rates, tariffs, credit control and debt collection, and indigent support.

1.2 Despite strict enforcement of the above policies, the Municipality will continuously be confronted by circumstances requiring the possible write-off of irrecoverable debt. To all this the approved Credit Control and Debt Collection Policy, *inter alia*, stipulate that -

"*The Accounting Officer must establish effective administrative mechanisms, processes and procedures to collect money that is due and payable to the Municipality*."

1.3 The Accounting Officer must ensure that all avenues are utilized to collect the Municipality's debt. However, for various reasons there will always be bad debt cases that needs to be catered for through a policy on the writing-off of irrecoverable debt for circumstances that allows for the valid termination of debt collection procedures as contemplated in section 109(2) of the Local Government: Municipal Systems Act, 2000 (Act 32 of 2000), such as -

(a) the insolvency of a debtor whose estate has insufficient funds;

(b) a balance being too small to recover, for economic reason, considering the cost of recovery; and

(c) where Council deems that a customer or group of customers are unable to pay for service rendered.

1.4 The Municipality will have to maintain audit trials in such instances where bad debt is written off and document the reasons for the abandonment of the actions or claims in respect of the bad debt.

2. OBJECTIVES OF POLICY

The objectives of this policy are the following:

2.1 To ensure any long outstanding debt is evaluated in order to determine the possibility of realizing such income as revenue.

2.2 To ensure that where it is evident that a particular debt cannot be turned into revenue such debt be procedurally regarded as irrecoverable.

2.3 To ensure that the Municipal Council makes enough provision for bad debts in the budget.

2.4 To ensure that outstanding monies which have been outstanding for a long time after all attempts have been made in terms of recovering them should then be written off.

2.5 To ensure the identification of bad debts during the course of the financial year.

2.6 To provide guidelines on the writing off of bad debts at least 3 months before the end of the financial year.

3. LEGISLATIVE FRAMEWORK

Local Government: Municipal Systems Act, 2000 (Act 32 of 2000).

Local Government: Municipal Finance Management Act, 2003 (Act 56 of 2003).

Standards of Generally Recognized Accounting Practice.

3.1 Purpose of the Policy

The purpose of this policy is to ensure that the principles and procedures for writing off irrecoverable debt are formalized.

3.2 Responsibility/Accountability

The Council has the overall responsibility for adopting and approving the policy on Writing of irrecoverable debt.

3.3 Policy principles

The following are guiding principles in implementing the Policy on Writing off of Irrecoverable Debt Policy:

(a) The policy was compiled in accordance with the Local Government: Municipal Finance Management Act, 2000 (Act 56 of 2003), Local Government: Municipal Systems Act, (Act 32 of 2000), as amended and other related legislation.

(b) Before any debt is written off it must be proven that the debt has become irrecoverable.

(c) To ensure that recommendations for write off are consistent and accurate, irrecoverable debt will be defined as debt where -

- (i) the tracing of the debtors is unsuccessful;
- (ii) all reasonable steps were taken by the officials to recover the debt; and
- (iii) any debt defined by Council at their discretion as irrecoverable.

(d) Bad debt written off must be considered in terms of cost benefit, when it becomes too costly to recover and the chances of collecting the debt are very slow, a write off should be considered.

(e) Time value of money is very important because the older the debt becomes, the more difficult and costly it becomes to collect. It is therefore imperative that a proper system of credit control is implemented and maintained to avoid debt reaching the stage of becoming too expensive to recover.

(f) Differentiation must be made between those household consumers who cannot afford to pay for basic services (indigent households) and those who just do not want to pay for these services.

(g) Debt can only be written off if the required provision exists in the Municipality's budget and/or reserves.

3.4 **Implementation and review of this Policy**

This policy shall be implemented as soon as it has been approved by Council. All future submissions for the writing off of debt must be considered in accordance with this policy.

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

4. STATEMENT

This policy is applicable to all categories of debt but not limited to -

(a) consumer debtors;
(b) sundry debtors; and
(c) housing rental debtors but excluding stand and housing instalments.

5. IDENTIFICATION OF IRRECOVERABLE DEBTS

Debt is identified to be irrecoverable after the whole credit control and debt collection process has been followed and no payments were received towards the outstanding account.

6. CATEGORIES OF DEBTORS THAT MAY QUALIFY FOR THE WRITING-OFF OF IRRECOVERABLE DEBT

6.1 **Small balances**

6.1.1 Where final accounts have been submitted and paid by the respective consumer and the remaining balance after finalization of any final readings and other administrative costs results in a balance of R100.00 or less, such account must be forwarded once to the consumer for payment.

6.1.2 Where such account is not paid by the respective consumers within a period of 60 days such accounts will automatically be written-off to the provisions of clause 7.4 (delegations to the Chief Financial Officer) below.

6.2 **Insolvent debtor and insolvent deceased estate**

6.2.1 Where a debtor becomes insolvent the Municipality must ensure that a creditor's claim is timeously registered. Any amount not being recovered due to insufficient funds must be written off subject to the provisions of clause 9 below.

6.2.2 In case of death of the debtor a creditor's claim must be timeously registered against the deceased's estate. Any amount being recovered due to insufficient funds-be written off subject to the provisions of clause 7 below.

7. IMPAIRMENT OF DEBTORS AND TRAFFIC FINES (PROVISION FOR UNDOUBTFUL DEBT)

7.1 Untraceable debtors

7.1.1 Where for any reason the forwarded address of a debtor becomes untraceable or the debtor becomes untraceable from the current address, such account must be handed over to a collection agent for recovery of debt (clause 6 cases excluded). The collection agent will be paid an all-inclusive fee. The terms of reference for such collection agent must include the appointment of a tracing agent to locate the debtor. Should a debtor be untraceable, the collection agent must report to the Municipality on the actions that were taken to attempt to trace the debtor.

7.1.2 Any amount owed by a debtor that has become untraceable, must be written off.

7.1.3 Debt written off in the above instances can result in the debtor being reported to the credit bureau by the Municipality.

7.2 Clearance Certificate

7.2.1 In terms of section 118 of the Local Government: Municipal Systems Act a Municipality may not issue a clearance certificate on any property unless all outstanding amounts that become due during the 2 years preceding the date of application are paid to date. However, outstanding debt older than 2 years have accumulated over a period of time and it may not be within the ability of the current owner or prospective new owner to pay such an amount in order to obtain a clearance certificate.

7.2.2 Where such circumstances may prevail the current owner or the prospective new owner may apply to the Municipality for relief of such outstanding debt or a portion thereof.

7.2.3 Upon reviewing, such application must be submitted to the Municipal Manager for consideration.

In reviewing such application, the Municipal Manager must ensure that -

(a) all reasonable measures have already been taken to recover the outstanding amount from the current debtor;

(b) the prospective buyer of the property is not in a financial position to settle the outstanding amount before a clearance certificate is issued; and

(c) it is not in the interest of the Municipality and/or the community to withhold a clearance certificate before the outstanding debt is fully paid.

7.3 Special incentives for household consumers, churches, welfare organizations, sporting bodies

7.3.1 Notwithstanding the Municipality's Credit Control and Debt Collection Policy a debtor may enter into a written agreement with the Municipality to repay any outstanding and due amount to the Municipality under the following conditions:

(a) The outstanding balance, costs and any interest thereon shall be paid in regular and consecutive monthly instalments as determined per arrangement.

(b) The current monthly amount must be paid in full.

(c) The written agreement has to be signed on behalf of the Municipality by a duly authorised officer.

(d) Must be in line with the Credit Control, Debt Collection and Indigent Policy.

7.4 **Delegations to write off debt**

7.4.1 The Chief Financial Officer will, after thorough review of any applications in terms of this Policy, be delegated to write off any amounts to the maximum of -

(a) in the case of a household consumer, church, welfare organization and sporting body an amount less R10 000 including interest and penalties per submission; and

(b) in the case of a business consumer an amount less R20 000 (excluding interest and penalties) per submission.

7.4.2 Any amount in excess of the delegation provided for in clause 7.4.1 above must be submitted together with a recommendation to the Municipal Manager for consideration. The Accounting Officer will, after a thorough review of any recommendation by the Chief Financial Officer and in terms of this policy, be delegated to write off any amounts to the maximum of -

(a) in the case of a household consumer, church, welfare organization and sporting body an amount less than R30 000 (including interest and penalties) per submission;

(b) in the case of a business consumer an amount less than R50 000 (including interest and penalties) per submission;

7.4.3 any amount in excess of the delegation provided for in clauses 7.4.1 – 7.4.2 above must be submitted together with recommendation to Council for consideration; and

7.4.4 All amounts to be written off in terms of clauses 7.4.1 – 7.4.3 above must be considered individually and on each case's own merits.

7.4.5 Detailed reports for all the write-offs must be submitted to Council.

7.5 <u>Implementation and review of this Policy</u>

7.5.1 This Policy shall be implemented once the final policy has been adopted by Council. All future submissions for the writing off of debt must be considered in accordance with this Policy.

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

8. <u>RECOVERY OF IRRECOVERABLE DEBTS</u>

Should there be a payment in respect of the account which has already been written off, such monies must be allocated to the specific vote number designed for the recovery of irrecoverable debts and not be paid back to the consumer.

9. IMPAIRMENT OF DEBTORS AND TRAFFIC FINES (PROVISION FOR DOUBTFUL DEBT)

9.1 Consumer debtors (accounts receivable), long term receivables and other debtors are stated at cost, less a provision for bad debt.

9.2 Significant financial difficulties of the debtor and default or delinquency in payments or all debt outstanding for more than 150 days are considered indicators to determine that debtors are impaired.

9.3 Impairment of debtors (provision for doubtful debt) is recognized as an expense in the statement of financial performance. When an under recovery occurs during the financial year an additional contribution for impairment is made at year-end.

9.4 In the assessment for impairment the following methodologies must be used.

9.5 **Consumer debtors**

9.5.1 According to GRAP 104, the assessment for impairment needs to be made for each individual financial asset separately or for groups of financial assets with similar credit risks. The following methodology was followed to make a provision for doubtful debts for the year under review.

9.5.2 Loans and receivables/trade receivables and trade and other payables (sometimes referred to as “financial liabilities not carried at fair value”) are subsequently measured at amortized cost. For receivables, this includes the effect of impairments. GRAP 104 tells us that an impairment of a financial asset is calculated as being the difference between the expected future cash flows and their present (discounted) value. This means another discounting calculation, distinct from any discounting calculations that may have been required to determine fair value at initial recognition.

9.5.3 The impairment calculation is forward-looking and one must therefore use the number of days that the particular financial asset is still expected to be outstanding based on the best information available at year-end.

9.5.4 Approach in calculating provision for doubtful debts:

9.5.4.1 A report from the system generates the following information:

(a) Ageing of each debtor
(b) Active/inactive account
(c) Tenants’/owners’ account
(d) Debtor type: Residential, Business, Indigent, Government, etc.

9.5.4.2 A cut-off list is generated by the system for which an additional score is added to an outstanding invoice on the debtor’s age analysis.

9.5.4.3 A scoring system would be used by adding additional fields in the database for each debtor/group of debtors indicating the following:

(a) Number of times an account appeared on the cut-off list.

9.5.4.4 The following matrix is used by the Municipality to give a score to an outstanding debtor invoice:

INDICATORS	DEBTOR TYPE			
	Residential	**Business**	**Indigent**	**Government**
Aging between 0 – 30 days outstanding	4	4	0	4
Aging between 30 – 90 days outstanding	3	4	0	4
Aging between 90 – 120 days outstanding	2	3	0	4
Aging between 120 – 180 days outstanding	1	2	0	4
Aging more that 180 days outstanding	0	1	0	4
Active account	2	2	0	2
Inactive account	0	0	0	1
Owners' account	2	2	0	2
Tenants' account	1	1	0	2
List of other examples				
Extended terms for a debtor agreed upon	As per agreement discount	As per agreement discount	As per agreement discount	As per agreement discount
Council approved write-off	0	0	0	0
MAX points that can be earned	8	8	6	8

9.5.4.4 A report by the system indicating a list of debtors falling within the following criteria:

Scoring	Residential	Business	Indigent
0 – 4	Most probably impaired	Most probably impaired	Most probably impaired
0	100% of debtor amount	100% of debtor amount	100% of debtor amount
1	Increase expected number of days outstanding with 80%	Increase expected number of days outstanding with 80%	Increase expected number of days outstanding with 80%
2	Increase expected number of days outstanding with 60%	Increase expected number of days outstanding with 60%	Increase expected number of days outstanding with 60%
3	Increase expected number of days outstanding with 40%	Increase expected number of days outstanding with 40%	Increase expected number of days outstanding with 40%
4	Increase expected number of days outstanding with 20%	Increase expected number of days outstanding with 20%	Increase expected number of days outstanding with 20%
5 – 8	Probably not impaired	Probably not impaired	Probably not impaired

Indicator	Impair
More than 2 entries on cut-off list	Increase days outstanding with 50%
Attorneys total cost on the account exceed 10% of total outstanding balance	Increase days outstanding with 80%
More than 2 final notices issued	Increase days outstanding with 60%
More than 2 summons on account issued	Increase days outstanding with 80%
Judgment on account that x % of outstanding balance will be received	Impair by the % of balance that will not be received
Tracing costs is more than 20% of outstanding balance	Increase days outstanding with 80%
An agreement with the debtor to determine an amount payable and a certain period to pay the amount	Impair using the agreed upon payment amount and period.

9.5.4.5 The following is determined for each of the items impaired at year-end:

(a) Amount to be received (determined by report or direct input from senior official of agreed upon amount).

(b) Estimated/actual date of amount to be received (total days after year-end until payment is received).

(c) Discount rate applicable to the group of debtors.

(d) Calculation of present value using above inputs.

9.5.4.6 The following journal will be processed at year-end to take the difference between the above calculation and existing (as at initial recognition) balance into account will be as follows:

(a) Provision for doubtful debts for current month.

(b) Debit doubtful debts provision allowance account (statement of financial performance).

(c) Credit doubtful debts provision adjustment (statement of financial position).

9.5.4.7 Reversal of doubtful debts in previous month before the current month's reassessed provision is done.

9.5.4.8 Additional calculation is done for debtors that are 150 days+ outstanding:

(i) Residential and business debtors that has an invoice outstanding 150 days+ at year-end are identified.

(ii) Payments received for the next 12 months for each of these accounts are calculated.

(iii) A calculation is done to determine the percentage of the 150 days+ invoices that was not paid after year-end.

(iv) This percentage is used to impair debtors that are 150 day+ outstanding.

9.6. **Provision for impairment of traffic fines**

9.6.1 GRAP 23 requires that revenue is recognised when it is probable that future economic benefits or service potential will flow to the entity and these benefits can be measured. IGRAP 1 clarifies that an entity should recognise <u>the full amount of revenue</u> at the transaction date when there is uncertainty about the entity's ability to collect such revenue based on past history, as the entity has an obligation to collect all revenue due to it. <u>Entities should not consider or assess the probability of collecting revenue at the transaction date</u>, because this is a subsequent measurement event (although this was required under GRAP23 in 2012-2013). <u>Subsequent to initial recognition and measurement, an entity should assess the collectability of the revenue and recognise an impairment loss where appropriate</u>.

Although IGRAP 1 requires an entity to recognise the full amount of revenue at the transaction date, an entity may need to use estimates to determine the amount of revenue that it is entitled to collect as early settlement discounts or reductions in the amount payable by the debtor are offered in certain circumstances. Where these exist, an entity considers past history in assessing the likelihood of these discounts or reductions being taken up by debtors.

9.6.2 From the above accounting information, all traffic fines issued should be recognised as revenue in the current year. The amount at which revenue is recognised will however have to be estimated based on discounts and reductions in fines from the past.

STEP 1

Initial Traffic Fines revenue recognised = Total fines issued during the year – withdrawn – reduced – written off

This amount should then be journalised as follows:

DT Fines debtors
CT Fines revenue

STEP 2

The actual amount of fines collected for the year should then be credited against fine debtors and not revenue as currently recorded.

STEP 3

At year-end the Municipality need to assess the recoverability of the traffic fine debtors for possible impairment.

At this stage the collectability of the revenue will be assessed and an impairment loss where appropriate will be recognised.

Only now when assessing recoverability, the Municipality may use the past payment history -

The journal entry will then be -

Dt Impairment loss (income statement)

Ct Provision for impairment (balance sheet).

9.6.3 Paragraph 6.1 of the Public Prosecution Act determine that warrants of arrest issued in terms of section 56 (5) of the Criminal Procedure Act, 1997 (Act 51 of 1977) in respect of minor traffic offences, have a life span of 2 years from the date of issue thereof and must be returned to the issuing office if not executed within that period.

Provision for impairment will thus be made for all traffic fines exceeding a period of 24 months after issuing of traffic fines.

9.6.4 A report will be written to Council to consider the write-off of traffic fines exceeding 24 months and older.

10. EVALUATION OF DEBTOR TYPES

10.1 Consumer debtors

Debtors are evaluated at each reporting date and impaired as described in subclauses 9.1 to 9.5.

10.2 Sundry debtors

Sundry debtors are assessed individually for impairment when necessary to ensure that no evidence exists that these debtors are irrecoverable.

10.3 Sale of erven

Loans were given at a low interest rate as determined by the contract per annum to encourage development through the sale of erven. Since the inception of the MFMA no new loans are granted. These debtor accounts may be assessed individually to establish whether evidence exists for impairment that these debtors are irrecoverable.

10.4 Housing rental debtors

Housing rental debtors may be assessed individually for impairment when necessary to ensure that no evidence exists that these debtors are irrecoverable. All debt in excess of 60 days will be provided for as irrecoverable.

10.5 Traffic Fines

The impairment of traffic fines will be done as described in section 9.6.

11. SHORT TITLE

This policy shall be called the Impairment of Debtors and Write-Off Policy.

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