Reference no. 13915/1
Umar Banda (8110)
MEETING OF THE ADMINISTRATOR: 3 September 2020

CITY OF TSHWANE
RESOLUTION
2020 -09- 03
ADMINISTRATOR

2.2.1 GROUP FINANCIAL SERVICES DEPARTMENT
IMPAIRMENT POLICY FOR CONSUMER DEBTORS, LONG TERM RECEIVABLE AND OTHER RECEIVABLE
(From the Executive Committee Meeing: 26 August 2020)

1. PURPOSE

The purpose of the report is to present the new Impairment Policy on consumer debtors, long term receivable and other receivable to Council for consideration and approval.

2. STRATEGIC PILLARS

PILLAR 5: A City that is open, honest and responsive.

The report aims to address the following areas with regards to service delivery:

- Building a capable City government;
- Fighting corruption; and
- Communicating regularly and effectively with residents.

3. BACKGROUND

During previous audit periods concerns were raised by the Auditor General with respect to the Debt Impairment Rationale and Discounting of Debtors which were not in accordance with the GRAP 104 Accounting Standards and subsequently led to an audit finding. To address the audit finding Group Financial Services Department procured the expert services of Nameng Chartered Accountants (SA) Inc. to assist with the development of an Impairment Model which will ensure alignment to the GRAP 104 Accounting Standards and National Treasury Guidelines. The Impairment Model was successfully developed and has subsequently been approved by the City's Audit and Performance Committee as well as the Auditor General of South Africa (AGSA).

Furthermore the sec 97 (1) (d) of the Local Government Municipal Systems Act states that the Municipality must adopt a credit control and debt collection policy which provides for realistic targets consistent with:

- General recognised accounting practices and collection ratios; and
- The estimates of income set in the budget less an acceptable provision for bad debts.

4. DISCUSSION

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".* . 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. Losses expected as a result of future events, no matter how likely, are not recognized.

Objective evidence that a financial asset or group of assets is impaired can be as a result of the occurrence of one or more of the following events:

- Significant financial difficulty experienced by the debtor;
- A breach of contract, such as a default or delinquency in interest or principal payments;
- For economic or legal reason, allowing disadvantaged customer who are experiencing financial difficulties to pay as and when they can. For example, allowing disadvantaged customers to pay their account when they can due to the fact that water is a basic human right;
- It is probable that the borrower will enter sequestration or other financial reorganization;
- The disappearance of an active market for that financial asset because of financial difficulties; and
- Observable data, indicating that there is a decrease in the estimated future cash flows that will be received (which can be measured reliably), from a group of financial assets since the recognition of those assets. These can include:
  - The payment status of debtors in the group has deteriorated; and
  - National or local economic conditions that are in line with non-payments in the group

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".*

5. COMMENTS OF THE STAKEHOLDER DEPARTMENTS

5.1 COMMENTS OF THE CHIEF FINANCIAL OFFICER

Cognisance is taken of the contents and recommendation of the report.

The purpose of the report is to present the new Impairment Policy on consumer debtors, long term receivables and other receivables to Council for consideration and approval.

The benefits of adopting the Impairment Policy in line with GRAP 104 will enable the City to be proactive in recognising expected losses on financial instruments. This will result in timeous financial reporting. The debt impairment policy will allow the City to recognize only the revenue that the City expects to receive and raise a provision for expected credit losses.

5.2 COMMENTS OF THE GROUP HEAD: GROUP LEGAL AND SECRETARIAT SERVICES

The purpose of the report is to present the new Impairment Policy on consumer debtors, long term receivable and other receivable to Council for consideration and approval.

In terms of Section 11(3) (j) & (n) of the Local Government Municipal Systems Act, 2000 (Act No. 32 of 2000) (hereafter referred to as the "MSA"), a municipality exercises its legislative or executive authority by monitoring the impact and effectiveness of any services, policies, programmes or plans and also by doing anything else within its legislative and executive competence.

Furthermore, section 97 (1) (d) of the Local Government Municipal Systems Act states that the Municipality must adopt a credit control and debt collection policy which provides for realistic targets consistent with:

(i) General recognised accounting practices and collection ratios; and
(ii) The estimates of income set in the budget less an acceptable provision for bad debts.

This initiative should be in compliance with the provisions of the Current Policy Management Processes of the City and Proposed Approach towards the Adoption of a New Policy, By-law and Strategy Development and Management System approved by Mayoral Committee on the 16th May 2018, which serves as the guideline for the development of policies, strategies, and By-laws for the City of Tshwane. It further provides the details and processes that should be considered in the development of sound policy instruments.

The Policy stipulates that, Policy/by-law development can be led internally within departments in the city or upon request by the political leadership. This includes reviews of existing policies or by-laws.

When initiating a policy, the first step is to engage with the Policy Advisor within the Office of the Executive Mayor who will place the matter on the agenda at the Policy Development Support Committee. The PDSC will check that the policy/by-law is in line with the IDP and the strategic direction of the City, and whether there are any current initiatives that may overlap.

In accordance with Annexure B clause 6 of the policy, when a final draft is ready, a C9 report must be generated so that the policy/by-law can serve before the Mayoral Committee. At this level the Mayoral Committee may refer the policy/by-law to public participation or alternatively send it straight to Council.

If the policy is subjected to public participation, the relevant Department must place a notice inviting all concerned to render comments, objections and/or representation on the policy document.

The draft policy will be translated into all official languages of the City of Tshwane. It must be placed on the City of Tshwane website in order to assist with the public participation and publication processes.

The notice must be published:

- in 3 local newspapers;
- on the notice boards of all regional offices of the City of Tshwane; and
- on the City of Tshwane's public website.

The relevant Department must incorporate any comments, objections and/or representations received from the community into the covering report as well as attached the original comments, objections and/or representation to the report.

Clause 8 of Annexure B of the Policy further states that, after approval of the policy document by Council, the policy must be made public by placing it on the City of Tshwane website.

The Department must ensure that the policy document is loaded onto the Electronic Policy Library and liaise with the PDSC if they require support on this matter.

The Policy Library will be based within Legal and Secretarial services.

All employees of the City of Tshwane must be made aware of a newly approved policy of the City of Tshwane by way of corporate email. All new employees of the City of Tshwane must be made aware of all policies as part of the orientation process.

The relevant Department must ensure that hard copies of the policy document are kept at the office of the Group Head of the relevant Department as well as at the City of Tshwane's Policy Library. Having taken regard to the aforesaid and with specific reference to the contents of the report, Group Legal and Secretariat Services Department supports the approval of the report and the recommendations.

6. IMPLICATIONS

6.1 HUMAN RESOURCES

N/A.

6.2 FINANCES

N/A.

6.3 CONSTITUTIONAL AND LEGAL FACTORS

N/A.

6.4 COMMUNICATION

N/A.

6.5 PREVIOUS COUNCIL OR MAYORAL COMMITTEE RESOLUTIONS

N/A.

7. CONCLUSION

The benefits of adopting the attached Impairment Policy will ensure the following:

(i) Compliance to Accounting Standards and National Treasury Guidelines;
(ii) Compliance to sec 97 (1) (d) of the Municipal Systems Act, No32 of 2000;
(iii) Sufficient Allowance will be made for the impairment of receivables in the Financial Statements;
(iv) Ensure receivables disclosed in the Financial Statements are stated at amounts that are deemed collectable, and
(v) To promote transparency and accountability as required by sections 215 and 216 of the Constitution when dealing with receivables and debt.

ANNEXURE:

A Rationale for the Impairment of Receivables_2020

RESOLVED:

That the attached Impairment Policy (Annexure A), be approved.

CITY OF TSHWANE
RESOLUTION
2020 -09- 03
ADMINISTRATOR

IMPAIRMENT OF RECEIVABLES POLICY

2020

CITY OF TSHWANE METROPOLITAN MUNICIPALITY

CONTENTS:

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 City of Tshwane Metro Municipality.

"reporting date" means 30 June of each year.

"AG" Appendix A - Application guidance

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:

	Service Category
Consumer receivables;	Electricity (Inc. prepaid) Industrial Effluent Interest Other Property Rates Sanitation Sundries Sundries - Ambulances Sundries - Solid Waste Vat Waste Management Water
Other receivables	Housing Rental
Long term receivables	Housing Loans Loans to Sport Clubs Sale of Land

APPLICABLE ACCOUNTING STANDARDS AND TREASURY GUIDELINES

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

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GRAP 104.61 "i*f 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".*

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AG124. Impairment losses recognised on a group basis represent an interim step pending the identification of impairment losses on individual assets in the group of financial assets that are collectively assessed for impairment. As soon as information is available that specifically identifies losses on individually impaired assets in a group, those assets are removed from the group.

AG125. Future cash flows in a group of financial assets 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. Entities that have no entity-specific loss experience or insufficient experience use peer group experience for comparable groups of financial assets. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in future cash flows reflect and are directionally consistent with changes in related observable data from period to period (such as changes in unemployment rates, inflation, property prices, commodity prices, payment status or other factors that are indicative of incurred losses in the group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

AG126. As an example of applying paragraph AG125. an entity may determine, on the basis of historical experience, that one of the main causes of default on consumer debtors is the death of the borrower. The entity may observe that the death rate is unchanged from one year to the next. Nevertheless, some of the borrowers in the entity's group of consumer debtors may have died in that year, indicating that an impairment loss has occurred on those loans even if, at the year-end, the entity is not yet aware which
specific borrowers have died. It would be appropriate for an impairment loss to be recognised for these 'incurred but not reported' losses. It would not be appropriate to recognise an impairment loss for deaths that are expected to occur in a future period, however, since the necessary loss event (the death of the borrower) has not yet occurred.

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

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 receivable 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;
- All accounts indicated as indigent accounts on the system
- When a formal arrangement is made on arrears debt;

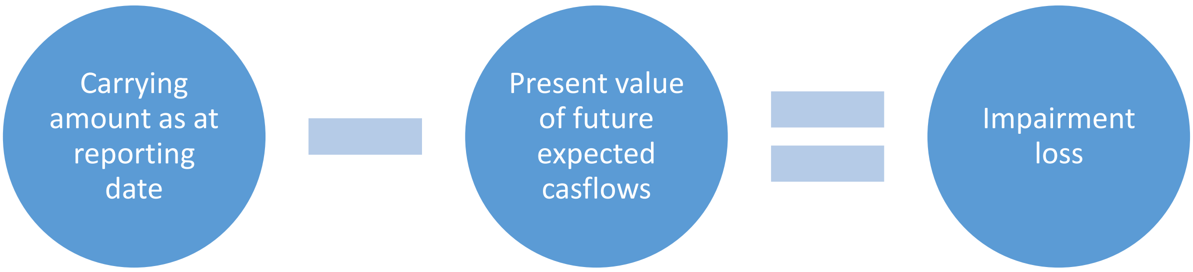
- All accounts with balances outstanding Sixty (60) days and longer as these accounts are considered to be past due
- In line with the Credit Control and Debt Collection policy amounts are considered to be past due without a grace from 59 days, as a result interest is charged. Therefore, it proper to considered amounts to be impaired from 60 days.

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 60 days at reporting date as these accounts are considered not 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.



Carrying values

Obtain the consumer receivables, Other receivables and long-term receivables age analysis as at reporting date and;

- Identify and exclude the following accounts from the age analysis:

- All accounts with zero or credit balance
- All accounts in Owner column indicated as TSHWANE METRO MUNICIPALITY
- All interdepartmental accounts

Present value of expected future cash flows *(per actuarial report)*

The following data sources were provided to perform the valuation:

- 5-year annual debtors age analysis i.e. the current reporting period and 4 year prior years (including negative balances that were considered to be creditors).
- 5 year payments history up to the end of current reporting period.

All debtors and payments were provided on an individual account basis. All inactive, indigent and inter-departmental accounts are excluded from the valuation

Actuarial consultants assisted with the calculation of present value of expected future cashflows using the assumptions below:

Assumptions

The actuary employes the Projected Unit Credit discounted cashflow method in calculating the impairment loss.

Prior payment patterns are considered to calculate the probability of debt being repaid in future periods, with the necessary adjustments.

In determining these assumptions, it is assumed the payments per account in the payment data provided are first allocated to the oldest debt incorporated in the age analyses provided.

Allocate the receivables into the following group: Group 1, Group 2 and Group 3as follows:

GROUP	REASON
GROUP 1 ▪ Government receivables, ▪ Councillors ▪ Embassies ▪ Employees	• Government accounts and embassies are expected to be recoverable. • Councillors and employees are considered low risk, as the City can garnish their allowances and salaries
GROUP 2 ▪ Business ▪ Long-term receivables ▪ Other receivables	• The probability of debt being recovered for businesses based on age is reasonable thus the risk is considered medium • Long-term receivables have been assessed for credit worthiness thus the risk is considered medium

GROUP 3 Residential	• These debtors have a poor payment history, and are considered as follows: ✓ High Risk: Top 25 percent paying wards ✓ Medium Risk: Remaining 50 wards ✓ Low Risk: Bottom 25 percent paying wards
▪ Approved indigents; ▪ In-active accounts	• Accounts marked as indigent and inactive, do not expect any re-payment and is therefore included at 100% in the allowance calculation

Impairment

- All accounts where there is no balance outstanding less than sixty (60) days
- Carrying amount less present value of expected future cash flows

IMPAIRMEMT MODEL

Total Rand Amount CARRYING AMOUNT	Remove= Credit balances, inter-dept	INDICATION OF OBJECTIVE EVIDENCE? YES= IF BALANCE IS 60 DAYS AND ABOVE	PRESENT VALUE OF EXPECTED FUTURE CASH FLOWS (per actuarial report)	IMPAIRMENT LOSS
A		B	C	(A-C)
67 559.23		27 821.56	40 612.00	26 947.23

Notes

A	Carrying amount as at 30 June 2018
B	Indication of objective evidence on Past due accounts 60 days and above.
G	Present value of expected future cash flow
H	Total debt to be impaired less Present value of expected future cash flows

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

SOURCE

- GRAP 104 financial instruments issued October 2009
- GRAP 104 application guide issued October 2009

National Treasury Accounting Guidelines GRAP 104 financial instrume