

EMAKHAZENI LOCAL MUNICIPALITY



FINANCIAL ASSET IMPAIRMENT POLICY

APPROVED BY COUNCIL ON: 30 MAY 2017

IMPLEMENTATION DATE 01 JULY 2017

COUNCIL RESOLUTION NO: 29/05/2017

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1 Introduction

1.1 Vision and value statement

It is the vision of Council to “be a developmental local municipality striving to accelerate provision of quality services to the satisfaction of our communities.

Council is committed to its mission to improve the quality of life of its citizens by providing accelerated services and creation of conducive environment for economic growth through good governance, innovation and integrated planning

The Values of the Council are:

Consultation
Service Standards
Access
Courtesy
Information
Transparency
Redress
Value for money
Responsiveness

1.2 Vision

“A secure environment with sustainable development to promote service excellence, unity and community participation resulting in a caring society

1.3 Mission

Emakhazeni Local Municipality exist to improve the quality of life of its citizens by providing accelerated services and creation of conducive environment for economic growth through good governance, innovation and integrated planning

2 Definitions

Financial asset – is any asset that 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 favourable to the entity;

Financial instrument – is any contract that gives rise to a financial asset of one entity and a financial liability or a residual interest of another entity.

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Amortised cost – The amortised cost of a financial asset or financial liability is the amount at which the financial asset or financial liability is measured at initial recognition minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount, and minus any reduction (directly or through the use of an allowance account) for impairment or uncollectibility.

Financial instruments at amortised cost are non-derivative financial assets or non-derivative financial liabilities that have fixed or determinable payments, excluding those instruments that:

- (a) The entity designates at fair value at initial recognition in accordance with paragraph .17 of GRAP 104; or
- (b) Are held for trading.

Financial instruments at cost are investments in residual interests that do not have a quoted market price in an active market, and whose fair value cannot be reliably measured.

Financial instruments at fair value comprise financial assets or financial liabilities that are:

- (a) Derivatives;
- (b) Combined instruments that are designated at fair value in accordance with paragraphs .20 or .21 GRAP104;
- (c) Instruments held for trading. A financial instrument is held for trading if:
 - (i) It is acquired or incurred principally for the purpose of selling or repurchasing it in the near-term; or
 - (ii) on initial recognition it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short term profit-taking;
- (d) Non-derivative financial assets or financial liabilities with fixed or determinable payments that are designated at fair value at initial recognition in accordance with paragraph .17 GRAP 104; and
- (e) Financial instruments that do not meet the definition of financial instruments at amortised cost or financial instruments at cost.

Financial year – 1 July to 30 June

Impaired – an account 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) 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.

Impairment loss – is the amount by which the carrying amount of a financial asset or group of financial assets exceeds its recoverable amount.

Significant account - Significance is arrived at by calculating the average debtor amount per geographical area e.g. All accounts for Dullstroom, all accounts for Belfast etc. Any amount above the average will be taken as a significant account.

3 Objectives

The objective of the policy document is to clearly define the responsibilities of the municipality in terms of the Municipal Finance Management Act No.56, 2003 in terms of the Impairment of Financial Assets in line with the accounting standards to ensure compliance.

This policy document addresses the following areas:

- assessing whether evidence exists indicating that a financial asset is impaired;

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- The procedures required to determine the amount of an impairment loss.

4 Scope

This policy directs those officials who are charged with the accounting for financial assets and related purposes, regarding the impairment of financial instruments.

5 Legislative Framework

At its broadest level, the Municipal Finance Management Act No.56, 2003 endeavours "to secure sound and sustainable management of the fiscal and financial affairs of the municipalities and municipal entities by establishing norms and standards and other requirements"

In particular Chapter 8 of the Municipal Finance Management Act No.56, 2003 places the onus on the accounting officer to ensure that the municipality's assets and liabilities are valued in accordance with the accounting standards.

GRAP 104 Financial Instruments

6 Principles

6.1. Impairment of financial asset

Financial assets are reviewed annually for any evidence of impairment and any impairment loss is recognized immediately in the Statement of Financial Performance.

6.1.1. Assess for any evidence of impairment

A financial asset (or group of financial assets) is impaired only if there is objective evidence of impairment as a result of one or more events that occurred after initial recognition and that event has an impact on the estimated future cash flows of the financial asset (or group of financial assets).

This assessment will be documented and recorded as part of the annual financial statements working papers, for review by the external auditors.

In making this assessment management may consider the following indicators as guidance for possible impairment:

- Significant financial difficulty experienced by the borrower/debtor;
- Delays in payments (including interest payments) or failure to pay/defaults;
- For economic or legal reasons, allowing disadvantaged customers who are experiencing financial difficulties to pay as and when they can. The entity would not otherwise have considered this concession. For example, allowing disadvantaged customers to pay their account when they can due to the fact water supplies to the customer is a basic human right;
- It is probable that the borrower/debtor will enter sequestration (bankruptcy) or other

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- Financial reorganization;
- The disappearance of an active market for that financial asset because of financial difficulties;
- Observable data, for example historical 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 (financial assets with similar credit risk characteristics grouped together) since the initial recognition of those assets. The decrease may not yet be identified for the individual financial assets in the group. These can include:
 - the payment status of borrowers/debtors in the group has deteriorated (e.g. an increased number of delayed payments); or
 - National or local economic conditions that are in line with non-payments in the group (e.g. an increase in the unemployment rate in the geographical area of the borrowers/debtors, or adverse changes in market conditions that affect the borrowers/debtors in the group).
- Is the account in arrears for a period longer than the initial estimated repayment period
- accounts with arrears of over 90 days showing no repayments in the last financial year
- accounts handed over for collection
- any negative changes in the ability of debtors and borrowers to repay the amounts due to the municipality (example: an increased number of late payments)
- a breach in contract, such as a default in interest or capital payments

Management need not utilize all the indicators given above as guidance but only use the indicators to which management has sufficient information to make the assessment for possible or actual impairment. The information which management will utilize should adequately reflect the current status, relating to the collectability of the receivables.

6.1.2. Assessing for impairment of financial assets

The municipality assesses financial assets individually, when assets are individually significant, and individually or collectively for financial assets that are not individually significant. Where no objective evidence of impairment exists for an individually assessed asset (whether individually significant or not), an entity includes the assets in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment.

Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised, are not included in the collective assessment of impairment.

For collective assessment of impairment, as indicated above, assets with similar credit risk characteristics are grouped together. The credit risk characteristics should be indicative of the debtors' ability to pay all amounts due according to the contractual terms.

Once an entity has concluded that there is objective evidence of an impairment loss, an entity should measure and record any impairment losses that arise in its financial statements through the reduction of the carrying amount of the financial assets or through an allowance account, whichever is appropriate.

6.1.3. Measurement of impairment

- Financial assets carried at amortized cost
 - If there is objective evidence that an impairment loss on financial assets measured at amortized 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

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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 recognized in surplus or deficit.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized (such as an improvement in the debtor's credit rating), the previously recognized impairment loss shall be reversed either directly or by adjusting an allowance account. The reversal shall not result in a carrying amount of the financial asset that exceeds what the amortized cost would have been had the impairment not been recognized at the date the impairment is reversed. The amount of the reversal shall be recognized in surplus or deficit.

- Financial assets carried at cost

If there is objective evidence that an impairment loss has been incurred on an investment in a residual interest that is not measured at fair value because the fair value cannot be measured reliably, the amount of the impairment loss is measured as the difference between the carrying amount of the financial asset and the present value of the estimated future cash flows discounted at the current market rate of return for similar financial assets.

7 Process of calculating the impairment

The process of calculating the impairment is to be elaborated in the procedure manual attached hereto as annexure A.

8 Profiling

Council will utilize the following profiling for the receivables of the municipality.

The matrix tables below are based on management's estimate of risk associated with the recoverability of the risk groups based on past experiences.

A scoring system is implemented within the impairment matrix, as can be seen in part 1. The points that can be awarded for a specific indicator vary between 0 and 8, 0 being no risk of impairment and 8 being the maximum (certain) risk of impairment. Based on management's judgement the scoring will vary between the risk groups as risk of recoverability may be higher for certain groups.

1. Part 1 - Scoring

- Determine the highest ageing bracket in which the consumer has a balance outstanding
- Based on the scoring matrix below allocate a point to that consumer account

Risk group	Area
100	Belfast
200	Dullstroom
300	Machado
400	Waterval Boven
500	Siyathuthuka
600	Emthonjeni
700	Emgwenya
800	Sakhelwe

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Indicator	Business	Gov	Risk group 100	Risk group 200	Risk group 300	Risk group 400& 500	Risk group 600	Risk group 700& 800	Sundry debtors	Non-current receivables
Residential										
≥ 360	5	3	7	8	8	8	8	8	8	8
180 days	4	3	6	7	7	7	8	8	8	8
150 days	3	2	5	6	6	6	7	7	7	7
120 days	3	2	4	5	5	5	6	6	6	6
90 days	2	2	3	4	4	4	5	5	5	5
60 days	1	1	2	3	3	3	4	4	4	4
30 days	1	1	1	2	2	2	3	3	3	3
current	1	1	1	1	1	1	2	2	2	2

Scoring	% to be
1	0%
2	0%
3	0%
4	20%
5	40%
6	60%
7	80%
8	100

- a. All Government, Municipal employees and municipal accounts, are not impaired regardless of the ageing
- b. All indigent accounts are 100% impaired

9 Delegation

The authority to approve the policy vest with the Council

10 Reporting

Management shall comply with the disclosure requirements for the annual financial statements in terms of paragraph 102 -132 of GRAP 104 Financial instruments.

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11 ANNEXURES

11.1 Impairment Procedures

12 IMPLEMENTATION

This Financial Asset Impairment Policy will be adopted and implemented at the start of the financial year after Council approval.

Approved on: 30 MAY 2017

Council Resolution nr: 29/05/2017