CASH MANAGEMENT POLICY

2020/2021 FINANCIAL YEAR

MIDVAAL
LOCAL MUNICIPALITY

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1. Introduction

Availability of cash is one of the key requirements for financial sustainability for any organisation. Accumulated surplus is not an indicator of available cash and should not be seen as having a direct correlation with surplus cash.

One of the first and most important issues that must be borne in mind is that financial statements of municipalities are compiled on the accrual basis (GRAP / GAAP accounting standards used as basis of compilation) and not on the cash basis as Provincial and National Government. In the past the accrual basis was used, but fund accounting was applied and not GRAP. This change in accounting basis led to the accumulation of larger than expected accounting surpluses with little or no relation to cash surpluses.

Cash Management will include the management of the following line items in the financial statements:

1.1 Investments (Long Term and Short Term)

1.2 Cash and Cash Equivalents

2. Determination of minimum cash levels to retain: Part 1: Encumbered Cash

2.1 Unspent Conditional Grants

Any grants received from the National or Provincial Government that have not been spent by the reporting date should be set aside in cash and not utilised for purposes other than the intended purpose as per the conditions of the grant.

2.2 Developers Contributions

Any amounts received as development contributions that have not been spent by the reporting date should be set aside in cash and not utilised for purposes other than capital infrastructure improvements. There is no requirement to spend the contributions received on the development where the contributions originated from but must be utilised for the creation of additional infrastructure capacity.

2.3 Capital Replacement Reserve

Funds set aside for the acquisition of capital assets in accordance with the approved capital budget of Council, may be held in cash and referred to as Capital Replacement Reserve.

2.4 Unspent Loan Funding

Any borrowed funds that have not been spent by the reporting date should be set aside in cash and not utilised for purposes other than the intended purpose as per the loan agreements.

2.5 Deposits held

Consumer deposits are amount paid by customers, to be withheld by the municipality from the opening of an account till termination. The deposits will be refunded on termination provided that the customer does not have any money owing to the municipality on any of municipal accounts.

Consumer deposits maybe cash-backed, however: -

The likelihood of all customers approaching the municipality simultaneously demanding that their deposits be refunded is highly unlikely.

In cases where a customer’s deposit is refunded, it is often replenished by another customers deposit - who acquires the property.

2.6 Retentions held

Retention in contracts are amounts held as a set off in the event the contractor does not honour the contract in rectifying any defects. Normally retention is held for the cost of rectification of defects during the construction period and for the cost of rectification of defects during the defects liability period, usually 12 months after the date of practical completion.

The retentions held are thus not available for purposes other than releasing the funds to the contractor at the end of the defects period, and should be held in cash and not utilised for other purposes.

3. Determination of minimum cash levels to retain: Part 2: Balance Sheet Provisions and Reserves

The Accounting Policy of the Midvaal Local Municipality contains the following sections relating to provisions:

A provision is recognised when the economic entity has a present obligation (legal or constructive) as a result of a past event and it is probable (i.e. more likely than not) that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

The economic entity does not recognise a contingent liability or contingent asset. A contingent liability is disclosed unless the possibility of an outflow of resources embodying economic benefits is remote.

Provisions are reviewed annually and those estimated to be settled within the next twelve months are treated as current liabilities. All other provisions are treated as long term liabilities.

The Midvaal Local Municipality has the following provisions that must be cash backed:

3.1 Provision for annual leave

Liabilities for annual leave are recognised as they accrue to employees.
The liability is based on the total accrued leave days at year end.
The leave accrual is cash backed.

3.2 Provision for the rehabilitation of the landfill site(s)

The **provision for the rehabilitation of the landfill site(s)** is created for the rehabilitation of the current operational sites at the future estimated time of closure.

The Provision is based on the expected future cost to rehabilitate the various sites discounted back to the balance sheet date at the cost of capital. The municipality has an obligation to rehabilitate these landfill sites.

Cash will be provided over the period until it becomes necessary for the rehabilitation.

3.3 Provision for post-retirement benefits (medical)

Actuarial valuations are conducted on an annual basis by independent actuaries to determine the amount of the provision that is required.

The provision is cash backed.

3.3 Provision for long service awards

The municipality offers various types of long service awards to its employees. The provision is to recognise the present value of the obligation as at the reporting date.

The provision is cash backed.

4. Determination of minimum cash levels to retain: Working Capital

Working capital is a financial metric which represents the operating liquidity that will be available to the organization Working capital is considered a part of operating capital. Net working capital is calculated as current assets minus current liabilities.
In line with National Treasury recommendations, the difference between current creditors and current debtors must be retained in cash as working capital for purposes of cash management.

5. Determination of minimum cash levels to retain: Liquidity Ratios

5.1 Liquidity ratio (also called current ratio)

This ratio expresses the current assets (debtors after provision has been made for impairment , inventory, investments maturing in 1 – 12 months and cash and cash equivalents as a ratio or percentage of current liabilities (creditors, unspent grant funding, amounts to be paid on long term loans within the next 12 months and short term provisions). This ratio should also be at least 1:1 but ideally greater than 1.2:1.

The ratio should always be a minimum of 1:1

5.2 Cost Coverage

A measure of a company's ability to meet its financial obligations. In broad terms, the higher the coverage ratio, the better the ability of the enterprise to fulfil its obligations to its lenders.

The ratio should always be a minimum of 1 month, in other words, the available cash should be enough to cover the municipality’s cash expenditure for one month.

5.4 Number of day's cash on hand

This indicator looks at, the number of days that the entity will be able to sustain itself, if no further cash is received.

This ratio should always be a minimum of 30 days.

These liquidity indicators should not be seen in isolation as a number of factors can impact on the ratios (which are stated at a specific date). There may be only 10 days of cash available on one day, whilst the next day grants may be transferred changing the days cash to 60. The opposite is also true – cash holdings can be reduced from the 60 days to 10 days within a day when interest and redemption payments are made or the monthly bulk purchases are paid.

Further factors that must be taken into account are:

- Long term borrowings and/or creditors: A municipality may have large cash balances whilst having long term borrowings and creditors. When comparing this with a municipality with lower cash balances, but also relatively lower borrowings and lower creditors, it may very well be found that the one with the lower cash balance is in a better financial position.
- Debtors: An entity may have a low cash balance, but a fairly significant debtors balance (which is collectable) which will change the cash position as soon as payment is received from the debtors.

These and other factors make it necessary to not only look at a specific (or even a range of) ratio at a specific date, but to monitor the trends over a period of time.

Excluding exceptions or specific interventions, the cash balance must increase on an on-going basis with at least the ruling inflation rate to ensure the financial position is sustained in real terms.

6. Implementation

The policy will be effective as from 1 July 2020.