CASH MANAGEMENT POLICY

2019/2020 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 reserves.

Cash Management will include all amounts disclosed on the financial statements on the following line items:

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 Capital Replacement Reserve must be held in cash and only utilised for the acquisition of capital assets in accordance with the approved capital budget of Council.

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 the customer does not owe the municipality on municipal accounts.

Consumer deposits must be cash-backed.

2.6 Retentions held

Retention in contracts are amounts be held as a set off in the event the contractor does honouring the contract in regards to 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. This is included in the creditors part of the Working Capital Cash Provision.

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 (accruals) that must be cash backed:

3.1 Leave Accrual

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 Landfill Rehabilitation Provision

The Landfill Rehabilitation Provision is created for the rehabilitation of the current operational sites at the future estimated time of closure.

The value of 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.

The Landfill Rehabilitation Provision must be fully cash backed.

3.3 Provision for post-retirement benefits

A policy has been adopted by Council on the provision of post-retirement medical benefits to qualifying members. Actuarial valuations are conducted on an annual basis by independent actuaries and this is raised as a provision.

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: Part 3: Working Capital

Working capital is a financial metric which represents operating liquidity available to a business, organization, or other entity, including governmental entity. Along with fixed assets such as plant and equipment, working capital is considered a part of operating capital. Net working capital is calculated as current assets minus current liabilities. If current assets are less than current liabilities, an entity has a working capital deficiency, also called a working capital deficit.

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: Part 4: Liquidity Ratios

5.1 Liquidity ratio (also called current ratio)

This ratio expresses the current assets (debtors after provision has been made for non-payment, inventory, investments maturing in 4 – 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 logic for this ratio is that an entity should be able to turn the current assets into cash within a 12 month period if required so that all of the liabilities due within the 12 months can be settled.

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

This indicator looks at, if no further income is received, for how long an entity will be able to sustain itself based on the current expenditure trends. This calculation is done using the approved budget as basis (eliminating all non-cash expenditure items) for a 365 day year. This ratio is similar to the cost coverage ratio, but it is stated in days and not months.

This ratio should always be a minimum of 30 days.

These liquidity indicators are should not be seen in isolation as a myriad 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 Eskom bill is settled.

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 2019.