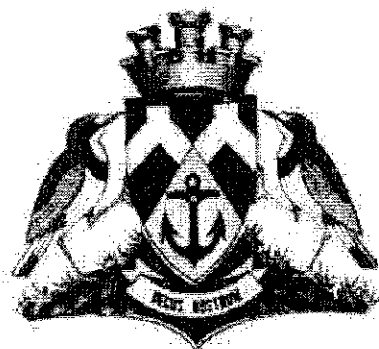


# **OVERBERG**

## **DISTRICT MUNICIPALITY**

### **LIQUIDITY POLICY**

Reviewed: 30 March 2017



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## 1. BACKGROUND

Liquidity is the amount of cash and / or “near cash” (which refers to assets or security that can easily and quickly be converted to cash), available to be utilized to meet obligations and / or pay commitments. The marketability or ability to buy or sell an asset without incurring unacceptable large losses thus determines the liquidity of an asset or defines it as near cash.

Various policies and procedures exist that direct the way in which the business of Overberg District Municipality is or should be conducted in a prudent manner. Generally these policies and procedures follow from prescription in Legislation, i.e. the Municipal Finance Management Act (“MFMA”) and / or directives issued by a national department such as National Treasury.

Guidelines provided by National Treasury indicate that an acceptable level of cash resources needs to be available for working capital requirements.

It is for this reason that the need to have an official Liquidity Policy was identified.

## 2. PURPOSE OF THE POLICY

This documented Liquidity Policy sets out the minimum risk management measures that the municipality has to implement and adhere to in order to ensure that its current and future liquidity position is managed in a prudent manner.

This Policy is implemented to provide guidance on the minimum liquidity level that the municipality has to maintain in order to comply with relevant legislation and / or National Treasury directives and within the overall financial management objectives as approved / reviewed by the Council from time to time.

## 3. DEFINITIONS

“JSE” refers to the Johannesburg Stock Exchange

“MFMA” refers to the Local Government: Municipal Finance Management Act (56 of 2003).

“Municipality” refers to the Overberg District Municipality.

## 4. LEGAL FRAMEWORK

4.1 The MFMA circular 71 stipulates the following two prescribed ratios to manage liquidity:

**Cash/Cost Coverage Ratio (Excluding Unspent Conditional Grants)** is calculated as:

$$\frac{((\text{Cash and Cash Equivalents} - \text{Unspent Conditional Grants} - \text{Overdraft}) + \text{Short Term Investment})}{\text{Monthly Fixed Operational Expenditure excluding (Depreciation, Amortisation, Provision for Bad Debts, Impairment and Loss on Disposal of Assets)}}$$

Criteria: 1 – 3 times

**Current Ratio** is calculated as:

Current Assets / Current Liabilities

Criteria: 1.5:1 - 2:1

- 4.2 The above guidelines are noted but the proposed policy is more conservative to ensure that the municipality secures its strong financial position thereby providing comfort to investors / creditors and other stakeholders.

## **5. SCOPE FOR APPLICATION**

- 5.1 This policy provides guidance on the determination of the minimum required liquidity of the municipality and the calculation of the liquidity available from time to time.

## **6. LIQUIDITY POLICY**

- 6.1 Notwithstanding the requirements as reflected in this policy, the municipality will ensure that its Current Assets (excluding debtors older than 90 days) cover all of its Current Liabilities at least 1.75 times.

- 6.2 The following constitute the key elements to take into consideration when determining the liquidity requirement of the municipality:

- 6.2.1 To comply with statutory requirements it is proposed that the following funds, reserves and provisions must be fully covered by unencumbered cash and investments:

6.2.1.1 All earmarked or conditional grant transfers from other spheres of Government or from Public Contributions made to the municipality that have not yet been utilized;

6.2.1.2 All commitments resulting from the legally entrenched rights and benefits employees have, with specific reference to the Council's short term commitment to staff retirement benefits and medical fund claims payable;

6.2.1.3 All funds received but not yet utilized in relation to agency services provided on behalf of Provincial or National Government, should also be treated as earmarked funds; and

6.2.1.4 All reserves stated by the municipality on its Statement of Financial Position that have been established for the purposes of making provisions for a defined purpose.

- 6.2.2 Cognisance also needs to be taken of the external loan commitments and the servicing of capital and interest on these loans. Therefore provision should be made that the municipality can meet its external loan/financial commitments

together with the normal operational expenditure, as well as its liabilities to staff.

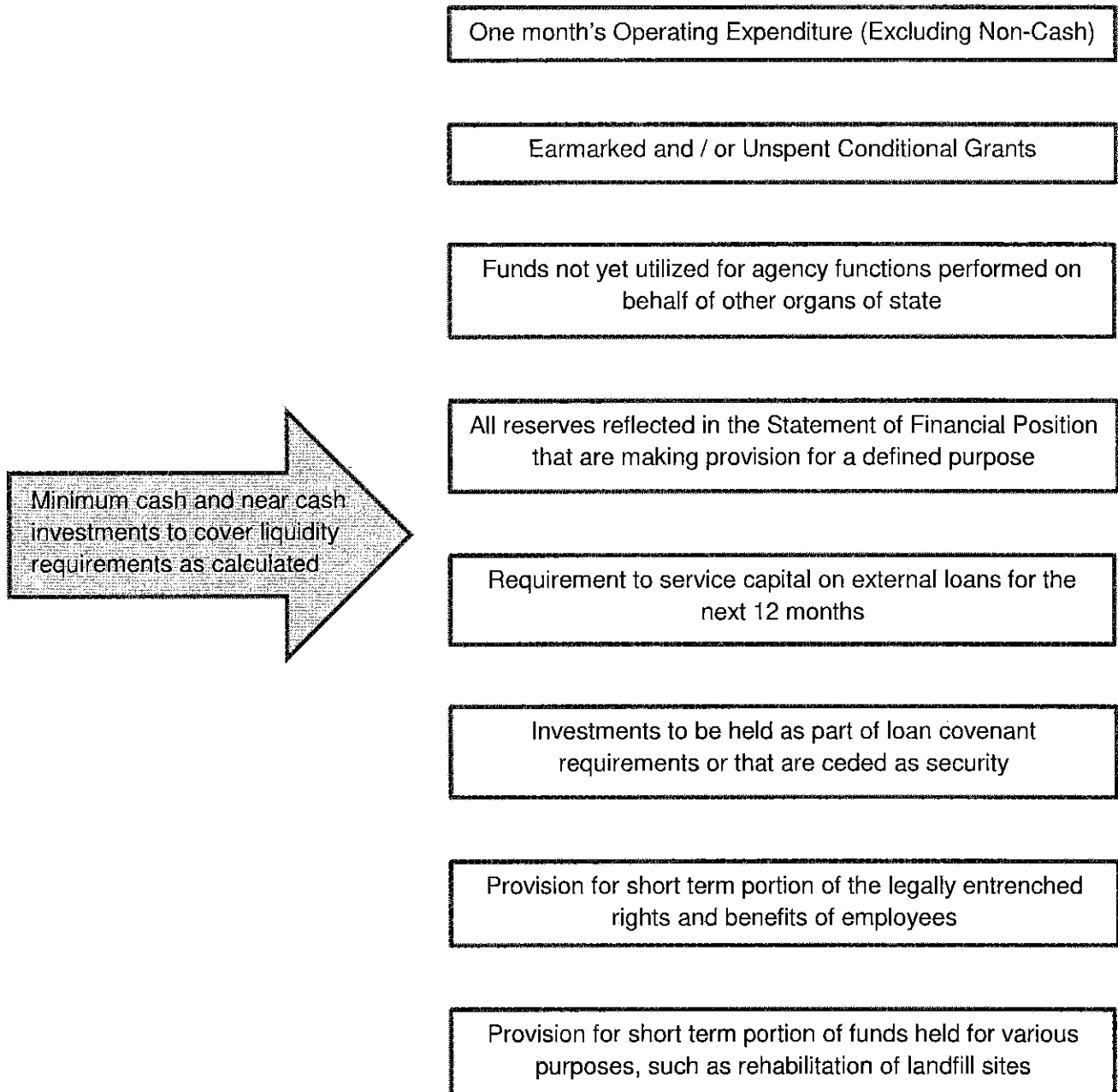
- 6.2.3 All investments ceded as security against long term loans need to be excluded from total cash and investment balances for calculation of the minimum liquidity level required.
- 6.2.4 In addition, a level of cash available for normal operational expenditure needs to be held in cash to ensure that, notwithstanding fluctuations in the monthly income levels of the municipality, the municipality will be in a position to meet its financial requirements. In this respect, the average monthly operational expenditure needs to be used as a guide of the minimum buffer required. At least one month's operational expenditure excluding debt impairments, depreciation and other non-cash expenses should be available for liquidity cover.
- 6.2.5 The "golden rule" is to ensure that the municipality will have adequate liquid assets (those that can be made into cash within 24 hours, weekly or monthly as the requirement might be) to meet its short term financial commitments.

## **7. CALCULATION OF AVAILABLE LIQUIDITY**

- 7.1 The amount of liquidity available should be determined at least once a month. Annexure 1 provides the detail format for the calculation thereof.
- 7.2 The following, should be regarded as cash and or near cash in calculating the available liquidity:
  - 7.2.1 All cash held in a bank account or invested with a money market fund, including funds held in the municipality's bank accounts but ring fenced for other purposes, viz.:
    - 7.2.1.1 Amount of unspent conditional grants and public contributions;
    - 7.2.1.2 Funds advanced for expenditure on activities executed on behalf of other spheres of Government (Provincial and / or National) as part of an agency-function;
    - 7.2.1.3 Funds ring-fenced for cash backed reserves;
    - 7.2.1.4 Cash amounts that need to be held by Council resulting from loan agreements that are part of the conditions of loans extended, but not ceded outright to lenders;
  - 7.2.2 95% of the value of all tradable instruments issued by a bank that are not already ceded;

- 7.2.3 90% of the market value of all listed bonds on the JSE in which *the municipality* is allowed and has invested in;
- 7.2.4 Consumer debtors aged current to 60 days;
- 7.2.5 The undrawn portion of unconditional bank overdraft facility or liquidity facility available to the municipality.

The aforementioned paragraphs are schematically reflected below:



## **8. IMPLEMENTATION AND MONITORING OF COMPLIANCE WITH THIS POLICY**

- 8.1 The Chief Financial Officer must ensure that the minimum cash to meet the requirements as set out in this policy is held.
- 8.2 The minimum required liquidity level should be calculated based on audited annual financial statements and the monthly cash projections.
- 8.3 When compiling the annual budget or any adjustment budget the level of liquidity required in terms of this policy needs to be maintained taken into account budgeted revenue (amended by the expected collection rates) and the expenditure (both capital and operational in nature).
- 8.4 The liquidity level must be reported to the Council and its committees on a quarterly basis or as might be stipulated by Council.

## **9. CORPORATE GOVERNANCE (OVERSIGHT)**

- 9.1 The minimum liquidity requirements must be determined on a monthly basis (at least) by the Chief Financial Officer and reported to the Municipal Manager.
- 9.2 Compliance with this policy will be monitored by the Chief Financial Officer and the Accounting Officer. The Chief Financial Officer must present the liquidity compliance reports to the Finance Committee and the Audit Committee of the municipality.
- 9.3 Where compliance has been breached the Chief Financial Officer must present an action plan to correct the non-compliance. The Finance Committee must monitor the successful implementation of the corrective action plans and report progress to Council.

## **10. RELATED POLICIES**

- 10.1 The Liquidity Policy forms part of the municipality's overall financial objectives and is therefore related to the following policies:
  - 10.1.1 Budget policy;
  - 10.1.1 Borrowing policy;
  - 10.1.3 Funds and reserves policy.

## **11. REVIEW**

- 11.1 The policy must be reviewed at least annually during the budget revision and presented to Council for approval.

**12. EFFECTIVE DATE**

12.1 The policy is effective from 1 July 2017



## ANNEXURE 1

Liquidity Requirement as per Liquidity Policy

Financial Year End: \_\_\_\_\_

### Liquidity Requirement Calculation [as stipulated in Paragraph 6.2]

All earmarked and/or conditional grants received but not yet utilised	
Value of the short term provisions held in cash for defined purposes, such as the rehabilitation of landfill sites	
Value of legally entrenched short term rights and benefits of employees related to Medical benefits & Retirement benefits	
Unspent Loan Funds	
Funds held for agency services not yet performed	
Reserve funds reflected in Statement of Financial Position that are assumed to be held in cash	
Capital redemption and interest payments on external loans not reflected as part of normal operational expenditure	
1 months operational expenditure excluding non-cash items	
Commitments resulting from contracts concluded as part of Capex Programme, not reflected in operational budget	
<b>TOTAL LIQUIDITY REQUIREMENT</b>	

### Actual available liquidity held [reference paragraph 7.2]

Bank Balance at e.g.:	
- ABSA, FNB, Standard Bank, Nedbank, Investec, Money Market	
<b>Bank balance sub total</b>	
95% of all other term investments with Banks	
90% of Market value of all Bonds on the JSE that are held	
Consumer debtors (current – 60 days)	
Other reserves held in cash <b>not reflected in bank balances mentioned above</b> for e.g.:	
- Unspent conditional grants	
- Payments received for agency functions not yet performed	
- The cash value of reserves held	
- Cash deposits held as part of loan covenants or ceded	
- Undrawn bank overdraft facility or committed liquidity lines available	
<b>TOTAL LIQUIDITY AVAILABLE</b>	

**LIQUIDITY SURPLUS (SHORT FALL)**

**SURPLUS TO BE APPROPRIATED TO CAPITAL REPLACEMENT RESERVE**

(See Borrowing, Funds and Reserves Policy)

**Liquidity Ratio (Minimum 1.75:1):**

Current Asset /Current Liabilities

