



Liquidity Policy

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[1] INTRODUCTION

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

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.

Generally Recognised Accounting Practice statement 2 on Cash Flow Statements defines “Cash” to comprise of cash on hand and demand deposits. It also states that “Cash equivalents” are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. This will mean the same as cash and near cash discussed in the policy.

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

[2] BACKGROUND AND APPROACH

Various policies and procedures exist that direct the way in which the business of Senqu Municipality is or should be conducted in a prudent manner.

Generally, these policies and procedures flow from the prescription made 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 (see below).

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

[3] LEGISLATIVE REQUIREMENTS

[3.1] Circular 71 Compliance

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

Criteria: 1.5 - 2:1

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 and the public.

[4] LIQUIDITY POLICY

This policy provides guidance on the determination of the minimum liquidity requirement and the calculation of the liquidity available of Senqu Municipality from time to time (see Annexure 1).

Notwithstanding the requirements as reflected in this policy, Senqu Municipality should ensure that its Current Assets (excluding debtors older than 90 days) cover all of its Current Liabilities at least two times.

The policy encapsulates certain key aspects and considerations which have been outlined below:

4.1. KEY COMPONENTS OF MINIMUM LIQUIDITY REQUIRED:

The following constitutes the key elements to take into consideration when determining the liquidity requirement of Senqu Municipality:

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

4.1.1.1. All earmarked or conditional grant transfers from spheres of Government or from Public Contributions made to Senqu Municipality that have not yet been utilized;

4.1.1.2. 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;

4.1.1.3. All funds not yet been utilized in relation to agency services provided on behalf of Provincial or National Government should also be treated as earmarked funds;

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

4.1.2. 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 Senqu Municipality can meet its external loan/financial commitments together with the normal operational expenditure, as well as its liabilities to staff.

4.1.3. 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.

4.1.4. 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 Senqu Municipality, Senqu 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. Two month's operational expenditure excluding debt impairments, depreciation and other non-cash expenses should be available for liquidity cover.

4.1.5. The "golden rule" should be to ensure that Senqu Local Municipality will have adequate liquid assets (those that can be made into cash within 24 hours, weekly

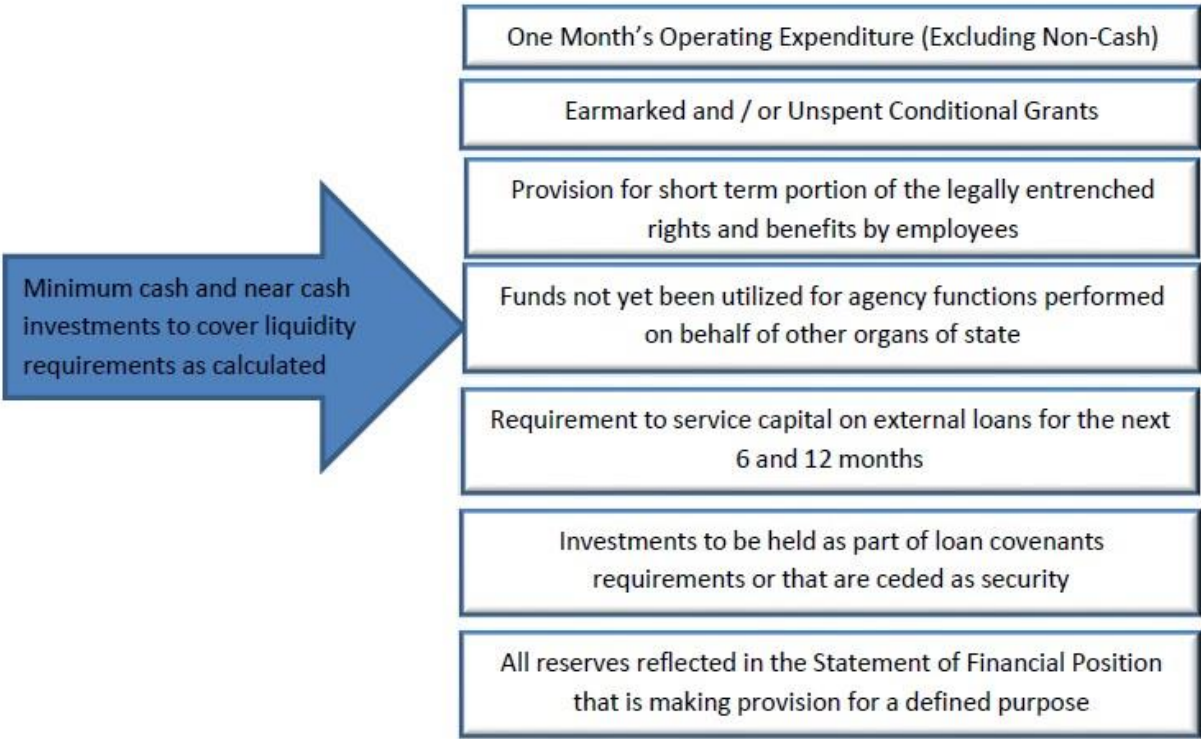
or monthly as the requirement might be) to meet its short term financial commitments.

4.2. CALCULATION OF AVAILABLE LIQUIDITY

The amount of liquidity available should be determined from time-to-time. The following, should be regarded as cash and or near cash in calculating the available liquidity:

- 4.2.1. All cash held in a bank account or invested with a money market fund or Investment Accounts Held by the Municipality;
- 4.2.2. 95% of the value of all Negotiable Certificate of Deposit (NCD's) or other tradable instruments issued by a bank that are not already ceded;
- 4.2.3. 90% of the market value of all listed bonds that may be on the JSE in which Senqu Municipality is allowed to invest in;
- 4.2.4. Consumer debtors aged current to 60 days;
- 4.2.5. Amount of unspent conditional grants and public contributions excluded from own funds held in bank accounts;
- 4.2.6. Funds provided to Council for expenditure on activities executed on behalf of other spheres of Government (Provincial and / or National) as part of an agency function, excluded from own funds held in bank accounts;
- 4.2.7. Funds ring-fenced for cash backed reserves that are excluded from own funds held in bank accounts;
- 4.2.8. Cash amounts that need to be held by Council resulting from loan covenants' that are part of the conditions of loans extended, but not ceded outright to lenders;
- 4.2.9. The undrawn portion of unconditional bank overdraft facility or liquidity facility available to Senqu Municipality.

The aforementioned in paragraphs 4.1. and 4.2. can schematically be reflected as follows:



4.3. IMPLEMENTATION AND MONITORING OF COMPLIANCE WITH LIQUIDITY POLICY:

Once the policy is approved, the CFO is to be tasked to ensure that the required cash has to be maintained to continue meeting the requirements as set out in this policy.

Firstly, the minimum required liquidity level should be calculated based on audited annual financial statements.
This level of liquidity required needs to be specifically budgeted for and on a quarterly basis be reported to the Finance Standing Committee and the Executive Committee.

Notwithstanding National Treasury's three months' operational expenditure guideline and the one-month operational expenditure buffer proposed as a minimum by the liquidity policy, it is recommended that Council set a target of one month's operational expenditure liquidity buffer to be achieved at the end of the transitional period (reference paragraph 6).

The cash provisions made to repay external loan commitments, if specifically, earmarked, should also be added to this minimum working capital liquidity, to prevent fluctuations in the working capital reserve that could put the minimum level of liquidity levels under pressure.

[5] CORPORATE GOVERNANCE (OVERSIGHT)

The minimum liquidity requirements must be determined, at least, on a monthly basis by the Chief Financial Officer and reported to the Municipal Manager.

Compliance with this policy will be monitored by the Chief Financial Officer. The Chief Financial Officer must present the liquidity compliance reports to the Finance Standing Committee and the Executive Committee of the municipality.

Where compliance has been breached the Chief Financial Officer must present an action plan to correct the non-compliance. The Finance Standing Committee must monitor the successful implementation of the corrective action plans and report progress to Council.

[6] POLICY MANAGEMENT

The Liquidity Policy forms part of Senqu Municipality overall financial objectives and therefore, forms part of approved Budget Policies.

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

The policy is effective from the date it is approved by Council.

[7] Annexure 1Liquidity Requirement as per Liquidity Policy

Financial Year End: _____

Liquidity Requirement Calculation [as stipulated in Paragraph 4.1.]

All earmarked and/or conditional grants received but not yet utilised	
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 month's operational expenditure excluding non-cash items	
Commitments resulting from contracts concluded as part of Capex Programme, not reflected in operational budget	

TOTAL LIQUIDITY REQUIREMENT***Actual available liquidity held [reference paragraph 4.2.]***

Bank Balance at e.g.:	
- ABSA, FNB, Standard Bank, Nedbank, Investec, Money Market	
Bank balance sub total	
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 not reflected in bank balances mentioned above 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	

TOTAL LIQUIDITY AVAILABLE**LIQUIDITY SURPLUS (SHORT FALL)****SURPLUS TO BE APPROPRIATED TO CAPITAL REPLACEMENT RESERVE**

(See Borrowing, Funds and Reserves Policy)

Liquidity ratio:**Current Asset/Current Liabilities**