

**MAKHADO
LOCAL MUNICIPALITY**

**DRAFT FRAMEWORK FOR
CASHFLOW MANAGEMENT**

Council Resolution A.30.30.03.15

MAKHADO MUNICIPALITY - FRAMEWORK FOR CASHFLOW MANAGEMENT

Annexure A: Second Draft – Proforma Cashflow

1. INTRODUCTION

- 1.1 Sections 17 and 18 of the Local Government: Municipal Finance Management Act (MFMA), Act no 56 of 2003 requires the Municipality to compile its annual budget in accordance with realistically anticipated revenue from each revenue source. In addition, section 71 (2) requires the Municipal Manager to submit a projection of the Municipality's revenue and expenditure for the rest of the financial year and any revisions from initial projections, on a monthly basis.
- 1.2 Realistically anticipated revenue implies that the non-payment of debtors' balances must be brought into consideration, as failure to do so will result in the Municipality experiencing serious cashflow difficulties. This becomes even more important where the Municipality has not provided sufficiently for working capital in their approved operating budget. It will not be possible to submit the required information without having a proper cashflow forecast and cash management plan in place.
- 1.3 Cashflow forecast is also an integral part of the Municipality's Service Delivery and Budget Implementation Plan (SDBIP) to be compiled and submitted to the Mayor immediately after approval of the annual budget.
- 1.4 As custodians of public funds, the Council also has an obligation to see to it that cash resources are managed as effectively as possible.
- 1.5 This framework has been compiled in accordance with the MFMA. Where this framework is contrary to other legislation, such legislation will override this framework. It is an explicit responsibility of the Municipal Manager to bring such conflicts immediately to the attention of the Council once he or she becomes aware of such conflicts and to propose changes to this framework to eliminate such conflicts.

2. DELEGATION OF POWERS

- 2.1 This framework should be applied with due observance of the Municipality's policy with regard to delegated powers. Such delegations refer to those between the Municipal Manager and other responsible officials as well as between the Council and the Executive Committee and the Council and the Municipal Manager. All delegations in terms of this policy must be recorded in writing.

2.2 According to the MFMA, the Municipal Manager is the accounting officer of the Municipality and therefore all designated officials are accountable to him/ her. The Municipal Manager is therefore accountable for all transactions entered into by his/ her designates.

2.3 The overall responsibility of cashflow management lies with the Municipal Manager. However, the day to day handling of cashflow management should be the responsibility of the Director Finance or his/her delegate.

3. PURPOSE OF THE FRAMEWORK

3.1 The purpose of this framework is to ensure that cashflow management forms part of the financial management procedures of the Makhado Municipality and to ensure that prudent cashflow procedures are applied consistently.

4. EFFECTIVE CASH MANAGEMENT

4.1 Cash Management Plan

4.1.1 Adequate and efficient cash management is one of the main functions of the Director Finance. It is therefore imperative that a cash management plan be established and adhered to at all times. Sound cash management includes the following: -

- ❑ Collecting revenue when it is due and banking it promptly;
- ❑ Accurately forecasting the Municipality's cashflow requirements;
- ❑ Recognising the time value of money, i.e. economically, efficiently, and effectively managing cash;
- ❑ Making payments, including transfers to other levels of government and non-government entities, no earlier than necessary with due regard for efficient, effective and economical programme delivery and the government's normal terms for account payments as well as within legislative requirements;
- ❑ Avoiding pre-payments for goods or services (i.e. payments in advance of the receipt of goods or services), unless required in terms of contractual arrangements with the supplier;

- ❑ Accepting discounts to effect early payment only when the payment has been included in monthly cashflow estimates prepared by the Municipality;
- ❑ Pursuing debtors with appropriate sensitivity and rigour to ensure that amounts receivable by the Municipality are collected and banked promptly;
- ❑ Timing the inflow and outflow of cash to ensure that significant cash outflows only occur when there is sufficient cash in the Municipality's bank account; and
- ❑ Taking any action that avoids locking up money unnecessarily and inefficiently, such as managing inventories to the minimum level necessary for efficient and effective programme delivery and selling surplus or under utilised assets.

4.2 Efficient Cash Collection Procedures

4.2.1 All monies due to the Municipality must be collected as soon as possible and banked on a daily basis. Cash left in the Municipality's safe can pose a security risk, could necessitate additional insurance coverage and does not earn any interest. Special deposits should be arranged for larger amounts received to make sure that these are banked on the same day they are received.

4.2.2 When the service is provided on credit, it is essential that all amounts owed to the Municipality be levied by way of a debit in the applicable debtors system. A well managed debtor and banking control system is a proper measure for ensuring that monies owed to the Municipality are timeously received and banked. It is also important to review the debt collection performance by regularly comparing monies presently owed to the Municipality in relation to the total income, both in the current and previous financial years, in order to determine whether the debt collection is deteriorating or improving.

4.3 Payment to Creditors

4.3.1 Another aspect of effective cash management is adequate control over the timing and payment of creditors accounts. To reduce bank costs with regard to cheque payments it is essential to limit the payment of creditors to one payment per creditor per month, if possible, and to consider making use of electronic transfer facilities if these are available, subject to strict control measures.

- 4.3.2 When considering the time to pay a creditor, proper consideration must be given to the conditions of credit/ terms of payment offered. In cases where cash discount is offered for early settlement the discount, if the relevant time scale is taken into account, will in most cases be more than any investment returns from temporarily investing the funds and if offered, they should be properly considered and utilised.
- 4.3.3 The normal conditions of credit/ terms of payment offered by suppliers should also be considered and utilised to the full by paying on the due date and not earlier.

4.4 Management of Investment in Inventories

- 4.4.1 Cash management can be improved by ensuring that adequate stock control is exercised over all goods in store. The inventory levels in any stores system have to be reviewed continually in the light of annual contracts from local suppliers. Only essential inventory levels are to be maintained in the case of inventory items that are readily available. Inventory items held in stock for a long period of time is an unproductive asset to which an opportunity cost can be attached.
- 4.4.2 In addition, inventory items held in stock for long periods of time could become redundant or obsolete. It is advisable, therefore, to dispose of outdated inventory items on a regular basis, thus recovering at least a part of its cost.

4.5 Investment of Surplus Cash

- 4.5.1 Before any money can be invested, the Director Finance, or his/her delegate, has to determine whether there will be surplus funds available. The term of investment should also be investigated in relation to projected outflows.
- 4.5.2 Prior to making investments for any fixed term, it is essential that cashflow estimates be compiled for at least the next twelve months.
- 4.5.3 When compiling monthly cashflow estimates it is essential that the Director Finance is aware of all expected cashflow and when it is to take place, as well as the timing with regard to cash outflows as far as both the operational and the capital budgets are concerned.
- 4.5.4 By utilising the available information and expertise, the Director Finance can assess the timing with regard to the applicable investment policy accordingly. Daily estimates will provide for daily call investments and investment withdrawals, whilst long-term investments are to be based on projections further into the future.

5. COMPILATION OF A MONTHLY CASHFLOW FORECAST

An example of a cashflow forecast is attached as Annexure A.

5.1 Income Forecast

5.1.1 Cash income can generally be divided into the following categories: -

- Income from Services;
- Sundry Income;
- Subsidies and Grants; and
- Other Cash Income.

5.1.2 When forecasting income it is important that only cash related income be included in the forecast. In this regard, income such as interest on arrears should not be included until such time that the particular debtor actually pays the interest levied.

5.1.3 When forecasting the income for each category it is important that, where possible, the average actual income for at least six months prior to the current period be determined. Reflecting the latest trend of payment culture the forecast should therefore be more accurately.

5.1.4 It is also important that the frequency for each category of income be determined, i.e. monthly or quarterly.

5.1.5 When forecasting income in respect of services such as electricity or water it is important that seasonal fluctuations be taken into account as, depending on climatic factors, consumption patterns may deviate during the year.

5.1.6 Taking into account any possible bank overdraft arrangements, income from the Equitable Share Allocation should be put into a call account and only be released on a monthly basis into the current account. This arrangement will allow for the cash benefits deriving from this income to be spread throughout the financial year.

5.2 Expenditure Forecast

5.2.1 Cash expenditure can generally be divided into the following categories: -

- Salaries and Allowances;

- ❑ General Expenses;
- ❑ Interest and Redemption on External Loans;
- ❑ Capital Expenditure; and
- ❑ Other Cash Expenditure.

5.2.2 All fixed commitments such as bulk purchases, lease agreements, external loan instalments, third party payments, etc. must always get preference to any general expenses.

5.2.3 When forecasting payments to bulk suppliers it is important that seasonal fluctuations be taken into account, as climatic factors will impact on the Municipality's usage. In this regard, it is important to note that Eskom has a winter tariff that is significantly higher than the summer tariff.

5.2.4 Expenditure should never be more than actual cash received for operational commitments. However, expenditure can exceed income in anticipation of income to be received such as bridging finance for a capital project. In this regard, the provisions of paragraph 6 below must be adhered to at all times.

5.3 General Notes

5.3.1 Where money is required to be available in current accounts on short notice it would be possible, as well as being an expedient practice, to bargain for more beneficial rates with regard to short-term deposits, for instance call deposits. These interest rates can further be increased by fixed term investments such as 32-day notice investments. The overriding principle is to limit the cash in the current account to the absolute minimum but always taking into account the cash management plan and monthly cashflow estimates.

5.3.2 Cashflow forecasts should be updated on a monthly basis. Based upon the actual results of the previous month, forecasts must be adjusted timeously. In this regard, it is important that updated cashflow forecasts be made available not later than the 10th of each month by the Director Finance to allow management to implement remedial actions timeously.

5.3.3 Where possible, taking into account the possible benefits of once off payments, payments should be spread into monthly equal instalments rather than large once off amounts thereby avoiding unnecessary pressure on cashflow. This will specifically be a prudent manner to address possible significant arrear amounts owed to creditors over a long period.

6. SHORT-TERM DEBT

6.1 Section 45 of the MFMA allows the Municipality to incur short-term debt in accordance with and subject to provisions of the Act as set out below and only when necessary to bridge: -

6.1.1 Shortfalls within a financial year during which the debt is incurred, in expectation of specific and realistic anticipated income to be received within that financial year; or

6.1.2 Capital needs within a financial year, to be repaid from specific funds to be received from enforceable allocations or long-term debt commitments.

6.2 The Municipality may incur short-term debt only if: -

6.2.1 A resolution to the Municipal Council, signed by the Mayor, has approved the debt agreement; and

6.2.2 The Municipal Manager has signed the agreement or other document, which creates or acknowledges the debt.

6.3 The Council may: -

6.3.1 Approve a short-term debt transaction individually; or

6.3.2 Approve an agreement with a lender for a short-term facility to be accessed as and when required, including a line of credit or bank overdraft facility provided that:

- ❑ The credit limit must be specified in the resolution of the Council;
- ❑ The terms of the agreement, including the credit limit, may only be changed by a resolution of Council; and

- If the Council approves a credit facility that is limited to emergency use, the Municipal Manager must notify Council in writing as soon as practical of the amount, duration and cost of any debt incurred in terms of such a credit facility, as well as options for repaying such debt.

6.4 The Municipality must: -

6.4.1 Pay off the short-term debt within the financial year; and

6.4.2 May not renew or refinance short-term debt, whether its own debt or that of any other entity, where such renewal or refinancing will have the effect of extending the short-term debt into a new financial year.

7. IMPLEMENTATION AND REVIEW OF THIS POLICY

7.1 This policy shall be implemented once approved by Council. Future cashflow management must be done in accordance with this policy.

7.2 In terms of section 17(1)(e) of the MFMA this policy must be reviewed on annual basis and the reviewed policy tabled to Council for approval as part of the budget process.
