

TOPIC 3.7: BANK OVERDRAFTS

This section of the manual sets out the FSOP's that need to be executed by the municipality regarding its Bank Overdraft. The FSOP's are drafted in the following categories:

- 3.7.1 Overview of the accounting for bank overdrafts.**
- 3.7.2 Determining whether a Bank Overdraft facility is necessary.**
- 3.7.3 Obtaining approval for the Bank Overdraft facility.**
- 3.7.4 Accounting for the Bank Overdraft over its term.**
- 3.7.5 Other procedures over the term of the Bank Overdraft.**
- 3.7.6 AFS disclosure requirements.**

3.7.1 OVERVIEW OF THE ACCOUNTING FOR BANK OVERDRAFTS

When accounting for bank overdrafts the municipality must ensure that the necessary finance standard operating procedures are executed to address the following issues, which are summarised here, but for which the detailed FSOP's are set out in the rest of this section.

Category	FSOP Section
1. Determining whether a bank overdraft facility is necessary. Apply for a bank overdraft facility only when unavoidable in terms of cash requirements. Indicate need in cash flow estimates and determine capacity for further debt, using appropriate ratios.	Section 3.7.2
2. Obtaining approval for the bank overdraft facility. Ensure compliance to the sections of the MFMA relevant to bank overdrafts.	Section 3.7.3
3. Accounting for the bank overdraft over its term. Ensure that a plan is prepared to pay off the overdraft, and that interest is correctly accounted for.	Section 3.7.4
4. Other procedures over the term of the bank overdraft. The municipality should ensure that all the municipality's bank accounts are maintained with the same banking institution to ensure pooling of balances for purposes of determining the interest payable to the municipality (in cases of net positive bank balances).	Section 3.7.5
5. AFS disclosure requirements. Ensure that all relevant disclosure requirements are met.	Section 3.7.6

3.7.2 DETERMINING WHETHER A BANK OVERDRAFT FACILITY IS NECESSARY

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
1		Apply for a Bank Overdraft facility / increase the current facility for the municipality only when it is unavoidable to do so in terms of cash requirements, whether for the capital or operating budgets or to settle any other obligations.	FCP / BP	CFO	Date short term debt is required
2		Indicate in the municipality's cash flow estimates the need, the extent and duration for a Bank Overdraft facility.	FCP	CFO	Date short term debt is required
3		If deemed necessary, the MM should delegate the function of incurring a Bank Overdraft facility / increasing the current facility to the CFO. The CFO will manage this responsibility in consultation with the MM.	FCP	CFO / MM	At date of delegation of function. Delegation of authority should be reviewed annually
4		Determine whether the municipality has the capacity to incur further debt. A discussion of the principles and ratios regarding a municipality's capacity to incur further debt is set out below in Annexure 1 .	FCP	CFO	Monthly

3.7.3 OBTAINING APPROVAL FOR THE BANK OVERDRAFT FACILITY

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
1	<p>Section 45 and 47 - 51 of the MFMA stipulates:</p> <ul style="list-style-type: none"> ➤ A municipality may incur debt only when necessary to bridge- <ul style="list-style-type: none"> • shortfalls within a financial year during which debt is incurred, in expectation of specific and realistic anticipated income to be received within that financial year; or • capital needs within a financial year, to be repaid from specific funds to be received from enforceable allocations or long-term debt commitments. ➤ A municipality may incur short-term debt only if- <ul style="list-style-type: none"> • a resolution of the municipal council, signed by the mayor, has approved the debt agreement; and • the accounting officer has signed the debt agreement. ➤ Council may approve an agreement with a lender for a short-term credit facility to be accessed as and when required, including a line of credit or bank overdraft facility, 	<p>Ensure compliance to sections 45 and 47 – 51 of the MFMA.</p> <p>In respect of a bank overdraft ensure that:</p> <ol style="list-style-type: none"> a) It has been authorised by council resolution. b) The credit limit was specified in the resolution of the council c) The terms of the agreement, including the credit limit, were only changed by a resolution of the council d) Where the credit facility was approved by the council only for emergency use, the accounting officer notify the council in writing, as soon as is practicable, of the amount, duration and cost of any debt incurred in terms of such a credit facility, as well as the options available for repaying such debts. 	LCP	CFO	Whenever the decision to incur short term debt is considered

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	<p>provided that-</p> <ul style="list-style-type: none"> • the credit limit must be specified in the resolution of the council; • the terms of the agreement, including the credit limit, may be changed only by a resolution of the council; and • if the council approves a credit facility that is limited to emergency use, the accounting officer must notify the 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. <ul style="list-style-type: none"> ➤ A municipality must pay off short term debt within the financial year and 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. ➤ A municipality may incur debt if the debt is denominated in Rand and is not indexed to, or affected by fluctuations in the value of the Rand against any foreign currency. 				

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
	<ul style="list-style-type: none"> ➤ A municipality may, by resolution of its council, provide security for any of its debt obligations. ➤ A municipality may provide any appropriate security, including- <ul style="list-style-type: none"> • giving a lien on, or pledging, mortgaging, ceding or otherwise hypothecating, an asset or right, or giving any form of collateral; • undertaking to deposit funds with the lender, investor or third party as security; • undertaking to effect payment directly from money or sources that may become available and to authorise the lender or investor direct access to such sources to ensure payment of the secured debt or performance of the secured obligations, but this form of security may not affect compliance to section 8 (2) of the MFMA (dealing with the minimum moneys that need to be in the municipality's bank account); • agreeing to specific payment mechanisms or procedures to ensure exclusive or dedicated payment to lenders and investors, including revenue intercepts, payments into dedicated 				

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	<p>accounts or other payment mechanisms or procedures;</p> <ul style="list-style-type: none"> • ceding as security any category of revenue or rights to future revenue; • undertaking to have disputes resolved through mediation, arbitration or other dispute resolution mechanisms; • undertaking to retain revenues or specific municipal tariffs or other charges, fees or funds at a particular level or at a level sufficient to meet its financial obligations; • undertaking to make provision in its budgets for the payment of its financial obligations, including capital and interest; • agreeing to restrictions on debt that the municipality may incur in future until the secured debt is settled or the secured obligations are met; and • agreeing to such other arrangements as the municipality may consider necessary and prudent. <p>➤ Should it be necessary for the municipality to provide security for any long-term debt, a council resolution authorising the provision of security-</p> <ul style="list-style-type: none"> • must determine whether the asset or right with respect to which the security is 				

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	<p>provided, is necessary for providing the minimum level of basic municipal services; and</p> <ul style="list-style-type: none"> • if so, must indicate the manner in which the availability of the asset or right for the provision of that minimum level of basic municipal services will be protected. <p>➤ Any person involved in the borrowing of money by a municipality must, when interacting with a prospective lender or when preparing documentation for consideration by a prospective investor-</p> <ul style="list-style-type: none"> • disclose all information in that person's possession or within that person's knowledge that may be material to the decision of that prospective lender or investor; and • take reasonable care to ensure the accuracy of any information disclosed. <p>➤ A lender or investor may rely on written representations of the municipality signed by the accounting officer, if the lender or investor did not know and had no reason to believe that those representations were false or misleading.</p>				

3.7.4 ACCOUNTING FOR THE BANK OVERDRAFT OVER ITS TERM

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
1		Ensure that the Bank Overdraft is recorded as a current liability and not as a non-current liability in the AFS.	AP	CFO	30 June
2		Ensure that a plan is prepared to address any cash flow problems the municipality may be experiencing that sets out how the municipality intends paying off the overdraft and thereby reducing the future reliance of the municipality on this overdraft facility	FCP	CFO	Whenever an overdraft facility exists
3		Ensure that interest paid or accrued on the overdraft is correctly accounted for during the financial year as an expense in the Statement of Financial Performance and also as a credit to the overdraft or general bank account, depending on how the bank recovers interest from the municipality.	AP	Manager budget Control	30 June

3.7.5 OTHER PROCEDURES OVER THE TERM OF THE BANK OVERDRAFT

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
1		Unless there are compelling reasons to do otherwise, and the council expressly so directs, it should be ensured that all the municipality's bank accounts are maintained with the same banking institution to ensure pooling of balances for purposes of determining the interest payable to the municipality (on the net positive bank balances).	FCP	CFO	30 June
2		Submit to the Provincial Treasury and the Auditor General, in writing- <ul style="list-style-type: none"> within 90 days after the municipality has opened a new bank account, the name of the bank where the account has been opened and the type and number of the account; and Annually before the start of a financial year, the name of each bank where the municipality holds a bank account, and the type and number of each account. 	LCP	CFO	During year when bank account is opened and at 30 June each year.

3.7.6 AFS DISCLOSURE REQUIREMENTS

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
1		<p>In respect of each bank account held by the municipality during the relevant financial year, disclose in a note to the AFS-</p> <ul style="list-style-type: none"> • the name of the bank where the account is or was held, the account number of each account and the type of account; • whether the account has a positive balance or whether it is overdrawn; and • year opening and year end balances in each of these bank accounts. 	LCP/AP	CFO	30 June each year
2		Disclose in the same note as referred to in procedure 1, the same detail as stated in the last two bullets in procedure 1, but for the cash book of the municipality.	AP	CFO	30 June each year
3		<p>Bank overdraft balances are classified as financial instruments and therefore disclosure requirements for financial instruments should be adhered to – refer to Section 1.10: Financial instruments, where these disclosure requirements are set out.</p> <p>Also refer to Section 1.16: Presentation of Financial Statements, for a more comprehensive discussion regarding the presentation and disclosure of Bank overdraft liabilities in the Statement of Financial Position.</p>	AP	CFO	30 June each year

ANNEXURE 1: MEASURING A MUNICIPALITY'S CAPACITY TO INCUR DEBT

A municipality's capacity to incur debt depends on its **solvency** and **liquidity**.

Solvency is the term used for a municipality where its assets, fairly valued, exceed its liabilities. Certain ratios could be calculated to serve as indicators of the solvency of the municipality, of which the following serves as an example:

Debt Ratio:

Total Assets/ Total Liabilities

This ratio gives an indication of the asset base available which can finance the total debt of the municipality.

Liquidity refers to the municipality's ability to pay its debt as it becomes payable, usually on the short term. Thus the liquidity of a municipality indicates whether a municipality's current assets are sufficient to service its current liabilities. Certain ratios could be calculated to serve as indicators of the liquidity of the municipality, of which the following serves as an example:

Working capital ratio:

Current assets / Current liabilities

This ratio gives an indication whether the current assets of a municipality are sufficient to pay the current liabilities of the municipality.

Asset test ratio:

Current assets minus inventory/ Current liabilities

This ratio serves the same purpose of the above-mentioned ratio; however inventory is excluded, as it is generally the least liquid current asset of municipalities.

Refer to example the annexure below – An example of the application of the above ratios.

ANNEXURE 2: EXAMPLE – RATIOS OF TWO MUNICIPALITIES

The following is an actual example of the application of ratios to 2 municipalities that have already implemented GRAP as at 30 June 2005.

	Municipality A	Municipality B
Total assets / Total liabilities	248%	106 %
Current ratio	1.48 : 1	0.51 : 1
Acid test ratio	1.46 : 1	0.49 : 1

The above ratios indicate that Municipality A is in a much better position to incur further debt than Municipality B. Municipality B is very highly geared and is therefore in a higher risk position than Municipality A. Municipality A has assets that are 2.48 times higher than its liabilities and therefore has a strong position of community wealth. Municipality B however has a situation of assets and liabilities nearly being equal to one another and therefore has very little community wealth. Furthermore municipality A has R 148 worth of current assets to pay every R 100 worth of current liabilities. Municipality B however has a situation where its current liabilities far outweigh its current assets and this indicates serious cash flow and going concern problems