CITY OF CAPE TOWN
ISIXEKO SASEKAPA
STAD KAAPSTAD

MANAGEMENT OF FOREIGN CURRENCY EXCHANGE RISK POLICY

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Definitions and Abbreviations

In this Policy, unless the context indicates otherwise –

"Act" means the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003);

"bid price" means the price quoted by a supplier in response to either an invitation to tender or a request for quotations or any other invitation to submit an offer; and

"City" means the City of Cape Town, a municipality established by the City of Cape Town Establishment Notice No. 479 of 22 September 2000, issued in terms of the Local Government: Municipal Structures Act, 1998, or any structure or employee of the City acting in terms of delegated authority;

"CFO" means the Chief Financial Officer of the City;

"exchange rate" means the ratio at which the currencies of two countries are exchanged;

"exchange differences" means exchange gains or losses which result when the rate used to initially record an item is different from the rate ruling at the final settlement date;

"foreign currency" means a currency other than the South African Rand;

"forward exchange contract" means an agreement with a commercial bank to exchange different currencies at a specified future date and at a specified exchange rate;

"forward rate" means a hedging rate that will be used to deliver a currency, bond or commodity at some future time based on the spot rate, adjusted for the cost of carry;

"hedge" means a transaction by which future exchange gains or losses are controlled within agreed margins or entirely eliminated;

"hedged item" means an item that exposes the entity to risk of changes in fair value or future cash flows and is designated as being hedged.

"hedging instrument" means a contract whose fair value or cash flows are expected to offset changes in the fair value or cash flows of a designated hedged item. Examples of such instruments include forward exchange contracts.

"hedging rate" means a rate applicable to a financial transaction that will take place in the future;

"IDP" means the Integrated Development Plan of the City of Cape Town

"local supplier" means a supplier based in the Republic of South Africa;

"overseas supplier" means a supplier based outside of the Republic of South Africa;

"premium or discount on a hedging instrument" means the difference between the spot rate at the time of inception of the hedging instrument and the hedging rate specified in the contract;

"SARB" means the South African Reserve Bank;

"settlement date" means the date at which the supplier or creditor is actually paid;

"spot rate" means the exchange rate for immediate delivery of currencies to be exchanged at a particular time;

"term bid" means a rates-based bid for the supply of goods, services or construction works, which are of an ad-hoc or repetitive nature where the individual rates are approved for use over a predetermined period of time.

"***Treasury"*** means a department which falls within the Finance Directorate of the City and is responsible for managing the City's accounting function, cash flow, investments, external financing, banking transactions and safeguarding its assets and liabilities. It also facilitates the City's annual credit rating, and manages its insurance portfolio.

1. Problem Statement

1.1 The City, from time to time, procures goods and services from suppliers outside of South Africa either by way of direct import, or, more commonly, through a local agent in South Africa. These goods and services are normally priced and payable in a foreign currency. Upon payment by the City, or by the local importer, of the foreign currency amount and conversion of that amount into South African Rand (Rand), an exchange profit or loss is realised. This exchange difference is normally for the account of the City.

1.2 The City must protect itself against potential foreign exchange losses arising from the import of goods and services by identifying and quantifying the risk in such transactions and by taking steps to manage this risk in accordance with an approved policy.

2. Desired Outcomes

2.1 This policy, in line with section 163 of the Act, sets out the procedures to be followed in cases where goods or services are obtained in a currency other than the Rand, thus creating possible foreign exchange risk implications.

2.2 The objective of this policy is to provide an agreed framework within which:

(a) foreign currency exchange risks are identified and managed in an efficient and cost effective manner; and

(b) foreign exchange conversion differences are properly quantified, accounted for and fairly apportioned between the foreign supplier, any local agent and the City.

3. Strategic intent

3.1 The City's Five Year IDP (2022-2027) identifies six priorities and three foundation areas, which support the vision of creating a City of Hope and provide a solid foundation for the articulation of service delivery and within which the City has identified linked objectives and programmes. The priorities and foundation areas are:

PRIORITY

(a) Economic Growth;

(b) Basic Services;

(c) Safety

(d) Housing;

(e) Public Space, Environmental and Amenities; and

(f) Transport.

FOUNDATION

1. A Resilient City;

2. A more spatially integrated and inclusive City;

3. A capable and collaborative City government;

3.2 This policy supports the following foundation, objective and programme:

(a) Foundation 3: A capable and collaborative City government
(b) Objective 16: A capable and collaborative City government; and
(c) Programme 16.1: Operational sustainability Programme.

3.3 This programme aims to ensure financial sustainability and procurement excellence

4. Policy parameters

4.1 The policy applies to all management of foreign currency exchange risk arising in the following areas of business of the City and any business entities under its control:

(a) the direct import of goods and services from an overseas supplier; and

(b) the indirect import of goods and services through a local supplier.

4.2 All foreign exchange payments by the City must be made in accordance with this policy and with national legislation.

5. Role players and stakeholders

5.1 The following role players fulfil a critical role in the implementation of this policy:

(a) Directors or managers who have to identify foreign exchange risk and either notify Treasury of the risk (direct imports) or instruct the supplier to address the risk (indirect imports);

(b) Treasury who facilitates the process of obtaining a hedging instrument; and

(c) Supply Chain Management Department who facilitates the procurement process.

6. Regulatory context

6.1 The legislative framework governing foreign exchange is informed by the following legislation and policies:

(a) Local Government: Municipal Finance Management Act, 2003 (Act 56 of 2003) (MFMA);

(b) Local Government: Municipal Systems Act, 2000 (Act 32 of 2000) (MSA); and

(c) The City's Supply Chain Management Policy.

7. Policy directive details

Exclusions

7.1 All procurement contracts which are subject to foreign exchange rate fluctuations, and hence foreign exchange rate risk, shall be carried out subject to the use of a hedging instrument, except in the following circumstances:

(a) In the event that hedging the transaction does not provide a cost effective outcome based on the difference between the hedging rate quoted and relevant spot rate at settlement date plus any interest lost due to making the payment before it is due, Treasury, in conjunction with the relevant procuring department, may decide to make the payments before they are due;

(b) In the event that the value of the foreign currency price or the date of payment are unknown, such as in the case of a term bid;

(c) Where the amount payable is less than R200 000, i.e. day to day operating expenses; or

(d) Contracts exceeding one year where there are no firm commitments.

Prices

7.2 Firm Rand prices

(a) It should not be an automatic assumption that goods or services or construction works sourced by the City from outside South Africa, whether directly from an overseas supplier or through a local supplier, should be priced in foreign currency with any exchange differences being for City's account.

(b) In view of the City's considerable purchasing power, a firm rand price should be obtainable in a competitive market situation with many suppliers bidding for the contract.

(c) However, for proprietary items and in situations where there is a limited number of potential suppliers, it is unlikely that the City will be able to insist on firm Rand prices in all circumstances.

Therefore:

(d) Wherever possible, the City should contract with suppliers on a firm Rand price basis, where the risk identified of the significance that variations in exchange rates would have on the contract is sufficiently low, with any exchange risk being managed and borne by the supplier.

(e) If a firm Rand price is not obtainable, then the City must manage the currency risk in association with the other parties to the procurement contract namely, the overseas supplier, the local agent, if applicable, and the commercial bank.

7.3 Bid prices

(a) Prices tendered in Rand by local suppliers for goods, services or construction works sourced from overseas must be indicated as either set or subject to adjustment for movement in exchange rates.

(b) All tenders or requests for quotation for the procurement of such goods or services must clearly state whether Rand prices, which are subject to exchange rate variation, are acceptable, or whether firm Rand prices are required.

(c) Where prices are offered subject to exchange rate variation, the underlying foreign currency elements and prices must be clearly identified and disclosed. The basis for their conversion to Rand and their incorporation into the final Rand price together with the local Rand denominated costs and prices, should also be clearly disclosed.

(d) In order to compare bid prices on a common basis, the City must specify, in the tender document, request for quotations, or other documents calling for bids, the exchange rates to be used by the local supplier for converting foreign currency prices to Rand. These should normally be the spot rates quoted by the City's main banker at the ruling rate referenced to a specific date.

(e) Prices offered by overseas suppliers for goods, services or construction works sourced directly from overseas suppliers would normally be in foreign currency.

Identification of risk

7.4 It is the responsibility of the Project Director or Manager to identify any element of foreign currency exchange risk to the City in a procurement contract and to bring this to the attention of Treasury immediately (after award of contract or placement of order) if the foreign currency exchange risk is not addressed in any bid document.

Hedging Decision

7.5 Treasury is responsible for obtaining the hedging instrument in the case of direct imports, subject to SARB approval. They are also responsible for overseeing the administrative tasks associated with this process and communicating to all relevant parties the information required to carry out the transaction. The Project Director or Manager is responsible for instructing the supplier to obtain a hedging instrument in the case of indirect imports.

Direct Imports

7.6 The following policy directives are relevant to direct imports.

(a) Once the identification of a foreign exchange risk has taken place by the relevant Director or Manager, a copy of, or relevant extracts from, the procurement contract or purchase order, should be submitted to Treasury within two working days of the signing of the contract or purchase order.

(b) The hedging instrument to be used should be obtained by the City and concluded within three working days of receipt of the necessary information or documentation from the relevant Director or Manager as per paragraph 7.4 above, subject to SARB approval.

(c) The type, extent and period of the hedge will be decided by Treasury in conjunction with the City's own banking advisers. The hedge should be tailored to the particular currency risk in each procurement contract.

Indirect Imports

7.7 The following policy directives are relevant to indirect imports.

(a) Where the City has accepted a tender or quotation which is subject to exchange rate variation, the supplier is entitled to claim from the City the Rand equivalent of the foreign currency prices incorporated in the contract price.

(b) The bid document shall contain an obligation on the supplier to take out a hedging instrument in respect of the foreign currency element of the contract.

(c) The contract/project manager is responsible for:
i.) instructing the local supplier to put the hedge in place;
ii.) obtaining a copy of the contract for the hedging instrument from the supplier's bankers;
iii.) documenting the hedging action; and
iv.) supplying the procurement or payments section with the necessary information for adjusting the eventual payment to the supplier to reflect the permitted price adjustments in respect of conversion of foreign currency to Rand.

(d) Where the City requests the supplier to take out a hedging instrument on its behalf, the rate of exchange payable in respect of the foreign currency component of the cost of the contracted goods or services shall be the hedging rate contracted with the relevant commercial bank on the City's behalf.

(e) Costs associated with the extension of the hedged period will be borne in terms of the contract.

(f) Where there is a delay in payment due to circumstances which are outside the supplier's control, the City will cover the costs associated with the extension of the hedged period. If the delay in payment is the fault of the supplier, the supplier will cover the costs of the extension.

(g) In the event where the supplier requests for a waiver in respect of taking out a hedging instrument, but agrees to provide the City with a foreign exchange rate equivalent to a hedging rate or better, the City reserves the right to allow for such an exception.

(h) Contract or project managers must submit the requests for waivers to Treasury for approval.

(i) The rate of exchange payable in respect of the foreign currency component of the contracted goods or services shall be the rate agreed with the supplier.

(j) The City may, at its sole discretion, require the supplier to furnish such documentation relating to any aspect of the foreign exchange component of the cost of such goods or services as it may deem necessary, including shipping and Customs documents.

8. Implementation programme

8.1 Treasury is responsible for ensuring the implementation of this policy.

9. Monitoring, evaluation and review

9.1 In the event of direct imports, Treasury shall be responsible for monitoring its hedging decisions regarding the management of foreign currency risk.

9.2 It should record full details of all decisions made and track the actual movement of exchange rates against the contracted hedge rates from the date of initial identification of currency risk through to the final settlement of the foreign exchange liability.

9.3 Realised exchange gains or losses, combined with the premiums and discounts payable on the hedging instrument, should be ascertained, together with the impact on City's costs, for each procurement transaction which has a foreign currency price component.

9.4 In this way, the efficiency of the hedging function in protecting the City against foreign currency losses can be monitored over time and corrective action can be taken as and when required.

9.5 The policy will be monitored by the Treasury officials annually and may be amended due to changing circumstances as a result of the legislation or otherwise.

9.6 A formal review of the policy will take place every five years.