



FUNDING & RESERVE POLICY

JOHN TAOLO GAETSEWE DISTRICT MUNICIPALITY

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SIGNATURE OF THE MUNICIPAL MANAGER

Ms P Q Mogatle

SIGNATURE OF THE SPEAKER

Reaffirmed

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1. INTRODUCTION AND OBJECTIVE

The Council sets as objective a long term financially sustainable municipality with acceptable levels of service delivery to the community.

The policy aims to set the standard and guidelines towards ensuring financial viability over both the short and long term and includes funding as well as reserves requirements.

2. SECTION A: FUNDING POLICY

2.1 LEGISLATIVE REQUIREMENTS

In terms of sections 18 and 19 of the Municipal Finance Act (Act no 56 of 2003), an annual budget may only be funded from:

- Realistically anticipated revenues to be collected;
- Cash backed accumulated funds from previous years' surpluses not committed for other purposes and
- Borrowed funds, but only for capital projects.

Furthermore, spending on a capital project may only be commenced once the funding sources have been considered, are available and have not been committed for other purposes.

The requirements of the MFMA are therefore clear in that the budget must be cash — funded i.e. cash receipts inclusive of prior cash surpluses must equal or be more than cash paid.

In determining whether the budget is actually cash funded and in addition ensuring long term financial sustainability, the municipality will use analytical processes, including those specified by National Treasury from time to time.

2.2 STANDARD OF CARE

Each functionary in the budgeting and accounting process must do so with judgment and care, under the prevailing circumstances, as a person of prudence, discretion and intelligence would exercise to the management of his or her own finances with the primary objective of ensuring that the objectives of this policy are achieved.

2.3 STATEMENT OF INTENT

The municipality will not pass a budget which is not cash — funded or where any of the indicators as listed in this document are negative, unless acceptable reasons can be provided for non-compliance, provided that the requirements of the MFMA must at all times be adhered to.

2.4. CASH MANAGEMENT

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Cash must be managed in terms of the municipality's Cash Management and Investment Policy.

2.5. DEBT MANAGEMENT

Debt must be managed in terms of the municipality's Debt Collection Management Policy, together with any requirements in this policy.

2.6. FUNDING THE OPERATING BUDGET

2.6.1 INTRODUCTION

The municipality's objective is that the user of municipal resources must pay for such usage in the period it occurs.

The municipality however, recognises the plight of the poor, and In line with national and provincial objectives, the municipality commits itself to subsidised services to the poor. This will necessitates cross subsidisation in tariffs to be calculated in the budget process.

2.6.2 GENERAL PRINCIPLE WHEN COMPILING THE OPERATING BUDGET

The following specific principles apply when compiling the budget:

- (a) The budget must be cash - funded, i.e. revenue and expenditure projections must be realistic and the provision for impairment of receivables must be calculated on proven recovery rates
- (b) Growth parameters must be realistic and be based on historic patterns adjusted for current reliable information;
- (c) Tariff adjustments must be fair, taking into consideration general inflation indicators as well as the geographic region's ability to pay;
- (d) Revenue from government Grants and subsidies must be in accordance with the amounts promulgated in the Division of the Revenue Act, proven provincial transfers and any possible transfers to or from other municipalities.

For the purpose of the cash flow budget any National or provincial grants that have been re-appropriated for roll-over purpose must be excluded from the calculation as it must be Included in the Change and Cash Equivalents and payables.

Furthermore, in the budget the total grants recognised as revenue must equal the total expected expenditure from grants, Inclusive of capital expenditure and VAT as per directive in MFMA circular 48.

- e) Projected revenue from services charges must be reflected as net (all billing less revenue foregone, which id free basic services, discounts and rebates).
- f) Projected revenue from property rates must include all rates to be levied, but rebates and discounts must be budgeted for as either revenue foregone or a grant, as per directive In MFMA Budget Circular 51, depending on the conditions of the exemption, rebate or reduction.
- g) Only changes in fair value related to cash may be included in the cash flow budget. Changes to unamortised discount must be included in the Operating Budget but excluded in the cash flow budget.

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- h) Employee related costs include contributions to non-current and current employee benefits. It is acknowledged that the non-current benefits requirements are well above the initial cash capabilities of the municipality,

and it is therefore determined that provision for the short term portion of employee benefits, as well as an operating surplus calculate at 5% of the prior year balance of the long-term benefits, be included in the operating budget, in order to build sufficient cash for these requirements. The cash portion of the employee benefits must be accounted for in "Employee Benefits Reserves"

- i) Depreciation must be fully budgeted for in the operating budget.

In order to ensure a sufficient accumulation of cash for the replacement of Property, Plant and Equipment and intangibles Assets, the amount of depreciation on assets funded from own sources, excluding assets funded from grants, public contribution and external must be reflected as a surplus on the cash flow budget.

- j) Contributions to provisions (no current and current) do not form part of the

cash flow. It is however, necessary to provide for an increase in the cash resources in order to comply with the conditions of the provisions at the time when it is needed.

It is therefore a requirement that the contribution to the current provisions, as well as 20% of the prior year balance of the non-current provision, is budgeted as such surpluses until the necessary funding is obtained.

2.7. FUNDING THE CAPITAL BUDGET

2.7.1. INTRODUCTION

The municipality's objective is to maintain through proper maintenance and replacement measures, existing levels of service and to Improve and implement services which are neglected or non-existent.

In order to achieve this objective the municipality must annually, within financial means, budget for the replacement of redundant assets as well as new assets.

2.7.2 FUNDING SOURCES FOR CAPITAL EXPENDITURE

The capital budget can be funded by way of own contribution, grants and public contribution as well external loans.

Own Contributions

The capital budget financed from own contributions must primarily be funded from the Capital Replacement Reserve.

Notwithstanding the above the capital budget or portions thereof may also be funded from surplus cash. The allocated of the funding sources from own contributions are determined during the budget process.

Grants (including Public Contribution)

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Grants for capital expenditure have become a common practice, especially in order to extend services delivery to previously disadvantaged areas. While such Grants are welcomed, care should also be taken that unusual grant funding does not place an unreasonable burden on the residents for future maintenance costs which may be higher than their ability to pay.

It is therefore determined that the accounting officer must evaluate the long term effect of unusual capital grants on future tariffs, and if deemed necessary, report on such to council.

It is furthermore determined that the depreciation charges on assets financed from grants and donations must not have a negative effect on tariffs charged to the users of such assets. The Accounting Officer must put such accounting measures in place to comply with this requirement, to a reasonable extent.

External Loans

The municipality may only raise loans in accordance with its Debt Collection Management Policy.

The Accounting Officer must also put such accounting measures in place to ensure that no unspent portions of loans are utilised for operating purpose

For budgeting purposes any difference between proposed capital spending from loans and proposed loans raised must be included in the cash surplus

for the year.

2.8 FUNDING COMPLIANCE MEASUREMENT

2.8.1 INTRODUCTION

The municipality wants to ensure that the budget or adjustments budget complies with the requirements of the MFMA and this policy. For this purpose a set of indicators must be as part of the budget process and be submitted with the budget. These indicators include all the indicators as recommended by National Treasury as well as reconciliations according to this policy. Any additional indicators recommended by National Treasury in future must also be taken into account, as well as any additional reconciliation items as either determined by the Council or the Accounting Officer.

If any of the indicators are negative during the compilation or approval process of the budget, the budget may not be approved until all the indicators explained and future budget projections address the turnaround of these indicators to within acceptable levels.

2.8.2 CASH AND CASH EQUIVALENTS AND INVESTMENTS

A positive Cash and Cash Equivalents position throughout the year is crucial. In addition, the forecasted cash position at year — end must at least be the amount as calculated in the reconciliation of Cash Requirements as determined by this policy and attached to this policy as Appendix 'A'.

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2.8.3 CASH PLUS INVESTMENTS LESS APPLICATION OF FUNDS

The overall cash position of the municipality must be sufficient to include:

- Unspent conditional grants;
- Unspent conditional public contributions;
- Unspent borrowings;
- Vat due to SARS;
- Secured investments;
- The cash portion of statutory funds such as the Housing Development Fund;
- Other working capital requirements; and
- In addition, it must be portions of provisions as indicated elsewhere in this policy.

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2.8.4. MONTHLY AVERAGE PAYMENT COVERED BY CASH AND CASH EQUILENTS ("CASH PER COVERAGE")

This Indicator shows the level of risk should the municipality experience financial stress

2.8.5 SURPLUS/DEFICIT EXCLUDING DEPRECIATION OF OFFSETS

It is almost certain that the operating budget, which includes depreciation charges on assets funded by grants and public contributions, as well as on revalued assets, will result in a deficit.

As determined elsewhere in this policy it is not the intention that the users of the assets funded from grants, public contribution and revaluations must be burdened with tariff increases to provide for such depreciation charges. In order to ensure a "balanced" budget but excluding such depreciation charges, the depreciation chargers may be offset against the net surplus/deficit. Should the budget result in a deficit after the offsetting, the budget will be deemed unfunded and must be revised.

2.8.6. CASH COLLECTION % RATE

- The object of the indicator is to establish whether the projected cash to be collected is realistic and complies with section 18 of the MFMA.
- The collection rate for calculating the provision for impairment of receivables must be based on past and present experience. Past experience refers to the collection rates of the prior years and present experience refers to the collection rate off the current financial year as from 1 July.
- It is not permissible to project a collection rate higher than the rate currently being obtained, even if the municipality recently approved a debt collection policy or implemented additional debt collection measures. Any improvement in

collection rates during the budget year may be appropriated in an adjustment Budget.

2.8.7. DEBT IMPAIRMENT EXPENSE AS A PERCENTAGE OF BILLABLE REVENUE

- This indicator provides information whether the contribution to the provision for impairment of receivables is adequate. In theory It is should be equal to difference between 100% and the cash collection rate, but other factors such as past performance might have an influence on it. Any difference, however must be motivated in the budget report.

2.8.8 CAPITAL PAYMENTS AS A PERCENTAGE OF CAPITAL EXPENDITURE

This indicator provides information as to the timing for payments on capital projects and utilising allowed payments terms.

2.8.9 BORROWING AS A PERCENTAGE OF CAPITAL EXPENDITURE (EXCLUDING GRANTS AND CONTRIBUTIONS)

This indicator provides information as to compliance with the MFMA in determining borrowing needs. The accounting Officer must ensure

compliance with the Municipality's Debt Management Policy.

2.8.10 GRANTS REVENUE AS A PERCENTAGE OF GRANTS AVAILABLE

The percentage should never be less than 100% and the recognition of expected unspent grants at the current year-end as revenue in the next financial year must be substantiated in a report.

2.8.11 CONSUMER DEBTORS CHANGE (CURRENT AND NON-CURRENT)

The object of the indicator is to determine whether budgeted reductions in outstanding debtors are realistic

An unacceptable high increase in either current or non-current debtors balances should be investigated and acted upon.

2.8.12 REPAIRS AND MAINTENANCE EXPENDITURE LEVEL

Exercised not to allow a declining maintenance program in order to fund other less important expenditure requirements.

Similarly, if the maintenance requirements become excessive, it could indicate that a capital renewal strategy should be implemented or reviewed.

As a general benchmark the maintenance budget should be between 4percent and 8 percent of the value of assets.

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2.8.13 ASSET RENEWAL/REHABILITATION EXPENDITURE LEVEL

This indicator supports further the indicator for repairs and maintenance.

The Accounting Officer must, as part of the capital budget, indicate whether each project is a new asset or a replacement/renewal asset in order to determine whether the renewal program is sufficient or needs revision.

2.8.14 FINANCIAL PERFORMANCE BUDGET

Although it is not a legal requirement that the financial performance budget. It includes capital grant revenues, depreciation charges including those where assets were funded from grants and public contributions, unamortised discounts and gains/losses on the disposal of Property Plant and Equipment. These items need to

be taken into consideration in order to establish if the operating budget is realistic and credible.

2.8.15 FINANCIAL POSITION BUDGET

This indicator provides an overall view of the projected financial position over the periods of the Medium Term Expenditure framework, including movements in inventory and payables.

2.8.16 CASH FLOW BUDGET

A positive cash flow is a good indicator of a balanced budget, as well as the ability of the municipality to meet its future commitments,

The cash flow budget, however, does not include those items such as contributions to the provisions described elsewhere in this policy, the effect of depreciation charges etc. and care must be taken not to let a projected positive cash inflow lead to additional expenditure requests, without taking the requirements of those items into consideration. Cash inflow lead to additional expenditure requests, without taking the requirements of those items into consideration.

3. SECTION B: RESERVES POLICY

3.1 INTRODUCTION

Fund accounting historically formed a huge part of municipal finance in the IMFO standards.

Since municipality, however, recognises the importance of providing to the municipality itself, as well as its creditors, financiers, staff, and general public a measure of protection for future losses, as well as providing the necessary cash resources for future capital replacements and other current and non-current liabilities.

This policy aims to provide for such measure of protection by creating certain reserves.

3.2 LEGAL REQUIREMENTS

There are no specific requirements for the creation of reserves, except for the Housing Development Fund. The GRAP standards itself also do not provide for reserves.

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However, the GRAP 'Framework for the Preparation and Presentation of Financial Statements' states in paragraph 91 that such reserves may be created, but 'Fund Accounting' is not allowed and any such reserves must be a 'legal' reserve, i.e. created by law or Council Resolution.

12 3.3 TYPES OF RESERVES

Reserves can be classified into two main categories being 'cash funded reserves' and 'non-cash funded reserves'.

3.3.1 CASH FUNDED RESERVES

In order to provide for sufficient cash resource for future expenditure, the municipality hereby approve the establishment of the following reserves:

(a) Capital Replacement Reserves (CRR)

The CRR is to be utilised for future capital expenditure from own funds and may not be used for maintenance or other operating expenditure.

The CRR must be cash]-back and Accounting Officer is hereby delegated to determine the contribution to the CRR during the completion of the annual financial statements.

(b) Employee benefits reserves

The aim of the reserve is to ensure sufficient cash resources are available for the future payment of employee benefits.

The contribution to the reserve must be in accordance with the directives set in Funding Policy,

(c) Non-current provisions reserve

The aim of this reserve is to ensure sufficient cash resource are available for future payment of non-current provision.

The contribution in the reserve must be made in accordance with directives set in this funding policy

(d) Valuation reserve

The aim of this reserve is to ensure sufficient cash resources are available to undertake a General Valuation as per the Municipality Property Rates Act.

The contribution to this reserve should be approximately 25% of the anticipated cost of the General Valuation and the Accounting Officer is hereby delegated to determine this amount annually during the compilation of the annual financial statements.

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(e) Other statutory reserves

It may be necessary to create reserves prescribed by law, such as the Housing Development Fund. The Accounting Officer must create such reserves according to the directives in the relevant laws

3.3.2. NON-CASH FUNDED RESERVES

It might be necessary to create non-cash funded reserves for a variety of reasons, including GRAP requirements. Accounting Officer must create any reserves prescribed by the accounting standards, such as the Revaluation Reserves, if required.

The Accounting Officer is hereby delegated and may also in the discretion of the Accounting Officer, create reserves for future depreciation offsetting, in the absence of the standard similar to IAS 20.

3.4 ACCOUNTING FOR RESERVES

3.4.1 REVALUATION RESERVES

The accounting for the Revaluation Reserves must be done in accordance with the requirements of **GRAP 17**

3.4.2 OTHER RESERVES

The accounting for all other reserves must be processed through the Statement of Financial Performance. The required transfer to or from the reserves must be processed in the Statement of the Net Asset to or from accumulated surplus. It is a condition of GRAP and this policy that no transactions may be directly appropriated against these reserves.

3.5 SECTION C: REVIEW OF THE POLICY

This funding and Reserves Policy is the only policy of the municipality and replaces any past policies in this regard. Any revision of the policy must be approved by the Municipal Council.

Wherever the Minister of Finance or the National Treasury or the Auditor General requests changes to the policy by way of legislation, changes to GRAP or otherwise, It must be reviewed and submitted for consideration by the Council on an annual basis. Such submission must be accompanied with a full description of the reason for the change to the policy.

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14. APPENDIX A

RECONCILIATION OF CASH REQUIREMENTS

Cash flow from operating activities	Rxx
Add: Depreciation from own funds	Rxx
Add: Contribution to current provisions	Rxx
Add: 20% of prior year non — current provisions balance	Rxx
Add: 5% of prior year non — current employee benefits balance	Rxx
Add: Contribution to valuation reserve	Rxx
Add: Unspent conditional grants	Rxx
Add: Unspent public contributions	Rxx
Add: Unspent borrowings	Rxx
Add: Vat due to SARS	Rxx
Add: Secured investments Add: Cash portion of Statutory Reserves	Rxx
Add: Working Capital Requirements	Rxx
= Minimum Cash Surplus Requirements for the year	Rxx

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