JOE GQABI DISTRICT MUNICIPALITY

Funding and Reserves Policy

2019/20

INDEX

FUNDING AND RESERVES POLICY

1. INTRODUCTION AND OBJECTIVE

The Council sets itself the objective of becoming a financially sustainable municipality with basic levels of service delivery.

This policy aims to set standards 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 Management Act (Act No 56 of 2003) (MFMA), 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 commence once the funding sources that have been considered, are available and have not been committed for other purposes.

The requirements of the MFMA are clear in that the budget must be cash – funded i.e. cash receipts (cash/cash equivalents) inclusive of prior cash surpluses must equal or be more than cash payments[1].

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.

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[1] The following budget schedules must reflect positive balances for:
A7: Budgeted Cash Flows - 'Cash/cash equivalents at the yearend'
A8: Cash backed reserves/accumulated surplus reconciliation – 'Surplus/(shortfall)'

2.2 STANDARD OF CARE

Each functionary in the budgeting and accounting process must do so with judgment and care 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 and provided that the requirements of the MFMA must at all times be adhered to.

2.4 CASH MANAGEMENT

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

2.5 LIABILITY MANAGEMENT

Debt must be managed in terms of the municipality's 'Banking and Investment' 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 in which it will occur.

The municipality recognises the plight of the poor, and in line with national and provincial objectives, commits itself to subsidising services to the poor. This may necessitate cross-subsidisation in some 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 Subsides must be in accordance with the amounts promulgated in the Division of Revenue Act, proven provincial transfers.

For the purpose of the Cash flow budget any National or Provincial grants that have been re-appropriated for roll–over purposes must be excluded from the calculation and be included in changes in Cash and Cash Equivalents and Payables.

Within the operational budget, grants recognised as revenue must equal the total expected expenditure from grants inclusive of capital expenditure and VAT, as per directives given in various MFMA Circulars.

e) Projected revenue from services charges must be reflected as net (ie all billing less revenue foregone, including free basic services, discounts and rebates).

f) Only changes in fair values related to cash may be included in the cash flow budget.

g) 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. It is therefore determined that provision for the short term portion of employee benefits, as well as an operating surplus calculated at 5 per cent of the prior year balance of the long–term benefits, be included in the operating budget to build sufficient cash for these requirements. The cash portion of the employee benefits must be accounted for in an "Employer Benefits Reserve".

h) 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 Intangible Assets, the amount of depreciation on assets funded from internally generated funds[2], excluding assets funded from transfers and grants, public contributions and borrowings should be reflected as a surplus on the cash flow budget, however it is accepted that this could create an affordability issue in the short term requiring the treatment to be flexible.

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[2] Including at least the capital replacement reserve and surplus cash

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 transfers and grants, public contributions and donations, borrowing and internally generated funds.

Internally Generated Funds

The capital budget financed from internally generated funds is primarily funded from the capital replacement reserve and surplus cash resources. The allocations of the funding sources from internally generated funds will be determined during the budget process.

Transfers and Grants (Including Public Contributions and Donations)

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

The Accounting Officer will annually evaluate the long term effect of capital grants on future tariffs, and if deemed necessary, report on such to Council.

Borrowings

The municipality may only raise long-term borrowings in accordance with its 'Banking and Investment' Policy..

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

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, i.e. any unspent borrowings at year end must be cash-backed in the 'Cash backed reserves/accumulated surplus reconciliation'.

Repaying long-term liabilities will impact directly on future tariffs that will be charged to consumers. For this reason, Council will give priority to borrowing for revenue-generating assets. Provision for acquiring non-revenue generating assets will be made by way of utilising other funding sources.

2.8 FUNDING COMPLIANCE MEASUREMENT

2.8.1 INTRODUCTION

The Municipality must ensure that the annual budget or any subsequent adjustments budget complies with the requirements of the MFMA and this policy. For this purpose a set of indicators must be used as part of the budget process and be submitted with the budget. These indicators will include all indicators as recommended by National Treasury as well as any additional indicators detailed in this policy.

If any of the indicators are negative during the compilation or approval process of the budget, the budget may not be approved, unless those negative indicators can be reasonably explained and any future budget projections address the turn-around of these indictors to within acceptable levels[3].

2.8.2 CASH AND CASH EQUIVALENTS AND INVESTMENTS

A positive cash/cash equivalents position should be maintained throughout the year. 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"[4].

2.8.3 CASH PLUS INVESTMENTS LESS APPLICATION OF FUNDS

The overall cash position (cash/cash equivalents and investments) of the municipality must be sufficient that it can:

- Provide for the cash-backing of:
  - unspent conditional transfers and grants;
  - unspent conditional public contributions;
  - unspent borrowing;
  - the cash portion of statutory funds;

[3] Indicators may include those referred to in the following budget schedules:
SA8: Performance indicators and benchmarks
SA10: Funding measurement
[4] A surplus balance on budget schedule A8: Cash backed reserves/accumulated surplus reconciliation

- VAT due to SARS;
- secured investments (whether long- or short-term);
- reserves as approved by the municipality;
- provisions as indicated elsewhere in this policy; and

- Take into account other working capital requirements.

2.8.4 INDICATORS

2.8.4.1 MONTHLY AVERAGE PAYMENT COVERED BY CASH AND CASH EQUIVALENTS ("CASH COVERAGE")[5]

This indicator shows the level of risk should the municipality experience financial stress.

2.8.4.2 SURPLUS/DEFICIT EXCLUDING DEPRECIATION OFFSETS[6]

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

In order to ensure a "balanced" budget, the depreciation charges on capital assets funded from grant and subsidies may be offset against the net surplus / deficit.

Should a budget result in a deficit after the offsetting, the budget will be deemed unfunded and must be revised.

2.8.4.3 PROPERTY RATES/SERVICE CHARGE REVENUE PERCENTAGE INCREASE LESS MACRO INFLATION TARGET[7]

The intention of this indicator is to ensure that tariff increases are in line with macro economic targets, but also to ensure that revenue increases for the expected growth in the geographic area are realistically calculated.

[5] Supporting Table SA10 Funding measurement: indicator no. 3
[6] Supporting Table SA10 Funding measurement: indicator no. 4
[7] Supporting Table SA10 Funding measurement: indicator no. 5

The formula to be used is as follows:

	DESCRIPTION	SERVICE CHARGES
A	Revenue of budget year	R XX
B	Less: Revenue of prior year	R XX
C	**=Revenue increase/decrease**	**R XX**
D	% Increase/(Decrease)	C/B %
E	Less: Upper limit of macro Inflation target	%
F	**=Growth in excess of inflation target**	%
G	Less: Expected growth %	%
H	**=Increase attributed to tariff Increase above macro inflation target**	%

In the event that the percentage in (h) is greater than zero, a proper motivation must accompany the budget at submission, or the budget must be revised.

2.8.4.4 CASH COLLECTION PER CENT RATE[8]

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 of the current financial year as from 1 July.

It is not permissible to project a collection rate higher than the current rate. Any improvement in collection rates during the budget year may be appropriated in an Adjustments Budget.

[8] Supporting Table SA10 Funding measurement: indicator no. 6

2.8.4.5 DEBT IMPAIRMENT EXPENSE AS A PERCENTAGE OF BILLABLE REVENUE[9]

This indicator provides information as to whether the contribution to the provision for impairment of receivables is adequate. In theory it should be equal to the difference between 100 per cent and the cash collection rate, but other factors such as past performance can have an influence on it. Excessive differences should be motivated and/or explained in the MTREF budget report.

2.8.4.6 BORROWING AS A PERCENTAGE OF CAPITAL EXPENDITURE (EXCLUDING GRANTS AND CONTRIBUTIONS)[10]

This indicator provides information as to compliance with the MFMA in determining borrowing needs. The Accounting Officer must ensure compliance with the municipality's liability management.

2.8.4.7 GRANT REVENUE AS A PERCENTAGE OF GRANTS AVAILABLE[11]

The percentage attained should never be less than 100 per cent 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.

2.8.4.8 CONSUMER DEBTORS CHANGE (CURRENT- AND NON-CURRENT)[12]

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

Any unacceptably high increase in either current or non–current debtors' balances should be investigated and reported.

2.8.4.9 REPAIRS AND MAINTENANCE EXPENDITURE LEVEL[13]

Property Plant and Equipment should be maintained properly at all times in order to ensure sustainable service delivery. The budget should allocate sufficient resources to maintain assets and care should be 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 infrastructure assets should be between 5 per cent and 10 per cent of the asset values (carrying values).

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[9] Supporting Table SA10 Funding measurement: indicator no. 7
[10] Supporting Table SA10 Funding measurement: indicator no. 8
[11] Supporting Table SA10 Funding measurement: indicator no. 10
[12] Supporting Table SA10 Funding measurement: indicator no. 11 and 12
[13] Supporting Table SA10 Funding measurement: indicator no. 13

Currently this ratio is far below this and the benchmark should be achieved within the next ten years.

Where the budgeted amounts for repairs and maintenance reflected on Table A9 are less than 5 per cent of the asset value (carry value) of the municipality's Plant Property and Equipment (PPE) as reflected in the municipality's annual financial statements, the municipality must provide a detailed explanation and assurance that the budgeted amount is adequate to secure the ongoing health of the municipality's infrastructure supported by reference to its asset management plan or disclosure of determination of the repairs and maintenance per asset class in the MTREF budget report.[14]

Should the municipality receive an audit qualification related to its assets register, where the budgeted amounts for repairs and maintenance reflected on Table A9 are less than 10 per cent of the municipality's operating expenditure on Table A4, the municipality must provide a detailed explanation and assurance that the budgeted amount is adequate to secure the ongoing health of the municipality's infrastructure supported by reference to its asset management plan.[15]

2.8.4.10 ASSET RENEWAL/REHABILITATION EXPENDITURE LEVEL[16]

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.

Where the municipality allocates less than 40 per cent of its Capital Budget (as reflected on Table A8) to the renewal of existing assets it must provide a detailed explanation and assurance that the budgeted amount is adequate to secure the ongoing health of the municipality's infrastructure supported by reference to its asset management plan.[17]

[14] Based on MFMA Circular 55, paragraph 4.2
[15] MFMA Circular 55, paragraph 4.2
[16] Supporting Table SA10 Funding measurement: indicator no. 14
[17] MFMA Circular 55, paragraph 4.2

3. SECTION B: RESERVES POLICY

3.1 INTRODUCTION

Fund accounting historically formed the major component of municipal finance in the Institute for Municipal Finance Officers (IMFO) standards.

After the change to General Recognised Accounting Practices (GRAP), fund accounting is no longer allowed.

However, the municipality recognises the importance to itself, its creditors, financiers, staff and the general public of providing for 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 therefore aims to provide for a measure of protection by creating certain reserves.

3.2 LEGAL REQUIREMENTS

There are no specific legal requirements for the creation of reserves. The GRAP Standards themselves do not provide for reserves.

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.

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 resources for future expenditure, the municipality hereby approves the establishment of the following reserves:

(a) Capital Replacement Reserve (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–backed and the Accounting Officer is hereby delegated to determine the contribution to the CRR during the compilation of the annual financial statements.

(b) **Employee benefits reserve**

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

The contributions to the reserve must be made in accordance with the directives set out in this Funding Policy..

(c) **Other statutory reserves**

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

3.3.2 NON – CASH FUNDED RESERVES

On occasion it is necessary to create non – cash funded reserves. The Accounting Officer must create any reserves prescribed by the accounting standards, such as the Revaluation Reserve, if required.

3.4 ACCOUNTING FOR RESERVES

The accounting for all 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 Net Assets to or from the accumulated surplus.

It is a condition of GRAP and this policy that no transactions may be directly appropriated against these reserves.

4 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 this policy must be approved by Council.

This policy must be reviewed and submitted for consideration by Council on an annual basis. Such submission must be accompanied with a full description of the reasons for the change to the policy.

APPENDIX A

RECONCILIATION OF CASH REQUIREMENTS

Cash flow from operating activities (As per schedule A7)	R XX
Add: Depreciation	R XX
Add: 5% of prior year non – current employee benefits balance	R XX
Add: Unspent conditional grants	R XX
Add: Unspent public contributions	R XX
Add: Unspent borrowings	R XX
Add: VAT due to SARS	R XX
Add: Secured investments	R XX
Add: Cash portion of Statutory Reserves	R XX
Add: Working Capital Requirements	R XX
= Minimum Cash Surplus Requirements for the year	R XX