SOL PLAATJE
LOCAL MUNICIPALITY

We Serve

FUNDING AND RESERVES POLICY

2018-2019

INDEX

1. INTRODUCTION AND OBJECTIVE

1.1. 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.

1.2. The objectives of the policy are to:

a) Ensure that the Medium-Term Expenditure Framework (annual budget) of the municipality is appropriately funded.

b) Ensure that cash resources and reserves are maintained at the required levels to avoid future year unfunded liabilities.

c) To achieve financial sustainability

2. SECTION A: FUNDING POLICY

2.1 LEGISLATIVE REQUIREMENTS

2.1.1. The policy is mandated by Section 8 of the Local Government Municipal Budget and Reporting Regulations which is made in terms of section 168 of the Municipal Finance Management Act, 2003, (Act No 56 of 2003)

2.1.2. 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:

i. Realistically anticipated revenues to be collected;

ii. Cash backed accumulated funds from previous years' surpluses not committed for other purposes and

iii. Borrowed funds, but only for capital projects.

2.1.3. 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.

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

2.2 STANDARD OF CARE

2.2.1 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 is achieved.

2.3 STATEMENT OF INTENT

2.3.1 The municipality will not pass a budget which is not 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 always be adhered to.

2.4 CASH MANAGEMENT

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

2.5 DEBT MANAGEMENT

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

2.6 FUNDING THE OPERATING BUDGET

2.6.1 INTRODUCTION

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

2.6.1.2 The municipality however, recognizes the plight of the poor, and in line with national and provincial objectives, the municipality commits itself to subsidized services to the poor. This will necessitate cross subsidization in tariffs to be calculated in the budget process.

2.6.2 GENERAL PRINCIPLE WHEN COMPILING THE OPERATING BUDGET

2.6.2.1 The following specific principles apply when compiling the budget:

a) The budget must be 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 (DORA), proven provincial transfers and any possible transfers to or from other municipalities.

e) For the purpose of the Cash flow budget, any National or Provincial grants that have been re-appropriated for roll–over purposes must be included in the adjustment budget.

f) Projected revenue from service charges must be reflected as net revenue (thus all billing less revenue foregone).

g) Projected revenue from property rates must include all rates to be levied, but rebates must be budgeted for as revenue foregone. For the purpose of the Cash flow Budget, all rebates and discounts must be deducted from the projected revenue.

h) Only changes in fair values related to cash may be included in the cash flow budget. Changes to unamortized discount must be included in the Operating Budget, but excluded in the cash flow budget.

i) 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

j) 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.

k) Contributions to provisions (non-current and current) do not form part of the cash flow. It is however, necessary to provide for an increase in cash resources in order to comply with the conditions of the provision at the time when it is needed.

2.7 FUNDING THE CAPITAL BUDGET

2.7.1 INTRODUCTION

2.7.1.1 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.

2.7.1.2 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

2.7.2.1 The capital budget can be funded by way of own revenue, grants, public contributions as well as external loans.

2.7.2.2 Own Revenue

a) The capital budget financed from own contributions must primarily be funded from the Capital Replacement Reserve and these funds must be cash-backed.

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

2.7.2.3 Grants (including Public Contributions)

a) 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 also be taken that grant funding does not place an unreasonable burden on the residents for future maintenance costs which may be higher than their ability to pay.

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

c) Grants used to fund the capital grant is monetary of nature. In kind grants will only be reflected in the financial statements when the Donation of the asset has taken place.

2.7.2.4 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.

2.7.2.5 External Loans

a) The municipality may only raise external loans to fund capital projects.

b) The Accounting Officer must also put such accounting measures in place to ensure that no unspent portions of loans are utilized for operating purposes.

2.8 FUNDING COMPLIANCE MEASUREMENT (INDICATORS)

2.8.1 INTRODUCTION

2.8.1.1 The municipality wants to ensure that the budget or adjustment 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 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 considered, as well as any additional reconciliation items as either determined by Council or the Accounting Officer.

2.8.2 CASH AND CASH EQUIVALENTS AND INVESTMENTS

2.8.2.1 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.

2.8.3 CASH PLUS INVESTMENTS LESS APPLICATION OF FUNDS

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

a) unspent conditional grants;

b) unspent conditional public contributions;

c) unspent borrowings;

d) VAT due to SARS;

e) secured investments;

f) the cash portion of statutory funds;

g) other working capital requirements; and

h) In addition, it must be sufficient to back reserves and the portions of provisions as indicated elsewhere in this policy.

2.8.4 MONTHLY AVERAGE PAYMENT COVERED BY CASH AND CASH EQUIVALENTS (“CASH COVERAGE”)

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

2.8.5 SURPLUS/DEFICIT EXCLUDING DEPRECIATION OFFSETS

2.8.5.1 As determined elsewhere in this policy it is not the intention that the users of the assets funded from grants and public contributions 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 charges may be offset against the net surplus / deficit.

2.8.6 CASH COLLECTION % RATE

2.8.6.1 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.

2.8.6.2 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.

2.8.7 DEBT IMPAIRMENT EXPENSE AS A PERCENTAGE OF BILLABLE REVENUE

2.8.7.1 This indicator provides information whether the contribution to the provision for impairment of receivables is adequate. In theory it should be equal to:

2.8.7.2 The 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

2.8.8.1 This indicator provides information as to the timing for payments on capital projects and utilizing allowed payment 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

2.8.10.1 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)

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

2.8.11.2 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

2.8.12.1 It is of utmost importance that the municipality's Property Plant and Equipment be maintained properly, 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 to fund other less important expenditure requirements.

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

2.8.13 ASSET RENEWAL/REHABILITATION EXPENDITURE LEVEL

2.8.13.1 This indicator supports further the indicator for repairs and maintenance.

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

2.8.14 FINANCIAL PERFORMANCE BUDGET

2.8.14.1 A number of line–items influence the net result of the financial performance budget. It includes capital grant revenue, depreciation charges including those where assets were funded from grants and public contributions, unamortized discounts and gains/losses on the disposal of Property Plant and Equipment. These items need to be taken into consideration to establish if the operating budget is realistic and credible.

2.8.15 FINANCIAL POSITION BUDGET

2.8.15.1 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

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

2.8.16.2 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.

3 SECTION B: RESERVES POLICY

3.1 INTRODUCTION

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

3.1.2 Since the municipality changed to General Recognized Accounting Practices (GRAP) fund accounting is no more allowed.

3.1.3 The municipality, however, recognizes 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.

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

3.2 LEGAL REQUIREMENTS

There are no specific legal requirements for the creation of reserves, except for the Housing Development Fund. The GRAP Standards itself also do not provide for reserves. However, the GRAP "Framework for the Preparation and Presentation of Financial Statements" states that such reserves may be created.

3.3 TYPES OF RESERVES

3.3.1 Reserves can be classified into two main categories being "cash funded reserves" and "non – cash funded reserves".

3.3.2 CASH FUNDED RESERVES

3.3.2.1 In order to provide for sufficient cash resources for future expenditure, the municipality approved the establishment of the following reserves:

a) Capital Replacement Reserve (CRR)

3.3.2.2 The CRR is to be utilized for future capital expenditure from own funds and may not be used for other operating expenditure.

3.3.2.3 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

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

c) Other statutory reserves

3.3.2.5 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.

3.3.2.6 A COID (Compensation for Occupational Injuries and Diseases) and Self-insurance reserve were created.

3.4 ACCOUNTING FOR RESERVES

3.4.1 RESERVES

3.4.1.1 All transactions must be accounted as prescribed by GRAP.

4 SECTION C: REVIEW OF THE POLICY

4.1 Whenever 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.