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**FUNDING AND RESERVE POLICY**

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## **FUNDING AND RESERVE POLICY**

### **1. INTRODUCTION AND OBJECTIVE**

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

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 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**

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 Management and credit control 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 necessitate cross subsidisation in funding 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 and in any line with any budget circulars issued by National and Provincial Treasury;
- c) Tariff adjustments must be fair;
- d) Revenue from Government Grants and Subsidies must be in accordance with the amounts promulgated in the Division of 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 purposes must be excluded from the calculation as it must be included in changes in Cash 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 given in MFMA circular 48.

- e) Projected revenue from services charges must be reflected as net (all billing less revenue foregone, which is free basic services, discounts and rebates).
- f) Only changes in fair values 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.
- 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, and it is therefore determined that provision for the short term portion of employee benefits, as well as an operating surplus calculated at the minimum of 10% of the prior year balance of the long-term benefits not yet cash-funded, 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 an "Employee 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 own sources, excluding assets funded from grants, public contributions and external loans must be reflected as a surplus on the cash flow budget. Capital Replacement Reserve must be fully cash funded and amount equal to the annual depreciation/amortisation must be transferred to the Capital Replacement Reserve annually.

- i) 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. All provisions must be cash backed and cash set aside for the payment of these contributions as they become due and payable.

## **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 contributions, grants, public contributions as well as external loans.

#### **Own Contributions**

The capital budget financed from own contributions must primarily be funded from the Capital Replacement Reserve which must be cash funded and/or current year surplus revenue.

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.

Annually the depreciation/amortization amount must be transferred to the capital replacement reserve. When the capital replacement reserve is

utilized for the funding of the capital budget, the capital replacement reserve must be replenished within two years to ensure adequate cash is available in the reserve to fund unforeseen and unavoidable capital purchases that was not included in the original budget.

### **Grants (Including Public Contributions)**

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 unusual grant funding does not place 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 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 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. Given the revenue restraints of a district municipality detail cost



analysis must be performed for considering raising loans and the ability to repay such obligations as they become due and payable. Loans must be used for purchasing of cash generated assets to ensure a constant revenue stream to be utilized for the repayment of such loans.

## **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 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 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 provide a positive return, unless any negative indicators can be reasonably explained and future budget projections address the turn-around of these indicators to within acceptable levels.

### **2.8.2 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 sufficient to back reserves as approved by the municipality and the portions of provisions as indicated elsewhere in this policy.

### **2.8.3 SURPLUS/DEFICIT EXCLUDING DEPRECIATION OFFSETS**

Should the budget result in a deficit after the offsetting, the budget will be deemed unfunded and must be revised. Annually the depreciation/amortization amount must be transferred to the capital replacement reserve to build up the reserve and it must be cash funded.

## **3. SECTION B: RESERVES POLICY**

### **3.1 INTRODUCTION**

The municipality 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 legal requirements for the creation of reserves, except for the Housing Development Fund, however this is not applicable to district municipalities currently. The GRAP Standards itself also do not provide for reserves.

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.

### **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. This fund must be fully cash backed.

**(b) Employee benefit reserve**

To be utilized for any provision of employee related benefits/provisions and must be cash backed.

#### **3.3.2 NON CASH FUNDED RESERVES**

Currently the district municipality do not have any such reserves.