



FUNDS AND RESERVES POLICY

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1. DEFINITIONS

"Municipality" means Umzumbe Local Municipality

"MFMA" means the Municipal Financial Management Act, 2003 (Act No 56 of 2003)

"GRAP" means Generally Accepted Accounting Practices standards.

"CFO" means the Chief Financial officer of the Municipality

"Accounting Officer" means the Municipal Manager of the Municipality

2. INTRODUCTION

The funding and reserves policy aims to ensure that the Municipality has sufficient and cost-effective funding in order to achieve its objectives through the implementation of its operating and capital budgets.

This policy aims to set guidelines towards ensuring financial viability over both the short- and long-term which includes reserves requirements.

3. OBJECTIVES OF THIS POLICY

The objectives of this policy are to:

- 3.1 Ensure that the Medium Term Expenditure Framework (annual budget) of the Municipality is appropriately funded.
- 3.2 Ensure that cash resources and reserves are maintained at the required levels to avoid future year unfunded liabilities.
- 3.3 To achieve financial sustainability with acceptable levels of service delivery to the community.

4. LEGISLATIVE REQUIREMENTS

The legislative framework governing borrowings are:

- 4.1 Local Government Municipal Finance Management Act, 2003 (Act No. 56 of 2003); and,
- 4.2 Local Government: Municipal Budget and Reporting Regulation, Regulation 393, published under Government Gazette 32141, 17 April 2009.

5. FUNDING OF ANNUAL BUDGET

- 5.1 An annual budget may only be funded from:
 - (a) Cash backed accumulated funds from previous year's surpluses and reserves not committed for any other purpose; and/or
 - (b) Borrowed funds but only for capital expenditure.
- 5.2 Realistic anticipated revenue projections must take into account:
 - (a) Projected revenue for the current year based on collection levels to date.
 - (b) Actual revenue collected in previous financial years.
- 5.3 Capital expediting may only incur on a capital project if:
 - (a) The funding for the project has been appropriated in the capital budget.
 - (b) The total cost for the project has been approved by Council.
 - (c) The future budgetary implications and projected cost covering all financial years until the project is operational has been considered.
 - (d) The implications of the capital budget on municipal tax and tariff increases.
 - (e) The sources of funding are available and confirmed and have not been committed for other purposes.

6. CASH MANAGEMENT

- 6.1 The availability of cash is one of the most important requirements for financial sustainability and must be closely monitored by Council to ensure minimum days cash on hand of ninety (90) days for its daily operations.
- 6.2 Changes in the municipal environment that may have an impact on the municipal

cash position includes:

- (a) Changes in revenue levels as a result of consumption patterns (water Restrictions, load shedding etc.);
- (b) Reduced growth as a result of economic conditions;
- (c) Increase in non-payment rate as a result of economic conditions;
- (e) Increased debt levels.

6.3 Surplus cash not immediately required for operational purposes is invested in terms of the Municipality's investment policy to maximize the return on cash.

7. DEBT MANAGEMENT

7.1 Debt is managed in terms of the municipal credit control and debt collection policy.

7.2 The provision for revenue that will not be collected are budgeted as an expense and is based on the projected annual non-payment rate for each service.

8. OPERATING BUDGET

8.1 The operating budget provides funding to departments for their medium term expenditure as planned. The Municipality categorises services rendered to the community according to its revenue generating capabilities.

- (a) Trading services - services that generate surpluses that can be used for cross subsidisation to fund other services.
- (b) Economic services - services that break even with no surpluses.
- (c) Rates and general services - services that are funded by rates, surpluses generated by trading services, and/or other revenues generated such as fines, interest received, grants and subsidies etc.

8.2 The operating budget is funded from the following main sources of revenue:

- (a) Property rates.
- (b) Surpluses generated from service charges. (Including electricity)
- (c) Government grants and subsidies.
- (d) Other revenue, fines, interest received etc.

- 8.3 The following guiding principles apply when compiling the operating budget:
- (a) The annual budget must be balanced and fully funded.
 - (b) Growth parameters must be realistic taking into account the current economic conditions.
 - (c) Tariff adjustments must be realistic, taking into consideration the general inflation, affordability, bulk increases and the demand according to the approved Integrated Development Plan (IDP).
 - (d) Revenue from government grants and subsidies must be in line with allocations gazette in the Division of Revenue Act and provincial gazettes.
 - (e) Revenue from public contributions, donations or any other grants may only be included in the budget if there are acceptable documentation that guarantees the funds such as:
 - (i) Signed service level agreement;
 - (ii) Contract or written confirmation; or
 - (iii) Any other legally binding document.
 - (f) Property rates are levied according to the Municipal Property Rates Act 2004 (Act No.6 of 2004), and property rates policy. The budget is compiled using the latest approved valuation and supplementary roll, consistent with current and past trends. Property rates tariffs and rebates are determined annually as part of the tariff setting process.
 - (g) Property rates rebates, exemptions and reductions are budgeted either as revenue foregone or expenditure as per directive in MFMA Budget Circular 51 depending on the conditions thereof.
 - (h) Projected revenue from service charges must be realistic based on current and past trends with expected growth considering the current economic conditions. The following factors must be considered for each service, where applicable:
 - (i) Electricity and Refuse removal services:
 - The actual number of stands/consumer points receiving the service per category; and
 - Actual revenue collected in previous financial years.
 - (i) Rebates, exemptions or reductions for service charges are budgeted either as revenue foregone or as expenditure as per directive in MFMA Budget Circular 51 depending on the conditions thereof.

- (j) Other projected income is charged in terms of the approved sundry\ tariffs and fines considering the past trends and expected growth for each category.
- (k) Provision for revenue that will not be collected is made against the expenditure item bad debt provision and based on actual collection levels for the previous financial year and the projected annual non-payment rate.
- (l) Interest received from actual long-term and or short-term investments are based on the amount reasonably expected to be earned on cash amounts available during the year according to the expected interest rate trends.
- (o) A detailed salary budget is compiled on an annual basis. All funded positions are budgeted for in total and new and/or funded vacant positions are budgeted for nine months only of the total package considering the recruitment process.
- (p) The annual cash flow requirement for the repayment of borrowings must fully be taken into consideration with the setting of tariffs.
- (q) To ensure the health of municipal assets, sufficient provision must be made for the maintenance of existing and infrastructure assets based on affordable levels, resulting that maintenance budgets are normally lower than the recommended levels. Therefore the mere reduction of maintenance budgets to balance annual budgets must carefully be considered. As a guiding principle repair and maintenance should constitute between 7% and 9% of total asset base and should annually be increased incrementally until the required targets are achieved.
- (r) Individual expenditure line items are to be revised each year when compiling the budget to ensure proper control over expenditure increases for these line items must be linked to the average inflation rate and macro-economic indicators unless a signed agreement or contract stipulates otherwise.

9. CAPITAL BUDGET

- 9.1 The capital budget provides funding for the municipality's capital programme based on the needs and objectives as identified by the community through the Integrated Development Plan and provides for the eradication of infrastructural backlogs, renewal and upgrading of existing infrastructure, new developments and enlargement of bulk infrastructure.
- 9.2 Provisions on the capital budget shall be limited to availability of sources of funding and affordability. The main sources of funding for capital expenditure are:
- (a) Accumulated cash backed internal reserves;
 - (b) Borrowings;
 - (c) Government grants and subsidies; and
 - (d) Public donations and contributions.
- 9.3 The following guiding principles apply when considering sources of funding for the capital budget:
- (a) Government grants and subsidies:
 - (i) Only gazette allocations or transfers as reflected in the Division of Revenue Act or allocations as per provincial gazettes may be used to fund projects;
 - (ii) The conditions of the specific grant must be taken into consideration when allocated to a specific project; and
 - (iii) Government grants and subsidies allocated to specific capital projects are provided for on the relevant department's operating budget to the extent the conditions will be met during the financial year.
 - (b) In the case of public contributions, donations and/or other grants, such capital projects may only be included in the annual budget if the funding is guaranteed by means of:
 - (i) Signed service level agreement;
 - (ii) Contract or written confirmation; and/or
 - (iii) Any other legally binding document.

All above documentation must be accompanied by a Council Resolution

- (c) Public donations, contributions and other grants are provided for on the relevant department's operating budget to the extent the conditions will be met during the financial year.
- (d) The borrowing requirements, to be used as a basis to determine the affordability of external loans over the Medium Term Income and Expenditure Framework. The ratios to be considered to take up additional borrowings:
 - (i) Long-term credit rating of BBB;
 - (ii) Interest cost to total expenditure to not exceed 5%;
 - (iii) Long-term debt to revenue (excluding grants) not to exceed 30%;
- (e) Allocations to capital projects from cash backed internal reserves will be based on the available funding for each ring-fenced reserve according to the conditions of each reserve as follows:
 - (i) Infrastructure projects to service new developments and the revenue is received through the sale of stands/land/site must be allocated to the capital reserve for services;
 - (ii) Capital projects of a smaller nature such as office equipment, furniture, plant and equipment etc. must be allocated to the capital reserve from revenue which is funding from the revenue budget for that specific year. A general principle is that these types of capital expenditure should not exceed more than 1% of total operating expenditure;
 - (iii) Capital projects to replace and/or upgrade existing assets will be allocated to the capital replacement reserve;
 - (iv) Capital projects to upgrade bulk services will be allocated to the capital bulk contributions reserve for each service.

9.4 All capital projects have an effect on future operating budget therefore the following cost factors should be considered before approval:

- (a) Additional personnel cost to staff new facilities once operational;
- (b) Additional contracted services, that is, security, cleaning etc.
- (c) Additional general expenditure, that is, services cost, stationery, telephones, material etc.

- (d) Additional other capital requirements to the operate facility, that is, vehicles, plant and equipment, furniture and office equipment etc.
- (e) Additional costs to maintain the assets;
- (f) Additional interest and redemption in the case of borrowings;
- (g) Additional depreciation charges;
- (h) Additional revenue generation. The impact of expenditure items must be offset by additional revenue generated to determine the real impact on tariffs.

10. RESERVES

- 10.1 All reserves are “*ring fenced*” as internal reserves within the accumulated surplus, except for provisions as allowed by the General Recognized Accounting Practices (GRAP).

11. PROVISIONS AND LIABILITIES

A provision is recognised when the municipality has a present obligation as a result of a past event and it is probable, more likely than not, that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

Provisions are revised annually and those estimates to be settled within the next twelve (12) months are treated as current liabilities. Those that are expected to be settled over a greater period than twelve (12) months are dealt with hereunder.

Liabilities are economic outflows which are as a result of past events. These are either constructive or legal obligations, for which the timing and amount is certain. Those that are expected to be settled within 12 months is deemed current liabilities whilst those expected to be settled greater than 12 months is deemed non-current and I more fully dealt with hereunder.

The municipality has the following main provisions and liabilities:

(a) *Leave provision*

Liabilities for annual leave are recognised as they accrue to employees.

An annual provision is made from the operating budget to the leave provision. Due

to the fact that not all leave balances are redeemed for cash, only 75% of the leave provision will be strived to be cash backed.

(b) *Landfill rehabilitation provision*

The landfill site rehabilitation provision is created for the current operational site at the future estimated time of closure. The value of the provision is based on the expected future cost to rehabilitate the landfill site. This provision must be fully cash backed to ensure availability of cash for rehabilitation on closure.

(c) *Long services awards and retirement gifts*

Municipal employees are awarded leave days or cash according to years in service at year end. Due to the fact that not all long service leave balances are redeemed for cash, the municipality shall strive to ensure only 75% of the non-current portion of the long service leave provision is cash backed.

(d) *Post employment medical care benefits*

The municipality provides post-retirement medical care benefits by subsidizing the medical aid contributions to retired employees and their legitimate spouses. The expected cost of these benefits is accrued over a period of employment. The municipality must strive to ensure the provision is cash backed to 75% ensure the availability of cash for the payment of medical aid payments

(e) *Non-current lease liabilities and annuity loans*

The non-current portion is not required to be cash backed unless:

- there is significant uncertainty that the municipality will not be in a position to meet the terms and conditions as stipulated in the agreement, and
- the agreement contains conditions that require the municipality to pay back the full amount should there be an uncertified breach of the terms and conditions, and
- it is probable that these will be enforced by the lending institution.

12. OTHER ITEMS TO BE CASH BACKED

12.1 *Donations, public contributions, unspent grant funding*

Revenue received from conditional grants, donations and funding is recognised as revenue to the extent that the municipality has complied with any of the criteria, conditions or obligations embodied in the agreement. Unspent amounts in relation to donations, public contributions and unspent grant funding are therefore retained in cash and are not available to fund any other items on the operating or capital budget other than that for which it was intended for. These items must be 100% cash backed.

12.2 *Consumer deposits*

Consumer deposits are partial security for a future payment of an account. Deposits are considered a liability as the deposit is utilised on the account once the service is terminated. Therefore the funds are owed to consumers and can therefore not be utilised to fund the operating or capital budget. These items must be 100 % cash backed.

12.3 *Developers Contributions:*

The municipality has entered into service level agreements with property developers to reimburse them for the cost of bulk electricity. The reimbursements are dependent on the developers meeting future targets as set out in the service level agreements. The reimbursive amounts as set out in the developers contribution register must be cash backed to 100% of the amount recognized as a liability for re-payment and at least 30% of the liability recognised as deferred liability.

12.4 *Other Current Liabilities*

Current Liabilities are liabilities which are expected to be settled within the next 12 months. These include but are not limited to current portion of non-current liabilities and trade payables As such 100% of this category should be cash backed.

13. ADHERENCE TO POLICY

Umzumbe Municipality is a developmental municipality and as such shall strive to meet the above funding requirements over the medium term (3-5 years). This shall be undertaken via the budget process annually and either realistically increasing revenues or decreasing capital and operating expenditure.

14. REVIEW

This policy will be reviewed annually to ensure that it complies with changes in applicable legislation and regulation.

15. POLICY ADOPTION

This policy has been considered and approved by the **COUNCIL OF UMZUMBE LOCAL MUNICIPALITY** as follows:

Resolution No:.....

Approval Date:.....