

FUNDING AND RESERVES POLICY

BREEDER VALLEY

Municipality

Munisipaliteit

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WORCESTER ▼ RAWSONVILLE ▼ DE DOORNS ▼ TOUWS RIVER

2015/2016

TABLE OF CONTENTS

	Page Number
1. INTRODUCTION	3
2. PURPOSE	3
3. GUIDING PRINCIPLES	3
4. FUNDING OF THE ANNUAL BUDGET	4
5. DEBT MANAGEMENT	5
6. CASH MANAGEMENT	5
7. OPERATING BUDGET	6
8. CAPITAL BUDGET	7
9. RESERVES	8
10. PROVISIONS	9
11. OTHER ITEMS TO BE CASH BACKED	10
12. IMPLEMENTATION AND REVIEW OF THIS POLICY	11

1. INTRODUCTION

1.1 The Funding and Reserves Policy is aimed at;

- Ensuring that the Municipality has sufficient and cost-effective cash funding;
- Ensuring that provisions and reserves are maintained at the required level to avoid future year unfunded liabilities;
- Ensure the achievement of the Municipality objectives through the implementation of its operating and capital budgets.

1.2 This policy is mandated by section 8 of the Local Government: Municipal Budget and Reporting Regulations.

2. PURPOSE

2.1 This policy sets out the assumptions and methodology for estimating the following:-

2.1.1 Projected billings, collections and all direct revenues;

2.1.2 The provision for revenue that will not be collected based on past trends and payment rates;

2.1.3 The funds the Municipality can expect to receive from investments;

2.1.4 The proceeds the Municipality can expect to receive from the transfer or disposal of assets;

2.1.5 The Municipality's borrowing requirements; and

2.1.6 The funds to be set aside in reserves.

3. GUIDING PRINCIPLES

3.1. The Funding and Reserves Policy is based on the following principles:-

3.1.1 Credibility

- Planned Activities must be consistent with the IDP and vice versa.
- Financial viability of municipality should not jeopardise.
- Ensure Capacity to spend the budget.

3.1.2 *Sustainability*

- Ensure financial sustainability / overall financial health of Municipality.
- Revenue / Expenditure budgeted must be realistic.

3.1.3 *Responsiveness*

- To the needs of the community / public.
- Alignment of IDP, LED Strategies with Budget to give effect to provincial and national priorities.
- Budget must be responsive to economic growth objectives and the socio-economic need of the community.

3.1.4 *Affordability*

- Tariffs must not be increased unreasonably and consumers must be able to afford tariffs.

4. FUNDING OF THE ANNUAL BUDGET

4.1. An annual budget may only be funded from:-

4.1.1 Realistically anticipated revenues to be collected;

4.1.2 Cash backed accumulated funds from previous years surpluses and reserves not committed for any other purpose; and

4.1.3 Borrowed funds but only for the capital budget.

4.1.4 Gazetted Grant Funding

4.2. Realistic anticipated revenue projections must take into account:-

4.2.1 Projected revenue for the current year based on collection levels to date; and

4.2.2 Actual revenue collected in previous financial years.

4.3. Spending on a capital project may only occur if:-

4.3.1 The money for the project, excluding the cost of feasibility studies, has been appropriated in the budget;

4.3.2 The project, including the total cost, has been approved by Council;

4.3.3 The sources of funding have been considered, are available and have not been committed for other purposes;

4.3.4 Council has considered:-

(a) The projected cost covering all financial years until the project is operational; and

(b) The future operations costs and revenue on the project, including municipal tax and tariff implications.

5. DEBT MANAGEMENT

5.1. Debt is managed in terms of the Council's Credit Control Policy.

5.2. The provision for revenue that will not be collected is adequately budgeted as an expense (bad debt provision) and must be based on the projected annual non-payment for services.

6. CASH MANAGEMENT

6.1. The availability of cash is one of the most important requirements for financial sustainability and must be closely monitored to ensure a minimum cash days on hand of ninety (90) days for daily operations.

6.2. Changes in the municipal environment that may have an impact on the municipal cash position include:-

6.2.1 Changes in revenue levels as a result of changes in consumption patterns (water restrictions, load shedding etc);

6.2.2 Reduced GDP growth as a result of economic conditions;

6.2.3 Increase in non-payment rate due to economic conditions;

6.2.4 Implementation of electricity industry pricing policy (inclining block tariffs).

6.2.5 Other economic conditions (global recession, inflation, high levels of unemployment, etc.)

6.3. Surplus cash not immediately required for operation purposes is invested to maximise the returns on the investments.

7. OPERATING BUDGET

7.1. 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 as in terms of the Budget Implementation and Management Policy.

7.2. 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:-

(a) Metered services comprising of electricity and water:-

- the consumption trends for the previous financial years;
- envisaged water restrictions or load shedding when applicable;
- actual revenue collected in previous financial years; and
- increases in tariffs by regulatory bodies

(b) Refuse removal services:-

- the actual number of erven receiving the service per category and
- actual revenue collected in previous financial years.

(c) Sewerage services:-

- the actual number of erven receiving the service per category and the consumption trends per category and
- actual revenue collected in previous financial years.

7.2.1 Other projected revenue is charged in terms of the approved sundry tariffs and fines considering the past trends and expected growth for each category.

7.2.2 Provision for revenue that will not be collected is made against the expenditure item working capital/debt impairment and is based on actual collection levels for the previous financial year and the latest projected annual non-payment rate.

7.2.3 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.

7.2.4 The annual cash flow requirement for the repayment of borrowings must be fully taken into consideration with the setting of tariffs.

8. CAPITAL BUDGET

8.1 Provisions on the capital budget will be limited to availability of sources of funding and affordability. The main sources of funding for capital expenditure are:

- 8.1.1 Cash backed accumulated surpluses;
- 8.1.2 Borrowings;
- 8.1.3 Government grants and subsidies;
- 8.1.4 Public donations and contributions; and
- 8.1.5 Operating revenue.

8.2. The following guiding principles apply when considering sources of funding for the capital budget:-

8.2.1 Government Grants and Subsidies:-

8.2.2 In the case of public contributions, donations and/or other grants,

8.2.3 The borrowing requirements are used as a basis to determine the affordability of external loans over the Medium Term Revenue and Expenditure Framework. The ratios to be considered to take up new borrowings include:- should be in accordance with norms

- (a) Long-term credit rating of at least BBB;
- (b) Interest cost to total expenditure not to exceed 5%;
- (c) Long-term debt to revenue (excluding grants) not to exceed 50%;
- (d) Payment rate of above 95%;
- (e) Percentage of capital charges to operating expenditure less than 15%.

8.2.4 Allocations to capital projects from Cash Backed Accumulated Surpluses (subject to the provisions of paragraph 9 below) will be based on the available funding for each ring-fenced reserve according to the conditions of each reserve as follows:-

- (a) Capital projects of a smaller nature such as office equipment, furniture, plant and equipment etc. must be funded from own generated revenue from the operating budget for that specific year;
- (b) Infrastructure projects to service new developments and the revenue received through the sale of erven must be allocated to the Capital Reserve for Services;

(c) Capital projects to replace and/or upgrade existing assets will be allocated to the Capital Replacement Reserve; and

(d) Capital projects to upgrade bulk services will be allocated to the Capital Bulk Contributions Reserve for each service.

8.3. In accordance with Section 19 (1) of the MFMA, the Municipality may spend money on a capital project only if:-

8.3.1 The money for the project has been budgeted (excluding feasibility study cost).

8.3.2 The project, including the total cost, has been approved by Council.

8.3.3 Compliance with section 33 (contracts with future budgetary implications) to the extent that the section may be applicable to the project.

8.3.4 The sources of funding have been considered, are available and have not been committed for other purposes.

9. RESERVES

9.1. To ensure that funding is readily available for future development and the timely replacement of Infrastructure responsible for service delivery it will be prudent for the Municipality to create dedicated reserves that are cash backed at all times.

9.2. All Reserves are “ring fenced” as internal reserves within the accumulated surplus, except for provisions as allowed by the General Recognised Accounting Practices (GRAP).

9.3. The following ring fenced reserves should be established and cash backed over a period of time:-

9.3.1 Capital Reserve for New Developments

This reserve will be used to fund capital expenditure to service new developments. Each development is ring fenced within this reserve. The value determines the price for the erven to be sold and the revenue generated through the sale of erven is then allocated to the specific development. This reserve must be cash backed at all times to ensure the availability of cash to fund the capital expenditure required to service the erven.

9.3.2 Capital Replacement Reserve

Funding for capital budgets of future financial years are generated through contributions from the operating budget. Once the Municipality has reached its

maximum gearing ability no further borrowings can be taken up. This necessitates that the Municipality also invests in a capital replacement reserve. However, it must be cash backed. This reserve once fully established will enable the Municipality to provide internal funding for its capital replacement and renewal programme.

Other contributions to the capital replacement reserve through the operating budget may include interest received on investments;

9.3.3 Bulk Capital Contribution Reserves

This reserve is intended to supplement capital expenditure for the necessary expansions and upgrading of bulk infrastructure due to new developments. Revenue generated through bulk services contributions are allocated to this reserve for each applicable service. This reserve must also be cash backed at all times.

10. PROVISIONS

10.1 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.

10.2 Provisions are revised annually and those estimates to be settled within the next twelve (12) months are treated as current liabilities.

10.3 The Municipality should have the following provisions:

10.3.1 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 to be redeemed for cash at once, only 20% of the leave provision is cash backed.

10.3.2 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. A portion of the provision must be cash backed to ensure availability of cash for rehabilitation on closure.

10.3.3 Long Services Awards

Municipal employees are awarded leave days according to years in service at year end. Due to the fact that not all long service leave balances are redeemed for cash at once, none of the long service leave provision is cash backed.

10.3.4 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 entitlement to post-retirement medical benefits is based on employees remaining in service up to retirement age and the completion of a minimum service period. The expected cost of these benefits is accrued over a period of employment. A portion of the provision must be cash backed to ensure the availability of cash for the payment of medical aid payments.

10.3.5 Performance bonuses – employee benefits

The provision for performance bonuses that will be paid one year in arrear as the assessment of the Section 56 employees had been taken place. This provision must be cash backed to ensure the availability of cash for the payment of performance bonuses.

11. OTHER ITEMS TO BE CASH BACKED

11.1. Donations, Public Contributions, Unspent Conditional Grants

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.

11.2. 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. Consumer deposits should be retained in cash. The consumer deposits are 100% cash backed.

12. IMPLEMENTATION AND REVIEW OF THIS POLICY

12.1. This policy shall be implemented once approved by Council.