

**MANGAUNG
METROPOLITAN MUNICIPALITY**



FUNDING AND RESERVES POLICY

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DOCUMENT AND VERSION CONTROL

Version:

Date:

Summary: This document describes the Policy on Funding and Reserves that will be applicable to the Mangaung Municipality, with effect from 01 July 2012.

Municipal Manager

Executive Mayor

Date: _____

Date: _____

MANGAUNG METROPOLITAN MUNICIPALITY **FUNDING AND RESERVES POLICY**

1. INTRODUCTION

- 1.1 The Funding and Reserves Policy is aimed at ensuring that the Municipality has sufficient and cost-effective cash funding in order to achieve its 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;
 - 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 Affordability;
 - 3.1.2 Financial sustainability;
 - 3.1.3 Equity; and
 - 3.1.4 Efficiency.

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.
- 4.2. 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 growth as a result of economic conditions;
 - 6.2.3 Increase in non-payment rate due to economic conditions or political reasons; and
 - 6.2.4 Implementation of electricity industry pricing policy (inclining block tariffs).
- 6.3. Surplus cash not immediately required for operation purposes is invested in terms of the Council's Investment Policy so as 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 follows:-
- 7.1.1 Trading services (services that generate predetermined surpluses that can be used to fund other services rendered by the Municipality);
 - 7.1.2 Economic services (services that should at least break-even, but do not necessarily generate any surpluses to fund other services rendered by the Municipality);
 - 7.1.3 Rates and General (services that are funded by property rates, government grants or surpluses generated by the trading services).
- 7.2. In accordance with Section 18 of the MFMA, the operating budget can only be funded from realistically anticipated revenue. Provision for Bad Debt and Depreciation, although non cash items, are not to be used to "balance" operating shortfalls.

- 7.3. The operating budget is funded from the following main sources of revenue:-
- 7.3.1 Property rates;
 - 7.3.2 Service charges;
 - 7.3.3 Government grants and subsidies;
 - 7.3.4 Other sundry revenue, such as fines, interest received etc; and
 - 7.3.5 Cash backed accumulated surpluses from previous years not committed for any other purposes.
- 7.4. The following guiding principles apply when compiling the operating budget:-
- 7.4.1 The annual budget must be cash backed. This implicates that apart from expenditure being budgeted it must always be cash funded (provision for bad debt must therefore be equal to actual payment levels).;
 - 7.4.2 Growth parameters must be realistic taking into account the current economic conditions;
 - 7.4.3 Tariff adjustments must be realistic, taking into consideration affordability, bulk increases and future projected growth according to the approved Integrated Development Plan (IDP);
 - 7.4.4 Revenue from government grants and subsidies must be in line with allocations gazetted in the Division of Revenue Act and Provincial Gazettes;
 - 7.4.5 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:-
 - (a) a signed service level agreement;
 - (b) a contract or written confirmation; or
 - (c) any other legally binding document.
 - 7.4.6 Property rates are levied according to the Municipal Property Rates Act and Property Rates Policy based on the market values. The budget is compiled using the latest approved Valuation Roll and any Supplementary Roll, consistent with current and past trends. Property rates tariffs and rebates are determined annually as part of the tariff setting process;
 - 7.4.7 Property rates rebates, exemptions and reductions are budgeted either as revenue foregone or as a grant as per MFMA Budget Circular 51 depending on the conditions thereof;
 - 7.4.8 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; and
 - actual revenue collected in previous financial years.
 - (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.
 - 7.4.9 Rebates, exemptions or reductions for service charges are budgeted either as revenue foregone or as a grant as per MFMA Budget Circular 51 depending on the conditions thereof;

- 7.4.10 Other projected revenue is charged in terms of the approved sundry tariffs and fines considering the past trends and expected growth for each category.
- 7.4.11 Provision for revenue that will not be collected is made against the expenditure item debt impairment and is based on actual collection levels for the previous financial year and the latest projected annual non-payment rate.
- 7.4.12 Transfers from the accumulated surplus to fund operating expenditure will only be allowed for specific once-off projects and with no recurring operating expenditure resulting thereof.
- 7.4.13 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.
- 7.4.14 Depreciation charges are fully budgeted for according to the asset register and to limit the impact of the implementation of GRAP 17 a transfer is made from the accumulated surplus. However this is limited to the deemed fair value of assets previously funded from grants and donations. In addition the annual cash flow requirement for the repayment of borrowings must be fully taken into consideration with the setting of tariffs.
- 7.4.15 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 (9) months only of the total package considering the time for the recruitment process. As a guiding principle the salary budget should not constitute more than 25% of annual operating expenditure.
- 7.4.16 To ensure the health of the municipal asset base, sufficient provision must be made for the maintenance of existing and infrastructure assets based on affordable levels as maintenance budgets are normally lower than the recommended levels. As a guiding principle repair and maintenance should constitute at least between 8 and 10% of total operating expenditure and should annually be increased incrementally until the required targets are achieved.
- 7.4.17 Individual expenditure line items are to be revised each year when compiling the budget to ensure proper control over operating 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.

8. CAPITAL BUDGET

- 8.1. 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.
- 8.2. 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:-
 - 8.2.1 Cash backed accumulated surpluses;
 - 8.2.2 Borrowings;
 - 8.2.3 Government grants and subsidies;
 - 8.2.4 Public donations and contributions; and
 - 8.2.5 Operating revenue.
- 8.3. The following guiding principles apply when considering sources of funding for the capital budget:-

- 8.3.1 Government Grants and Subsidies:-
- 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;
 - The conditions of the specific grant must be taken into consideration when allocated to a specific project; and
 - Government grants and subsidies allocated to specific capital projects are provided for on the relevant department's operating budget to the extent that the conditions will be met during the financial year.
- 8.3.2 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:-
- A signed service level agreement;
 - A contract or written confirmation; and/or
 - Any other legally binding document.
- 8.3.3 Public donations, contributions and other grants are provided for on the relevant department's operating budget to the extent that the conditions will be met during the financial year.
- 8.3.4 The borrowing requirements as contained in the borrowing policy 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:-
- Long-term credit rating of at least BBB;
 - Interest cost to total expenditure to not exceed 8%;
 - Long-term debt to revenue (excluding grants) not to exceed 50%;
 - Payment rate of above 90%;
 - Percentage of capital charges to operating expenditure less than 15%.
- 8.3.5 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:-
- 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;
 - Infrastructure projects to service new developments and the revenue received through the sale of erven must be allocated to the Capital Reserve for Services;
 - Capital projects to replace and/or upgrade existing assets will be allocated to the Capital Replacement Reserve; and
 - Capital projects to upgrade bulk services will be allocated to the Capital Bulk Contributions Reserve for each service.
- 8.4. In accordance with Section 19 of the MFMA, the Municipality may spend money on a capital project only if:-
- 8.4.1 The money for the project has been budgeted (excluding feasibility study cost).
 - 8.4.2 The project, including the total cost, has been approved by Council.
 - 8.4.3 Compliance with section 33 (contracts with future budgetary implications) to the extent that the section may be applicable to the project.
 - 8.4.4 The sources of funding have been considered, are available and have not been committed for other purposes.

8.5. Before approving a capital project the Council must consider:-

8.5.1 The projected cost covering all financial years until the project is operational;

8.5.2 The future operational costs and revenue on the project, including municipal tax and tariff implications.

8.6. All capital projects have an effect on future operating budgets. The following cost factors must therefore be considered before approval:-

8.6.1 Additional personnel cost to staff new facilities once operational;

8.6.2 Additional contracted services, such as security, cleaning etc.

8.6.3 Additional general expenditure, such as services cost, stationery, telephones, material etc.

8.6.4 Additional other capital requirements to operate the facility, such as vehicles, plant and equipment, furniture and office equipment etc.

8.6.5 Additional costs to maintain the assets;

8.6.6 Additional interest and redemption in the case of borrowings;

8.6.7 Additional depreciation charges;

8.6.8 Additional revenue generation. The impact of expenditure items must be offset by additional revenue generated to determine the real impact on tariffs.

9. RESERVES

9.1. To ensure that funding is readily available for future development and the timeous 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 valuer 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. **(to be considered)**

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:

- (a) interest received on investments;

- (b) surface rentals from mines as identified from time to time; and

This reserve must be cash backed at all times to ensure the availability of cash to fund the municipal capital programme.

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 75% 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. This 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, only 75% 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. This provision must be cash backed to ensure the availability of cash for the payment of medical aid payments.

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. Due to the fact that it is not likely that all of the consumer deposits will be redeemed at once, only 75% is cash backed.

12. IMPLEMENTATION AND REVIEW OF THIS POLICY

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

12.2. In terms of section 17(1)(e) of the MFMA this policy must be reviewed on annual basis and the reviewed policy tabled to Council for approval as part of the budget process.

Approved by Council on 1 June 2012 under item 56, with effect from 1 July 2012.