OVERSTRAND MUNICIPALITY

FUNDING & RESERVES POLICY

Approved by Council
29 May 2013
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1 July 2013

INDEX

FUNDING AND RESERVES 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 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 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 and 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 Investment and Cash Management Policy.

2.5 LIABILITY MANAGEMENT

Debt must be managed in terms of the municipality's Borrowing 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 in which it will occur.

The municipality recognises the plight of the poor, and in line with national and provincial objectives, commits itself to subsidising services to the poor. This may necessitate cross-subsidisation in some tariffs 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;

(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, 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 and be included in changes in Cash and Cash Equivalents and Payables.

Within the budget, grants recognized as revenue must equal the total expected expenditure from grants.

(e) Projected revenue from services charges must be reflected as net (i.e. all billing less revenue foregone, including free basic services.

(f) Projected revenue from property rates must include all rates to be levied.

For the purpose of the Cash flow Budget all rebates and discounts must be deducted from the projected revenue.

(g) 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.

(h) 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. It is therefore determined that the short term expenditure portion of employee benefits be funded from the current year operating cash surplus.

(i) Depreciation must be fully budgeted for in the operating budget.

(j) Contributions to provisions (non-current and current) do not form part of the cash flow. It is 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

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 cash, grants, public contributions as well as external loans.

Cash

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

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 an unreasonable burden on the residents for future maintenance costs which may be higher than their ability to pay.

The accounting officer will annually evaluate the long term effect of unusual capital grants on future tariffs, and if deemed necessary, report on such to Council.

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 will put such accounting measures in place as to comply with this requirement as far as possible.

External Loans

The municipality may only raise loans in accordance with its Borrowing Policy.

The Accounting Officer must also put such accounting measures in place to ensure that no unspent portions of loans raised must be included in the cash surplus for the year.

2.8 FUNDING COMPLIANCE MEASUREMENT

2.8.1 INTRODUCTION

The municipality must ensure that the annual budget or any subsequent 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 any additional indicators detailed in this policy.

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 those negative indicators can be reasonable explained and any future budget projections address the turn-around of these indicators to within acceptable levels.

2.8.2 CASH AND CASH EQUIVALENTS AND INVESTMENTS

A positive Cash and Cash Equivalents position should be maintained throughout the year.

2.8.3 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
- the cash position must be sufficient to back reserves as approved by the municipality and those portions of provisions as indicated elsewhere in this policy.

INDICATORS

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

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

2.8.5 SURPLUS/DEFICIT EXCLUDING DEPRECIATION OFFSETS

It is probable that the operating budget including depreciation charges on assets funded by grants and public contributions, as well as on revalued assets, will result in a deficit.

As determined elsewhere in this policy it is not the intention that residents be burdened with tariff increases to provide for such depreciation charges. In order to ensure a "balanced" budget, the cash position must be determined.

Should a budget result in a deficit cash position, the budget will be deemed unfunded and must be revised.

2.8.6 PROPERTY RATES/SERVICE CHARGE REVENUE PERCENTAGE INCREASE LESS MACRO INFLATION TARGET

The intention of this indicator is to ensure that tariff increases are in line with macro economic targets, but also to ensure that revenue increases for the expected growth in the geographic area are realistically calculated.

2.8.7 CASH COLLECTION % RATE

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.

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.

It is not permissible to project a collection rate higher that the current rate. Any improvement in collection rates during the budget year may be appropriated in an Adjustments Budget.

2.8.8 DEBT IMPAIRMENT EXPENSE AS A PERCENTAGE OF BILLABLE REVENUE

This indicator provides information as to whether the contribution to the provision for impairment of receivables is adequate. In theory it should be equal to the difference between 100% and the cash collection rate, but other factors such as past performance can have an influence on it. Any difference must be motivated in the budget report.

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 Borrowing Policy.

2.8.10 GRANT REVENUE AS A PERCENTAGE OF GRANTS AVAILABLE

The percentage attained should never be less that 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)

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

Any unacceptably high increase in either current or non-current debtors' balances should be investigated and reported.

2.8.12 REPAIRS AND MAINTENANCE EXPENDITURE LEVEL

Property Plant and Equipment should be maintained properly at all times in order 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 in order to fund other less important expenditure requirements.

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

This indicator supports further the indicator for repairs and maintenance.

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

3 SECTION B: RESERVES POLICY

3.1 INTRODUCTION

Fund accounting historically formed the major component of municipal finance in the IMFO standards.

After the change to General Recognised Accounting Practices (GRAP), fund accounting is no longer allowed.

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.

This policy therefore aims to provide for a 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 themselves do not provide for reserves.

3.3 TYPES OF RESERVES/PROVISIONS

Reserves/Provisions can be classified into two main categories being “cash funded” and “non–cash funded”.

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) Statutory reserves

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 NON – CASH FUNDED RESERVES

On occasion it is necessary to create non – cash funded reserves. The Accounting Officer must create any reserves prescribed by the accounting standards, such as the Revaluation Reserve, if required.

3.4 ACCOUNTING FOR RESERVES

3.4.1 REVALUATION RESERVE

The accounting for the Revaluation Reserve must be done in accordance with the requirements of GRAP 17.

3.4.2 OTHER RESERVES

The accounting for all other reserves must be processed through the Statement of Financial Performance. The required transfer to or from the reserves must be processed in the Statement of Net Assets to or from the accumulated surplus.

It is a condition of GRAP and this policy that no transactions may be directly appropriated against these reserves.

4. SECTION C: REVIEW OF THE POLICY

This policy must be reviewed and submitted for consideration by Council on an annual basis. Such submission must be accompanied with a full description of the reasons for the change to the policy.

POLICY SECTION:	MANAGER: ACCOUNTING SERVICES
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