

NGQUSHWA LOCAL MUNICIPALITY



FUNDING AND RESERVES POLICY 2022/2023

Summary

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| Related Legislation/Applicable Section of Legislation | Municipal Finance Management Act 56 of 2003 |
| Related Policies, Procedures, Guidelines, Standards, Frameworks | |
| Replaces/ Repeals (whichever is relevant, if any) | |
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| Policy Officer (Phone) | |
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1. NAME OF POLICY

This is the Funding and Reserves Policy of the Ngqushwa Local Municipality (“The Municipality”)

2. INTRODUCTION AND OBJECTIVE

The Municipality sets as its objective to be 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. It also ensures the operating and capital budgets of Council are appropriately funded and reserves are maintained at the required levels.

3. LEGISLATIVE REQUIREMENTS

In terms of Section 18 and 19 of the Municipal Finance Management Act, No. 56 of 2003 (MFMA), an annual budget may only be funded from: -

- Realistically anticipated reserves to be collected
- Cash-backed accumulated funds from surpluses of previous years not committed for other purposes; and
- Borrowed funds, but only for capital projects.

Furthermore, spending on a capital budget may only be commenced if the sources of funding have been considered, are available and have not been committed for other purposes (Section 19 (1) (d) of the MFMA). In accordance with the requirements of the MFMA, the Budget must be cash funded.

4. CASH MANAGEMENT

Cash Management is done in terms of the Municipality's Cash Management and Investment Policy.

5. DEBT MANAGEMENT

Debt Management is done in terms of the Municipality's Debt and Borrowing Policy and the Customer Care, Indigent, Credit Control, Debt collection and any other relevant Policy.

6. FUNDING OF THE CAPITAL BUDGET

The Capital Budget can be funded by way of own contributions, grants, public contributions or any other financing source secured by the Municipality.

6.1. Own Funding Sources

The Municipality has established a Capital Replacement Reserve (CRR) for the purpose of financing capital projects and the acquisition of capital assets on the following conditions: -

6.1.1 Purpose of the CRR

6.1.1.1 It is the policy of the Municipality to establish a Capital Replacement Reserve.

6.1.1.2 The purpose of the CRR is to set funds aside for the financing of capital assets. The CRR is therefore a capital asset financing source that represents an alternative to other funding sources available to municipalities, namely external loans (interest bearing borrowings) and government grants and subsidies.

6.1.2 Contributions to the CRR

- 6.1.2.1** It is the policy of Council to make contributions annually to the CRR to ensure that the CRR remains a capital funding source for the future. The Chief Financial Officer, in consultation with the Municipal Manager, will determine the Municipality's future capital financing requirements and endeavour to transfer sufficient cash to its CRR in terms of this determination in order to secure the sustainability of the CRR. The Integrated Development Plan, the Municipality's ability to raise external finance and the amount of Government grants and subsidies that will be received in future will be taken into account in determining the amount that must be transferred to the CRR.
- 6.1.2.2** The Chief Financial Officer must transfer all cash proceeds on the sale of capital assets (including the sale of buildings and land) and will be transferred from the Accumulated Surplus to the CRR via the Statement of Changes in Net Assets.
- 6.1.2.3** The Chief Financial Officer must transfer all cash proceeds from Developers Contributions and payments received in respect of the buyout of parking areas from the Accumulated Surplus to the CRR via the Statement of Changes in Net Assets.
- 6.1.2.4** Council will annually, with the approval of its budget, provide for a contribution from Revenue to the CRR.
- 6.1.2.5** Apart from this, an annual contribution equal to the depreciation of that financial year; less the repayment portion of the external loans (interest bearing borrowings) will be contributed from the accumulated surplus to the CRR.
- 6.1.2.6** Annually every year, with the closure of the financial records, the Chief Financial Officer can decide on an increased contribution to the CRR if sufficient cash surpluses were generated through savings on expenditure or additional income sources during the year or if any surplus cash is available after performing the following cash available reconciliation:

| | | |
|--|--|-----|
| Cash and Cash Equivalents | XXX | |
| Investments | XXX | |
| | XXX | |
| Less: | XXX | |
| Unspent Committed Conditional Grants | | |
| VAT Payable | | |
| Consumer deposits | | |
| Non-current deposits | | |
| Operating capital requirement: | _____ | |
| Payables | <div style="border: 1px solid black; padding: 5px; display: inline-block;"> XXX XXX XXX XXX XXX <div style="border: 1px solid black; padding: 2px; display: inline-block; margin-top: 5px;"> XXX XXX </div> </div> | |
| Less: Receivables | | |
| Resources available for working capital requirements | | |
| | | xxx |
| Allocated to: | | |
| Housing Development Fund | xxx | |
| Capital Replacement Reserve | xxx | |
| Current portion of Employee Benefits | xxx | |
| Current portion of Provisions | xxx | |
| Resources available for working capital requirements | xxx | |

6.1.2.6 Similarly the Chief Financial Officer can decide on a lesser amount but only if the cash revenue from interest on investments and other charges did not realise as budgeted for.

6.1.2.7 The actual final contribution compared to the budgeted amount, must be annually reported to Council.

6.1.3. Accounting Requirements

6.1.3.1 The balance of the CRR must always be represented by cash.

6.1.3.2 The CRR may only be utilised for the financing of capital_assets of the Municipality and may not be used for the maintenance of any assets.

6.1.3.3 Whenever a capital asset is financed out of the CRR an_amount equal to the cost capitalised as a capital asset is transferred from the CRR into Accumulated Surplus on the Statement of Changes in Net Assets. This is done to accommodate future annual depreciation charges on capital assets funded from the CRR.

6.1.3.4 A register must be kept with full details of all the following_transactions:

- (a) Land Sales;
- (b) Developers Contributions; and
- (c) Parking Areas.

6.2. Other Funding Sources

6.2.1 The Capital Budget shall be financed from external sources such as the following:

- Grants and subsidies as allocated in the Division of Revenue Act
- Grants and subsidies as allocated by Provincial Government
- External loans
- Public contributions
- Any other financing sources secured by local authorities

6.2.2 These funds will only be taken up in the Annual / Adjustment Budget once an official letter/contract has been received and signed for the allocation of such funds to the Municipality.

7. FUNDING OF THE OPERATING BUDGET

7.1 Basis of Calculation

7.1.1 The incremental approach is used in preparing the annual Operating Budget, except in cases where contractual commitment has been made that would span over more than one financial year. In these instances the zero-based method will be followed.

7.1.2 The annual Operating Budget shall be based on realistically anticipated revenue that should be equal to the anticipated operating expenditure in order to result in a balanced budget.

7.1.3 An income-based approach shall be used where the realistically anticipated income is determined first and the level of operating expenditure would be based on the determined income, thus resulting in a balanced budget.

7.2. Assumptions for different categories

The following assumptions are used when compiling the budget for the following expenditure categories: -

7.2.1 Employee-Related Costs

The salaries and allowances are calculated based on the percentage increases as per the South African Local Government Bargaining Council (SALGBC) collective agreement between organised labour and the employer for a particular period.

The remuneration of all political office bearers is based on the limitation and percentages as determined by the responsible National Minister as provided for in the approved Upper Limits annually.

7.2.2 Collection Costs

It refers to costs attributed for the collection of outstanding amounts according to the Credit Control Policy and the relevant Service Level Agreement.

7.2.3 Depreciation and Amortisation

Depreciation is calculated at cost using the straight line method, to allocate depreciation cost to the cost values over the estimated useful lives of the capital assets.

7.2.4 Interest External Borrowings

The above refers to interest that has to be repaid on an external loan taken up by the Municipality. The Budget is determined by using the repayments that the Municipality is liable for based on the loan agreements entered into with the Institutions and calculating the interest portion. The redemption portion is included in the cash flow budget.

7.2.5 Bulk Purchase

The expenditure on bulk purchases shall be determined by using the tariffs as stipulated by the Department of Water Affairs and NERSA or any other service provider from time to time.

7.2.6 General Expenses

The growth will be based on a percentage growth in line with the prevailing growth rates and the CPI and prior actual expenditure trends.

7.2.7 Repairs and Maintenance

Repairs and Maintenance shall be determined in conjunction with the needs of the different Directorates and in accordance with the Asset Maintenance Plan for the maintenance of Infrastructure Assets and Normal Maintenance.

7.2.8 Contributions to provisions

7.2.8.1 Contributions made to provisions are based on actual expenditure in the previous year and any other factor that could have effect.

7.2.8.2 Contributions to Debt impairment provision are calculated by applying the following two methods:

- a) GRAP 104.61 using the estimated future cash flows, discounted at the effective interest rate; and
- b) By calculating payment percentages of debtors for the past twelve months and apply that payment percentage on all debtors with outstanding balances longer than longer than 30 days on the whole outstanding amount.
- c) The calculation with the highest value of the two is then used as basis for the contribution to this provision.

7.2.9 Contributions to Employee benefits are based on Actuarial valuations done on the Medical aid, Long-service and ex-gratia benefits.

7.2.10 Contributions to provisions for the Clearing of Alien Vegetation and the Rehabilitation of Landfill sites are based on reports from an expert on the specific field of interest.

7.3 The Operating Budget shall be financed from the following sources.

7.3.1 Service Charges where these services are provided:

- Electricity charges
- Water sales
- Refuse removal fees
- Sewerage fees

7.3.2 Taxes

Assessment rates are levied in terms of the Municipal Property Rates Act based on land and improvements value as per the approved Valuation Roll of the Municipality. Tariffs are set in accordance with the stipulations as set out in the Tariff Policy.

7.3.3 Grants and Subsidies

Grants and subsidies shall be based on all Gazetted grants from the National and Provincial Treasuries and all other Public Contributions from organisations.

7.3.4 Interest on Investments

The Municipality has a Cash and Investment policy which purpose is to secure the sound and sustainable management of any surplus cash and investments. The budget for interest on investments and is based on a forecast of projected interest rates and projected investments to be made/withdrawn for the period.

7.3.5 Rental Fees

The budget for income from rental will be based on the fees set out in the rental contracts.

7.3.6 Fines

Income from fines will be budgeted for on actual Income received in the preceding year and a percentage growth rate for the particular year.

7.3.7 Other Income

All other income will be budgeted on the actual Income received in the preceding year and a percentage growth rate for the particular year.

8. RESERVES

8.1. 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.

8.2. Legal Requirements

As there are no legal requirements for the creation of reserves, the Housing Act, 1997 (Act No. 107 of 1997), requires the creation of the Housing Development Fund. According to GRAP “Framework and Preparation and Presentation of Financial Statements” such reserves may be created, but “Funding Accounting” is not allowed and any such reserves must be legal reserves created by law or through a Council Resolution.

8.3. Types of Reserves

Reserves can be classified as cash-funded reserves and non-cash-funded reserves:

8.3.1. Cash-Funded Reserves

8.3.1.1. Housing Development Fund (Only applicable when this function has been devolved to the Municipality or when appropriate agreements have been entered into between the Municipality and the responsible Department)

8.3.1.1.1 The Accounting Officer must create a Housing Development Fund in terms of the Housing Act.

8.3.1.1.2 The Housing Development Fund must be cash backed. The proceeds of the Housing Development Fund are utilised for housing development in accordance with the National Housing Policy.

8.3.1.1.3 Any profit on the rental, sale or alienation of property financed previously from Government housing funds has to be transferred and paid into the Housing Development Fund

8.3.1.2. Capital Replacement Reserve (CRR)

8.3.1.2.1 The CRR may only be utilised for purpose of financing capital assets and may not be used for the maintenance of any assets.

8.3.1.2.2 The CRR is a capital asset financing source that represents an alternative to the other funding sources available, namely external loans, government grants and subsidies.

8.3.2. Non-Cash-Funded Reserves

8.3.2.1. Revaluation Reserve

8.3.2.1.1 The accounting for the Revaluation Reserve must be done in accordance with the requirements of GRAP, if the Municipality adopted an accounting policy of revaluation as required.

8.3.2.1.2 The accounting entries to and from the revaluation reserve must be necessary to create non cash funded reserves according to GRAP requirements and the Accounting Officer must create any reserves as prescribed by the Accounting Standards Board.

9. REVIEW OF THE POLICY

The CFO of the Municipality must, for the purposes of ensuring that this policy is aligned to legislation, advise the Municipal Manager when it becomes necessary to amend this Policy.

The Municipal Manager of the Municipality, in accordance with Regulation 7(1) of the Budget and Reporting Regulations, must prepare or take all reasonable steps to ensure the preparation of the budget related policies of the municipality, or any amendments to such policies in accordance with the legislation applicable to those policies, for tabling in the Municipal Council by the applicable deadline specified by the Mayor in terms of section 21(1)(b) of the MFMA

**REVIEWED BY COUNCIL ON.....2022 UNDER AGENDA ITEM
NO.....**

MUNICIPAL MANAGER

MAYOR OBO COUNCIL