

**UMDONI MUNICIPALITY**



<b>Department</b>	<b>FINANCIAL SERVICES</b>
<b>Policy Name</b>	<b>DRAFT FUNDING &amp; RESERVES POLICY</b>
<b>Policy Number</b>	
<b>Status</b>	<b>DRAFT FUNDING &amp; RESERVES POLICY</b>
<b>Date</b>	<b>2024/2025</b>
<b>Approved by</b>	
<b>Date Approved</b>	
<b>Date Last Approved</b>	<b>23 May 2023</b>
<b>Date for Next Review</b>	<b>May 2024</b>
<b>Date Published on Intranet &amp; Website</b>	

## Table of Contents

1. DEFINITIONS .....	2
2. LEGISLATIVE FRAMEWORKS AND REGULATIONS.....	4
3. LEGISLATIVE OBLIGATIONS FOR THE POLICY .....	4
4. PURPOSE AND OBJECTIVES OF THE POLICY .....	5
5. PRINCIPLES OF FUNDING A MUNICIPAL BUDGET .....	5
6. PROJECTED REVENUE AND COLLECTIONS.....	7
7. PROVISION FOR REVENUE NOT TO BE COLLECTED .....	8
8. PROCEEDS ON INVESTMENTS AND INTEREST EARNED .....	8
9. DIVIDENDS FROM MUNICIPAL ENTITIES.....	9
10. PROCEEDS FROM THE DISPOSAL AND/OR TRANSFER OF ASSETS.....	9
11. EXTERNAL BORROWINGS .....	9
12. FUNDING OF RESERVES.....	10
13. HOUSING DEVELOPMENT FUND.....	10
14. UNFUNDED MANDATES.....	11
15. CAPITAL EXPENDITURE AND ACCELERATION OF PROJECTS.....	11
16. APPLICATION OF THE FUNDING TO MSCOA.....	12
17. POLICY REVIEW .....	13
18. POLICY ADOPTION.....	13

## **1. DEFINITIONS**

- 1.1 “Accounting Officer” means the person appointed by the Municipal Council as the Accounting Officer for the municipality in terms of section 82 of the Local Government Municipal Structures Act, 1998 (Act No. 117 of 1998) and includes any person to whom the Accounting Officer has delegated a power, function or duty in respect of such a delegated power, function or duty.
- 1.2 “Budget Steering Committee” means the committee that is established in terms of Budget and Reporting Regulation 4(1) to provide technical assistance to the Mayor in discharging the responsibilities set out in section 53 of the MFMA.
- 1.3 “Capital expenditure” where used alone shall mean the same as asset, for example capital expenditure shall refer to expenses incurred to create an asset or assets in terms of Generally Recognised Accounting Practice.
- 1.4 “Capital Project” means capital project as defined in terms of the mSCOA project segment.
- 1.5 “Chief Financial Officer” shall mean the head of the Financial Services Department as contemplated in Section 80 of the MFMA.
- 1.6 “CRR” shall mean Capital Replacement Reserve.
- 1.7 “Council” shall mean the Council of the municipality, any committee or person to which or to whom an instruction has been given or any power has been delegated or sub-delegated in terms of, or as contemplated in, section 59 of the Local Government: Municipal Systems Act, 2000 or a service provider in respect of any power, function or duty of the Council.
- 1.8 “Data string” shall mean the total budget line which includes all seven segments as prescribed in terms the Municipal Regulation on Standard Chart of Accounts.
- 1.9 “Financial year” shall mean the period from 1 July until 30 June of the next year
- 1.10 “Function” in terms of mSCOA is the municipal function as per Schedule 4B and 5B of the Constitution.
- 1.11 “Funding Segment” refers to the segment that identifies the various sources of funding available to municipalities and municipal entities for financing expenditure relating to the operation of the municipality and provides for both capital and operational spending. The appropriate classification of a transaction in this segment will be determined according to the source of funding against which a payment is allocated and the source of revenue against which income is received.

- 1.12 "GRAP" means the Standards on Generally Accepted Accounting Practice, as issued by the Accounting Standards Board
- 1.13 "Housing Development Fund" means the fund that was established in terms of the Housing Act, 1997 (Act No 107 of 1997). Loans from national and provincial government used to finance housing selling schemes undertaken by the Municipality were extinguished on 1 April 1998 and transferred to a Housing Development Fund. Housing selling schemes both complete and in progress as at 1 April 1998, were also transferred to the Housing Development Fund.
- 1.14 "MBRR" means the Municipal Budget and Reporting Regulations, as issued by National Treasury.
- 1.15 "MFMA" means the Municipal Financial Management Act, 2003 (Act No 56 of 2003)
- 1.16 "mSCOA" refers to the latest version of the Municipal Standard Chart of Accounts issued in terms of the Municipal Regulation on Standard Chart of Accounts.
- 1.17 "Municipal Running Cost" in terms of mSCOA refer to any other expenditure not relating to a specific project for example general expenses relating to the daily running and operation of the municipality.
- 1.18 "Municipality" means Umdoni Local Municipality
- 1.19 "Operational" shall mean revenue or expenditure included in or to be incurred on the operating budget.
- 1.20 "Operational projects" shall mean the same as per the project segment in the mSCOA chart and project summary definition and refer to current and short- term projects for which the cost is immediately recognised as an expense and funded from the municipalities' operational budget.
- 1.21 "Standard chart of accounts" means a multi-dimensional classification framework providing the method and format for recording and classifying financial transaction information in the general ledger forming part of the books of account containing a standard list of all available accounts.
- 1.22 "Typical Workstream Projects" in terms of mSCOA refer to projects are created under this group for "operational projects" for example agricultural projects, capacity building, training and development, spatial planning, etc. Typically, these "projects" consist of various expense-items contributing to the outcome or objective of an initiative.
- 1.23 "Unfunded / underfunded mandate" is defined as "when the municipality perform the functions of other spheres of government and bear significant cost out of their own revenue

sources". These unfunded / underfunded mandates pose an institutional and financial risk to the municipality as substantial amounts of municipal own funding is being allocated to non-core functions at the expense of basic service delivery which is the core mandate of the municipality.

## **2. LEGISLATIVE FRAMEWORKS AND REGULATIONS**

2.1 The legislative frameworks and regulations considered in determining the funding and reserves policy are:

- (a) Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003)
- (b) Local Government: Municipal Budget and Reporting Regulation, Regulation 393, published under Government Gazette 32141, 17 April 2009
- (c) Local Government: Municipal Finance Management Act: Municipal Regulations on Standard Chart of Accounts, Regulation 10178, published under Government Gazette 37577, 22 April 2014

## **3. LEGISLATIVE OBLIGATIONS FOR THE POLICY**

3.1 In accordance with Section 8(1) of the MBRR, each municipality must have a funding and reserves policy which must set out the assumptions and methodology for estimating:

- (a) Projected billings, collections and all direct revenues
- (b) The provision for the revenue that will not be collected
- (c) The funds which the municipality can expect to receive from investments
- (d) The dividends the municipality can expect to receive from municipal entities
- (e) The proceeds the municipality can expect to receive from the transfer or disposal of assets
- (f) The municipality's borrowing requirements
- (g) The funds to be set aside in reserves

3.2 Section 8(2) of the MBRR requires that, when developing or amending the funding and reserves policy of the municipality, the municipal manager must ensure that the policy:

- (a) Is consistent with the most recent actual billings and collection trends
- (b) Takes into account the credit rating of the municipality, if available, the financial position of the municipality, the cost of borrowing and the capacity to repay debt
- (c) Takes into account all the budget-related policies of the municipality, particular recent amendments to any of those policies
- (d) Takes account of any statutory requirements to set aside funds in reserves
- (e) Takes account of the transfer and disposal of assets

3.3 In accordance with Section 18(1) of the MFMA, an annual budget may only be funded from:

- (a) realistically anticipated revenues to be collected;

- (b) cash-backed accumulated funds from previous years' surpluses not committed for other purposes; and
- (c) borrowed funds, but only for the capital budget referred to in section 17(2) of the MFMA.

#### **4. PURPOSE AND OBJECTIVES OF THE POLICY**

- 4.1 The funding and reserves policy aims to ensure that the Municipality has sufficient and cost-effective funding sources in order to achieve its objectives through the implementation of its operating and capital budgets.
- 4.2 This policy aims to set guidelines towards ensuring financial viability over both the short- and long-term which includes reserves requirements.
- 4.3 The objectives of the funding and reserves policy are to:
  - (a) Ensure that the Medium Term Expenditure Framework (annual budget) of the Municipality is appropriately funded.
  - (b) Ensure that cash resources and reserves are maintained at the required levels to avoid future year unfunded liabilities.
  - (c) To achieve financial sustainability with acceptable levels of service delivery to the community.
  - (d) To effectively utilise the fund segment as required in terms of mSCOA, to measure committed expenditure and obligations of the municipality as well as the anticipated cash available by funding source.

#### **5. PRINCIPLES OF FUNDING A MUNICIPAL BUDGET**

- 5.1 When preparing an annual or adjustment budget, the municipality shall determine all revenue funding sources available to the municipality, including projected revenue, by taking into account the following:
  - (a) Grant and subsidy allocations in terms of the Division of Revenue Act;
  - (b) Funding agreements with the Provincial Government as well as community;
  - (c) Revenue sources in accordance with the revenue and tariff policy of the municipality;
  - (d) Available cash and investments that are cash backed in terms of reserves, subsequent to taking into account outstanding creditors and relating obligations;
  - (e) Anticipated collections from outstanding debtors
  - (f) cash-backed accumulated funds from previous years' surpluses not committed for other purposes
- 5.2 When funding budgeted expenditure on an annual or adjustments budget, the following shall be applied:
  - (a) Funds must be allocated to capital projects that require a contractual commitment to the municipality in excess of one financial year, prior to budgeting for new

- capital acquisitions.
- (b) Operational contractual commitments as well as necessary municipal running costs to the municipality needs to be determined, with funds being allocated to meet these obligations, prior to funding additional operational expenditure.
  - (c) Funds shall further be allocated for the payment of liabilities that are anticipated to be due within 12 months of the commencement of the budget year.
- 5.3 Whilst the municipality may have multiple revenue sources that are collectible, it is further considered necessary for the municipality to determine the available and reliable funding sources of revenue to fund the budgeted expenditure and commitments of the municipality.
- 5.4 The municipality considers the following revenue sources as reliable to fund the municipal budget;
- (a) Equitable share
  - (b) Transfers and subsidies
  - (c) Property rates
  - (d) Service charges, specifically waste management
  - (e) Cash backed reserves
  - (f) Rental of facilities
  - (g) License and Permits
  - (h) Fines
  - (i) Operational revenue
  - (j) Interest on investments
  - (k) Agency Services
- 5.5. Budgeted expenditure and obligations shall be funded based on the above mentioned reliable funding sources within the respective Votes of the municipality.
- 5.6. 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.
- 5.7 In determining whether the budget is adequately funded, the municipality shall consider the following:
- (a) The level of funding of the accrued expenditure (capital and operational) and existing commitments against accrued revenue and receivable sources
  - (b) The level of cash flow anticipated to be paid by funding source against the cash revenue to be received in the budget year.
  - (c) Adequate cash on hand of at least ninety (90) days for its daily operations, shall be maintained.
- 5.8. When considering available cash on hand, consideration shall further be given to changes in the municipal environment that may have an impact on the municipal cash

position, which includes:

- (a) Changes in revenue levels as a result of consumption patterns by consumers;
- (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; and
- (f) Impact of Covid 19 pandemic on future investments and reserves.

5.9. The following funds, reserves, liabilities and provisions shall be cash-backed in determining the funding of the budget:

- (a) Unspent conditional grants;
- (b) Housing development fund;
- (c) Unutilised loans received;
- (d) Loan repayments due;
- (e) Provision for environmental rehabilitation;
- (f) Employee benefit obligation for post-retirement medical aid;
- (g) Provision for long service awards;
- (h) Consumer deposits;
- (i) Provision for leave;
- (j) Capital replacement reserve; and
- (k) Working capital (to be equal to budgeted fixed operating expenditure divided by 12).

5.10. The municipality shall strive to ensure that all provisions being provisions for environmental rehabilitation, employee benefit obligation for provision for environmental rehabilitation, post-retirement medical aid, provision for long service awards and provision for leave is 75% cash backed, with the remaining liabilities indicated in the above-mentioned paragraph being 100% cash backed.

## **6. PROJECTED REVENUE AND COLLECTIONS**

6.1 Anticipated billing on property rates is in terms of the Municipal Property Rates Act, which is based on property valuation roll. All property values as per the municipal valuation roll shall be subjected to the proposed rates randages for the budget year under consideration.

6.2 In order to ensure that the rand values on the sources of funding are realistic, the average collection rates based on previous financial year trends, for the various revenue streams shall be determined, taking into account the current economic environment.

6.3 When budgeting for collections on receivables, the anticipated budget for collections shall be determined by applying the average collection rates to the budgeted opening balances and billing for receivables for the year.



- 6.4 Where revenue relates to direct cash transactions, these shall not be billed to debtors, and therefore the revenue should be based on past collection levels, taking into account any estimated changes in application of municipal policies and current economic environment for the respective revenue sources.
- 6.5 Anticipated transfers and subsidies shall be budgeted to be received by the municipality based on the Division of Revenue Act allocations as well as written agreements with Provincial Government and other related organisations.

## **7. PROVISION FOR REVENUE NOT TO BE COLLECTED**

- 7.1 The municipality shall budget on a yearly basis per financial year for revenue that may not be collected from debtors.
- 7.2 Free basic services on services and property rates rebates shall be budgeted for in accordance with the municipality's adopted tariff policy and indigent policy.
- 7.3 The budgeted free basic services provided in accordance with the legislative frameworks shall be funded via the Equitable Share of the municipality.
- 7.4 The budgeted free basic services provided, in addition to the legislative requirements, shall be funded via the Equitable Share and/or the respective revenue source being provided by the municipality.
- 7.5 The municipality shall further provide for debtors that may not be able to meet their obligations. These estimates shall be based on the assumptions and methodologies adopted in the municipality's debt impairment policy.

## **8. PROCEEDS ON INVESTMENTS AND INTEREST EARNED**

- 8.1 The budgeted interest on investments and bank accounts shall be determined based on the anticipated interest to be earned on the current account and investments of surplus funds, taking into account the current interest rates.
- 8.2 The interest earned on investments and bank accounts may be utilised to fund operational expenditure or capital acquisitions required by the municipality, and is dependent on the realisation of the anticipated funds.
- 8.3 In accordance with the National Treasury Project Summary Document for implementation of mSCOA, investment proceeds may be utilised to fund capital acquisitions where the municipality has established a cash backed reserve in accordance with this policy, and has ring fenced the rand value of the reserve in an investment account dedicated for this purpose.

## **9. DIVIDENDS FROM MUNICIPAL ENTITIES**

- 9.1 Whilst the municipality has not established a municipality entity, or hold any obligations with related municipal entities, this section has been included in the policy, as required by the MBRR.
- 9.2 The municipality shall budget for dividends that are anticipated to be received from municipal entities, where required. These dividends shall be based on reliable estimates, taking into account past trends of the receipt of such dividends, as well as any anticipated changes due to economic conditions.
- 9.3 The funding of anticipated expenditure utilising dividend income to be received from municipal entities shall only be considered, once certainty on the collection of the dividend income has been determined.

## **10. PROCEEDS FROM THE DISPOSAL AND/OR TRANSFER OF ASSETS**

- 10.1 The municipality shall budget for anticipated revenue to be realised on the disposal, sale or transfer of assets where Council has resolved for such to occur.
- 10.2 The anticipated revenue shall only be included in the budget once reliable estimations are received and the timing for the sale of the assets are determined.
- 10.3 The funding of operational expenditure using the proceeds from the disposal, sale or transfer of assets shall only be committed once the funds have been received.

## **11. EXTERNAL BORROWINGS**

- 11.1 External borrowings may only be considered as a funding source for capital projects and the lifespan is not anticipated to be less than the redemption term of the envisaged external loan.
- 11.2 The municipality shall budget for anticipated borrowings, including the interest and redemption payments to be incurred on such borrowings in terms of the MTREF framework.
- 11.3 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%

## **12. FUNDING OF RESERVES**

12.1 In accordance with GRAP, the municipality provides for various non-cash provisions and contributions such as, but not limited to:

- (a) Depreciation, amortisation and impairment on assets
- (b) Contribution to long service and employee benefit provisions
- (c) Contribution to refuse site rehabilitation provision

12.2 In accordance with prudent financial management practice to enable to municipality to fund future capital and long term provision expenditure, the municipality shall establish the following reserves;

**(a) Capital Replacement Reserve**

This reserve is to be used for future capital expenditure from own funds only and may be used for maintenance or other operating expenditure. The capital replacement reserve must be cash-backed.

**(b) Employee Benefit Reserve**

The aim to the reserve is to ensure sufficient cash resources are available for the future payment of employee benefits.

**(c) Non-current Provision Reserve**

The aim to the reserve is to ensure sufficient cash resources are available for the future payment of non-current provisions.

12.2 Contributions to the reserves shall be provided in the annual budget which shall be determined based on the availability of uncommitted cash available. However, the municipality shall endeavour to contribute a minimum of 50% of the non-cash provision to the reserve.

12.3 The reserves shall be cash backed, with the cash being ring fenced in a dedicated bank account and utilised for this purpose.

## **13. HOUSING DEVELOPMENT FUND**

13.1 In terms of the Housing Act, 1997 all proceeds from housing developments which include rental income and sale of houses must be paid into the Housing Development Fund.

13.2 Monies standing to credit of the Housing Development Fund can be used only to finance housing developments within the municipal areas subject to the approval of the Provincial MEC responsible for housing.

- 13.3 In order to ensure compliance with GRAP, all revenue to be received related to the Housing Development Fund and expenditure to be incurred that shall be funded from the Housing Development Fund, shall be budgeted for as revenue and expenditure respectively, with the surplus/deficit resulting from these transactions being transferred to the Housing Development Fund via the Statement of Net Assets in the Annual Financial Statements.

#### **14. UNFUNDED MANDATES**

- 14.1 When determining funding for an annual budget, the municipality shall determine whether the function being provided is core or non-core to the municipality.
- 14.2 Core Functions provides for the matters in terms of sections 156 (1) of the Constitution. These are functions performed by local government and constitutionally assigned to local government in terms of Part B of Schedule 4 and Part B of Schedule 5 of the Constitution.
- 14.3 Non-core Functions refers to the functions performed by local government that are constitutionally assigned to provincial government in terms of section 156(4) of the Constitution.
- 14.4 The municipality shall endeavour to be compensated or reimbursed for delivering these functions on behalf of provincial government.
- 14.5 The municipality shall assess, prior to approval of the budget, as to whether all non-core functions are adequately funded via external revenue to the municipality, and to identify potential unfunded mandates.

#### **15. CAPITAL EXPENDITURE AND ACCELERATION OF PROJECTS**

- 15.1 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. It provides for the eradication of infrastructural backlogs, renewal and upgrading of existing infrastructure, new developments and enlargement of bulk infrastructure.
- 15.2 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) External Borrowings;
  - (c) Capital Government grants and Subsidies;
  - (d) Realistically budgeted operational revenue set aside for capital projects

15.3 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:

- (a) Infrastructure projects to service new developments and the revenue received through the sale of stands/land/site must be allocated to the capital reserve for services;
- (b) 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 funded 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;
- (c) Capital projects to replace and/or upgrade existing assets will be allocated to the capital replacement reserve;

15.2 Capital spending and acceleration may only incur on a capital project in instances where:

- (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 have 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.

## **16. APPLICATION OF THE FUNDING TO MSCOA**

16.1 The implementation of mSCOA requires the allocation of funding sources at a data string level to the budget of the municipality.

16.2 The Fund Segment of mSCOA shall reflect the underlying principle in recording of transactions to determine whether transact cash based or funds available to utilise.

16.3 The Funding segment's structure distinguishes between "Operational, Capital and Non-Funding Transactions":

- (a) **Operational:** Operational revenue provides for funds from all other sources of income such as taxes, service charges, commercial services, transfer and subsidies, etc.
- (b) **Capital:** Funds to finance capital projects.
- (c) **Non-funding Transactions:** This is items that does not relate to a cash transaction.

16.4 Non-cash transactions shall be indicated as non-funding transactions.

## **17. POLICY REVIEW**

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

## **18. POLICY ADOPTION**

18.1 This policy has been considered and approved by the COUNCIL OF UMDONI MUNICIPALITY as follows:

Resolution No.....

Approval Date: