THABO MOFUTSANYANA District Municipality

FUNDING AND RESERVES POLICY

March 2022

1. DEFINITIONS AND ABBREVIATIONS

"IDP" means the Integrated Development Plan of the Thabo Mofutsanyana District, which sets out the strategic and budget priorities adopted by the Council of the Thabo Mofutsanyana District in terms of section 25(1) of the Municipal Systems Act.

"MBRR" means the Municipal Budget and Reporting Regulations made in terms of section 168 of the MFMA (Act No. 56 of 2003);

"MFMA" means the Local Government Municipal Finance Management Act No 56 of 2003.
"Municipal Systems Act" means the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000).

"MTREF" means Medium Term Revenue and Expenditure Framework, as prescribed by the MFMA. It sets out indicative revenue and projected expenditure for the budget year, plus two outer financial years.

2. PROBLEM STATEMENT

Regulation 8 of the MBRR states that each municipality must have a funding and reserves policy.

3. FOCUS AREA

Thabo Mofutsanyana District Municipality has adopted Strategic Objectives that will support its programs to meet the government priorities.

These key priorities are as follow:

- Sustainable infrastructures
- Local Economic Development, Job creation and Tourism
- Agriculture and Rural Development,
- Social Development, Sports, Arts and Culture
- Good Governance and Community Participation
- Financial viability

This policy supports the following strategic focus area and objective:

Operational sustainability

This objective is about delivering services and creating value for community in an operationally sustainable manner based on evidenced led decision making so that the district can remain financially stable and resilient to shocks in a changing environment.

4. ROLE PLAYERS AND STAKEHOLDERS

In order to give effect to the policy, the following role players including their respective powers, duties and responsibilities are listed below:

Budget Department - Review the policy and strategy, in consultation with relevant stakeholders, to ensure maximum compliance in terms of legislation.

Directorates and departments - Inform the Budget department of any matters which may influence this policy.

Council - Responsible for the approval of the policy.

5. REGULATORY CONTEXT

Section 18 of the MFMA states: 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 the capital budget referred to in section 17 (2).

Section 19 of the MFMA states: A municipality may spend money on a capital project only if– the money for the project, excluding the cost of feasibility studies conducted by or on behalf of the municipality, has been appropriated in the capital budget referred to in section 17(2); the project, including the total cost, has been approved by the council; section 33 has been complied with, to the extent that that section may be applicable to the project; and the sources of funding have been considered, are available and have not been committed for other purposes.

Before approving a capital project in terms of subsection (1) (b), the council of a municipality must consider – the projected cost covering all financial years until the project is operational; and the future operational costs and revenue on the project, including the municipal tax and tariff implications.

Section 21 (1) of the MFMA states that the Mayor of a municipality must –

Co–ordinate the processes for preparing the annual budget and for reviewing the municipality's integrated development plan and budget related policies to ensure that the tabled budget and any revisions of the integrated development plan and budget-related policies are mutually consistent and credible

Regulation 8 of the MBRR states that:

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 revenue which will not be collected
(c) the funds the municipality can expect to receive from investments;
(d) the dividends the municipality can expect to receive from the transfer or disposal of assets;
(e) the proceeds the municipality can expect to receive from the transfer or disposal of assets;
(f) the municipality's borrowing requirements; and
(g) the funds to be set aside in reserves.

6. PURPOSE

This policy intends to set out the assumptions and methodology for estimating the following:

- The funds the municipality can expect to receive from investments
- The proceeds the municipality can expect to receive from the transfer or disposal of assets
- The municipality's borrowing requirements; and
- The funds to be set aside in reserves

7. POLICY DIRECTIVE DETAILS

Projected billings, collections and direct revenue are prepared in accordance to the following annual approved Council policies:

The Credit Control and Debt Collection policy is required in terms of Chapter 9 of the Municipal Systems Act and Section 62 (f) of the MFMA. The objective of the Credit Control and Debt

7.1 Collection Policy is as follows:

Focus on providing standardised credit control procedures and mechanisms; provide standardised collection procedures to enforce payments of all outstanding debt as raised on the debtor's account, provide provisions for indigent debtors that is consistent with the Rates and Tariff policy promote a culture of good payment habits amongst debtors and instill a sense of responsibility towards the payment of accounts and reducing municipal debt, subject to the principles provided for in this Policy, use innovative, cost effective, efficient and appropriate methods to collect as much of the debt in the shortest possible time without any interference in the process; and effectively and efficiently deal with defaulters in accordance with the terms and conditions of this policy.

7.2 The funds the municipality can expect to receive from investments.

Thabo Mofutsanyana District has a Cash Management and Investment Policy which purpose is to secure the sound and sustainable management of Thabo Mofutsanyana District's surplus cash and investments. The budget for investment income is calculated by considering the timing of anticipated inflows and outflows of cash during the year as well as the interest earned on the expected cash balances of reserves to be backed by cash.
The dividends the municipality can expect to receive from municipal entities. This is not applicable to the Thabo Mofutsanyana District as no dividends are received.
The proceeds the municipality can expect to receive from the transfer or disposal of assets.

This methodology is governed by the Asset Management Policy, the Supply Chain Management Policy and the Immovable Property Asset Management Policy and Framework.

7.3 The municipality’s borrowing requirements.

Borrowing is done in terms of the Thabo Mofutsanyana District’s Borrowing Policy. The annual borrowing requirements for the budgeted year are determined in accordance with the Thabo Mofutsanyana District’s cash flow requirements. Borrowing requirements over the MTREF is annually included in the Thabo Mofutsanyana District’s approved budget.

The following funds are required to be set aside in reserves.
The Thabo Mofutsanyana District creates and maintains reserves in terms of specific requirements, namely:

7.4 Capital Replacement Reserve (CRR).

In order to finance the acquisition of property, plant and equipment and other assets from internal sources, cash amounts are transferred from the accumulated surplus to the CRR.

The following guidelines are set for the creation and utilization of the CRR:
The cash funds that back up the CRR are invested until utilised;

The CRR may only be utilised for purchasing items of property, plant and equipment, and not for their maintenance, unless otherwise directed by Council; and

Whenever an asset is purchased out of the CRR, an amount equal to the cost price of the asset is transferred from the CRR, and the accumulated surplus is credited by a corresponding amount.

7.5 Insurance reserves Self-insurance reserve

A general insurance reserve has been established and covers claims that may occur, subject to reinsurance where deemed necessary. Premiums are charged to the respective services, taking into account the claims history and replacement value of the insured assets.

Compensation for occupational injuries and diseases (COID) reserve The COID Act requires the Thabo Mofutsanyana District to deposit cash and/or securities with the Commissioner, the market values of which in aggregate shall not be less than the capitalised value of the Thabo Mofutsanyana District’s continuing liability as at 31 December each year.

7.6 Debt Management

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

7.7 Cash Management

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

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

- Reduced growth as a result of economic conditions;
- Increase in non-payment rate due to economic conditions or political reasons; and
- Implementation of electricity industry pricing policy (inclining block tariffs). 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.

7.8 Operating Budget

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:-

- Trading services (services that generate predetermined surpluses that can be used to fund other services rendered by the Municipality);
- Economic services (services that should at least break-even, but do not necessarily generate any surpluses to fund other services rendered by the Municipality);
- Rates and General (services that are funded by property rates, government grants or surpluses generated by the trading services).

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.

The operating budget is funded from the following main sources of revenue:-

- Government grants and subsidies;
- Other sundry revenue, such as fines, interest received etc; and

- Cash backed accumulated surpluses from previous years not committed for any other purposes.

The following guiding principles apply when compiling the operating budget:-

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).;

Growth parameters must be realistic taking into account the current economic conditions;

- Tariff adjustments must be realistic, taking into consideration affordability, bulk increases and future projected growth according to the approved Integrated Development Plan (IDP);

- Revenue from government grants and subsidies must be in line with allocations gazetted in the Division of Revenue Act and Provincial Gazettes;

- 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 signed service level agreement; a contract or written confirmation; or any other legally binding document.

- 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;

- 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;

- 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:-

- 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. Refuse removal services:- the actual number of erven receiving the service per category; and actual revenue collected in previous financial years. 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.

- 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;

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

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.

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.

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.

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.

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.

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.

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

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.

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:-

Cash backed accumulated surpluses;
Borrowings;
Government grants and subsidies;
Public donations and contributions; and
Operating revenue.

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

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.

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.
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.

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%.

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; (to be considered)

- Capital projects to replace and/or upgrade existing assets will be allocated to the Capital Replacement Reserve; (to be considered)
- Capital projects to upgrade bulk services will be allocated to the Capital Bulk Contributions Reserve for each service. (to be considered)

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

- The money for the project has been budgeted (excluding feasibility study cost.
- The project, including the total cost, has been approved by Council.
- Compliance with section 33 (contracts with future budgetary implications) to the extent that the section may be applicable to the project.
- The sources of funding have been considered, are available and have not been committed for other purposes.

Before approving a capital project the Council must consider:-

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

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

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

- Additional personnel cost to staff new facilities once operational;
- Additional contracted services, such as security, cleaning etc.
- Additional general expenditure, such as services cost, stationery, telephones, material etc.
- Additional other capital requirements to operate the facility, such as vehicles, plant and equipment, furniture and office equipment etc.
- Additional costs to maintain the assets;
- Additional interest and redemption in the case of borrowings;
- Additional depreciation charges;

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

9. PROVISIONS

A provision is recognized 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.

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

The Municipality should have the following provisions:-

Leave Provision

Liabilities for annual leave are recognized 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.

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.

Post-Employment Medical Care Benefits

The Municipality does not provides post-retirement medical care benefits by subsidizing the medical aid contributions to retired employees and their legitimate spouses

10. OTHER ITEMS TO BE CASH BACKED

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. IMPLEMENTATION, EVALUATION AND REVIEW

This policy framework is important for the financial compliance of the Thabo Mofutsanyana District. It provides for an administrative guidance for the Funding and Reserves management
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In terms of section 17(3)(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.

Changes in legislation must be taken into account for future amendments to this policy. Any amendments to this policy must be re-submitted to council for review and approval.