CITY OF

uMHLATHUZE

VISION INTO ACTION

FUNDING AND RESERVES POLICY

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ABBREVIATIONS

AO Accounting Officer

ASB Accounting Standards Board
CFO Chief Financial Officer
CRR Capital Replacement Reserve
GRAP Generally Recognised Accounting Practise
IDP Integrated Development Plan
MFMA Municipal Finance Management Act
MSA Municipal Systems Act
VAT Value Added Tax
SDBIP Service Delivery and Budget Implementation Plan

1. DEFINITIONS

In this Policy, unless the context otherwise indicates, a word or expression to which a meaning has been assigned in the Local Government: Municipal Finance Management Act, 2003 (Act No 56 of 2003), has the meaning so assigned, and:

"Accounting Officer" – means the City Manager and vice versa;

"Act" – means the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003);

"Chief Financial Officer" – means an officer of the Municipality, designated by the City Manager to be administratively in charge of the financial affairs of the municipality;

"Council" or "Municipality" – means the Municipal Council of City of uMhlathuze as referred to in Section 18 of the Municipal Structures Act;

"Creditor" – in relation to a municipality, means any person or service provider to whom money is owing by the Municipality;

"Debt" – means –

(a) a monetary liability of obligation created by a financing agreement, note, debenture, bond, overdraft or the issuance of municipal securities; or
(b) a contingent liability such as that created by guaranteeing a monetary liability or obligation of another.

"Delegatee" – means an official / person delegated to perform tasks on behalf of another person;

"Financial Statement" – means statements consisting of at least –
(a) a balance sheet (statement of financial position);
(b) an income statement (statement of financial performance);
(c) a cash-flow statement;
(d) statement of comparison of budget and actual amounts
(e) notes to the financial statements

"Financial year" – means a period of twelve months ending on the 30 June;

2. BACKGROUND

The Local Government: Municipal Finance Management Act No 56 of 2003 (*hereafter MFMA*) section 18 requires that 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 capital projects.

Section 19 of the MFMA also requires 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 Local Government: Municipal Finance Management Act No 56 of 2003 Municipal Budget and Reporting Regulations, 2009 Section 8 requires that each Municipality should have a Funding and Reserves Policy.

3. OBJECTIVES

The objectives of the policy relating to funding and reserves are as follows:

(a) To comply with the legislative requirements;

(b) To ensure that the Municipality's Operating and Capital budgets are adequately funded;

(c) To ensure that the Municipality's reserves are maintained at the required levels, in order to mitigate unfunded liabilities in future financial years; and

4. POLICY AMENDMENT

The AO must–

(a) at least annually review the implementation of this Policy; and

(b) when the AO considers it necessary, submit proposals for the amendment of this Policy to the Council.

The review of this policy and any amendment should be made with due consideration and in conjunction with the annual review of the budget related policies as prescribed in the Municipal Budget and Reporting Regulations, 2008.

5. RELATIONSHIP WITH OTHER POLICIES

This policy needs to be read in conjunction with other relevant adopted policies of the municipality, including the following:

- Cash Management and Investment Policy
- Borrowing Policy
- Insurance Policy

6. PRINCIPLES REGARDING THE FUNDING OF THE ANNUAL BUDGET

6.1 An annual budget may only be funded from:-

6.1.1 Realistically anticipated revenues to be collected;

6.1.2 Cash backed accumulated funds from previous years surpluses and reserves not committed for any other purpose; and

6.1.3 Borrowed funds but only for the capital budget.

6.2 Realistic anticipated revenue projections must take into account:-

6.2.1 Projected revenue for the current year based on collection levels to date; and

6.2.2 Actual revenue collected in previous financial years.

6.3 Spending on a capital project may only occur if:-

6.3.1 The money for the project, excluding the cost of feasibility studies, has been appropriated in the budget;

6.3.2 The project, including the total cost, has been approved by Council;

6.3.3 The sources of funding have been considered, are available and have not been committed for other purposes;

6.3.4 Council has considered:-

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

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

7. FUNDING THE OPERATING BUDGET

7.1 The operating budget provides funding to departments for their medium term expenditure as planned.

7.1.1 The Municipality categorises services rendered to the community according to its revenue generating capabilities as follows:-

7.1.2 Trading services (services that generate predetermined surpluses that can be used 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 The operating budget is funded from the following main sources of revenue:-

7.2.1 Property rates;

7.2.2 Service charges;

7.2.3 Government grants and subsidies;

7.2.4 Other sundry revenue, such as fines, interest received etc.

8. FUNDING THE CAPITAL BUDGET

8.1 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. 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:-

8.1.1 Cash backed accumulated surpluses;

8.1.2 Borrowings;

8.1.3 Government grants and subsidies;

8.1.4 Public donations and contributions; and

8.1.5 Operating revenue.

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

8.2.1 Government grants and subsidies:-

8.2.1.1 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;

8.2.2 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:-

8.2.2.1 A signed service level agreement;

8.2.2.2 A contract or written confirmation; and/or

8.2.2.3 Any other legally binding document.

8.2.4 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. As far as possible, the borrowing funding must be utilized for assets with a longer life span so that the term of the loan is aligned to these assets.

8.2.5 Allocations to capital projects from cash backed capital replacement reserve will be based on the available funding for each financial year as determined in the reserves section of this policy.

9. CAPITAL REPLACEMENT RESERVE

Funding for capital budgets of future financial years are generated through contributions from the operating budget. This reserve once fully established will enable the Municipality to provide internal funding for its capital replacement and renewal programme.

9.1 SOURCES OF INCOME FOR THE RESERVE

Income allocated to the Capital Replacement Reserve will arise from:

- Sale of property plant equipment (Predominantly land sales);
- Engineering contributions ;
- Depreciation of assets after taking into account loan redemption;

9.2 METHODOLOGY FOR FAIR AND TRANSPARENT SPLIT BETWEEN DEPARTMENTS

- Alienation of land income will be allocated solely to Rates and General Services. Principle reasoning here due Trading Services been profit orientated and self-sufficient compared to the various Departments falling under Rates and General. In addition, equitable share grants are allocated solely to the trading services. Split within Rates and General Services will be based on the proportion of the departments cost of assets as per the Assets Register.

- For the purposes of this Policy only, due to their permanent capital requirement needs, the Information Technology and Communications and the Fleet Services Departments will not be considered as support departments, but rather as Municipal Service Departments under Rates and General Services.

- The capital split between the service departments is based on a 50/50 weighting of Cost of Assets and gross income. Departments funded by Rates will be separately allocated funding based solely on their cost of Assets.

- Engineering Contributions will be allocated per Department from which such contributions arise;

- The cash backed component of accumulated surplus will be split on the basis of Total Income, excluding capital and operating grant Income, from each Department with both Electricity and Water Departments having there total income being net of Electricity and Water purchase costs respectively (Gross Income). Within Rates and General Services the further split will be based on the same methodology as per first bullet above;

9.3 BUDGETING FOR CAPITAL REPLACEMENT RESERVE

- Budgeting will based on the principle of previous plus current financial years reserve accumulations, with a maximum appropriation of 80% of the total balance. i.e. if R100m anticipated accumulated reserve, a maximum of R80m will be put in the Budget for the ensuing year;
- At commencement of the financial year in which the budget is to be spent the Chief Financial Officer (CFO) must ensure that the funds are cash backed before such funds are expensed;
- At the commencement of the Departments Budgeting Cycle in August each year the CFO will notify the Departments through the Annual Budget Policy of the anticipated CRR that will be available for budgeting purposes.

9.4 CASH LINKED TO THE CAPITAL REPLACEMENT RESERVE

The accumulated CRR must be ring-fenced in a separate Municipal bank account to reflect:

- Current CRR – This balance will reflects the amount available for the current year capital budget on approved by council less any current spending to date;
- Future CRR – This balance will reflects the accumulated funds on a proportional basis month to month in line with the cash and working capital policy.

9.5 ACCOUNTING FOR THE CAPITAL REPLACEMENT RESERVE

- The equity balance of the reserve is reflected in a separate general ledger account (GL 9000000200) and presented as a sub-reserve under accumulated surplus in the financial statements.
- The equity contribution to the capital replacement reserve will be a transfer out of accumulated surplus into the reserve.
- The reserve will be reduced based on the actual spending against it and a transfer from the reserve into accumulated surplus will be made.

10. SELF-INSURANCE RESERVE

The self-insurance reserve is set aside for managing risk of specified assets internally and not through the broker and underwriter. The determination of assets to be insured internally through self-insurance is done annually by the Chief Financial Officer. Currently, all fleet and plant with the cost price below a value determined by the Chief Financial Officer annually are under self-insurance excluding third partly liability.

10.1 SOURCES OF INCOME FOR THE RESERVE

Income allocated to the Self-Insurance Reserve will arise from:

- Sale of property plant equipment (Predominantly land sales);
- Depreciation of assets after taking into account loan redemption.

10.2 BUDGETING FOR SELF-INSURANCE RESERVE?

- An amount determined annually by the Chief Financial Officer is allocated to the self-insurance reserve from internally generated funds.
- This amount covers both insurance incident repairs and replacement;
- The budget split into: repairs (operational) is 40% and for replacements (capital) is 60% of the total annual amount.
- The Chief Financial Officer reviews the self-insurance amount and the split annually.

10.3 CASH LINKED TO THE SELF-INSURANCE RESERVE

The self-insurance reserve funds are ring-fenced in a same bank account as the capital replacement reserve.

10.4 ACCOUNTING FOR THE SELF-INSURANCE RESERVE

- The equity balance of the reserve is reflected in a separate general ledger account (GL 9000000500) and presented as a sub-reserve under accumulated surplus in the financial statements.
- The equity contribution to the self-insurance reserve will be a transfer out of accumulated surplus into the reserve.
- The reserve will be reduced based on the actual spending against it and a transfer from the reserve into accumulated surplus will be made.

11. POLICY IMPLEMENTATION

This policy will effective as from 1 July 2024.