BITOU MUNICIPALITY

LIQUIDITY, FUNDING AND RESERVES POLICY

DRAFT REVIEW SUBMITTED TO COUNCIL 31 MARCH 2017

(POLICY PREVIOUSLY APPROVED BY COUNCIL 30 JUNE 2016 PER RESOLUTION C/3/152/06/16)

INDEX

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Date: July 2014

Summary: This document describes the Liquidity, Funding and Reserves Policy that will be applicable to the municipality, detailed.

Approved: This policy was approved by the Municipal Council on ……...

Signature: ________________ **Date**: _______________

Municipal Manager

LIQUIDITY, FUNDING AND RESERVE 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 liquidity funding as well as reserves requirements.

The documented Liquidity, Funds and Reserves Policy, sets out the framework for the prudent use of Liquidity, Funds and Reserves available to the municipality.

This policy is implemented to provide guidance on the appropriation of capital funding resources on a sustainable basis in the longer term.

With reference to the applicable legislation as referred to below. Legislation exists and prescribes the framework of Funds and Reserves Policy and these factors will all be addressed in this Policy.

Although legislation provides guidance as to the broader framework to ensure financial management of resources to ensure the Council meets all of its obligations timeously, it is not prescriptive with regards to quantifying not only the prudent level of Liquidity, Funds and Reserves but more so the optimal level hereof.

Therefore in this Policy cognizance has been taken of the legislative guidelines whilst more prescriptive guidelines are set for the optimal management and monitoring of resources to the Municipality’s avail based on sound financial practices.

2. SECTION A: LIQUIDITY POLICY

2.1 <u>INTRODUCTION</u>

The documented Liquidity Policy sets out the minimum risk management measures that Bitou Municipality has to implement and adhere to in order to ensure that its current and future liquidity position is managed in a prudent manner.

Liquidity is the amount of cash and / or “near cash” (which refers to assets or security that can easily and quickly be converted to cash), available to be utilized to meet obligations and / or pay commitments. The marketability or ability to buy or sell an asset without incurring unacceptable large losses thus determines the liquidity of an asset or defines it as near cash.

This Policy is implemented to provide guidance on the minimum liquidity level that Bitou Municipality has to maintain in order to comply with required legislative and / or National Treasury directives and within the overall financial management objectives as approved/reviewed by the Council from time to time.

2.2 BACKGROUND AND APPROACH

Various policies and procedures exist that direct the way in which the business of Bitou Municipality is or should be conducted in a prudent manner. Generally these policies and procedures flow from the prescription made in Legislation i.e. the Municipal Finance Management Act ("MFMA") and/or directives issued by a national department such as National Treasury.

Guidelines provided by National Treasury indicate that an acceptable level of cash resources needs to be available for working capital requirements (see below).

It is for this reason that the need to have an official Liquidity Policy was identified.

2.3 LEGISLATIVE REQUIREMENTS

3.1. The MFMA circular 71 stipulates the following two prescribed ratios to manage liquidity:

Cash/Cost Coverage Ratio (Excluding Unspent Conditional Grants) is calculated as:
((Cash and Cash Equivalents - Unspent Conditional Grants - Overdraft) + Short Term Investment) / Monthly Fixed Operational Expenditure excluding (Depreciation, Amortisation, Provision for Bad Debts, Impairment and Loss on Disposal of Assets)

Criteria: 1 – 3 times

Current Ratio Current Assets / Current Liabilities

Criteria: 1.5 - 2:1

The above guidelines are noted but the proposed policy is more conservative to ensure that the municipality secures its strong financial position thereby providing comfort to investors.

2.4 POLICY

This policy provides guidance on the determination of the minimum liquidity requirement and the calculation of the liquidity available of Bitou Municipality from time to time (see Appendix 1).

Notwithstanding the requirements as reflected in this policy, Bitou Municipality should ensure that its Current Assets (excluding debtors older than 90 days) cover all of its Current Liabilities at least two times.

The policy encapsulates certain key aspects and considerations which have been outlined below:

2.4.1 KEY COMPONENTS OF MINIMUM LIQUIDITY REQUIRED:

The following constitutes the key elements to take into consideration when determining the liquidity requirement of Bitou Municipality:

1) To comply with statutory requirements it is proposed that the following funds, reserves and provisions be fully covered by unencumbered cash and investments:
   a) All earmarked or conditional grant transfers from spheres of Government or from Public Contributions made to Bitou Municipality that have not yet been utilized;
   b) All commitments resulting from the legally entrenched rights and benefits employees have, with specific reference to the Council's short term commitment to staff retirement benefits and medical fund claims payable;
   c) All funds not yet been utilized in relation to agency services provided on behalf of Provincial or National Government should also be treated as earmarked funds;
   d) All reserves stated by Bitou Municipality on its Statement of Financial Position that have been established for the purposes of making provisions for a defined purpose.
2) Cognisance also needs to be taken of the external loan commitments and the servicing of capital and interest on these loans. Therefore provision should be made that Bitou Municipality can meet its external loan/financial commitments together with the normal operational expenditure, as well as its liabilities to staff.
3) All investments ceded as security against long term loans need to be excluded from total cash and investment balances for calculation of the minimum liquidity level required.
4) All unspent long term loans need to be excluded from total cash and investment balances for calculation of the minimum liquidity level required.
5) In addition, a level of cash available for normal operational expenditure needs to be held in cash to ensure that, notwithstanding fluctuations in the monthly income levels of Bitou Municipality, Bitou Municipality will be in a position to

meet its financial requirements. In this respect, the average monthly operational expenditure needs to be used as a guide of the minimum buffer required. One month's operational expenditure excluding debt impairments, depreciation and other non-cash expenses should be available for liquidity cover.

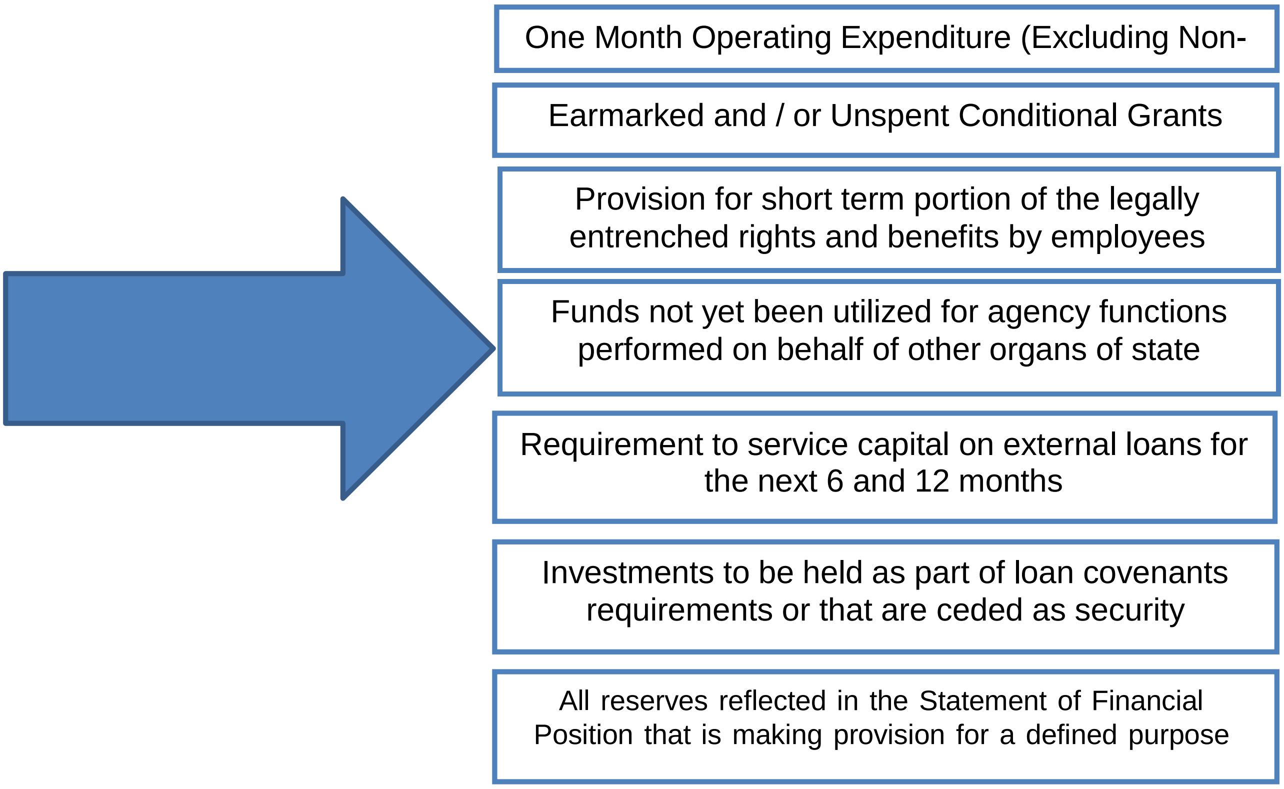
6) The "golden rule" should be to ensure that Bitou Local Municipality will have adequate liquid assets (those that can be made into cash within 24 hours, weekly or monthly as the requirement might be) to meet its short term financial commitments.

2.4.2 CALCULATION OF AVAILABLE LIQUIDITY

The amount of liquidity available should be determined from time-to-time. The following, should be regarded as cash and or near cash in calculating the available liquidity:

1) All cash held in a bank account or invested with a money market fund;
2) 95% of the value of all NCD's or other tradable instruments issued by a bank that are not already ceded;
3) 90% of the market value of all listed bonds on the JSE in which Bitou Municipality is allowed to invest in;
4) Consumer debtors aged current to 60 days;
5) Amount of unspent conditional grants and public contributions excluded from own funds held in bank accounts;
6) Funds provided to Council for expenditure on activities executed on behalf of other spheres of Government (Provincial and / or National) as part of an agency function, excluded from own funds held in bank accounts;
7) Funds ring-fenced for cash backed reserves that are excluded from own funds held in bank accounts;
8) Cash amounts that need to be held by Council resulting from loan covenants' that are part of the conditions of loans extended, but not ceded outright to lenders;
9) The undrawn portion of unconditional bank overdraft facility or liquidity facility available to Bitou Municipality.

The aforementioned in paragraphs 2.4.1. and 2.4.2. can schematically be reflected as follows:



2.4.3 IMPLEMENTATION AND MONITORING OF COMPLIANCE WITH LIQUIDITY POLICY:

Once the policy is approved, the CFO is to be tasked to ensure that the required cash has to be maintained to continue meeting the requirements as set out in this policy.

Firstly, the minimum required liquidity level should be calculated based on audited annual financial statements. This level of liquidity required needs to be specifically budgeted for and on a quarterly basis be reported to the Finance Committee and / or other Committees as might be stipulated by Council as well as to Council.

Notwithstanding National Treasury's three months operational expenditure guideline and the one month operational expenditure buffer proposed as a minimum by the liquidity policy, it is recommended that Council set a target of one month's operational expenditure liquidity buffer to be achieved at the end of the transitional period.

The cash provisions made to repay external loan commitments, if specifically earmarked, should also be added to this minimum working capital liquidity, to prevent fluctuations in the working capital reserve that could put the minimum level of liquidity levels under pressure.

3. SECTION B: FUNDING POLICY

3.1 LEGISLATIVE REQUIREMENTS

The Local Government Municipal Budget and Reporting Regulation, Regulation 393, published under Government Gazette 32141, 17 April 2009 stipulates:

8. (1) 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 that 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 municipal entities;
(e) the proceeds the municipality can expect to receive from transfer or disposal of assets;
(f) the municipality's borrowing requirements;
(g) the funds to be set aside in reserves.

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

- Cash backed accumulated funds from previous years' surpluses not committed for other purposes:

Transfers from the accumulated surplus to fund operating expenditure will only be allowed for specific once-off projects with no recurring operating expenditure resulting thereof.

- Borrowed funds, but only for capital projects:

Actual capital expenditure may only be incurred on a capital project if the funding for the project has been appropriated in the Capital Budget, but has also been secured from the financial source that is not committed for another purpose.

- Realistically anticipated revenues to be collected:

  Realistic anticipated revenue projections must take into account projected revenue for the current year based on actual collection levels in previous financial years.

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 therefore 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.

3.2 STANDARD OF CARE

Each functionary in the budgeting and accounting process must do so with judgment and care, under the prevailing circumstances, as a person of prudence, discretion and intelligence would exercise to the management of his or her own finances with the primary objective of ensuring that the objectives of this policy are achieved.

3.3 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, provided that the requirements of the MFMA must at all times be adhered to.

3.4 CASH MANAGEMENT

Cash must be managed in terms of the municipality's Cash Management and Investment Policy.

3.5 DEBT MANAGEMENT

Debt must be managed in terms of the municipality's Debt Management Policy, together with any requirements in this policy.

3.6 FUNDING THE OPERATING BUDGET

3.6.1 INTRODUCTION

The municipality's objective is that the user of municipal resources must pay for such usage in the period it occurs.

The municipality however, recognises the plight of the poor, and in line with national and provincial objectives, the municipality commits itself to subsidised services to the poor. This will necessitate cross subsidisation in tariffs to be calculated in the budget process.

3.6.2 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 as it must be included in changes in Cash and Cash Equivalents and Payables.

   Furthermore, in the budget the total grants recognised as revenue must equal the total expected expenditure from grants, inclusive of capital expenditure and VAT as per directive given in MFMA circular 48.

e) Revenue from public contributions, donations or any other grants may only be included in the Budget if there is acceptable documentation that guarantees the funds and if the transfers are unconditional of nature.

f) Projected revenue from services charges must be reflected as net (all billing less revenue foregone, which is free basic services, discounts and rebates).

g) Projected revenue from property rates must include all rates to be levied, but rebates and discounts must be budgeted for as either revenue foregone or a grant, as per directive in MFMA Budget Circular 51, depending on the conditions of the exemption, rebate or reduction.

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

h) Provision for revenue that will not be collected is made against the expenditure item bad debt and based on actual collection levels for the previous financial year and the reasonably projected annual non-payment rate.

i) 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. The actual amount allocated for interest on investments is to be contributed to the Capital Replacement Reserve.

j) Only changes in fair values related to cash may be included in the cash flow budget. Changes to unamortised discount must be included in the Operating Budget but excluded in the cash flow budget.

k) A detailed salary budget is compiled on an annual basis. All funded positions are budgeted for in total as well as new and/or funded vacant positions. As a guiding principle the salary budget should not constitute more than 35% of annual Operating Expenditure.

l) 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, and it is therefore determined that provision for the short term portion of employee benefits, as well as an operating surplus calculated at 5% of the prior year balance of the long–term benefits, be included in the operating budget, in order to build sufficient cash for these requirements. The cash portion of the employee benefits must be accounted for in an "Employee Benefits Reserve".

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

In order to ensure a sufficient accumulation of cash for the replacement of Property, Plant and Equipment and Intangible Assets, the amount of depreciation on assets funded from own sources, excluding assets funded from grants, public contributions and external loans must be reflected as a surplus on the cash flow budget.

n) A provision is recognised 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.

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

p) The Municipality should have the following provisions:

- Leave Provision

Liabilities for annual leave are recognised 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 to be cash backed.

- Landfill Rehabilitation Provision

The landfill site rehabilitation provision is created for the current operational site at the future estimated time of closure. The value of the provision is based on the expected future cost to rehabilitate the landfill site. This provision must be cash backed to ensure availability of cash for rehabilitation on closure. This provision must be 100% backed by cash.

- 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 must be cash backed.

- Post-Employment Medical Care Benefits

The Municipality provides post-retirement medical care benefits by subsidizing the medical aid contributions to retired employees and their legitimate spouses. The entitlement to post-retirement medical benefits is based on employees remaining in service up to retirement age and the completion of a minimum service period. The expected cost of these benefits is accrued over a period of employment. This provision must be 80% cash backed to ensure the availability of cash for the payment of medical aid payments.

It is therefore a requirement that all provision be backed by cash, the contribution to all current provisions be set at 70%.

q) The annual cash flow requirement for the repayment of borrowings must fully be taken into consideration with the setting of tariffs.

r) Sufficient provision must be made for the maintenance of existing infrastructure based on affordable levels. The maintenance budgets are normally lower than the recommended levelsAs a guiding principle repair and maintenance should constitute between 5% and 8% of total operating expenditure and should annually be increased incrementally until the required targets are achieved.

s) Individual expenditure line items are to be revised each year when compiling the budget to ensure proper control over expenditure.

3.7 FUNDING THE CAPITAL BUDGET

3.7.1 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.

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.

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.

3.7.2 FUNDING SOURCES FOR CAPITAL EXPENDITURE

The capital budget can be funded by way of own contributions, grants, public contributions as well as external loans. The capital budget is also limited by the availability and access to these sources of funding.

Own Contributions

The capital budget financed from own contributions must primarily be funded from the Capital Replacement Reserve.

Notwithstanding the above the capital budget or portions thereof may also be funded from surplus cash. The allocations of the funding sources from own contributions are 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.

It is therefore determined that the accounting officer must evaluate the long term effect of unusual capital grants on future tariffs, and if deemed necessary, report on such to Council.

It is furthermore determined that the 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 must put such accounting measures in place to comply with this requirement, to a reasonable extent.

Only Government Gazetted 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.

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 has been received by the municipality already.

External Loans

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

The Accounting Officer must also put such accounting measures in place to ensure that no unspent portions of loans are utilised for operating purposes.

For budgeting purposes any difference between proposed capital spending from loans and proposed loans raised must be included in the cash surplus for the year.

All capital projects have an effect on future operating budget therefore the following additional cost factors should be considered before approval:

a) Personnel cost to staff new facilities once operational;
b) Contracted services, that is, security, cleaning etc.;
c) General expenditure such as services cost, stationery, telephones, material etc.;

d) Other capital requirements to the operate facility such as vehicles, plant and equipment, furniture and office equipment etc.;
e) Costs to maintain the assets;
f) Interest and redemption in the case of borrowings;
g) Depreciation charges;
h) Revenue generation as the additional expenses incurred may be offset by additional revenue generated to determine the real impact on tariffs.

3.8 FUNDING COMPLIANCE MEASUREMENT

3.8.1 INTRODUCTION

The municipality wants to ensure that the budget or 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 reconciliations according to this policy. Any additional indicators recommended by National Treasury in future must also be taken into account, as well as any additional reconciliation items as either determined by the Council or the Accounting Officer.

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

3.8.2 CASH AND CASH EQUIVALENTS AND INVESTMENTS

A positive Cash and Cash Equivalents position throughout the year is crucial. In addition, the forecasted cash position at year-end must at least be the amount as calculated in the Reconciliation of Cash Requirements as determined by the Liquidity Policy and attached to this policy as Appendix “A”.

3.8.3 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
- In addition, it must be sufficient to back reserves as approved by the municipality and the portions of provisions as indicated elsewhere in this policy.

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

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

3.8.5 SURPLUS/DEFICIT EXCLUDING DEPRECIATION OFFSETS

It is almost certain that the operating budget, which includes 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 the users of the assets funded from grants, public contributions and revaluations must be burdened with tariff increases to provide for such depreciation charges. In order to ensure a "balanced" budget but excluding such depreciation charges, the depreciation charges may be offset against the net surplus / deficit.

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

3.8.6 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 is realistically calculated.

The formula to be used is as follows:

	DESCRIPTION	**PROPERTY RATES**	**SERVICE CHARGES**	**TOTAL**
A	Revenue of budget year	R XX	R XX	R XX
B	Less: Revenue of prior year	R XX	R XX	R XX
C	**=Revenue increase/decrease**	**R XX**	**R XX**	**R XX**
D	% Increase/(Decrease)	C/B %	C/B %	C/B %
E	Less: Upper limit of macro Inflation target	%	%	%

F	**=Growth in excess of inflation target**	**%**	**%**	**%**
G	Less: Expected growth %	%	%	%
H	**=Increase attributed to tariff Increase above macro inflation target**	**%**	**%**	**%**

In the event that the percentage in (h) above is greater than zero, a proper motivation must accompany the budget at submission, or the budget must be revised.

3.8.7 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 than the rate currently being obtained, even if the municipality recently approved a debt collection policy or implemented additional debt collection measures. Any improvement in collection rates during the budget year may be appropriated in an Adjustment Budget.

3.8.8 DEBT IMPAIRMENT EXPENSE AS A PERCENTAGE OF BILLABLE REVENUE

This indicator provides information 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 might have an influence on it. Any difference, however, must be motivated in the budget report.

3.8.9 CAPITAL PAYMENTS AS A PERCENTAGE OF CAPITAL EXPENDITURE

This indicator provides information as to the timing for payments on capital projects and utilising allowed payment terms.

3.8.10 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 Debt Management Policy.

3.8.11 GRANTS REVENUE AS A PERCENTAGE OF GRANTS AVAILABLE

The percentage should never be less than 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.

3.8.12 CONSUMER DEBTORS CHANGE (CURRENT AND NON - CURRENT)

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

An unacceptable high increase in either current– or non– current debtors' balances should be investigated and acted upon.

3.8.13 REPAIRS AND MAINTENANCE EXPENDITURE LEVEL

It is of utmost importance that the municipality's Property Plant and Equipment be maintained properly, 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.

As a general benchmark the maintenance budget should be between 4% and 8% of the asset values.

3.8.14 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.

3.8.15 FINANCIAL PERFORMANCE BUDGET

Although it is not a legal requirement that the financial performance budget should balance, it only makes management sense that it should balance.

A number of line–items influence the net result of the financial performance budget. It includes capital grant revenue, depreciation charges including those where assets were funded from grants and public contributions, unamortised discounts and gains/losses on the disposal of Property Plant and Equipment. These items need to be taken into consideration in order to establish if the operating budget is realistic and credible.

3.8.16 FINANCIAL POSITION BUDGET

This indicator provides an overall view of the projected financial position over the periods of the Medium Term Expenditure framework, including movements in inventory and payables.

3.8.17 CASH FLOW BUDGET

A positive cash flow is a good indicator of a balanced budget, as well as the ability of the municipality to meet its future commitments.

The cash flow budget, however, does not include those items such as contributions to the provisions described elsewhere in this policy, the effect of depreciation charges etc, and care must be taken not to let a projected positive cash inflow lead to additional expenditure requests, without taking the requirements of those items into consideration.

4. SECTION C: RESERVES POLICY

4.1 INTRODUCTION

Fund accounting historically formed a huge part of municipal finance in the IMFO standards.

Since the municipality changed to General Recognised Accounting Practices (GRAP) fund accounting is no more allowed.

The municipality, however, 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.

This policy aims to provide for such measure of protection by creating certain reserves.

4.2 LEGAL REQUIREMENTS

There are no specific legal requirements for the creation of reserves, except for the Housing Development Fund. The GRAP Standards itself also do not provide for reserves.

However, the GRAP "Framework for the Preparation and Presentation of Financial Statements" states in paragraph 91 that such reserves may be created, but "Fund Accounting" is not allowed and any such reserves must be a "legal" reserve, i.e. created by law or Council Resolution.

4.3 TYPES OF RESERVES

Reserves can be classified into two main categories being "cash funded reserves" and "non – cash funded reserves".

4.3.1 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) Capital Replacement Reserve (CRR)

The CRR is to be utilised for future capital expenditure from own funds and may not be used for maintenance– or other operating expenditure.

The CRR must be cash–backed and the Accounting Officer is hereby delegated to determine the contribution to the CRR during the compilation of the annual financial statements.

The municipality endeavors to effectively utilise and maintain the Capital Replacement Reserve for the funding of capital replacement and renewal for future financial years. This reserve needs to be cash backed. This will provide the municipality with a more balanced capital funding approach in the longer term thereby reducing the risk of reaching its maximum gearing ability or depleting its free cash.

This Reserve can be generated as follows from the Operating Budget; the following methodology needs to be read in conjunction with the Liquidity Policy:

a) Cash generated from Operating Activities:
   a. The municipality has maintained a marginal ability to generate surplus operational cash flow which it has used to fund most of its capital spending in the past;
   b. Depreciation is a method to generate future cash. Therefore it is prudent to annually measure the cash coverage for depreciation charges to ensure it is fully funded from cash through tariff setting. Cash generated from depreciation is to be transferred to the Capital Replacement Reserve;
   c. As at year end it is to be determined whether the municipality meets its Minimum Liquidity Criteria as stipulated in the Liquidity Policy, excess cash in addition to this prescribed level is to be calculated and appropriated to the Capital Replacement Reserve and no more than 50% of the balance of the Capital Replacement Reserve as at year end should be allocated to the following year's capital budget unless sufficient recommendations are made to Council to substantiate such a decision.

b) Interest received on the investment made for the Capital Replacement Reserve

(b) **Employee benefits reserve**

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

The contributions to the reserve must be made in accordance with the directives set in this Funding Policy.

(c) **Non-current provisions reserve**

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

The contributions to the reserve must be made in accordance with the directives set in this Funding Policy.

(d) **Valuation reserve**

The aim of this reserve is to ensure sufficient cash resources are available to undertake a General Valuation as per the Municipal Property Rates Act.

The contribution to this reserve should be approximately 25% of the anticipated cost of the General Valuation and the Accounting Officer is hereby delegated to determine this amount annually during the compilation of the annual financial statements.

(e) **Other 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.

4.3.2 NON – CASH FUNDED RESERVES

It might be necessary to create non – cash funded reserves for a variety of reasons, including GRAP requirements. The Accounting Officer must create any reserves prescribed by the accounting standards, such as the Revaluation Reserve, if required.

The Accounting Officer is hereby delegated and may also in the discretion of the Accounting Officer, create reserves for future depreciation offsetting, in the absence of a standard similar to IAS 20.

4.4 ACCOUNTING FOR RESERVES

4.4.1 REVALUATION RESERVE

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

4.4.2 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.

5. SECTION D: REVIEW OF THE POLICY

This Funding and Reserves Policy is the only policy of the municipality and replaces any past policies in this regard. Any revision of the policy must be approved by the Municipal Council.

Whenever the Minister of Finance or the National Treasury or the Auditor – General requests changes to the policy by way of legislation, changes to GRAP or otherwise, it must be reviewed and submitted for consideration by the Council on an annual basis. Such submission must be accompanied with a full description of the reasons for the change to the policy.

5.1.1 CORPORATE GOVERNANCE (OVERSIGHT)

Compliance with the various stipulations as documented in this Borrowing, Funds and Reserves Policy need to be monitored by the Chief Financial Officer and reported on to the Municipal Manager on a monthly basis and to the Finance/Audit Committee on a quarterly basis.

Where compliance has been breached the Chief Financial Officer must present an action plan to correct the non-compliance. The Finance Committee must monitor the successful implementation of the corrective action plans and report progress to Council.

5.1.2 TRANSITIONAL ARRANGEMENT

Upon adoption of this policy by the Council, the Municipal Manager in conjunction with the Chief Financial Officer must determine the current performance levels of the municipality against this Policy and present a plan of action towards achieving and maintaining the stipulation as set out in this policy thereby utilising a more blended funding mix for capital infrastructure investment.
The Council must approve an appropriate timeframe within which the municipality must achieve the approved stipulations as set out in this Policy. The period between the date of the policy adoption by Council and the target date for compliance shall be known as the Transitional Period.

The Finance Committee must report progress during the approved Transitional Period to the Council.

5.1.3 POLICY MANAGEMENT

The Borrowing, Funds and Reserves Policy forms part of the municipality overall financial objectives and therefore forms part of approved Budget Policies. The policy must be reviewed at least annually during the budget revision and presented to Council for approval. The Policy is effective from the date it is approved by Council.

APPENDIX 1: Liquidity Requirement as per Liquidity Policy

Financial Year End: ___________________________

Liquidity Requirement Calculation [as stipulated in Paragraph 2.4.1.]

All earmarked and/or conditional grants received but not yet utilised	
Value of legally entrenched short term rights and benefits of employees related to Medical benefits & Retirement benefits	
Funds held for agency services not yet performed	
Funds held for unspent long term loans	
Reserve funds reflected in Statement of Financial Position that are assumed to be held in cash	
Capital redemption and interest payments on external loans not reflected as part of normal operational expenditure	
1 month operational expenditure excluding non-cash items	
Commitments resulting from contracts concluded as part of Capex Programme, not reflected in operational budget	
TOTAL LIQUIDITY REQUIREMENT	

Actual available liquidity held [reference paragraph 2.4.2.]

Bank Balance at e.g.: - ABSA, FNB, Standard Bank, Nedbank, Investec, Money Market	
Bank balance sub total	
95% of all other term investments with Banks	
90% of Market value of all Bonds on the JSE that are held	
Consumer debtors (current – 60 days)	
Other reserves held in cash not reflected in bank balances mentioned above for e.g.:	
- Unspent conditional grants	
- Payments received for agency functions not yet performed	
- The cash value of reserves held	
- Cash deposits held as part of loan covenants or ceded	
- Undrawn bank overdraft facility or committed liquidity lines available or unspent loans	
TOTAL LIQUIDITY AVAILABLE	

LIQUIDITY SURPLUS (SHORT FALL) ________________

SURPLUS TO BE APPROPRIATED TO CAPITAL REPLACEMENT RESERVE ________________

Liquidity ratio: Current Assets/Current Liabilities ________________