# UBUHLEBEZWE LOCAL MUNICIPALITY

## FUNDING AND RESERVES POLICY

**Financial Year:** 2022/23

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## 1. INTRODUCTION

1.1 The Funding and Reserves Policy is aimed at;

- Ensuring that the Municipality has sufficient and cost-effective cash funding;
- Ensuring that provisions and reserves are maintained at the required level to avoid future year unfunded liabilities;
- Ensure the achievement of the Municipality objectives through the implementation of its operating and capital budgets.

1.2 This policy is mandated by section 8 of the Local Government: Municipal Budget and Reporting Regulations.

## 2. PURPOSE

2.1 This policy sets outs the assumptions and methodology for estimating the following: -

2.1.1 Projected billings, collections and all direct revenues;

2.1.2 The provision for revenue that will not be collected based on past trends and payment rates;

2.1.3 The funds the Municipality can expect to receive from investments;

2.1.4 The proceeds the Municipality can expect to receive from the transfer or disposal of assets;

2.1.5 The Municipality's borrowing requirements; and

2.1.6 The funds to be set aside in reserves.

## 3. GUIDING PRINCIPLES

3.1. The Funding and Reserves Policy is based on the following principles: -

*3.1.1 Credibility*

- Planned Activities must be consistent with the IDP and vice versa.
- Financial viability of municipality should not jeopardise.
- Ensure Capacity to spend the budget.

*3.1.2 Sustainability*

- Ensure financial sustainability / overall financial health of Municipality.
- Revenue / Expenditure budgeted must be realistic.

3.1.3 *Responsiveness*

- To the needs of the community / public.
- Alignment of IDP, LED Strategies with Budget to give effect to provincial and national priorities.
- Budget must be responsive to economic growth objectives and the socioeconomic need of the community.

*3.1.4 Affordability*

- Tariffs must not be increased unreasonably and consumers must be able to afford tariffs.

**4. <u>FUNDING OF THE ANNUAL BUDGET</u>**

4.1. An annual budget may only be funded from: -

4.1.1 Realistically anticipated revenues to be collected;

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

4.1.3 Borrowed funds but only for the capital budget.

4.1.4 Gazetted Grant Funding

4.2. Realistic anticipated revenue projections must take into account: -

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

4.2.2 Actual revenue collected in previous financial years.

4.3. Spending on a capital project may only occur if: -

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

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

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

4.3.4 Council has considered: -

(a) The projected cost covering all financial years until the project is operational; and

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

## 5. DEBT MANAGEMENT and CREDITORS PAYMENTS

Debt Management

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

5.1.2. 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.

**Creditors payments**

5.2.1 Due to the high bank charges with regard to cheque payments, it is essential to limit the payment of creditors to one payment per creditor per month. Exceptions for more than one payment per month, authorised by the Chief Financial Officer, with regard to emerging contractors can however be made, should the cash position allow for it. Should the facility be available, payments should be done by electronic transfer – subject to strict control measures.

5.2.2 When considering the time to pay a creditor, proper consideration must be given to the conditions of credit terms of payment offered:

- In cases where a cash discount is given for early settlement, the discount, if the relevant time scale is taken into account, must be more than any investment benefit that could be received from temporarily investing the funds.
- If discounts are offered for early settlement they must be properly considered and utilised.

5.2.3 Besides this, the normal conditions of credit terms of payment offered by suppliers, must also be considered and utilised to the full by paying on the due date and not earlier

## 6. CASH AND INVESTMENT MANAGEMENT

6.1. The availability of cash is one of the most important requirements for financial sustainability and must be closely monitored to ensure a minimum cash day on hand of ninety (90) days for daily operations.

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

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

6.2.2 Reduced GDP growth as a result of economic conditions;

6.2.3 Increase in non-payment rate due to economic conditions;

6.2.4 Implementation of electricity industry pricing policy (inclining block tariffs).

6.2.5 Other economic conditions (global recession, inflation, high levels of unemployment, etc.)

6.3. Surplus cash not immediately required for operation purposes is invested to maximise the returns on the investments.

6.3.1 Legal Requirements

6.3.1.1 The way in which surplus funds and other municipal funds can be invested, is controlled in terms of legislation:

- GRAP 9;
- Local Government Municipal Finance Management Act 2003, Act No 56 of 2003, section 13(1);
- Municipal Finance Management Act 2003: Municipal Investment Regulations

6.3.1.2 The Minister, acting with the concurrence of the Cabinet member responsible for local government, may prescribe a framework which municipalities must –

(a) Conduct their cash management and investments; and

(b) Invest money not immediately required. Invest only with –

- Deposits with banks registered in terms of the Banks Act, 1990 (Act No. 94 of 1990);
- Securities issued by the National Government;

- Deposits with the Public Investment Commissioners as contemplated by the Public Deposits Act, 1984 (Act No. 45 of 1984);
- Deposits with the Corporation for Public Deposits as contemplated by the Corporation of Public Deposits Act, 1984 (Act 46 of 1984);
- Listed corporate bonds with an investment grade rating from an internationally recognized credit rating agency;
- Bankers, acceptance certificates or negotiable certificates of deposits of banks registered in terms of the Banks Act, 1990 (Act 94 of 1990);
- Guaranteed endowment policies with the intention of establishing a sinking fund;
- Repurchase agreements with banks registered in terms of the Banks Act, 1990 (Act 94 of 1990);
- Any other instruments or investments in which a Municipality was under a law permitted to invest before the commencement of the Local Government Transition Act, 1996: Provided that such instruments shall not extend beyond the date of maturity or redemption thereof; and
- Any other investments determined by the Minister of Finance and published in the Government Gazette.
- Municipal bonds issued by a Municipality.

6.3.2 Cash Flow Estimates

6.3.2.1 Before money can be invested, the Chief Financial Officer must determine whether there will be surplus funds available during the term of the investment. He/she must fix the term of the investment.

6.3.2.2 In order to be able to make investments for any fixed term, it is essential that cash flow estimates be drawn up.

6.3.2.3 When drawing up cash flow estimates, it is essential that the Chief Financial Officer take note of the following:

- Be aware of the expected cash flow and when it is likely to take place, as well as the timing with regard to cash outflow, as far as both the operating and the capital budgets are concerned;
- By utilising the available information and expertise, the Chief Financial Officer or his/her delegate must assess the timing with regard to when, for how long and the amount to be invested; and

- Daily cash flow estimates must provide for daily call investments and investment withdrawals, whereas long-term investments must be based on projections further into the future.

6.3.3 From time to time the Council will have surplus funds available which are not needed immediately and which could be invested. Depending on circumstances some funds could be invested for a long term whilst others would only be short-term investments. Surplus funds in the current account may also be invested for short periods (days).

6.3.4 Generally investments are done every month when prior investments mature and funds are available for re-investment. Investments may be made by the Chief Financial Officer as follows:

6.4 Investment Ethics

The following ethics must apply when dealing with financial institutions and other interested parties:

6.4.1 The Municipal Manager and Chief Financial Officer will be responsible for the investment of funds, and he/she has to steer clear of outside interference, regardless of whether such interference comes from individual Councillors, agents or any other institution.

6.4.2 Under no circumstances may he/she be forced or bribed into making an investment. No official may accept any gift unless that gift can be deemed so small that it would not have an influence on his/her work or was not intended to do so, and can merely be seen as goodwill. A certificate in respect of the gift should be furnished to the Chief Financial Officer. The gift should not be in lieu of a commission.

6.4.3 The Chief Financial Officer must act according to his/her discretion and must report any serious cases of payment in kind or gifts, to the Municipal Manager. Excessive gifts and hospitality should however be avoided.

6.4.4 **Interest rates offered should never be divulged to another institution**.

6.5 Investment Principles

6.5.1 Exposure to a single institution:

Money, especially large sums of money, must be invested with more than one institution, in order to limit risk exposure of the Municipality. All available funds should not be placed with a single institution, the invested amount should, where possible, be spread equally to all relevant institutions. If legislation permits, the Chief Financial Officer must try to plan the distribution of the investments to cover different types of investments.

6.5.2 Risks and return

It can be accepted as a general rule that the larger the return, the greater the risk.

6.5.3 Borrowing money for re-investment

The Municipality may not borrow money for reinvestment, as this would mean interest rates would have to be estimated in advance, which can be seen as speculation with public funds.

6.5.4 Registered Financial Institutions

If the Chief Financial Officer invests with financial institutions, he/she must ensure that such institutions are registered in terms of the Banks Act 94 of 1990 and that they are approved financial institutions – as approved by the Reserve Bank, from time to time. An updated list of the approved financial institutions should be obtained regularly.

6.5.5 Growth-related Investments

When making growth-related investments, the Chief Financial Officer must obtain a guarantee that at least the capital amount invested is safe, and must exercise due diligence in this regard.

6.5.6 A Municipality may make an investment only if the investment is denominated in Rand and is not indexed to, or affected by, fluctuations in the value of the rand against foreign currency.

6.6 Investment of Funds by the Municipality:

6.6.1 The investment register must be examined on a fortnightly basis to identify investments falling due within the two weeks following and start the investment process such as looking at alternatives, cash flow requirements and timeous reporting to the Municipal Manager and Council.

6.6.2 Prior to the investment of monies, the Chief Financial Officer, must determine whether there will be surplus funds available, as well as to fix the term for which such money should be invested.

6.6.3 In order to be able to make investments for any fixed term, it is essential that cash flow forecasts be drawn up.

6.6.4 In the instance surplus funds are available for investment, the Chief Financial Officer should contact the various banking institutions for interest rate quotations and prepare a manual or computerised list of the quotations indicating the amounts to be invested, the rates quoted and the maturity values (maximum return).

6.6.5 Based on the results of 6.5.4 above, and the value of the prospective investment, the Chief Financial Officer should, authorise the investment. All relevant information must be filed together with the investment documentation.

6.7 Call Deposits and Fixed Deposits

6.7.1 Quotations should be obtained from a minimum of three financial institutions bearing in mind the limits of the term of which it is intended to invest the funds.

6.7.2 Quotations must be obtained electronically, otherwise per facsimile, as rates can generally change on a regular basis and time is a determining factor when investments are made. It is however prudent to obtain written (e-mail acceptable) quotations**. No quotes received after closing date** and time may be considered. The person responsible for requesting quotations from institutions must record the following:

- Name of institution;
- Name of person quoting rates;
- Closing date and time;
- Period of the investment;
- Relevant terms; and
- Other facts i.e. are interest payable monthly or on maturation date.

6.7.3 Once the required number of quotes has been obtained, a decision must be taken regarding the best terms offered and the institution with which funds are going to be invested. The best offer must under normal circumstances be accepted, with thorough consideration of investment principles. The Chief Financial Officer must note any deviation if such best offer is not accepted.

6.7.4 If institutions have been asked for a quotation with regard to a specific package, the institution must be requested to give the best rate in their quotation.

6.7.5 The above procedure must be followed for all investments.

6.7.6 The Chief Financial Officer must make sure that the investment document received is a genuine document, issued by an approved institution, and the investment capital must be paid over only to the institution with which it is to be invested and not to an agent.

## 6.8 Other External Deposits

Other investment possibilities, which are subject to the applicable legislation and are available to the Municipality, include debentures and other securities of the state as well as other municipalities or statutory bodies in the Republic, instituted under and in terms of any law. With regard to such investments, the principles and practices set out above must apply.

## 6.9 Controls over Investments

6.9.1 An investment register must be kept of all investments made. The following facts must be indicated:

- Name of institution
- Type of investment
- Capital invested
- Capital withdrawn
- Date invested
- Term of investment
- Interest rate
- Maturation date
- Interest earned
- Interest received
- Interest capitalised

The investment register and accounting records must be reconciled on monthly basis.

6.9.2 The investment register must be examined on a fortnightly basis to identify investments falling due within the next two weeks. It must then be established as what to do with the funds bearing in mind the cash flow requirements.

6.9.3 Interest, correctly calculated, must be received timeously, together with any distributable capital. The Chief Financial Officer must check that the interest is calculated correctly.

6.9.4 Investment documents and certificates must be kept in a safe place. The following documents must be safeguarded:

- Confirmation letter of funds transferred to the financial institution.
- Receipt for capital invested
- Copy of electronic transfer or cheque requisition
- Excel schedule of comparative investment figures
- Commission certificate indicating no commission was paid on the investment and
- Interest rate quoted

6.9.5 The Chief Financial Officer is responsible for ensuring that the invested funds are secure and, should there be a measure of risk, that such risk be rated realistically.

6.10 General Investment Practice

6.10.1 General

After determining whether there is cash available for investment and fixing the maximum term of investment, the Chief Financial Officer must consider the way in which the investment is to be made. As rates can vary according to money market perceptions with regard to the terms of investment, quotations must be requested electronically, within term limitations, and these must be set out on a schedule.

6.10.2 Commission Certificate

The Auditor General requires the financial institution, where the investment is made, to issue a certificate for each investment made. This certificate must state that no commission has, nor will, be paid to any agent or third party, or to any person nominated by the agent or third party.

6.10.3 Reports:

6.10.3.1 The Council must be given a monthly report on all borrowings and investments. With specific reference to:

(a) Borrowings: (For each individual loan)

- Name of institution
- Date of initial borrowing/loan received (in respect of existing loans)
- Balance beginning of month
- Loans received during month
- Loans redeemed during month

- Balance at end of the month
- Interest rate
- Interest paid during month
- Maturity date
- Type of loan
- Total amount

(b) Investments: (For each individual investment)

- Name of Institution invested with
- Date of investment
- Type of investment
- Period of investment
- Interest rate
- Maturity date
- Interest earned during month
- Balance of investment at beginning of month
- Investments made during month
- Investments withdrawn during month
- Balance of investments at end of the month
- Allocation of investments to reserves and other funds
- Source of investment
- Appropriation of investment

6.10.3.2 The Municipality must within 30 days after an investment with currency of 13 months or longer has been made, publish in a local newspaper in circulation within its area of jurisdiction, full details of any investments so made.

6.10.3.3 (1) Reporting Requirements

The accounting officer of a Municipality or municipal entity must within 10 working days of the end of each month, as part of the section 71 report required by the Act, submit to the mayor of the Municipality or the board of directors of the municipal entity a report describing in accordance with the generally recognised accounting practise the investment portfolio of that Municipality or municipal entity as at the end of the month.

6.10.3.4 (2) The report referred to in sub (1) must set out at least –

(a) the market value of each investment as at the beginning of the reporting period

(b) any changes to the investment portfolio during the reporting period

(c) the market value of each investment as at the end of the reporting period and

(d) fully accrued interest and yield for the reporting

6.10.4 Cash in the Bank

6.10.4.1 Where money is kept in current accounts, it would be possible to bargain for more beneficial rates with regards to deposits, for instance call deposits. Fixed term deposits can increase these rates.

6.10.4.2 The most important factor is that the cash in the current account must be kept to an absolute minimum and must be closely monitored to ensure a minimum cash day on hand of ninety (90) days for daily operations.

6.10.5 Cash worthiness

When investments are placed with smaller registered institutions, the Chief Financial Officer has to see to it that the Municipality is not exposed to too much risk. He/she has to ensure that the creditworthiness and performance of the institution are to his/her satisfaction, before investing money in the institution. The Chief Financial Officer is entitled to information from which the creditworthiness of financial institutions can be determined. This must be obtained and analysed annually.

6.10.6 GRAP

It is of utmost importance that the Chief Financial Officer applies GRAP in the compilation of the budgets and financial statements of the Municipality as well as the financial systems in use.

6.10.7 Performance Measurement

Measuring the effectiveness of council's treasury activities is achieved through a mixture of subjective measures. The predominant subjective measure is the overall quality of treasury management information. Objective measures include:

- Adherence to policy
- Timely receipt of interest income

6.11 Investment Managers

If the council will benefit from it, it is permitted to make use of Investment Managers as defined in the Municipal Investment Regulations.

6.12 Oversight role of council

6.12.1 The council reserves its right to maintain oversight over the implementation of this Policy.

6.12.2 For the purposes of such oversight the accounting officer must –

(a) ensure that the policy, or any necessary amendments to the policy, are tabling in the council by the applicable deadline specified in terms of Section 21(1) (b) of the MFMA

(b) whenever there are serious and material problems in the implementation of this Policy, immediately submit a report to the council.

## 7. OPERATING BUDGET

7.1. 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 in terms of the Budget Implementation and Management Policy.

7.2. 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: -

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

7.2.2 Provision for revenue that will not be collected is made against the expenditure item working capital/debt impairment and is based on actual collection levels for the previous financial year and the latest projected annual non-payment rate.

7.2.3 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.

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

## 8. CAPITAL BUDGET

8.1 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: -

8.2.2 In the case of public contributions, donations and/or other grants,

8.2.4 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: -

(a) 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;

(b) Infrastructure projects to service new developments and the revenue received through the sale of erven must be allocated to the Capital Reserve for Services;

(c) Capital projects to replace and/or upgrade existing assets will be allocated to the Capital Replacement Reserve; and

(d) Capital projects to upgrade bulk services will be allocated to the Capital Bulk Contributions Reserve for each service.

8.3. In accordance with Section 19 (1) of the MFMA, the Municipality may spend money on a capital project only if: -

8.3.1 The money for the project has been budgeted (excluding feasibility study cost.

8.3.2 The project, including the total cost, has been approved by Council.

8.3.3 Compliance with section 33 (contracts with future budgetary implications) to the extent that the section may be applicable to the project.

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

## 9. RESERVES

9.1. To ensure that funding is readily available for future development and the timeous replacement of Infrastructure responsible for service delivery it will be prudent for the Municipality to create dedicated reserves that are cash backed at all times.

9.2. All Reserves are "ring fenced" as internal reserves within the accumulated surplus, except for provisions as allowed by the General Recognised Accounting Practices (GRAP).

9.3. The following ring-fenced reserves should be established and cash backed over a period of time: -

9.3.1 *Capital Reserve for New Developments*

This reserve will be used to fund capital expenditure to service new developments. Each development is ring fenced within this reserve. The value determines the price for the erven to be sold and the revenue generated through the sale of erven is then allocated to the specific development. This reserve must be cash backed at all times to ensure the availability of cash to fund the capital expenditure required to service the erven.

9.3.2 *Capital Replacement Reserve*

Funding for capital budgets of future financial years are generated through contributions from the operating budget. Once the Municipality has reached its maximum gearing ability no further borrowings can be taken up. This necessitates that the Municipality also invests in a capital replacement reserve. However, it must be cash backed. This reserve once fully established will enable the Municipality to provide internal funding for its capital replacement and renewal programme.

Other contributions to the capital replacement reserve through the operating budget may include interest received on investments.

9.3.3 *Bulk Capital Contribution Reserves*

This reserve is intended to supplement capital expenditure for the necessary expansions and upgrading of bulk infrastructure due to new developments. Revenue generated through bulk services contributions are allocated to this reserve for each applicable service. This reserve must also be cash backed at all times.

## 10. <u>PROVISIONS</u>

10.1 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.

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

10.3 The Municipality should have the following provisions:

### *10.3.1 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 8 days of leave provision is cash backed.

### *10.3.3 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, none of the long service leave provision is cash backed.

### *10.3.4 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. A portion of the provision must be cash backed to ensure the availability of cash for the payment of medical aid payments.

### *10.3.5 Performance bonuses – employee benefits*

The provision for performance bonuses that will be paid one year in arrear as the assessment of the Section 56 employees had been taken place. This provision must be cash backed to ensure the availability of cash for the payment of performance bonuses.

## 11. <u>OTHER ITEMS TO BE CASH BACKED</u>

11.1. *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.

11.2. *Consumer Deposits*

Consumer deposits are partial security for a future payment of an account. Deposits are considered a liability as the deposit is utilised on the account once the service is terminated. Therefore, the funds are owed to consumers and can therefore not be utilised to fund the operating or capital budget. Consumer deposits should be retained in cash. The consumer deposits are 100% cash backed.

## 12. <u>IMPLEMENTATION AND REVIEW OF THIS POLICY</u>

12.1. This policy shall be implemented once approved by Council.