

FUNDING AND RESERVES



POLICY, PROCESSES & PROCEDURES

RECOMMENDED

THAT the **Funding and Reserves Policy** and the contents thereof be tabled for approval at the Mayoral Committee.

Version Version 3.2021

Date March 2021

Document Name **Funding and Reserves Policy and Procedures**

Reviewed By

INTERNAL AUDITOR **Date:** _____

Supported By

ACTING CHIEF FINANCIAL OFFICER **Date:** _____

Signature

ACTING MUNICIPAL MANAGER **Date:** _____

Adopted by the Mayoral Committee

CHAIRPERSON **Date:** _____

Approved by the Council

Approved: A1532
1st Review: A1631
2nd Review A1927

RESOLUTION **Date:** _____

08 June 2016
31 May 2017
29 March 2019

Effective date **01 July 2021**

Next revision date **April 2022**

Contents

| | |
|--|----|
| 1. Policy..... | 4 |
| 1.1. Overview..... | 4 |
| 1.2. Purpose..... | 4 |
| 1.3. Objective..... | 5 |
| 1.4. Business Process Framework..... | 5 |
| 1.4.1 Legislative Framework..... | 5 |
| 1.4.2 Accounting Framework..... | 5 |
| 1.5. Recommendations..... | 5 |
| 2. Processes..... | 6 |
| 2.1 Operating Budget Processes..... | 6 |
| 2.2 Capital Budget Processes..... | 7 |
| 3. Procedures..... | 7 |
| 3.1 Allocation of Funds..... | 7 |
| 3.2 Multi-year budget and commitments..... | 8 |
| 3.3 Capital Budget relative to operating budget..... | 8 |
| 3.4 Funding..... | 8 |
| 3.4.1 Operating Budget..... | 8 |
| 3.4.2 Capital Budget..... | 9 |
| 3.5 Reserves..... | 9 |
| 3.6 Amendment and Review of the policy..... | 10 |
| Annexure A: GRAP 17 (IAS 16) Property, Plant and Equipment [PPE]:..... | 10 |

1. Policy

1.1. Overview

Sedibeng District Municipality has developed its funding and reserves policy to include activities at all departments at which municipality business is conducted. This in recognising its:

- i. community orientation; and
- ii. the need for good governance.

The funding and reserves policy is a transparent and codified internal control system aimed at promoting its core District Objectives to ensure that the limited resources at the disposal of Sedibeng District Municipality will be focused towards serving the various stakeholders in the pursuit of their interactions with Sedibeng District Municipality both efficiently and congruent to approved budgets and broader financial policies of Sedibeng District Municipality, whilst minimizing the temptation of misuse of municipality funds.

The policy is applicable to all Sedibeng District Municipality staff charged with discharging municipality related activities. It seeks to institutes the necessary control measures to facilitate the daily activity of the municipality by providing:

- i. A guideline for all stakeholders both internal and external;
- ii. An internal dynamic document detailing the processes required for the efficient discharge of duties to ensure the efficient administration of the Sedibeng District Municipality budgets

The policy is intended to provide a framework for Municipality's debt management and implement effective processes to sustain cash flow in a manner prescribed in the Municipal Finance Management Act, 2003 and National Treasury Regulations.

1.2. Purpose

- i. To ensure the operating and capital budgets of council are appropriately funded
- ii. To ensure that provisions and reserves are maintained at the required levels to avoid future year unfunded liabilities

- iii. To bring to life a Capital Replacement reserve so as to make provision for the replacement of assets at the end of their useful life.

1.3. Objective

The funding of the operating and capital budgets is done on an annual basis for a three year horizon and must be balanced both from an accounting perspective as well as a cash perspective in the budget.

1.4. Business Process Framework

1.4.1 Legislative Framework

The *Municipal Systems Act (No. 32 of 2000) (MSA)*, *Municipal Finance Management Act (MFMA) (No. 56 of 2003)*, the *King IV Code on Corporate Governance in South Africa (2016)* and other applicable legislation informs and seeks to regulate the provision of funding and the maintenance of adequate reserves..

1.4.2 Accounting Framework

The responsibility of making provision for funding and that adequate reserves be maintained lies with the Accounting Officer and Chief Financial Officer, or delegated official, who has to ensure that reasonable controls exist to support the implementation of policies. In delegating this function to subordinates, it does not alleviate the responsibility of the Chief Financial Officer. The HOD has to ensure all policies and procedures are communicated to and implemented by the responsible individual(s).

1.5. Recommendations

- i. This policy, processes and procedures document supersedes all previously issued references to funding and reserves;
- ii. This policy, processes and procedures document be recognised as providing the framework of operation and internal control mechanisms for all staff members of the municipality charged with funding and the provision and maintenance of reserves in a particular vote;

- iii. This policy document be adopted by the Executive Management and the broader Council of Sedibeng District Municipality as the framework for Funding and reserves.

2. Processes

2.1 Operating Budget Processes

The Operating Budget provides funding to departments for medium term expenditure. The Operating Budget is developed with certain guiding principles, including the following:

- 2.1.1 A Funded Budget is compiled on an annual basis.
- 2.1.2 Other income is charged in terms of the approved tariffs. The budget is compiled based on historic trends and adjusted for expected growth and or contraction in service levels.
- 2.1.3 Provision for revenue that will not be collected is made against the "Provision for bad debt" line item.
- 2.1.4 Interest from investment income is based on the actual long term investments that the municipality has, as well as the amount reasonably expected to be earned on cash amounts held during the year.
- 2.1.5 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).
- 2.1.6 It will be endeavoured to limit tariff increases to the annual inflation rate or the bulk purchases increases from Council's service providers. Any increases in excess of the above will be to fund additional capital expenditure to address service delivery backlogs and to upscale maintenance activities
- 2.1.7 A budget implementation circular is issued on an annual basis to provide guidance on the utilisation of the various line items in the operating budget
- 2.1.8 The Municipal Property Rates Act allows for assessment rates to be levied to fixed property within the municipal boundaries based on the latest approved valuation and subsequent rolls
- 2.1.9 Consumption based revenue flowing from electricity and water usage is billed at tariff rates fixed on an annual basis

- 2.1.10 Solid waste is linked to the erven size which receives the service and is based on historical trends
- 2.1.11 The budget compiled is net of Vat i.e. the position after vat has been accounted for
- 2.1.12 Offsetting of income relative to expenses is not permitted
- 2.1.13 A detailed salary budget is to be compiled annually and relative to the MTREF compilation. An amount is to be set aside to fund critical new positions identified on an annual basis – subject to the Municipal Manager buy in
- 2.1.14 Line items on the operating budget are to be reviewed annually to ensure proper controls

2.2 Capital Budget Processes

- 2.2.1 An annual capital budget will be developed as part of the annual budget. Expenditure on capital will be in terms of the annual capital budget. Provision on the annual capital budget will be limited to available internal and external funds.
- 2.2.2 Allocations made to departments from the available internal funding, will be determined by a Budget Panel.

3. Procedures

3.1 Allocation of Funds

Sedibeng District Municipality has huge service delivery backlogs, especially Infrastructure. Far more funds should be made available on an annual basis to eradicate then backlog. However, to provide services in an equitable and balanced manner throughout the community, certain other projects must also be implemented. Communities need the “softer services”, such as health facilities or sport and recreational facilities just as much as core infrastructure services.

This capital budget aims to stimulate job creation and economic growth by means of allocating funds towards the District development segment. Job creation will not only be addressed by the District development segment but also by all other segments in the execution of the capital budget. Certain projects will be executed in terms of the principles of the “Expanded Public Works Programme” to ensure maximum job creation.

Allocations made to departments from the available internal funding, will be determined by the Budget Steering Committee.

3.2 Multi-year budget and commitments

Departments are allowed to commit both the internal and confirmed external funds in accordance with the Multi-year budget

3.3 Capital Budget relative to operating budget

The fiscal effect of capital budgets on future operating budgets need to be accounted for. In this respect the following should be considered:

- 3.3.1 Additional staffing costs necessary for infrastructure operations
- 3.3.2 Additional services to maintain the newly completed infrastructure
- 3.3.3 Additional general expenditure for variable overhead costs
- 3.3.4 Additional maintenance costs
- 3.3.5 Additional non cash – depreciation charges
- 3.3.6 Additional interest and loan redemption costs to service capital raised whilst the above have to be noted, we have to account for additional revenue generation which gather the real effect of the proposed capital project.

3.4 Funding

3.4.1 Operating Budget

SDM categorises services rendered to the community according to its revenue generating capabilities:

Example:

| | | |
|---|--------------------------|--|
| 1 | <i>Trading services</i> | <i>Services that generate surpluses that can be used to fund other services rendered by the municipality</i> |
| 2 | <i>Economic services</i> | <i>Services that break-even, but do not generate any surpluses to fund other services rendered by the municipality</i> |
| 3 | <i>Other</i> | <i>Assessment based service levies, government grants and surpluses generated by trading services</i> |

The operating budget is thus funded from a funding mix of the following main sources of income:

| | |
|---|--|
| 1 | <i>Equitable Share</i> |
| 2 | <i>Trade Service Charges, fines, assessment based charges, consumption based service charges and sundry income</i> |
| 3 | <i>Other Government Grants</i> |

3.4.2 Capital Budget

The Capital budget is mainly funded from Direct Government Grants [*Contributions*] & Subsidies, External Loans, Donor Funding and Own Internal Funding ex surplus apportionment from the operating budget as well as indirect grants or donations from the general populous and business community.

3.5 Reserves

As required by GRAP, only provisions are shown separately on the face of the Statement of Financial Position. All reserves are “ring-fenced” as internal reserves within the Accumulated Surplus, and are as follows:

3.5.1 Assets fair value reserve

The Assets fair value reserve is not supported by cash but is only used for the phasing in of increased depreciation charges as a result of the full implementation of GRAP 17 – see Annexure A below.

3.5.2 Liquid Funds set aside in reserve, subject to affordability and retained to a maximum of 50% of surplus funds

3.5.3 Bulk contribution reserves (Electricity, Water and Sanitation, Roads and Parks)

3.5.4 Capital Replacement Reserve (to make provision for the renewal of assets posts their useful life)

3.6 Amendment and Review of the policy

The Funding and Reserves Policy shall be reviewed at the discretion of the CFO due to changing circumstances as a result of the legislation or otherwise.

Annexure A: GRAP 17 (IAS 16) Property, Plant and Equipment [PPE]:

[Source: KPMG Services (Pty) Ltd 2008]

RECOGNITION AND INITIAL MEASUREMENT

Recognise when it is probable that:

- The future economic benefits or service potential associated with the asset will flow to the entity; and
- The cost or the fair value of the asset that can be reliably measured.

Measurement:

- Initially recorded at cost
- Where an asset is acquired at no cost, or for a nominal cost, its cost is its fair value as at the date of acquisition.

Cost Comprises:

- Purchase price plus import duties and non-refundable taxes, net of trade discounts and rebates;
- Any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in a manner intended by management.
- The initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located
- May also include borrowing costs incurred on qualifying assets

MEASUREMENT SUBSEQUENT TO INITIAL RECOGNITION

Cost Model

The asset is carried at cost less accumulated depreciation and accumulated impairment

Depreciation

The depreciable amount (cost less residual value) should be allocated on a systematic basis over the assets useful life. The residual value, the useful life and the depreciation method of an asset should be reviewed at least at each financial year-end. Changes in residual value, depreciation method and useful life represent changes in estimates and are accounted for prospectively in accordance with GRAP 3 Accounting policies, changes in accounting estimates and errors. Depreciation is charged to surplus or deficit, unless it is included in the carrying amount of another asset. Depreciation begins when the asset is available for use.

The Revaluation Model

The asset is carried at a revalued amount, being its fair value at the date of the revaluation, less subsequent depreciation and subsequent impairment, provided that fair value can be measured reliably.

Revaluations should be carried out regularly (the carrying amount should not differ materially from its fair value at the reporting date). If an item is revalued, the entire class of PPE to which that asset belongs should be revalued. Revalued assets are depreciated the same way as under the cost mode. An increase in value is credited to a revaluation surplus unless it represents the reversal of a revaluation decrease of the same asset previously recognised in surplus or deficit; in this case the increase in value is recognised in surplus or deficit.

OTHER

Derecognition

Remove the asset from the statement of financial position on disposal/ when no future economic benefits or service potential are expected from its use or disposal. The gain or loss on derecognition is the difference between the net disposal proceeds, if any, and the carrying amount and should be recognised in surplus or deficit. When a revalued asset is disposed of, any revaluation surplus is transferred directly to accumulated surpluses or deficits. The transfer to retained earnings is not made through surplus or deficit.

Component Accounting

- Significant parts/components should be depreciated over their estimated useful life
- Costs of replacing parts should be capitalised and the existing parts being replaced should be derecognised

Heritage Assets

Choice to either:

- Recognise and therefore disclosure in terms of GRAP 17, not required to apply measurement criteria or
- Not recognise and show disclosure

DISCLOSURE

For each class of PPE disclose:

- Basis for measuring gross carrying amount;
- Depreciation method(s) used;
- Useful lives or depreciation rates;
- Gross carrying amount and accumulated depreciation and impairment losses;
- Reconciliation of the carrying amount at the beginning and the end of the period, showing:
 - + Additions, disposals, acquisitions through business combinations, revaluation increases, impairment losses, reversals of impairment losses, depreciation, net foreign exchange difference on translation and other movements
- Additional disclosure requirements in respect of revalued assets

| | |
|---|--|
| <p>Operating Budget Policies</p> <p>The Operating Budget provides FUNDING to departments for medium term expenditure. The Operating Budget is developed with certain guiding principles, including the following</p> | <p>The budget is compiled based on historic trends and adjusted for expected growth and or contraction in service levels.</p> <p>Provision for revenue that will not be collected is made against the "Provision for bad debt" line item</p> <p>Interest from investment income is based on the actual long term investments that the municipality has, as well as the amount reasonably expected to be earned on cash amounts held during the year</p> <p>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).</p> <p>A budget implementation circular is issued on an annual basis to provide guidance on the utilisation of the various line items in the operating budget</p> |
| <p>Capital Budget Policies</p> | <p>An annual capital budget will be developed as part of the annual budget. Expenditure on capital will be in terms of the annual capital budget. Provision on the annual capital budget will be limited to available internal and external funds.</p> <p>Allocations made to departments from the available internal funding, will be determined by a Budget Steering Committee</p> |

| <p>Allocation of Funds</p> | <p>Allocations made to departments from the available internal funding , will be determined by the Budget Steering Committee</p> <p>Multi Year Allocations</p> <p style="text-align: center;">DIRECTORATE-CAPITAL BUDGET</p> <table border="1" data-bbox="513 436 1466 926"> <thead> <tr> <th></th> <th>Directorate</th> <th>Core Functions</th> <th>Funding Mechanisms</th> </tr> </thead> <tbody> <tr> <td>1</td> <td>XXXX</td> <td>XXXX</td> <td>XXXX</td> </tr> <tr> <td>2</td> <td>XXXX</td> <td>XXXX</td> <td>XXXX</td> </tr> <tr> <td>3</td> <td>XXXX</td> <td>XXXX</td> <td>XXXX</td> </tr> <tr> <td>4</td> <td>XXXX</td> <td>XXXX</td> <td>XXXX</td> </tr> <tr> <td>5</td> <td>XXXX</td> <td>XXXX</td> <td>XXXX</td> </tr> </tbody> </table> | | Directorate | Core Functions | Funding Mechanisms | 1 | XXXX | XXXX | XXXX | 2 | XXXX | XXXX | XXXX | 3 | XXXX | XXXX | XXXX | 4 | XXXX | XXXX | XXXX | 5 | XXXX | XXXX | XXXX |
|-----------------------------------|--|--|---------------------------|--|---------------------------|--------------------------|--|----------|--------------------------|---|----------|--------------|----------------|----------|------|------|------|----------|------|------|------|----------|------|------|------|
| | Directorate | Core Functions | Funding Mechanisms | | | | | | | | | | | | | | | | | | | | | | |
| 1 | XXXX | XXXX | XXXX | | | | | | | | | | | | | | | | | | | | | | |
| 2 | XXXX | XXXX | XXXX | | | | | | | | | | | | | | | | | | | | | | |
| 3 | XXXX | XXXX | XXXX | | | | | | | | | | | | | | | | | | | | | | |
| 4 | XXXX | XXXX | XXXX | | | | | | | | | | | | | | | | | | | | | | |
| 5 | XXXX | XXXX | XXXX | | | | | | | | | | | | | | | | | | | | | | |
| <p>Operating Budget</p> | <p>The Municipality categorises services rendered to the community according to its revenue generating capabilities:</p> <p>Example:</p> <table border="1" data-bbox="513 1117 1466 1623"> <tbody> <tr> <td>1</td> <td>Trading services</td> <td>Services that generate surpluses that can be used to fund other services rendered by the municipality</td> </tr> <tr> <td>2</td> <td><i>Economic services</i></td> <td><i>Services that break-even, but do not generate any surpluses to fund other services rendered by the municipality</i></td> </tr> <tr> <td>3</td> <td><i>Rates and General</i></td> <td><i>Services that are funded by assessment rates, government grants or surpluses generated by the trading services</i></td> </tr> <tr> <td>4</td> <td><i>Other</i></td> <td>XXXXXXXXXXXXXX</td> </tr> </tbody> </table> | 1 | Trading services | Services that generate surpluses that can be used to fund other services rendered by the municipality | 2 | <i>Economic services</i> | <i>Services that break-even, but do not generate any surpluses to fund other services rendered by the municipality</i> | 3 | <i>Rates and General</i> | <i>Services that are funded by assessment rates, government grants or surpluses generated by the trading services</i> | 4 | <i>Other</i> | XXXXXXXXXXXXXX | | | | | | | | | | | | |
| 1 | Trading services | Services that generate surpluses that can be used to fund other services rendered by the municipality | | | | | | | | | | | | | | | | | | | | | | | |
| 2 | <i>Economic services</i> | <i>Services that break-even, but do not generate any surpluses to fund other services rendered by the municipality</i> | | | | | | | | | | | | | | | | | | | | | | | |
| 3 | <i>Rates and General</i> | <i>Services that are funded by assessment rates, government grants or surpluses generated by the trading services</i> | | | | | | | | | | | | | | | | | | | | | | | |
| 4 | <i>Other</i> | XXXXXXXXXXXXXX | | | | | | | | | | | | | | | | | | | | | | | |