FUNDING & RESERVES POLICY

MAY 2010

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1. INTRODUCTION

Purpose

In terms of regulation 8 of the Municipal Budget and Reporting Regulations, each Municipality must have a funding and reserves policy. It is for this reason that a policy has been developed.

Scope of Policy

This policy applies to the Nelson Mandela Bay Metropolitan Municipality (hereafter referred to as the Municipality) and any municipal entity established in terms of the Municipal Finance management Act (MFMA).

Objectives

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

- To comply with the legislative requirements;
- To ensure that the Municipality's Operating and Capital budgets are adequately funded;
- To ensure that the Municipality's provisions and reserves are maintained at the required levels, in order to mitigate unfunded liabilities in future financial years.

1.4 Definitions

The following definitions are applied in this document:

Municipality	Means the Nelson Mandela Bay Metropolitan Municipality
Act	Means the Municipal Finance Management Act, No. 56 of 2003
IDP	Means the Integrated Development Plan
MTEF	Means the Medium Term Expenditure Framework
Council	Means the Council of the Nelson Mandela Bay Metropolitan Municipality
SDBIP	Means the Service Delivery Budget Implementation Plan
MTIEF	Means the Medium Term Income and Expenditure Framework
Policy	Means the Funding & Reserves Policy

2. LEGISLATION

According to the Municipal Budget and Reporting Regulations, each Municipality must have a funding and reserves policy which must set out the assumptions and methodology for estimating:

(a) projected billings, collection 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 the transfer or disposal of assets;

(f) the Municipality's borrowing requirements; and

(g) the funds to be set aside in reserves.

3. FUNDING AND RESERVES POLICY

3.1 Background

The Operating and Capital budgets are prepared on an annual basis for a three-year period, based on the Integrated Development Plan (IDP). The expenditure as proposed in these budgets must be funded from the available revenue streams, without placing an undue financial burden on consumers and ratepayers.

The impact on the Municipality's financial position is also taken into account, when considering the balancing of the budget, i.e. ensuring that revenues are sufficient to meet the proposed expenditure.

3.2 Operating Budget Principles

The Operating budget allocates funding to Directorates over the Medium Term Expenditure Framework (MTEF). The preparation of the Operating budget is underpinned by the following guiding principles:

- A Balanced Budget is prepared on an annual basis;
- Property Rates are levied in accordance with the Municipal Property Rates Act, based on land and improvements. The budget is compiled using the latest approved valuation roll as a basis, whilst also taking into account the anticipated growth in the property market. Property Rates Tariffs and Rebates are determined annually as part of the rating policy review process.
- Projected billings for metered services, such as Electricity, Water and Sanitation - the actual consumption patterns for previous financial years are used as basis, which is then adjusted with the anticipated growth and/or contraction in consumption patterns.

The tariffs in question are determined on an annual basis as part of the tariff setting process.

- Projected billings for Solid Waste is based on number of erven receiving the service. The tariffs are determined on an annual basis as part of the tariffs setting process.
- Other income (excluding services charges) is levied in accordance with the Council's approved schedule of fees and charges. The budget is compiled based on historic trends, which is adjusted for anticipated growth in utilisation of municipal services.
- Actual collection levels for the period immediately preceding the budget year is used as a benchmark for setting the anticipated collection levels for the ensuing financial year.
- Interest accruing from investments is based on the investments held by the Municipality, as well as the interest income reasonably expected to be earned on surplus cash invested during the year. The budgeted financial statements are used as a guide to determine the available cash for investment purposes.
- No budget provision has been made for dividends that the Municipality may receive from its municipal entities.
- Budget provision is made for income attributable to the transfer or disposal of assets, as and when it arises.
- The level of the Provision for Bad Debts is determined, taking into account the annual collection rates targets as set out in the IDP and SDBIP. The Council's policy further stipulates that the overall level of the provision be based on all outstanding debts older than 90 days, excluding government debt.
- The Municipality supports the principle of making adequate budgetary provision for the rehabilitation and maintenance of existing assets and infrastructure, taking financial affordability considerations into account.
- Individual line items in the Operating Budget are subjected to close scrutiny when preparing the annual budget to ensure proper control over the expenditure. In this regard a zero-based budget approach is followed.
- The level of property rates and tariff increases takes into account the need to address maintenance and infrastructural backlogs, including the expansion of services.
- An assessment of the relative capacity to implement the Budget.
- The need to enhance the municipality's revenue base.

3.3 Capital Budget Principles

The Capital budget allocates funding to projects over the MTEF. The amounts provided for in the Capital budget will be limited to the available internal and external sources of funding, taking financial affordability considerations into account.

Budget allocations to Directorates, are based on the key service delivery priorities as reflected in the IDP.

3.3.1 <u>Impact of Capital budget on future Operating budgets</u>

Capital projects have a recurring effect on future operating budgets. The following main cost components should be considered before capital projects are approved:

- Additional staffing costs to man any new facility once operational
- Additional contracted services, i.e. external security, cleaning services, etc.
- Additional general expenditure, i.e. services cost, stationery, cleaning materials, etc.
- Additional costs to maintain the assets
- Additional interest and redemption to service loans to fund the capital budget

Projects may, however, also result in additional revenue generation. The impact that the expenditure has, must be offset by the additional revenue generated to determine the real impact on the operating budget, and the possible effect on tariffs.

3.3.2 <u>Borrowing Requirements</u>

The Municipality's borrowing requirements are determined via its Capital Sustainability Model. This model determines the financial affordability of external borrowing over the Medium Term Income and Expenditure Framework (MTIEF).

The amount of borrowing will thus be limited to the amount that the Municipality can financially afford to service.

4. 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.

4.1 Balance Sheet Reserves and Provisions

The Accounting Policy of the Nelson Mandela Bay Metropolitan Municipality contains the following sections relating to provisions:

A provision is recognised when the Municipality has a present obligation (legal or constructive) as a result of a past event and it is probable (i.e. more likely than not) that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

Provisions are reviewed at the Statement of Financial Position reporting date and adjusted to reflect the current best estimate.

Leave Provision

Liabilities for annual leave are recognised as they accrue to employees. The liability is based on the total accrued leave days at year end."

As leave may not be encashed, it is only required that the current portion of the leave provision be cash backed.

Compensation for Occupational Injuries and Diseases (COID) Provision

The continuing liability is that of pensions, with the capitalised value being determined on the basis of an actuarial determination as prescribed by the Commissioner. A COID reserve has been established to at least equate to the value of the continuing liability. The market value of the securities is determined annually by the Commissioner and the Municipality is required to meet any shortfall in the aggregate value of the securities as at 31 December. Monthly pensions are funded by transferring funds out of the reserve to the expense account in the Statement of Financial Performance.

The COID Reserve must be cash backed to ensure availability of cash for payment of claims.

Provision for Rehabilitation of Refuse Landfill Sites

The applicable GRAP standard states that a provision should be recognised where there is a present obligation to rehabilitate sites.

The Municipality has an obligation to rehabilitate its landfill sites in terms of its license stipulations. Provision is made for this obligation based on the net present value of cost.

The Landfill Rehabilitation Provision does not require immediate cash backing as the rehabilitation of the landfill sites will occur at a future date.

Donations and Public Contributions Reserve

The Accounting Policy of the Nelson Mandela Bay Metropolitan Municipality contains the following section relating to donations and public contributions:

"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. To the extent that the criteria, conditions or obligations have not been met a current liability is recognised."

Unspent amounts in relation to donations, public contributions and unspent grant funding are therefore retained in cash and are not available to fund any items on the operating or capital budget other than in terms of the conditions of the donations, public contributions or grants.

Self Insurance Reserve

A Self-Insurance Reserve exists to provide cover for selected risks including fire, storm, workmen's compensation, public liability and motor vehicles. The reserve is re-insured externally to cover major losses.

Premiums are charged to the respective Directorates at market related rates, taking into account past experience of claims and replacement values of the insured assets.

The reserves covers the first R10 000 000 in respect of fire insurance, R5 000 000 in respect of public liability insurance and R3 000 000 in respect of fidelity guarantee insurance, of any one claim.

The maximum aggregate exposure during any one year in respect of public liability insurance amounts to R10 000 000 and in respect of fidelity guarantee insurance amounts to R17 000 000. There is no maximum aggregate exposure in respect of fire insurance.

Claims in excess of the above maximum aggregate exposures are covered by re-insurance.

4.2 Other balance sheets items to be cash backed

Consumer Deposits

Consumer deposits are regarded as creditors, i.e. 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.

Working Capital

Working capital is required to ensure cash availability in the event of emergencies. Council must retain cash for a period of 60 days as minimum cash balance to ensure sufficient working capital.