



## POLICY 02/2019 RAADSBELEID

SUBJECT/ONDERWERP: VIREMENT POLICY

REFERENCE/VERWYSING: 5.1.B

RESOLUTION NR/BESLUIT NO: 38.5/05/2019 (CM)

DATE/DATUM: 30 May 2019

### 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 funding as well as reserves requirements.

### 2. SECTION A: FUNDING POLICY

#### 2.1 LEGISLATIVE REQUIREMENTS

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

- Realistically anticipated revenues to be collected;
- Cash backed accumulated funds from previous years surpluses not committed for other purposes. and
- Borrowed funds, but only for capital projects.

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.

## **2.2 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.

## **2.3 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.

## **2.4 CASH MANAGEMENT**

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

## **2.5 DEBT MANAGEMENT**

Municipal debt (short or long term) shall be raised in strict compliance with the requirements of Chapter 6 of the Municipal Finance Management Act (Act 56 of 2003).

## **2.6 FUNDING THE OPERATING BUDGET**

### **2.6.1. 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 subsidise services to the poor. This will necessitate cross subsidisation in tariffs to be calculated in the budget process.

### **2.6.1. 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 Subsidies 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) Projected revenue, as per A4, from services charges must be reflected as net (all billing less free basic services, discounts and rebates).
- f) Projected revenue from property rates must include all rates to be levied, but rebates and discounts must be budgeted for as revenue foregone.
- g) 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.
- h) 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 contribution to the provision be calculated for the 2019-2020 financial year at 0% (zero) for the current and non-current portion of employee benefits.
- i) 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.

- j) Contributions to provisions (non-current and current) do not form part of the cash flow. It is however, necessary to provide for an increase in cash resources in order to comply with the conditions of the provision at the time when it is needed.

It is therefore acknowledged that the contribution to current provisions must be budgeted as cash surpluses until the necessary funding level is obtained, however for the 2019-2020 financial year a 0% (zero) contribution will be made as it is not in the municipality's capability to make contributions to the provision.

## **2.7 FUNDING THE CAPITAL BUDGET**

### **2.7.1. 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.

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.

### **2.7.1. FUNDING SOURCES FOR CAPITAL EXPENDITURE**

The capital budget can be funded by way of own contributions, grants, public contributions as well as external loans.

#### **Own Contributions**

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

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. For example INEP (Counter-funding for the underground electrification of houses

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.

#### **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.

## **2.8 FUNDING COMPLIANCE MEASUREMENT**

### **2.8.1 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.

### **2.8.2 CASH AND CASH EQUIVALENTS AND INVESTMENTS**

A positive Cash and Cash Equivalents position throughout the year is crucial.

### 2.8.3 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;  
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.

### 2.8.4 MONTHLY AVERAGE PAYMENT COVERED BY CASH AND CASH EQUIVALENTS (“CASH COVERAGE”)

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

### 2.8.5 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.

The implementation of GRAP 17 accounting standard has meant bringing a range of assets previously not included in the assets register onto the register. This has resulted in a significant increase in depreciation relative to previous years. This depreciation is not allowed to be offset as per SA1 as the municipality is not on the revaluation model of GRAP 17. The municipality only adopted GRAR 17 with the higher Depreciated Replacement Cost (DRC) values, and therefore the municipality must budget for the full budgeted amount for depreciation, otherwise it will result in unauthorised expenditure.

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.

### 2.8.6 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	%	%	%

3. That Council revoke all previous policies regarding virements.