

THEEWATERSKLOOF MUNICIPALITY



FUNDING AND RESERVES POLICY

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FUNDING AND RESERVES POLICY

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

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Signature:

Municipal Manager

Date:

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 in 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 if 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 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 is negative, unless acceptable reasons can be provided for non-compliance, provided that the requirements of the MFMA must at all times be adhered to.

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2.4 **CASH MANAGEMENT**

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

2.5 **DEBT MANAGEMENT**

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

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 for the poor, and in line with its Indigents Policy and National and Provincial Government objectives, the municipality commits itself to subsidized services to the poor. This might necessitate cross subsidization in tariffs to be calculated in the budget process.

2.6.2 **GENERAL PRINCIPLE WHEN COMPILING THE OPERATING BUDGET**

The following specific principles apply when compiling the budget:

- The **budget must be cash-funded**, i.e. revenue and expenditure projections must be realistic and the provision for impairment of trade receivables must be calculated on proven recovery rates
- **Growth Parameters** must be realistic and be based on historic patterns adjusted for current reliable information.
- **Tariff Adjustments** must be fair, taking into consideration general inflation indicators as well as the geographic region's ability to pay.
- **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, as well as roll-over amounts for which expenditure will be incurred in the budget period.

For the purpose of the **Cash flow budget roll-over amounts** 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 recognized as revenue must equal the total expected expenditure for grants, inclusive of capital expenditure.

- **Projected Revenue from Services Charges** must exclude free basic services, discounts and rebates.

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- **Projected Revenue from Property Rates** must include all rates to be levied, but rebates and discounts must be budgeted for as an expenditure item. For the purpose of the **Cash flow Budget** all rebates and discounts must be deducted from the projected revenue.
- Only **Changes in Fair Values** related to cash may be included in the cash flow budget. **Changes to Unamortized Discount** must be included in the Operating Budget but excluded in the cash flow budget.
- **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 this requirements. The cash portion of the employee benefits must be accounted for in an "**Employer Benefits Reserve**".
- **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.
- **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 a requirement that the contribution to current provisions, as well as 20% of the prior year balance of the non-current provision, is budgeted as cash surpluses until the necessary funding level is obtained.

2.7 **FUNDING THE CAPITAL BUDGET**

2.7.1 **INTRODUCTION**

The municipality's objective is to maintain, through proper maintenance and replacement measures, existing high levels of services and to improve and implement services which are neglected or non – existent.

To achieve this objective the municipality must annually, within financial means, **Budget for the Replacement of Redundant Assets** as well as new assets.

2.7.2 **FUNDING SOURCES FOR CAPITAL EXPENDITURE**

The **Capital Budget** can be funded as follows:

- Own Contributions
- Grants
- Public Contributions
- External Loans

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Own Contributions

The **Capital Budget** financed from own contributions must primarily be funded from the Capital Replacement Reserve.

Notwithstanding the above may the capital budget or portions thereof 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 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 the 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 the 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. This will prevent double taxation. 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 furthermore put such measures in place to ensure that **no Unspent Portions of Loans** are being utilized 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 considered, 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.

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2.8.2 **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 this policy and attached to this policy as Appendix “A”.

2.8.2.1 That all conditional grants, insurance claim refunds and auction income be ringfenced in an interest-bearing call account upon receipt of deposit in the primary bank account.

2.8.2.2 These ringfenced allocations only be utilized on approved projects and only expense when invoices have been verified and authorized.

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.
- the cash portion of statutory funds
- 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.

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 must 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.

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2.8.6 **PROPERTY RATES/SERVICE CHARGE REVENUE % 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	New Year Revenue Budget	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	%	%	%

If the percentage in (H) above is greater than 0, a proper motivation must accompany the budget at submission, or the budget must be revised.

2.8.7 **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, as well as the current financial year as from 1 January.

It is not permitted to project a collection rate higher than the rates 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.

2.8.8 **DEBT IMPAIRMENT EXPENSE % OF BILLABLE REVENUE**

This indicator provides information on 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.

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2.8.9 **CAPITAL PAYMENTS % OF CAPITAL EXPENDITURE**

This indicator provides information as to the **Timing for Payments** on capital projects and utilizing allowed payment terms.

2.8.10 **BORROWING AS A % 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 that the Municipality's Debt Management Policy is being complied with.

2.8.11 **GRANTS REVENUE AS A % OF GRANTS AVAILABLE**

To ensure that the budget contains all grants available, this indicator must be calculated. The percentage may 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.

2.8.12 **CONSUMER DEBTORS CHANGE (CURRENT AND NON - CURRENT)**

The objective of the indicators is to determine whether budgeted reductions in outstanding debtors are realistic.

Non-current Debtors should include debtors where arrangements for payment over an extended period were made.

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

2.8.13 **REPAIRS AND MAINTENANCE EXPENDITURE LEVEL**

It is of utmost importance that the municipality's Property Plant and Equipment be maintained properly, 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 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 5% and 8% of the asset value.

2.8.14 **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 to determine whether the renewal program is sufficient or needs revision.

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2.8.15 **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, unmortised discounts and gains/losses on the disposal of Property Plant and Equipment. These items need to be taken into consideration to establish if the operating budget is realistic and credible.

2.8.16 **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.

2.8.17 **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.*

3. **SECTION B: RESERVES POLICY**

3.1 **INTRODUCTION**

Fund Accounting historically formed a huge part of municipal finance in the IMFO Standards.

Since the municipality changed to General Recognized Accounting Practices (GRAP), Fund Accounting is no more allowed.

The municipality, however, recognizes 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 measures of protection by creating certain reserves.

3.2 **LEGAL REQUIREMENTS**

There are no specific legal requirements for the creation of Reserves, except for the Housing Development fund.

The GRAP Standards themselves also do not provide for reserves.

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However, Paragraph 91 of the GRAP “Framework for the Preparation and Presentation of Financial Statements” states 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.

3.3 **TYPES OF RESERVES**

Reserves can be classified into two main categories being “Cash Funded Reserves” and “non – Cash Funded Reserves”.

3.3.1 **CASH FUNDED RESERVES**

To **provide for sufficient cash resources for future expenditure**, the municipality hereby approves the establishment of the following reserves:

3.3.1.1 **Capital Replacement Reserve (CRR)**

An annual review on the activation of a capital levy recommended by Budget Steering Committee and approved by Council.

A ring-fenced capital levy per service will be managed through the Capital Replacement Reserves.

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 is to be utilised for future capital expenditure for:

- New Projects
- Enhancement and upgrades
- Co-funding

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.

3.3.1.2 **Employee Benefits Reserve**

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

The contributions to the reservation must be made in accordance with the directives set in the funding policy.

3.3.1.3 **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 reservation must be made in accordance with the directives set in the Funding Policy.

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3.3.1.4 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.

3.3.2 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.

3.4 ACCOUNTING FOR RESERVES

3.4.1 REVALUATION RESERVE

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

3.4.2 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.

4. **SECTION C: 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. Such submission must be accompanied with a full description of the reasons for the change to the policy.

APPENDIX A

RECONCILIATION OF CASH REQUIREMENTS

Cash flow from operating activities	R XX
Add: Depreciation from own funds	R XX
Add: Contribution to current provisions	R XX
Add: 20% of prior year non – current provisions balance	R XX
Add: 5% of prior year non – current employee benefits balance	R XX
Add: Unspent conditional grants	R XX
Add: Unspent public contributions	R XX
Add: Unspent borrowings	R XX
Add: VAT due to SARS	R XX
Add: Secured investments	R XX
Add: Cash portion of Statutory Reserves	R XX
Add: Working Capital Requirements	R XX
= Minimum Cash Surplus Requirements for the year	R XX