FUNDING AND RESERVES POLICY

1. Application and Scope

The Funding and Reserves Policy is applicable to the Ekurhuleni Metropolitan Municipality as well as to all of the municipal entities of the Metro, being:

- Brakpan Bus Company
- East Rand Water Care Company
- Ekurhuleni Development Company, including Pharoe Park, Phase Two and Lethabong Housing Institute

The policy ***as amended*** will be effective as from 1 July 2011.

2. Objectives of Policy

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

3. Introduction

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

The impact of movements in the Statement of Financial Position is taken into account when considering the balancing of the budget.

4. Operating Budget Policies

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

- A Balanced Budget is compiled on an annual basis.
- Assessment Rates are levied in terms of the Municipal Property Rates Act based on land and improvements value. The budget is compiled using the latest approved valuation roll as basis and adjusted for expected growth in the property market. Assessment Rates Tariffs and Rebates are determined annually as part of the tariff setting process.
- Billed revenue for metered services comprise Electricity and Water and Wastewater. The actual consumption for the previous financial years will be used as basis, adjusted with expected growth and or contraction in service levels. The tariffs are set on an annual basis as part of the tariff setting process.
- Solid Waste revenue is billed based on number of erven receiving the service. 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.
- Provision for revenue that will not be collected is made against the ñProvision for bad debtò line item. Actual collection levels for the period directly proceeding the budget year is used as benchmark for setting the expected collection level.
- 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. The budgeted financial statements are used as guide on cash amounts that will be available to generate interest income.

- No provision is made for dividends from municipal entities as there is no expectation of dividends as detailed in the Entities Policy.
- No provision is made for income from transfer of assets as only incidental asset transfers are taking place at present.
- 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).
- The increased depreciation impact as a result of the implementation of GRAP 17 will be phased in over a ten year period (funding from accumulated surplus).
- 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.
- The budget is compiled net of VAT, i.e. the amounts budgeted for will be the net cost to Council after VAT has been taken into consideration.
- The Ekurhuleni Metropolitan Municipality is registered on the Payments Basis for VAT with the Turnover Based Method as the apportionment calculation method.
- 100% VAT is claimable on all departments for expenditure items that comply with the relevant VAT legislation.
- The offsetting of income and expenditure amounts is not supported and income and expenditure amounts are budgeted for where recoverable jobs are undertaken. This includes recoveries from staff on telephone accounts.
- A detailed salary budget is compiled on an annual basis. All funded positions are budgeted for in total and funded vacancies are budgeted for at 50% of the total package. In addition to this, an amount is determined on an annual basis to fund critical new positions. This amount is budgeted for centrally and transferred to the relevant departments as and when allocations are made by the City Manager.
- Provision for Bad Debts is based on the annual income targets set in the IDP and SDBIP. Full provision is made for penalties on property rates and interest on debtor's accounts.
- Council supports the principle of making sufficient provision for the maintenance of existing assets and infrastructure, yet affordability does result in maintenance budgets being lower than the levels recommended by the World Band.
- Individual line items in the Operating Budget are to be reviewed each year when developing the budget to ensure proper control over the expenditure and to examine the possibility of rationalization.
- 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.

5. Capital Budget Policies

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.
Allocations made to departments from the available internal funding, will be based on the Growth and Development Strategy. The Budget Steering Committee facilitates the allocation of resources.

5.1. Allocation of internal funds

The Ekurhuleni Metropolitan Municipality has huge service delivery backlogs, especially Infrastructure. Far more funds should be made available on an annual basis to eradicate the backlog. However, to provide services in an equitable and balanced manner throughout the community, certain other projects must also be implemented. Communities need the ñsofter servicesò, such as health facilities or sport and recreational facilities just as much as core infrastructure services. Similarly, the safety and security of the community must be addressed to secure a safe environment. It is furthermore critical to grow the local economy. Job creation, one of the national priorities, must be addressed in this budget. This capital budget aims to stimulate job creation and economic growth by means of allocating funds towards the city development segment. Job creation will not only be addressed by the city 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 ñExpanded Public Works Programmeò to ensure maximum job creation.

Allocations made to departments from the available internal funding, are based on the Growth and Development Strategy.

The following principles must, as far as possible, be addressed in the implementation of the capital budget:

- Job creation
- Labour based construction
- Advancement of SMMEôs
- Supporting of BBBEE

Multi-year allocations will be made using the following prioritisation methodology:

1. Revenue generating projects (with aim of generating revenue to provide services) ï (Example: Water & Electricity meters). The projects must be linked to the Capital Investment Framework as contained in the Metro Spatial Development Framework.
2. Projects to reduce cost (Examples: Protective structures, fuel management system, telephone management system and consumption management system ï indigent excess consumption).
3. Refurbishment of Infrastructure resulting from the maintenance backlog. The condition of the assets will be rated as follows for prioritisation purposes:
    a. 1: If the asset is not refurbished is the next financial period, it will have to be replaced within 2 ï 3 years at a higher cost.
    b. 2: Current maintenance cost of the assets is exceptionally high.
    c. 3: Pro-active refurbishments ï Road resurfacing will in future years be included in this component and not operating expenditure as agreed with the AG.
    d. Creation of sustainable human settlements in terms of infrastructure services (as contemplated by the National Human Settlements Department).
    e. Eradication of access backlogs (towns already promulgated but not yet fully integrated, i.e. residents do not have access to all required service). The services sub-prioritised as follows:
        - Essential Services: No 1: Water and Sanitation, No 2: Electricity, No 3: Roads and Stormwater (non negotiable services).
        - Social Infrastructure: No 1: Health facilities, No 2: Emergency facilities, No 3: Prevention of Crime, No 4: Libraries (Education), No 5: Other community and sports facilities
    f. Formalisation of Informal Settlements into sustainable human settlements. The services sub-prioritised as follows:
        - Essential Services: No 1: Water and Sanitation, No 2: Electricity, No 3: Roads and Stormwater (non negotiable)

- Social Infrastructure: No 1: Health facilities, No 2: Emergency facilities, No 3: Prevention of Crime, No 4: Libraries (Education), No 5: Other community and sports facilities

Note: The split between the funding allocated to eradication of access backlogs and formalisation of informal settlements will have to be further workshopped as part of the development of the prioritisation model.

5.2. Impact of capital budget on future operating budgets

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

- Additional staff cost required to staff 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 depreciation charges (non cash item)
- 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.

5.3 Multi-year budget and commitments

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

5.4 Borrowing requirements

The borrowing requirements as contained in the Borrowing Policy provide for the following:
Ekurhuleniõs Long Term Financing Strategy has been used as basis to determine the affordability of loans over the Medium Term Income and Expenditure Framework (MTIEF) Period.

The assumptions of the forecast model are as follows:

- The operating income and expenditure will grow with between 6% and 35% per annum (within the current inflation target setting and Eskom indicative price increases).
- Debtorõs payment levels of 92% on current billings. In addition, amounts in arrears will be collected and written off with varying amounts over the 3 year period.
- New loans are repaid in 10 annual instalments at an interest rate of 11%.
- The capital budget has an actual implementation rate of 100%. This was used as indicator of how the cash position will be as ñworst-caseò scenario.

From the above, the extent of borrowings recommended to be taken up in the MTIEF Period will be determined.

Borrowings of Municipal Entities

All proposed borrowings of Municipal Entities must be authorised by the Ekurhuleni Metropolitan Municipality.

The Ekurhuleni Metropolitan Municipality will consider the provision of guarantees for the borrowings of Entities as approved by Council within limits of affordability.

It will be endeavoured to negotiate consolidated borrowings for the EMM group when possible, however, individual borrowings are allowable in terms of this policy.

6. Funding Policies

6.1. Operating Budget

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

- Trading services (services that generate surpluses that can be used to fund other services rendered by the municipality)
- Economic services (services that break-even, but do not generate any surpluses to fund other services rendered by the municipality)
- Rates and General (services that are funded by assessment rates, government grants or surpluses generated by the trading services).

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

- Assessment Rates
- Equitable Share
- Fuel Levy
- Surplus generated from Electricity Service
- Surplus generated from Water Service
- Other Service Charges, fines and sundry income
- Other Government Grants

The funding mix will be presented on an annual basis as part of the operating budget.

6.2. Capital Budget

The capital budget is mainly funded from Government grants and Borrowings at present.

The funding mix will be presented on an annual basis as part of the capital budget.

Funding for capital budgets of future years will be generated through a combination of methods, being depreciation (as main source), grants and donations (with a dedicated effort to lobby for additional grant allocations and private sector injections) as well as borrowings as and when the current debt book is redeemed to ensure maximum use is made of funding options, including gearing at the optimal levels.

The increased asset value as a result of the GRAP 17 asset depreciation will be phased in for tariff setting purposes and more cash will be generated in a progressive manner over the next eight years. At present, the cash generated from depreciation are used for the redemption payments due. It is anticipated that the following cash amounts will be generated through depreciation until 2017/2018:

Fin Year	Cash generated through Depreciation budget	Less Redemption payments due (utilization of cash)	Available cash before investments made for future year loan redemptions with bullet profiles
2010/2011	712,555,107.36	452,820,219.99	259,734,887.37
2011/2012	867,465,720.54	204,824,338.41	662,641,382.13
2012/2013	1,022,376,333.72	208,730,782.89	813,645,550.83
2013/2014	1,177,286,946.90	632,027,006.34	545,259,940.57
2014/2015	1,332,197,560.09	165,527,759.23	1,166,669,800.85
2015/2016	1,487,108,173.27	177,477,379.12	1,309,630,794.15
2016/2017	1,642,018,786.45	191,350,088.39	1,450,668,698.06
2017/2018	1,796,929,399.63	206,629,259.23	1,590,300,140.40

In other words, depreciation will generate cash (the difference between the annual depreciation charged to the statement of financial performance and the offset depreciation used to phase the additional depreciation in) as indicated above until 1718 (based on current depreciation levels ï as the asset base increases with capital investments, the amount of cash generated through depreciation will also increase).

The current debt book must be repaid in terms of the repayment conditions from this cash and the balance is then available for utilisation. A portion must be used to set up zero coupon bonds / sinking funds (or other alternative investments that will be utilised for the redemption of the bonds when they become due). The balance will then be available for capital funding.

7. Reserves

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

- Assets fair value reserve
- Bulk contributions reserves (Electricity, Water and Sanitation, Roads and Parks)

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.

The Cash Management Policy provides for the cash requirements for provisions and reserves. Reserves must be funded and cash backed as detailed in the Cash Management Policy.