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| KZN 436 AND INGWE MUNICIPALITY |
| FUNDING COMPLIANCE POLICY |
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| **Date Approved:** |  |
| **Effective Date:** |  |

**Introduction**

This policy further clarifies the meaning of the MFMA’s ‘funding’ compliance requirements,andisalsoinresponsetocommentsandquestionsreceivedregardingtheapplicationofsomeMFMArequirementsandMFMACircular42.

TherehasbeenacommonmisconceptionthatGRAPcompliant‘accounting’isaproxyforafundingstrategy. MFMACircular42attemptedtodispelthisbelief,butthismessagemaytakesometimetodisseminateandreinforce. Someofthekey reasonsan‘accounting’approachisdifficulttoapplyare:

• Any analysis of the Financial Performance Budget ‘Result’ is reliant on key underlyingassumptions;e.g.debtors’collectionrates,growthrates,consumptionchanges etc, which also need to be proven as credible and realistic beforeadherencetoMFMA‘funding’requirementscanbeattestedto;

• Theterms‘realisticandcredible’,especiallyasthetermsrelatetosustainability,requiretheinterpretationofawiderangeofassumptionsandoutcomes;

• Accrualbudgetingrequiresaccountingforliabilityprovisioning,butinmanycases(exceptinminority of mandatory situations) the strategy for fundingthefutureobligationsrecognisedby the provision is a separate decision and approval process;

• Complexity

Budget funding that conforms to MFMA requirements, ensuring adherence withvarious provisionsoftheMFMA,shouldbemulti-facetedinachievinganumberoffinancialmanagementobjectives,including:

• MFMAcompliance,inparticulartosections18and19;

• Shorttermviabilityandconsiderationofthecommunity‘payingitsway’relativeto economicbenefitsreceived;

• Medium and long term sustainability; ensuring that the broader communitymaintainscontroloveroutcomeswithinappropriatelevelsofaffordability(which islikelytobedifferent foreverymunicipality);

• Achievementofcommunityaspirationsandservicedeliverygoals;

• Maintenanceofagoodcreditratingandminimisingfinancingcosts;and

• Achievingandmaintainingkeyprudentialmeasurements;e.g.borrowinglimits.

**MFMA**

Sections18and19includethefollowingrequirements:

An annualbudgetmay***only***befundedfrom:

• ***realistically***anticipatedrevenues***tobecollected***;

• cash-backedaccumulatedfundsfrompreviousyears’surpluses***notcommittedforother purposes***;and

• borrowedfunds,butonlyforthecapitalbudgetreferredtoinsection17(2).

Revenueprojectionsmustbe***realistic***takingintoaccount:

• projectedrevenueforthe***current year***basedoncollectionlevelstodate;and

• actualrevenuecollectedin***previousfinancialyears***.

Amunicipalitymayspendmoneyonacapitalprojectonlyifthesourcesoffundinghave beenconsidered, are available and have ***not been committed for otherpurposes***.

**Fundingcomplianceoverview**

Themethodologyadvocatedforensuringfundingcomplianceisan‘iterative’process,requiredtobeinitiallyundertakenasaself-assessmentbymunicipalitiesaspartofthebudgetdevelopmentprocess. Non-achievementoftherequiredstandardofanyoftheanalysisfactorsmayrequirethataspectsofabudgetberevisiteduntil‘fullcomplianceorsubstantiation’isachieved. Abudgetshouldnotbetableduntilthisrigourhasbeenfully appliedandtheappropriatestandardsachievedandsubstantiated.

Budget format table A10 (‘Funding measurement’) contains 14 factor measuresderived from information from the Annual or Budgeted Statements of FinancialPerformance,FinancialPositionandCashFlows. Atemplatetobeprovided,aspartof the ‘Budgetformats’(table A10); will calculate the measurements when thebudgeted financialstatements have been completed. Refer Annexure**Afor**anillustrationofadraftformatoftheTableA10template. Similarly,budgetformattableA8(‘Performanceindicatorsandbenchmarks’)arealsoautomaticallycalculated. Thefullfundingcompliancemethodologycontains18factorsthatcanbeallansweredbyreference tomeasurements contained in Table A10, Table A8 and the BudgetedFinancialStatements.

Thesequenceofthefactorsisdeliberate,progressingfromsolvencytosustainability.Theinitialfactorsfocusoncashfundamentals,thenfactorsrelatingtocollectionratesandrevenuegrowth,andfinallywithfactorsabouttherevenueprotectionandoverallfinancialoutcomemeasures. AnaimistokeepthenumberoffactorstotheminimumlevelthatcanprovideaCouncilandotherstakeholderswithcomplianceconfidencewithoutbecomingoverlyunwieldyandcomplex,althoughitisacceptedthatarangeofotherfactorsalsocouldbeincludedinsuchananalyticaltool. Initialtestsonanumberof municipal budgets indicates that, as aby-product of the budget developmentprocess,theprocedureisrelativelystraight-forwardandeasytocompleteoncethebudgetedfinancialstatementshavebeenassembled.

This analytical toolisaniterativeprocess, meaningthatwhena responsetoafactoris unfavourable,orcannotbeappropriatelysubstantiated,itisexpectedthatthebudgetwouldbereviseduntiltheanswerisfavourable. However,manyofthemeasurementsare inter-related,soa revision of the budget would require that a review of themeasurementsberecommencedfromthebeginningtoensurethatalloutcomesarestill favourable. Amunicipalitytesting its budget should not progress to anothermeasurementinthesequenceuntilafavourableoutcomeisachievedonthecurrentmeasurement being reviewed. Afavourableoutcomein some instances is the substantiationormotivationinthemunicipality’sbudgetdocument.

The selection of measures applied are also deliberately based upon informationsourcedonlyfrombudgetdocumentsorauditedannualfinancialstatements,toensurerelative ease ofcalculation and that the measurements can be independentlycalculatedandverifiedbystakeholdersexternaltotheorganisation. Forexample,theversionofthecollectionrateusedistheactualorbudgetedcashreceiptsfromtherevisedformatCashFlowBudget(orstatement)andthetotalofratepayerandotherrevenue(muchofwhichiscashcollectionsandthereforeacollectionrateisalways

100percent)fromtheFinancialPerformanceBudget(orstatement).Thiswillbea

different resulttoacollectionrateofonlycashfrom consumerdebtorsrelatedtoconsumerdebtorbillings,dependingontheproportionof‘otherrevenue’cashbillingsandcollections. Thedifference is not significant as a key focus is on individual

municipalcollectionperformanceandtrends,andisapreferableapproachtorequiringevengreatercashcollectioninformationdisclosureandtherelatedinaccuraciesthatmaycause.Especiallyasthevolatilityofthecollectionratecausedbythegenerally-acceptedapproachoftheinclusionofarreardebtorsinthecashcollectionrateismoresignificant.

Thefollowingtableliststhefactorsthataretobereviewed. Eachofthefactorsisthenfurtherdescribedbelow.

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| **No.** | **FundingCompliance** |
| 1 | Cash/cashequivalentposition |
| 2 | Cashplusinvestmentslessapplications |
| 3 | Monthlyaveragepaymentscoveredbycashorcashequivalents |
| 4 | Surplus/deficitexcludingdepreciationoffsets |
| 5 | PropertyRates/servicechargerevenue%increaselessmacroinflationtarget |
| 6 | Cashreceipts%ofratepayerandotherrevenue |
| 7 | Debtimpairmentexpense%ofbillablerevenue |
| 8 | Capitalpayments%ofcapitalexpenditure |
| 9 | Borrowingasa%ofcapitalexpenditure(lesstransfers/grants/contributions) |
| 10 | Transfers/grantsrevenueasa%ofGovernmenttransfers/grantsavailable |
| 11 | Consumerdebtors’change(CurrentandNon-current) |
| 12 | Repairs&maintenanceexpenditurelevel |
| 13 | Assetrenewal/rehabilitationexpenditurelevel |
| 14 | FinancialPerformanceBudgetresult |
| 15 | FinancialPositionBudget |
| 16 | CashFlowBudget |
| 17 | Otherkeyperformancemeasures |
| 18 | Summaryquestion |

**Fundingcompliancefactordescription**

Acompleted‘FundingMeasurement’assessmentsupportsthisprocedure. RefertothebudgetformatrequirementsdeterminedbyNationalTreasury.

Eachofthefactorsisfurtherdescribedbelow. These‘fundingfactor’descriptions shouldbereviewedintheirentiretypriortoundertakinganyanalysis.

Analyseeachfactorinsequence.Ifafactorappearsunfavourableandcannotbe adequatelymotivated,adjustthebudgetappropriatelyandbegintheanalysisagainfromthefirstfactor.Thefinalstepisanoverallreviewtoensurethatallmeasureseithermeetthe specifiedrequirementsorhavebeenappropriatelymotivatedinthebudgetdocument

**1. Cash/cash equivalent position:** the municipality’s forecast cash position is fundamental. A‘positive’cashposition,foreachyearofthemediumtermbudgetwouldgenerallybeaminimumrequirement,subjecttotheplannedapplicationofthesefundssuchascash-backingofreservesandworkingcapitalrequirements(referfactor2).

Ifthemunicipality’sforecastcashpositionisnegative,foranyyearofthemediumtermbudget,thebudgetisunlikelytomeetMFMArequirementsorbesustainableandcouldindicateariskofnon-compliancewithsection45(shorttermdebt). A

revision of budgeted revenue and/or expenditure, and funding, is required toimprovecashforecasts.

**2. Cashplusinvestmentslessapplicationoffunds:**Thepurposeofthismeasureis tounderstand how the municipality has applied the available cash andinvestments identified at factor 1. The budget formats contain a table that reconcilestheamountofcashandinvestments(includingnon-currentinvestments) comparedto the past application and budgeted application of funds. The reconciliationisintendedtobearelativelysimplemethodologyforunderstandingthe budgeted amount of cash and investments available with any planned orrequiredapplicationstobemade. Theseapplicationsaredefinedas:

• Unspentconditionaltransfers/grantsandreceipts-amunicipalitymayhavereceivedanadvanceofcashforwhichconditionalexpenditurehadnotoccurredby theend oftheyear being analysed.This is most common for capital expenditure funded by government transfers.Government transfers/grantrevenuewillonlyhavebeenrecognisedtotheextentithadbeen‘earned’;i.e.that conditionshad been met, such as capital expenditure incurred for thepurposesforwhichtheconditionaltransfer/grantwasprovided. Anyunspentfundsareconsideredaliabilitytothetransferoruntilsuchtimeastheconditionsaremetusuallybeingtheexpenditurehasbeenincurred,regardlessofthelikelihood of having to repay the funds iftheconditions are not met.Municipalitiesshouldnotbudgetforunspenttransfers.

• Unspentlongtermborrowing-longtermborrowingmayonlybeincurredforthepurposes ofcapitalexpenditure orrefinancingofborrowingunderrestrictedconditions(MFMAsection46(5)). Borrowingisusuallyundertakenonatenderbasis and one tendermay relate to an entire year’s capital program or sometimesamulti-yearappropriation. Ifthecapitalprogramtobefundedbyborrowing has not beencompleted within a financial year there should be unspentborrowingwhichmustbecash-backeduntilthecapitalexpenditureisincurred andthepaymentsmadeprovidedtheloanfundshavebeenfullydrawndown. Agoodpracticewouldbeonlydrawdownloanfundsintheyeartheyareneeded, butthismaynotbepracticalforsomeloantypes;e.g.bond.

• ValueAddedTax(VAT)-VATcollectedandfundsduetoSARS. Insome instancesitispossiblethattheamountofVATcreditsclaimedoffsetanyfunds collected.

• Otherworkingcapitalrequirements-workingcapitalwilllikelyberequiredtofund anytiming mismatchbetween revenue receipts, and payments beingmade. Forexample, employee remunerationand trade creditor paymentswouldhavetobepaidona30daybasis,butcollectionofdebtors’revenuemayaverageoveralongerperiod.Therefore,areasonableestimateneedstobe madeofthefundinggap(whichisthe minimumworkingcapitalrequirement) thatwilloccur. Thecalculationtosupportthemeasurementshouldbebased ontheproportionofservicechargesandotherdebtorsexpectedtobecollectedwith 30 days.The averagecollection rate could be used tocalculatetheamount,oramoreaccurateseasonalcollectionrateifavailable.

• Otherprovisionsoffunds-provisionsmayhavebeenmadethatrequiresomelevelofcashbacking. Amunicipalityshouldhaveabudgetpolicytoguideitonthelevelofcash-backingforsuchprovisionsas‘debtimpairment’(bad/doubtfuldebts). Theremaybeotherprovisionssuchasself-insurance,employeeinjury,pensionplans,post-retirementmedicalaidandlandfillsiterehabilitation thatrequireastrategy programforfunding. Insomeofthesecircumstancesthe entireamountofaprovisionmaynotneedtobefullycash-backedimmediately.

Careneedstobetakentoensurethattheratesuchfundsareaccumulatedis equitablerelativetotheleveloftariffsandtaxesthecommunityisbeingaskedtopay;forexample:itwouldlikelybeinequitabletofundthefuturerehabilitationofarefusedisposalsitefromaonce-offincreasetotaxesandtariffs,whentheliabilitywasincurredprogressivelyovermanyyears.

• Longterminvestmentscommitted-theremaybeotherfundsthathavebeen committedforwhichlongterminvestmentshavebeensetaside. Acommonexampleistheholdingof‘sinkingfunds’fortherepaymentoffutureborrowingliabilities. Thecreationofsinkingfundsisoftenaconditionofaborrowingbytheoriginatingfinancial institutionoftheloan. The‘sinking’fundssometimes maynotbeutilisedforother purposes,evenonatemporarybasis,withoutbeinginbreachoftheborrowingagreement.

• Reservefunds-theremaybelegalobligationstoholdfundsinspecialreservefunds,e.g.HousingFund. Also,asmentionedpreviouslyunderthesectionon‘otherprovisions’Councilmayhaveresolvedtoprogressivelysetasidecertainfundsintoareservefundtomeetfutureobligations

Afterincludingcalculationsforallapplicationsoffundsthe‘fundingbalance’shouldbe reviewed. Ifthereisacashshortfall(negative)inanyofthe3yearsofthebudgetthereneedstobearevisionuntilsuchtimeasatleastabreak-evenfundingpositionisachieved.AnoverallcashshortfallisindicativethattheMFMAisnotbeingcompliedwith,thatexpenditurebudgetsarenotfunded. Ashortfallwouldnot exist if the budget wasfunded in accordance with MFMA section 18(1).However,ifthereisasurplusofcash,overthemediumtermorinanybudgetyear,thereshouldnotbeanautomaticassumptionthatrevenueistoohigh. Firstlythereneedstobeanexaminationofthe future cashposition.Itisbecomingmorecommonformunicipalitiestohavelongtermfinancialstrategies,whichincorporateestimatesforanumberofyearsbeyondthemediumtermbudget. Oneadvantageofthesestrategiesisthattheyhighlighttheneedforsustainablelevelsofcapitalexpenditureandborrowing(borrowinglevelsthatcanberepaidonthe maturitydate). An examination oflonger term obligations may reveal significant cashoutflowsinyearbeyondtheMTREF.

**3. Monthlyaveragepaymentscoveredbycashorcashequivalents**:thepurpose ofthismeasureistounderstandtheleveloffinancialriskshouldthemunicipalitybeunderstress.Regardlessoftheannualcashpositionanevaluationshouldbemadefortheabilitytomeetmonthlypaymentsasandwhentheyfalldue. Itisespeciallyimportanttoconsiderthepositionshouldthemunicipalitybefacedwithanunexpecteddisasterthatthreatensrevenuecollection. Ausefulindicatorforthis isincludedinTableA10 whichisknownasthe‘cashcoverageratio’;i.e.thenumberoftimesaveragemonthlypaymentsarecovered,calculatedbydividingtheestimatedaveragemonthlypaymentsintotheavailablecashbalance.

Amunicipality should also consider whether the ‘cash coverage ratio’ exhibitsnegative‘trend’characteristics;i.e.theratiodepictsadeterioratingtrendcomparedto previousyears?A low or reducing ratio may indicate an inability to meet paymentobligationswhentheyfalldue,althoughtheindividualcircumstancesof municipalitiesisakeyconsideration;i.e.municipalitieswhichdonothaveaheavyreliance onthecollectionofservicesrevenuemayhavelessofanexposuretodisaster. Inthisinstancetrendanalysiswouldbeofgreaterimportance. Theratiosofcomparablemunicipalitiesmayassistinanassessment.

Aloworreducingratiowouldrequirethateitherthebudgetisrevisedtoimprovethecashpositiontoanacceptablelevel,oracomprehensivejustificationincludedinthebudgetdocument.

**4. Surplus/deficit excluding depreciation offsets**: the mainpurpose ofthismeasureistounderstandiftherevenuelevelsaresufficienttoconcludethatthecommunity ismakinga sufficient contribution for the municipal resourcesconsumedeachyear.An‘adjusted’surplus/deficitisachievedbyoffsettingthe amountofdepreciationrelatedtoexternallyfundedassets. Itiscontendedthatif grossdepreciationisincludedintheFinancialPerformanceBudgettodeterminetariff levelsthe community isbeing taxedtwice forthe same expenditure; i.e.payingtaxtothenationalgovernmentwhichisusedtofundtransferstosupportspecificcapitalbudgetsandthenpayingtax(propertyrates)tothemunicipalitytofundthedepreciationrelatedtotheassetthatwasfundedbythetransfer. Asimilar argumentcanbemountedwherepropertydevelopersprovideinfrastructure. The issuewiththiscontentionisthatif/whentheassetshavetobereplacedinthefuturethenationalfundingmaynotbeavailable. Municipalitiesneedtoassesstheresultofthiscalculationtakingintoconsiderationitsowncircumstances;i.e.theability to funddepreciation may be a different issue for a rapidly growingmunicipalityfacedwithmajorservicedeliverybacklogscomparedtoonethatiswellestablishedandexperiencingslowgrowth.

Amunicipalityshould analyse whethertheFinancialPerformance result surplus/deficit),adjustedfor‘offsetdepreciation’,isadeficitforanyoralloftheyearsofthemediumtermbudget. Adeficitmayindicatethattariffsandtaxesareinsufficienttoensurethatthecommunityismakingasufficientcontributiontowardtheeconomicbenefitstheyareconsumingoverthemediumtermbudgetperiod.Tariffsandpropertytaxincreasesmayhavetobereviewedsimultaneouslywithaconsiderationofareductioninexpendituretoimprovetheresult. Alternativelya comprehensivejustificationshouldbediscussedinthebudgetdocument;e.g.aphasedincreaseorrealignmentintariffsmayrequireacceptanceofadeficittobelatercompensatedforbyaprogressivemovetoasurpluspositionthroughstagedtariff increasesorrealignmentoftherevenuemix.

Asurplussituationdoesnotobviatetheneedtocomplywithcashrequirementsmeasured byfactor2.

**5. PropertyRates/service charge revenue % increase less macro inflationtarget:** thepurposeofthismeasureistounderstandwhetherthemunicipalityiscontributing appropriatelytotheachievementofnational inflation targets.This measureisbasedontheincreasein‘revenue’,whichwillincludeboththechangeintherateortariffaswellasanyassumptionaboutrealgrowth(i.e.newpropertydevelopment,services consumption growth).Importantly recall that non- achievement of the macro benchmark of this and other analysis factors mayrequirethataspectsofabudgetberevisiteduntil‘fullcomplianceorsubstantiation’is achieved.

Thefactoriscalculatedbydeductingthemaximummacro-economicinflationtargetincrease(asadvisedannuallybyNationalTreasurycircular;currently3-6percent)fromthetotalprojectedgrowth(increase)inrevenue. Theresultisintendedtobeanapproximationoftherealincreaseinrevenue. This‘realincrease’should becomparedwiththeprojectedunderlyingcitygrowthandconsumptiongrowthto

justifytheincrease. Recenttrendsshouldalsobeanalysed. Forexampletheremaybeanaverage1percentincreasefromnewtaxablepropertyvalueanda2percentincreaseinelectricity/waterconsumptionbyexistingconsumers,withasimilartrendinthepreviousfinancialyear. Ifthetotalgrowthandconsumptionincreaseshownbythemeasurementfortheproposedbudgetisevengreaterthenthis measurement outcomethiswill be considered evidence of the proposedtax/tariffincreasesexceedingmacro-economicinflationtargets,inwhichcasethe budgetshouldeitherberevisedorthebudgetdocumentwouldneedtothoroughlysubstantiatetheextraordinaryincrease.

Toundertaketheanalysisamunicipalityshouldfirstly,comparethepercentageincrease inpropertyratesandservicechargerevenuewiththemacroinflationtargetforthebudgetyear. Secondly,ascertainanestimateofprojectedrealcity growthandservices’consumptiongrowth. Finally,ascertaintheprojectedCPIXforthebudgetyears.

Ifthe proposedbudget increaseexceedsthe macro inflation target and/ortheprojected CPIX then the increase would need to be motivated in the budgetdocumentasthecommunitywillhaveanexpectationthatincreasesdonotexceedCPIXchanges. Where, theincreasealsoexceedscityandconsumptiongrowth projections,considerationshouldbegiventorevisingthebudgetor,alternativelythoroughly motivating the revenue increase including a description of the consultationprogramproposedtogainacceptancefromthecommunity.

Therewillbeinstanceswhereexternalinfluencescreatepressureforjustifiablerevenue increases in excess of the macro target.Examples may include sanctionednational localgovernment salary increasesorbulkservice provider priceincreases,suchaselectricityandwater,overwhichlocalgovernmenthasminimalinput.Theseincreaseshaveadifferentimpactonindividualmunicipalities,andthereforeneedtobemotivatedwidelywithincommunities.

**6.Cashreceipts%ofratepayerandotherrevenue**:thisfactorisamacromeasureoftherateatwhichfundsare‘collected’. Thismeasureisintendedtoanalyseanunderlyingassumedcollectionrate;i.e.howmuchcashisexpectedtobecollectedfromcurrentbilling,chargesandarreardebtors? Thefirstpartoftheanalysisistocomparethepercentagewiththecurrentandprioryeartrends. Ifthepercentageismuchhigherthanrecenttrendsthenitishighlyprobablethatthecashcollectionrateassumptionsdonotcomplywithsection18oftheMFMA,asitisprobablethat the‘anticipatedrevenuestobecollected’areunrealistic.Trendsinrecentmonthsshouldalsobeconsideredtoascertainiftheseareconsistent withtheaverageannualtrend. Ifthepercentageisgreaterthan100percentthenthiscouldindicatethatthemunicipalityisimprovingthecollectionofarreardebt.Thisplanwould havetobewellsubstantiated.

Theanalysisshouldfirstlycomparetheprojectedcollectionratewiththeoverall year-to-dateoutcome of the ‘currentyear’(the financialyear during which thebudget isbeing prepared).Secondly, the projected collection rate shouldbe comparedwiththeoutcome forthe‘prior’financialyear.Finally,comparethe projectedcollectionratewithamore‘recent’trend;e.g.thecollectiontrendofonlyrecentmonthsinthecurrentfinancialyear. Theproposedbudgetedcollectionratemust berealistic intermsofallofthecomparisons.

The MFMA (section 18(2)) is very definitive on the issue of realistic revenue collections, only allowing the budget to be formulated on the basis of provencollection ratesin the current and previous years.Therefore, if the projected collectionratesforthebudgetaregreaterthanthecurrentyear,includingrecenttrendsinthecurrentyearwhichwouldbeincorporatedintotheprojectionforthecurrentyear,orthecollectionratesexperiencedinpreviousfinancialyears,thenthisisevidencethatthecashcollectionassumptionsdonotcomplywithsection18of the MFMA.Collection rateprojection assumptions should berevised, oralternativelyadetailedjustificationmadefortheincrease.Ifthecollectionrateprojectioncannotbesubstantiatedthenthecollectionrateassumptionsandcash flowforecastsshouldbereviewedandbasedonlyoncurrentandpreviousyears’ experience.

Plansorcollectionpolicychangesshouldnotberelieduponasjustificationuntilsuch time asactualimprovedcollectionperformanceisproven.Ifindoubt,a municipalitymustapplytherealisticapproachand,iffavourablecollectionsactually eventuate, then review the situation as part of the next mid-year budget and performanceassessmentorre-considerthesituationduringthenextbudgetcycle.

**7.Debtimpairment expense %of billable revenue**-this factoristomeasurewhethertheprovisionfordebtimpairmentisbeingadequatelyfundedandisbasedontheunderlyingassumptionthattheprovisionfordebtimpairment(doubtfulandbaddebts)hastobeincreasedtooffsetunder-collection. Themeasureneedstocomparebudgetprojections withrecentcurrentyearandmonthlytrendstohave confidencethatarealisticprovisionis beingincluded. Collectionofarreardebt, andpoliciesrelatedtotheadequacyofthetotalprovisionmaketheassessmentofanadequateprovisionsomewhatcomplex. Historicaltrendsofthemunicipal‘baddebt’ expense may be influenced by adjustments forindividual financial yearoutcomes. However,iftheprojectedcollectionrateofbillablerevenueislessthan

100%itcangenerallybeexpectedthatanincreasetotheprovisionwillberequired

tooffset the collection shortfall.It may also be the casethat past improved collectionperformanceresultsinan‘over’-provision.

Ifthedebtimpairmentexpensepercentageofbillablerevenueisinconsistentwithforecastcollectionratesdiscussedatfactor6;i.e.theincreaseintheprovisionfordebtimpairmentisinconsistentwiththeunder-collectionrate(budgetmaybetoohighortoolow),thisis evidencethatthebudgetisunrealistic,notcredibleorsustainable. Without revision therewill be insufficient funds to meet planned expenditure. Ifthisisthecasethelevelofimpairmentexpenseandtherelated debt impairment provision need to be revisedconsistent with reasonable debtcollectionexpectations. Alternatively,ifthereisareasonfortheinconsistencythisshouldbemotivatedinthebudgetdocument.

Tounderstandwhetherthereisaninconsistencyitcanbeuseful,althoughoverly simplistic,to sum the collection percentage of individual years’ and the debt impairmentpercentage. Inthemediumtermthesumofthesepercentagesshouldbeapproximately100percent. Asumthatislessthan100percentmayindicatethat thereisan insufficient provision for debt impairment; for example: if thebudgetedrevenuecollection rate is assumed to be 90 per cent and the debtimpairmentexpensebudgetis5percentofbillablerevenue,thenthiswouldbegoodevidencethatthedebtimpairmentexpensebudgetwastoolow(exceptinthe casewhereapreviouslyfundedprovisionwastoohighandisbeingadjusted).

A totalgreaterthan100percentmayindicatethateithertheexpensebudgetistoohighorforecastcollectionlevelsareunrealistic,althoughaonce-offsituationcouldbejustifiedbyamajorprovendrivetocollectarreardebtorthattheexpensebudgetistoohigh.

**8. Capitalpayments%ofcapitalexpenditure**:thepurposeofthismeasureistomainly understandwhetherthe timingof paymentsisbeingtakeninto considerationwhenforecastingthecashposition. Themeasurefocusesonthecapital budget,becauseexpenditurelevelsforthiscomponentofthebudgetcanvarysignificantlyfrommonthtomonth,astheretendstobemonthlyconsistencyforoperational budgets.Despite the monthly variability of expenditure on the capitalprogrammanymunicipalbudgetshaveidenticalamountsintheircapitalexpenditurebudgetsandcashflowbudgets.Applyingaccrualaccountingitisunlikelythatcapitalpayments(cash)willequalcapitalexpenditure,asthereisatimingdifferencebetweentheinvoicebeingprocessedandthepaymentbeingmadewhichismostlikelyapproximatelyonemonth. Thereislikelytobeatimingdifferencebetweentheinvoicesforexternalworksandsuppliesbeingprocessedandthepaymentsactuallymadeinthemonthfollowingexpenditurebeingincurred (theinvoiceshouldhavebeenprocessedtoexpenditureandcreditorsinthemonth theservicesorgoodswerereceived).

Ifthebudgetyear’scapitalbudgetisgreaterthanthecurrentyearthenthisgrowthwill normally translate into a percentage less than 100 per cent for capitalpayments. Ifthecapitalbudgetislessthanthecurrentyearthenitisprobablethepercentagewillbegreaterthan100percent. Amunicipalitymayalsotakeintoconsiderationthatactualexpenditurewillbelessthantheexpenditurebudgetduetoefficiencyimprovements,althoughamunicipalitywouldneedtohavesound justificationfordoingso. Percentagesthatvarygreatlyfrom100percentshouldbereviewedtakingintoconsiderationacomparisonbetweenthemonthlycapital expenditureandcashflowbudgetsofboththecurrentandbudgetyears.

Ifthetotalcapitalexpenditurebudgetequalsthecapitalassetspaymentsiteminthe CashFlow Budget then the budget should be reviewed to confirm.A comparison of the amount of capital expenditure and capital payments of thepreviousyear’sJuneandJulywouldbeaguideastotheadjustmentnecessarytobudgetedcapitalpayments,intheabsenceofmorespecificinformationandplans.

**9.Borrowing asa%ofcapital expenditure(excludingtransfers, grants and contributions)**:thepurposeofthismeasurementistodeterminetheproportionofamunicipality’s‘own-funded’capitalexpenditurebudgetthatisbeingfundedfromborrowedfundstoconfirmMFMAcompliance. Externallyfundedexpenditure(bytransfers/grants andcontributions)shouldbeexcluded.Theborrowingamount usedinthecalculationissourcedfromthecashflowbudget,andthereforewillexcludeanyunspentloanfundsfromapreviousyear. Apercentagegreaterthan100percentcouldindicatenon-compliancewithsection46oftheMFMAasitmayindicate that new borrowing exceeds capitalexpenditure;unlessthe excess iscausedbyaloanraisedinoneyearforamulti-yearcapitalappropriation(inthiscase the measurementshould be averaged over the period of the multi-yearappropriation)unlesstheloanfacilityallowsforfundstobedrawn downasneeded.

Somemunicipalitieshaveprudentialborrowinglimitslessthanthe100percentbasedonsustainabilityforecasts;e.g.thatonly50percentof‘own-funded’capital

expenditure will be borrowedand the remainderwill be fundedfrominternally generatedfunds (from operations).The percentage should also bereviewed consideringpastaveragesandtrends,asadeterioratingtrendmayalsoindicatethattheproposedborrowingisnotsustainableorthat insufficient borrowingisbeingused.

Ifthereisevidenceofnon-compliancewiththeMFMAborrowinglimitations,thatlongtermborrowingisbeingusedtosupportshorttermfundingrequirements,theamountofbudgetedborrowingshouldbereducedsothattheratiodoesnotexceed100%. Similarly,ifthemunicipalityhasprudentialborrowinglimitpolicythatlimitsborrowingtoaspecifiedpercentage,andthebudgetisinbreachoftheCouncil’sownpolicy,thenbudgetorthepolicyshouldberevised.

**10.Transfers/grantsrevenueasa%ofGovernmenttransfers/grantsavailable:**the purposeofthismeasurementismainlytoensurethatallavailabletransfersfromother government(national,provincialordistrictmunicipalities)havebeenincludedinthemunicipalbudget,orthatthetransfer/grantbudgetsdonotexceed available funds.Apercentage less than 100 per cent could indicate that allDivisionofRevenueAct(DoRA),provincialtransfersordistricttransfershavenotbeenbudgetedandshouldbeimmediatelyreviewed. Apercentagegreaterthan100percentcouldindicatethatthereareunspenttransfersbeingcarriedforwardfrom theprevious financial year, orthat an estimate of transfers/grants isunrealistic. Itmayalsoindicatethatgrantsarebeingincludedinthebudgetthatwill never eventuatee.g. the budget includes grants for provincial or nationalgovernmentthathavenotbeenbudgetedforordonorgrantswithalowlikelihood ofsuccess.Ifthebudgetedamountsareunrealistictheyshouldberevised. There mayalsobeaconsequentialchangerequiredtoexpenditurebudgetsifgrantsarechanged.

**11.Consumerdebtorschange(Current andNon-current):** thepurposeofthesemeasuresistoascertainwhetherbudgetedreductionsinoutstandingdebtorsarerealistic. Thereare2measuresshownforthisfactor;thechangeincurrentdebtorsand the change in longterm receivables, both from the Budgeted FinancialPosition. Longtermreceivablesofteninclude‘arrangementdebtors’tobepaidbythedebtoroveranextendedperiodoftime. Thereshouldbeconsistencybetween the debt collection rate assumptions andchanges in the consumer debtors’ balances budgetedfor. Debtwrite-offswillhaveanimpactonthebalances.

Alargeincreaseineithermeasurecouldindicatethatdebtors’collectionrateisexpectedtodeteriorate. Adecreasewouldindicatethatdebtorsareexpectedtobereduced. Bothsituations shouldbere-examined and checked against recenttrends. Specialplanstoreduceconsumerdebtorsneedmotivationinthebudgetdocument.

(Alsorefertofactor7-“Debtimpairmentexpense%ofbillablerevenue)

**12.Repairs&maintenance(R&M)expenditurelevel**:thismeasureisincludedwithinthefundingmeasurescriteriabecauseatrendthatindicatesinsufficientfundsarebeing committedtoassetrepaircouldalsoindicatethattheoverallbudgetisnotcredible and/orsustainable in the medium to long term because the revenuebudget is not beingprotected.For example, a degrading electricity or water network will not earn revenue if supply cannot be sustained.

Repairs and maintenancelevels shouldbeexaminedbytrend,benchmarkingandengineering recommendations. Maintenancebacklogsarealsoakeyfactorthatmayhavetobefunded.

IffundingforR&Mdisplaysareducingtrendthisisevidencethatinsufficientfundsarebeingcommittedtoassetrepairandcouldalsoindicatethattheoverallbudgetisnotcredibleand/orsustainableinthemediumtolongterm,andthereforethebudgetshouldeitherbereviewedorthefundinglevelsubstantiatedinthebudgetdocument.

**13.Asset renewal/rehabilitation expenditure level:** this measure has a similarobjective totheR&Mmeasures,butfocusingonthecredibilityofthelevelsofassetrenewalplans. Arequirementofthedetailedcapitalbudget(sinceMFMACircular28wasissuedinDecember2005)istocategoriseeachcapitalprojectasanewassetorarenewal/rehabilitationproject. Theobjectiveistosummariseandunderstandtheproportionofbudgetsbeingprovidedfornewassetsandalsoassetsustainability. Adecliningorlowlevelofrenewalfundingmayindicatethatabudgetisnotcredibleand/orsustainableandfuturerevenueisnotbeingprotected, similartothejustificationfor‘repairsandmaintenance’budgets.Highlevelsof investmentsinnewassetsmaynotbesustainableinthelongterm.

Thismeasurealsohelpsunderstandintergenerationalfunding,toassessiffuture generationsmayhavetofundthecostofthecurrentgeneration’sconsumptionoftheassetbase. Highlevelsofnewassetsmaynotbesustainableinthelongtermandevidenceofanassetmanagementstrategyshouldbeprovided. Themediumtermcapitalbudgetshouldmaintainanappropriatemixbetweennewassetsand renewalofassets,takingchangesintechnologyintoconsideration.

**14.FinancialPerformance Budget result (surplus/deficit)**: the purpose of thismeasure is to assess the overall budget. A ‘balanced’ budget (revenue = expenditure)mayindicatefundingcompliance,takingintoconsiderationsomekeyaspects ofthebudgetaftercloserexamination(depreciation,assetcontributions,capitalgrants),andevidenceofacommunitypayingitswayfortheresourcesit planstoconsumeduringthebudgetperiod. Adeficitmaybeindicativeofpropertytaxes/rates, services tariffs orother fees and charges being too low to cover consumption by the community in thebudget period (community may not be‘payingitsway’andmaybedeferringobligationstofuturegenerations). Adeficitgreater than the level of non-cash itemssuch as depreciation may indicate asevere fundingshortfallandnon-compliancewiththeMFMA.Thismayrequire furtherreviewandshouldbeconsideredinthecontextoftheresponsestofactors4“surplus/deficitexcludingdepreciationoffsets” and16“cash flowbudget”.A surplusisnotnecessarilyindicativeofadditionalfundsavailabletospend,asitemssuchasconditionalcapitaltransfers/grantsmayhaveaninfluenceandthesurplusshouldbe examinedwithcare.Asurplusmayberequiredtobeatalevelto produce sufficientinternally generated funds to support asustainable capitalbudget. Analysis of the trend of previous years’ surplus/deficits is also veryrelevant,asanimprovingordeterioratingtrendmaymotivatefurtherordifferentaction.

Care should be taken to motivate and review contributions to provision itemsinitiatedforthefirsttimetocomplywithGRAP/GAMAP;e.g.landfillrehabilitation.Someitemsmayaffectthesurplus/deficit,butnothaveanimmediateeffecton

cashposition.These items and assumptions should be described in budget documentation.

If the Financial Performance Budget result is in ‘balance’ (revenue equals expenditure)dependingonthecircumstancesofthemunicipalityitmayalsobeevidenceofnon-compliance. Ifa‘balanced’resultisbeingsupportedbyalargeamountofcapitaltransfers/grantsandotherassetcontributionsitisreasonabletoconclude that the levelsof tax and service revenue are insufficient to besustainable.

**15.Financial Position Budget**:thepurposeofthismeasureistoalsoassesstheoverallbudget. SpecialattentionshouldbegiventokeyitemssuchasInventory,Current Debtors,Non-currentdebtors(these3itemsbroadlygroupedaspartof‘workingcapital’),BorrowingandCommunityWealth. Recognitionalsoneedstobe

given to community growth and its impact on the financial resources of the municipality. Ifacommunityisexperiencingsubstantialgrowthitwilllikelybecausingexpandedmunicipaloperations,withincreasedbilling,creditorpaymentsandinventory(refertoindividualitemsforspecificdiscussion). Thismayrequireanincreasedinvestmentininventory(anotherworkingcapitalitem);requiringacashpaymentthatis notdirectlyreflectedintheFinancialPerformanceBudgetuntiltheinventoryisbookedtooperationalexpenses.Efficiencyimprovementssuchas‘Just-in-time’mayreducetheinvestmentininventorywithabeneficialcashflowimpact relativeto previousfinancial years.Debtor collection andcreditor paymenttimingmaycauseacashflowshortfall;i.e.ifaveragedebtorcollectionis45daysandcreditorpaymentandremunerationis30daysthengrowthwillcauseanincreasedneedforcashtocoverthegapbetweenpaymentandcollection. Borrowinglevelsneedtobesustainableinthatthemunicipalitymustbeabletoprovethatitwillgeneratesufficientfundstomeettherepaymentobligations. Anaccumulatedsurplusmayindicatethatpastrevenuesexceededexpenditure,butunlessthesurplusiscash-backeditisnotavailabletofundthenextmediumtermbudget(referfactor2“cash plusinvestmentslessapplicationoffunds”).

**16.CashFlowBudget**: thepurposeofthismeasureistoalsoassesstheoverallbudget. TheFinancialPerformanceBudgetonanaccrualbasiscontainsanumberofnon-cashitemsandexcludessomecashitems,sotheCashFlowBudgetiscrucialtoanalyse.Positive cashpositionandcashflowsarerequiredtomeetobligationsasandwhentheyaredue. Asteadilyimprovingcashflowbalance,relative to the growth of the municipalityis a good sign of financial health. Decliningcashbalancesmaybeevidenceoffinancialdifficulties. Careneedstobetakenthattoomuchfocusisnotputontheyearendbalancesofcashalone. Thiscouldbethemostunfavourablecashpositiontimeofthefinancialyear,evenofthewell-managedmunicipality,asitcouldbeasignthattheallexpenditureprogramshavebeenfinalisedprior to theend ofthe year.An examinationof average monthlybalanceswillovercomethisdeficiency.

Largecashbalancesmaybeasignofmismanagementordisguisingmid-year performance problems.Large cash balances could meanthat the capital expenditureprogramwasrushedatyearendandcontractors/suppliershavenotbeenpaid,ortheprogramhasnotbeencompletedandanadjustmentbudgetwillberequired.

Poorrevenuecollectionperformanceforsomemonthsduringtheyearmaycreate temporarycashshortfalls.

**17.Otherkeyperformancemeasures**:thismeasurerequiresanoverallreviewofthe performance indicators presented in Table A8 to ascertain if funding related measuresaredeteriorating,whichmaybeindicativeofafundingissue.Crucial performancemeasures(currentdebtors’collectionrate,thenon-currentdebtors’collectionrate,thecapitalexpenditurerate,borrowinglevel,own-fundsdevotedtothecapitalprogramandtherateofnewandrenewal/rehabilitatedassetacquisition; alsoelectricityandwaterlossesiftheseapply)shouldbeanalysedtoascertainiftheyaredeteriorating.

A deteriorating trend could be evidence of a budget that is not credible and sustainable.Trendsofthesemeasurescanbeascrucialastheabsoluteamount. Deterioratingmeasurementsrequireinvestigationandpossiblycauseareviewofthebudget.

**18.Summary**:thefinalstepisanoverallreviewtoensurethatallmeasureseithermeetthespecifiedrequirementsorhavebeenappropriatelymotivatedinthebudgetdocument.

Ifananalysisoffactors1to17meetthestatedrequirements(orafterreviewthebudgethasbeenamendedbyamunicipalitytodothis),thenthisisgoodevidencethatthebudgetiscompliantwiththefundingrequirementsoftheMFMAandisthereforeprobablycredible,realisticandsustainable.

Thefollowingannexures areincluded:

**AnnexureA: BudgetFormatTableA10-Fundingmeasurement**

**AnnexureB: MFMACircular42(FundingaMunicipalbudget-30March**

**2007)**

1. **COUNCIL APPROVAL AND EFFECTIVE DATE**

Approval of Policy by Council and Effective date: -------------------

MUNICIPAL MANAGER DATE

……………………………………….. ………………………………………..

**AnnexureA: BudgetFormatTableA10**

**exampleMunicipality-Fundingmeasurement-TableA10**

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Description** | **MFMA**  **section** | **Ref** | **PriorYr-3** | **PriorYr-2** | **PriorYr-1** | **CurrentYear** | | | **MediumTermRevenue&Expenditure**  **Framework** | | |
| **Audited**  **Outcome** | **Audited**  **Outcome** | **Audited**  **Outcome** | **Original**  **Budget** | **Adjusted**  **Budget** | **FullYear**  **Forecast** | **BudgetYear** | **BudgetYear**  **+1** | **BudgetYear**  **+2** |
| **Fundingmeasures**  Cash/cashequivalentsattheyearend-R'000  Cash+investmentsattheyrendlessapplications-R'000  Cashyearend/monthly employee/supplierpayments  Surplus/(Deficit)excludingdepreciationoffsets:R'000  Servicechargerev%change-macrotargetexclusive  Cashreceipts%ofRatepayer&Otherrevenue  Debtimpairmentexpenseasa%oftotalbillablerevenue  Capitalpayments%ofcapitalexpenditure  Borrowingreceipts%of capitalexpenditure(excl.transfers)Grants%ofGovt.legislated/gazettedallocations  Currentconsumer debtors%change-incr(decr)Longtermreceivables%change-incr(decr)R&M%ofPropertyPlant&Equipment  Assetrenewal%ofcapitalbudget | 18(1)b  18(1)b  18(1)b  18(1)  18(1)a,(2)  18(1)a,(2)  18(1)a,(2)  18(1)c;19  18(1)c  18(1)a  18(1)a  18(1)a  20(1)(vi)  20(1)(vi) | 1  2  3  4  5  6  7  8  9  10  11  12  13  14 |  |  |  |  |  |  |  |  |  |

*References*

*1. Positivecashbalancesindicativeofminimumcompliance-subjectto2*

*2. Deductcashandinvestmentapplications(defined)fromcashbalances*

*3. Indicativeofsufficientliquiditytomeetaveragemonthlyoperatingpayments*

*4. Indicativeoffundedoperationalrequirements*

*5. Indicativeofadherencetomacro-economictargets(priorto2003/04revenuenotavailableforhighcapacitymunicipalitiesandlaterforothercapacityclassifications)*

*6. Realisticaveragecashcollectionforecastsas%ofannualbilledrevenue*

*7. Realisticaverageincreaseindebtimpairment(doubtfuldebt)provision*

*8. Indicativeofplannedcapitalexpenditurelevel&cashpaymenttiming*

*9. Indicativeofcompliancewithborrowing'only'forthecapitalbudget-shouldnotexceed100%unlessrefinancing*

*10.SubstantiationofNational/Provinceallocationsincludedinbudget*

*11.Indicativeofrealisticcurrentarreardebtorcollectiontargets(priorto2003/04revenuenotavailableforhighcapacitymunicipalitiesandlaterforothercapacityclassifications)*

*12.Indicativeofrealisticlongtermarreardebtorcollectiontargets(priorto2003/04revenuenotavailableforhighcapacitymunicipalitiesandlaterforothercapacityclassifications)*

*13.Indicativeofacredibleallowanceforrepairs&maintenanceofassets-functioningassetsrevenueprotection*

*14.Indicativeofacredibleallowanceforassetrenewal(requiresanalysisofassetrenewalprojectsas%oftotalcapitalprojects-detailedcapitalplan)-functioningassetsrevenueprotection*