



Fezile Dabi

District Municipality

FUNDING AND RESERVES POLICY

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Funding And Reserves Policy

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Definitions

Accounting Standards Board	Was established by the Public Finance Management Act to set standards of Generally Recognised Accounting Practice (GRAP) as required by the Constitution of the Republic of South Africa.
Acquisition Management	Acquisition management is the process of procurement of goods or services and includes the: <ul style="list-style-type: none">• Identification of preferential policy objectives;• Determination of market strategy;• Application of depreciation rates;• Application of total cost of ownership principle;• Compilation of bid documentation, including conditions;• Determination of evaluation criteria;• Evaluation of bids and tabling of recommendations;• Compilation and signing of contract documents;• Contract administration.
Affordable	Affordable in relation to a PPP agreement, means that the financial obligations to be incurred by a Municipality in terms of the agreement can be met by: <ul style="list-style-type: none">• Funds designated in the Municipality's budget for the current year for the activity outsourced in terms of the agreement;• Funds destined for that activity in accordance with the future budgetary projections of the Municipality;• Any allocations of the Municipality;• Or a combination of such funds and allocations.
AGSA	Auditor-General of South Africa
Agreement	In relation to a <i>prohibited Practice in terms of the Competition Act 89 of 1998 as amended</i> , includes a contract, arrangement or understanding, whether or not legally enforceable
AO	Accounting Officer – (Municipal Manager)
Appropriation	Money set aside by Council for a specific purpose
Asset	It is a resource controlled by an entity as a result of past events and from which future economic benefits or service potential is expected to flow to the entity. It has the following characteristics: It possesses service potential or future economic benefit that is expected to flow to the entity. It is controlled by the entity. It originates as a result of a past transaction or event.

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Capital Assets	Are all assets with a life cycle of greater than one year and above the capitalisation threshold (where applicable). For example, this would include property, plant and equipment (infrastructure network, furniture, motor vehicles, computer equipment, etc.), intangible assets, and investment property.
CFO	The Chief Financial Officer of a municipality designated by Municipal Manager to be administratively in charge of the budgetary and treasury functions.
Cost	is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction, or, where applicable, the amount attributed to that asset when construction or, where applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other GRAP.
Cost Of Acquisition	Is all the costs incurred in bringing an item of plant, property or equipment to the required condition and location for its intended use.
Current Replacement Cost	Is the cost of replacing an existing asset with a modern asset of equivalent capacity.
Customer Service	It is the process of serving customers in accordance with acceptable, pre-determined standards in such a manner that it increases customer satisfaction and minimises times and costs.
Demand Management	Demand management ensures that the resources required to support the strategic objectives are delivered at the correct time, at the right price, location, quantity and quality that will satisfy the needs.
Economic Life	is either: (a) The period over which an asset is expected to yield economic benefits or service potential to one or more users, or (b) The number of production or similar units expected to be obtained from the asset by one or more users.
Economic Principle	Obtain the highest possible output for the lowest possible use of resources.
Equipment	A-class accountable stores that are issued and accounted for on an inventory.
FA	Financial Accountant
Fair Value	Is the amount for which an asset could be exchanged between knowledgeable willing parties in an arm's length transaction.
Financially Sustainable	in relation to the provision of a municipal service, means the provision of a municipal service in a manner aimed at ensuring that the financing of that service from internal and external

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sources, including budgeted income, grants and subsidies for the service, is sufficient to cover the costs of—

(a) The initial capital expenditure required for the service;

(b) Operating the service; and

(c) Maintaining, repairing and replacing the physical assets used in the provision

GRAP

Stands for “generally recognised accounting practice”.

IDP

Integrated Development Plan

Investments

In relation to funds of a municipality, means; preserving those funds not immediately required for the defraying of expenses and invested at approved financial institutions a person appointed in terms of section 83 of the Municipality Structures Act, 1998 (Act 117 of 1998) as the head of municipality administration;.

MFMA

Municipal Finance Management Act

MM

Municipal Manager (Accounting Officer)

MSA

Municipal Systems Act

mSCOA

Municipal Standard Charts of Accounts

A multi-dimensional classification framework providing the method and format for recording and classifying financial transaction information in the general ledger forming part of the books of account containing a standard list of all available accounts

MTEF

Medium Term Expenditure Framework

Municipal Functions

Means:

A municipal service.

Any other activity within the legal competence of a Municipality.

Municipal Manager

is the person defined as the Accounting Officer of a Municipality

Municipal Stock

Stock certificate issued by the municipality as a proof of a long-term fixed period loan of which the capital is repayable at the end of the period. Interest is payable at predetermined intervals at a fixed rate.

Negotiable Certificate

A loan certificate that is tradable on the capital market.

Official

Official means:

An employee of a Municipality;

A person seconded to a Municipality to work as a member of the staff of the Municipality;

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	<p>A person contracted to a Municipality to work as a member of the staff of the Municipality otherwise than as an employee.</p>
Operation And Maintenance Plan	<p>The objective of operation and maintenance plans is to ensure assets remain appropriate to programme requirements, are efficiently utilised, and are maintained in the necessary condition to support programme delivery at the lowest possible long-term cost.</p>
Other Applicable Legislation	<p>Means any other legislation applicable to municipal supply chain management, including:</p> <p>The Preferential Procurement Policy Framework Act, 2000 (Act No 5 of 2000).</p> <p>The Broad-Based Black Economic Empowerment Act, 2003 (Act No 53 of 2003).</p> <p>The Construction Industry Development Board Act, 2000 (Act No 38 of 2000).</p>
PPP	<p>Public Private Partnership</p>
PPPFA	<p>Preferential Procurement Policy Framework Act (Act 5 of 2000)</p>
Procedures	<p>Policies are carried out by means of more detailed guidelines called "standard methods". A series of actions conducted in a certain order or manner.</p>
Process	<p>A series of actions or steps towards achieving a particular end.</p>
Project Management	<p>Project management is the planning, directing and controlling of an organisation's resources over a short term to ensure that specific objectives are successfully met.</p>
Property, Plant And Equipment	<p>are tangible assets that:</p> <ol style="list-style-type: none">Are expected to be used during more than one period.Are held by a Municipality for use in the production of goods or supply of goods or services, for rental to others, for administrative purpose; and
Public-Private Partnership	<p>Means a commercial transaction between a Municipality and a private party in terms of which the private party:</p> <ul style="list-style-type: none">Performs a municipal function on behalf of a Municipality.Acquires the use of municipal property for its own commercial purposes.Performs both a municipal function and acquires the use of municipal property as referred to above.Assumes substantial financial, technical and operational risks in connection with the performance of the municipal function or use of municipal propertyReceives a benefit for performing a municipal function or from utilising municipal property, by way of:

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- Consideration to be paid by the Municipality.
- Charges or fees to be collected by the private party from users or customers of a service provided to them.
- A combination of the above.

Quittance	The acknowledgement by the recipient of the receipt of issued stores, reflecting a signature, receipt voucher number and date of receipt.
Reproduction Cost	Is the cost of reproducing the asset in its present physical form (substantially the same materials and design).
Residual Value	Is the net amount that the Municipality expects to obtain for an asset at the end of its useful life after deducting the expected costs of disposal.
Risk Management	Risk management may be defined as the identification, measurement and economic control of risks that threaten the assets and earnings of a business or other enterprise.
Rules	Rules are statements that a specific action must or must not be taken in a given situation.
Salvage	The Act of saving any goods or property in danger of damage or destruction.
The MFMA	Means the Local Government: Municipal Finance Management Act, 2003 (Act No 56 of 2003).
TOR	Terms of Reference
Transfer	Shifting of allocated funds from one department (vote), line-item (vote number) or both to the other.

Funding And Reserves 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 towards ensuring financial viability over both the short- and long term and includes funding as well as reserves requirements.

This policy intends to set out the assumptions and methodology for estimating the following:

- a) Projected direct revenues;
- b) The provision for revenue that will not be collected;
- c) The funds the municipality can expect to receive from investments;
- d) The dividends the municipality can expect to receive from municipal entities;
- e) The proceeds the municipality can expect to receive from the transfer or disposal of assets;
- f) The municipality's borrowing requirements; and
- g) The funds to be set aside in reserves

2 Underlying Policies and Application

Projected direct revenue

These projections are prepared in accordance to the approved Budget Virement policy

The provision for revenue that will not be collected

This is not applicable to the municipality as the municipality does not derive direct revenue from sources other than from government grants and subsidies.

The funds the municipality can expect to receive from investments

The municipality has a Bank and Cash Management Policy which purpose is to secure the sound and sustainable management of the municipality's surplus cash and investments.

It is calculated based on the Budgeted cash-flow, taking into consideration the timing of anticipated inflows and outflows of cash during the year.

The dividends the municipality can expect to receive from municipal entities

This is not applicable to the municipality as no dividends are received from any of the municipality's entities.

The proceeds the municipality can expect to receive from the transfer or disposal of assets

This methodology is governed by the Asset Management Policy and the Supply Chain Management Policy.

The municipality's borrowing requirements

The municipality's borrowing requirements are determined in accordance with the municipality's affordability thereof.

The funds to be set aside in reserves

The funds to be set aside in reserves are subject to affordability

3 Funding Policy

3.1 Legislative Requirements

In terms of Sections 18 and 19 of the Municipal Finance Management Act (Act No 56 of 2003)

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(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.

3.2 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.

3.3 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.

3.4 Cash Management

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

3.5 Debt Management

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

3.6 Funding the Operating Budget

3.6.1 Introduction

The municipality's objective is that the user of municipal resources must pay for such usage in the period it occurs.

3.6.2 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.

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

- Government grants and subsidies;
- Administration and management fees, recoveries etc, and
- Cash backed accumulated surpluses from previous years not committed for any other purposes.

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.

For the purpose of the Cash flow Budget all rebates and discounts must be deducted from the projected revenue.

- e) 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.
- f) 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 these requirements. The cash portion of the employee benefits must be accounted for in an "Employee Benefits Reserve".
- g) 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.

- h) 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.

3.7 Funding the Capital Budget

3.7.1 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.

3.7.2 Funding Sources for Capital Expenditure

The capital budget can be funded by way of own contributions, grants and 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.

Notwithstanding the above the capital budget or portions thereof may also be funded from surplus

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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.

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 Accounting Officer must 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.

3.8 Funding Compliance Measurement

3.8.1 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.

3.8.2 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".

3.8.3 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 such as the Housing Development Fund;
- 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.

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3.8.4 Monthly Average Payment Covered By Cash and Cash Equivalents ("Cash Coverage")

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

3.8.5 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 may 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.

3.8.6 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.

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

3.8.7 Capital Payments as a Percentage of Capital Expenditure

This indicator provides information as to the timing for payments on capital projects and utilising allowed payment terms.

3.8.8 Borrowing As a Percentage 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 compliance with the Municipality's Debt Management Policy.

3.8.9 Grants Revenue as a Percentage of Grants Available

The percentage should 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.

3.8.10 Repairs and Maintenance Expenditure Level

It is of utmost importance that the municipality's Property Plant and Equipment be maintained properly, in order 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 in order 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.

Considering the values of the assets, it is more prudent for the maintenance budget to be between 1% and 8% of the value and the municipality must provide a detailed explanation and assurance that the budgeted amount is adequate to secure the ongoing health of the municipality's infrastructure supported by reference to its asset management plan.

3.8.11 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 in order to determine whether the renewal program is sufficient or needs revision.

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

3.8.13 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.

3.8.14 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.

4 Reserves Policy

4.1 Introduction

Fund accounting historically formed a huge part of municipal finance in the IMFO standards.

Since the municipality changed to General Recognised Accounting Practices (GRAP), fund accounting is no more allowed.

The municipality, however, recognises 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 measure of protection by creating certain reserves.

4.2 Legal Requirements

There are no specific legal requirements for the creation of reserves, except for the Housing Development Fund. The GRAP Standards itself also do not provide for reserves.

However, the GRAP "Framework for the Preparation and Presentation of Financial Statements" states in paragraph 91 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.

4.3 Types of Reserves

Reserves can be classified into two main categories being "cash funded reserves" and "non - cash funded reserves".

4.4 Cash Funded Reserves

In order to provide for sufficient cash resources for future expenditure, the municipality hereby approves the establishment of the following reserves:

Capital Replacement Reserve (CRR)

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 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.

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Employee benefits reserve

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

The contributions to the reserve must be made in accordance with the directives set in this Funding Policy.

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 reserve must be made in accordance with the directives set in this Funding Policy.

Valuation reserve

The aim of this reserve is to ensure sufficient cash resources are available to undertake a General Valuation as per the Municipal Property Rates Act.

The contribution to this reserve should be approximately 25% of the anticipated cost of the General Valuation and the Accounting Officer is hereby delegated to determine this amount annually during the compilation of the annual financial statements.

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.

4.5 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.

4.6 Accounting for Reserves

4.6.1 Revaluation Reserve

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

4.6.2 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.

5 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 on an annual basis. Such submission must be accompanied with a full description of the reasons for the change to the policy.

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Appendix A

Reconciliation of Cash Requirements

	Cash flow from operating activities	RXX
Add	Depreciation from own funds Contribution to current provisions 20% of prior year	RXX
Add	Non - current provisions balance 5% of prior year	RXX
Add	Non - current employee benefits balance	RXX
Add	Contribution to Valuation reserve	RXX
Add	Unspent conditional grants	RXX
Add	Unspent public contributions	RXX
Add	Unspent borrowings	RXX
Add	VAT due to SARS	RXX
Add	Secured investments Cash portion of Statutory	RXX
Add	Reserves Working Capital Requirements	RXX
Add	Minimum Cash Surplus Requirements for the year	RXX