

SETSOTO LOCAL MUNICIPALITY

BUDGET FUNDING PLAN 2020/2021

BACKGROUND

The purpose of this document is to provide clarity and a plan to submit funded budgets for the current year and future years to follow. This plan derived from Provincial Treasury's letter submitted to the Accounting Officer highlighted that the Budget 2020/2021 are unfunded. Even though the budget reflects a deficit, the unique situation should be taken into consideration.

The budget is compiled according to the legislative requirements set out in terms of chapter 4 of the MFMA, Act 56 of 2003.

In order to have a better informed understanding of the unfunded budget situation, one should take into account the attached letter/report written to National Treasury dated 10 November 2017, as well as our visit to National Treasury on 5 June 2018 pertaining the implementation of Circular 58. See attached letter/report.

BUDGET FUNDING PLAN

To demonstrate the approach followed to compile the budget funding plan, one needs to take the below calculation in consideration. The calculations followed by the municipality to determine if the budget is funded or not.

	<i>75% Payment</i>	<i>64% Payment *</i>
Description	Amount	Amount
Total service charges	289,905,432.00	289,905,432.00
Less Debt impairment. *	-71,253,360.00	-104,504,928.00
Total services collectable	218,652,072.00	185,400,504.00
Equitable share	243,949,482.00	243,949,482.00
Other cash charges	47,719,584.00	47,719,584.00
Cash Operating rev	510,321,138.00	477,069,570.00
Capital Grants Rev	179,873,004.00	179,873,004.00
TOTAL REVENUE	690,194,142.00	656,942,574.00
Less: Total Operating Expenditure	-657,938,688.00	-657,938,688.00
Count back Impairment budget above. *	71,253,360.00	71,253,360.00
Exclude Depreciation based on Circular 58	126,155,652.00	126,155,652.00
Less: Total Capital Expenditure	-182,370,440.00	-182,370,440.00
Surplus/(Deficit)	47,294,026.00	14,042,458.00

*According to the methodology used above it is anticipated that the budget is funded. (See the attached letter wrote to National Treasury mentioned above). Should a scenario being used that the payment rate will only be as high as 64% as assumed according to Provincial Treasury letter, the municipality will still budget for a surplus.

Cognisance should also be taken that the municipality are reporting on an accrual basis in terms of GRAP.

The following areas will be addressed:

Cash Flows:

To maintain a positive cash flow, cash flow projections are made monthly and updated daily to prevent circumstances transacting into negative cash flow. Priority is given to core service delivery issues to provide the necessary basic needs required by the consumers. The biggest contributors to distress the cash flow is Bulk electricity purchases and employee related costs.

Enhancing the cash flow, the municipality opt for the provision of pre-paid electricity within its distribution area that also assists with the collection of arrear accounts.

Reduction in non-core expenditure:

The council adopt the National Treasury cost containment measures and all effort is being done to ensure that cost containment measures are implemented.

Management is also in the process to review the staff structure to limit a bloated structure. Special attention will be given to non-core functions and staff compliment. The non-core expenditure has already been cut to the bone, and council will limit any further increases by reducing the expenditure with a 5% year on year.

Trade Payables:

The biggest single creditor remains the payment of the Eskom account, however the necessary agreements have been reached between Eskom and the Municipality. The Eskom account does not accumulate more than 120 days outstanding and are settled quarterly.

Pension funds, Medical aids, PAYE, and other employee related cost are fully paid to date.

The council will also embark to conduct business with VAT registered SMME and other companies to receive the advantage of claiming back the VAT. This will also assist in decreasing expenditure.

Liquidity:

The municipality's risk to liquidity is a result of the funds available to cover future commitments. The municipality manages liquidity risk through an ongoing review of future commitments and credit facilities.

Cash flow forecasts are prepared, and adequate utilised borrowing facilities are monitored.

The table below analyses the municipality's financial liabilities and net-settled derivative financial liabilities into relevant maturity groupings based on the remaining period at the statement of financial position to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows. Balances due within 12 months equal their carrying balances as the impact of discounting is not significant.

At 30 June 2020

	Less than 1 year.	1 to 2 years	2 to 5 years	Over 5 years
Borrowings	9 107 194	9 107 194	1 661 710	-
Consumer deposits	3 221 649	-	-	-
Unspent conditional				

Grants and receipts	47 605 354	-	-	-
	59 934 197	9 107 194	1 661 710	-
At 30 June 2019				
	Less than 1year	1 to 2 years	2 to 5 years	Over 5 years
Borrowings	7 637 045	-	20 772 460	-
Consumer deposits	3 219 260	-	-	-
Unspent conditional grants and receipts	8 979 260	-	-	-
	19 835 565	-	20 772 460	-

Credit risk

Credit risk consists mainly of cash deposits, cash equivalents, derivative financial instruments, and trade debtors. The municipality only deposits cash with major banks with high quality credit standing and limits exposure to any one counterparty. Trade receivables comprise a widespread customer base. Management evaluated credit risk relating to customers on an ongoing basis. If customers are independently rated, these ratings are used. Otherwise, if there is no independent rating, risk control assesses the credit quality of the customer, taking into account its financial position, past experience and other factors. Individual risk limits are set based on internal or external ratings in accordance with limits set by the board. The utilisation of credit limits is regularly monitored. Sales to retail customers are settled in cash or using major credit cards. Credit guarantee insurance is purchased when deemed appropriate. Financial assets exposed to credit risk at year end were as follows:

Financial instrument	2020	2019
Receivables from exchange transactions	200 815 148	208 757 363
Receivables from non-exchange transactions	43 575 983	39 882 399
VAT receivable	10 913 084	-
Cash and cash equivalents	30 216 676	29 385 855

Market risk

Interest rate risk

The municipality analyses its interest rate exposure on a dynamic basis. Various scenarios are simulated taking into consideration refinancing, renewal of existing positions, alternative financing, and hedging. Based on these scenarios, the municipality calculates the impact on surplus and deficit of a defined interest rate shift. For each simulation, the same interest rate shift is used for all currencies.

At 30 June 2020, if interest rates on Rand-denominated borrowings had been 0.1% higher/lower with all other variables held constant, surplus for the year would have been R 6 825 lower/higher, mainly as a result of higher/lower interest expense on floating rate borrowings.

The Municipality assessed the impact of COVID-19 pandemic by comparing the financial indicators of 2019 and 2020 as illustrated below:

Current Ratio (norm - 2:1)	1,5	1,7
Creditors days (norm - 30 days or less)	183,53 days	226,92 days
Debtors collection rate (95% or more)	567,74 days	546,42 days

When analysing the results of the ratios, it can be concluded that the COVID-19 pandemic had an adverse effect from a financial sustainability perspective. The results are not solely because of COVID-19 and subsequent lockdown regulations but has been significantly impacted by the pandemic. The results are still however reasonable within the norms. The municipality has assessed that no going concern issues has been noted and that the municipality can continue in operational existence for the foreseeable future.

Debtors Collection Rate:

The collection rate remains under pressure and collection does not yield positive results. Areas where the municipality distribute electricity to its consumers performs well. This can be attributed to the electricity prepaid system that has been installed as well as that the system contributes to collection on arrear accounts. A specific measure already implemented is whenever a consumer is more than 60 days outstanding, at least 50% of the prepaid electricity purchase will be allocated to the arrears account. The table below depicts the payment rate per ward for the month of October 2020.

Ward	Total Settlements	Total Movement	Billing	CreditNotes	Debit Notes	Other Adjustments	Payment Rate (Movement)
WARD 1	-1,182,572.17	2,265,117.93	2,338,512.83	-110,821.70	52,779.90	-15,353.10	53%
WARD 2	-27,337.19	1,207,415.30	1,284,241.41	-15,037.32	-	-61,788.79	2%
WARD 3	-106,897.45	383,255.56	380,554.00	-1.44	-	2,703.00	28%
WARD 4	-605,136.88	1,243,858.17	1,292,953.37	-43,823.89	-	-5,271.31	49%
WARD 5	-5,084.91	372,524.15	380,828.61	-1,062.45	-	-7,242.01	1%
WARD 6	-916,193.87	1,759,936.72	1,804,614.51	-52,191.99	-	7,514.20	52%
WARD 7	-59,599.79	926,706.79	990,344.44	-22,030.11	-	-41,607.54	6%
WARD 8	-35,954.89	827,545.05	874,309.92	-1,219.77	-	-45,545.10	4%
WARD 9	-764,617.67	1,367,185.71	1,729,203.54	-39,692.55	21,157.27	-343,482.55	56%
WARD 10	-569,874.75	967,920.75	1,259,146.16	-138,904.12	-	-152,321.29	59%
WARD 11	-30,119.40	802,151.52	816,060.40	-13,908.88	-	-	4%
WARD 12	-12,272.95	732,670.00	732,352.02	-	-	317.98	2%
WARD 13	-36,025.89	633,581.41	824,364.12	-	-	-190,782.71	6%
WARD 14	-22,232.31	801,242.93	811,070.00	-	-	-9,827.07	3%
WARD 15	-3,526,999.03	3,786,556.42	4,144,403.80	-307,890.63	1,021.41	-50,978.16	93%
WARD 16	-29,816.90	865,042.33	914,796.03	-	-	-49,753.70	3%
WARD 17	-19,502.16	649,958.44	704,202.36	-	-	-54,243.92	2%
PAYMENT ADVANCED	-300,502.67	-	-	-	-	-	0%
Total	-8,250,740.88	19,592,669.18	21,281,957.52	-746,584.85	74,958.58	-1,017,662.07	42%

The municipality is in the process to approve its Revenue enhancement strategy policy and document to improve on revenue collection. Possible additional revenue sources to be optimal utilised. The table below depicts the percentage payment rates for the past 4 years, in terms of the calculation methodology as contained in Circular 71. The collection rates have been calculated in line with MFMA Circular No.71 which deals with Uniform Financial Ratios and Norms. The formula used to calculate the collection rate, as indicated in Circular 71, is as follows: $(\text{Gross Debtors Opening Balance} + \text{Billed Revenue} - \text{Gross Debtors Closing Balance} - \text{Bad Debts Written Off}) / \text{Billed Revenue} \times 100$. The COVID 19 pandemic did had a detrimental effect on the payment rate as indicated below.

	2019/2020	2018/2019	2017/2018	2016/2017
Gross Debtors Open Bal	421,633.00	388,975.00	360,738.00	291,591.00
+ Billed revenue	242,878.00	244,642.00	231,244.00	195,618.00
- Gross Deb Close Bal	-435,507.00	-425,993.00	-388,975.00	-360,738.00
- Bad debt written off	-111,589.00	-86,245.00	-85,526.00	-53,148.00
Sub-Total	117,415.00	121,379.00	117,481.00	73,323.00
/ Billed revenue	242,878.00	244,642.00	231,244.00	195,618.00
% Payment	48%	50%	51%	37%

Oversight:

Financial reports are submitted to the Financial Committee monthly to advise and report to the Executive Mayor.



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YOUR REF:

OUR REF

2017/11/10

Mr. Jan Hattingh
Chief Director: Local Government Budget Analysis and Intergovernmental Relations
National Treasury
Private Bag X115
Pretoria
0001

Sir,

IMPLEMENTATION OF NATIONAL TREASURY CIRCULAR NO. 58 PARAGRAPH 4.3

In light of the above the Municipality has received an exception from the Auditor General that there is an unauthorised expenditure in relation to depreciation.

The Municipality has since the end of financial year 2010/2011 adopted and/or used the revaluation model with the implementation of GRAP 17. The Municipality revalued its existing assets in terms of GRAP 17 using the CRC (Current replacement cost) method and that all newly purchased assets in future being included in the asset register at cost. The impact of this exercise resulted in a massive increase in the value of the Municipality's assets in the Municipal financial position as well as a huge increase towards the value of depreciation in the Municipal statement of financial performance. This may also impact on higher tariffs to be set that will effect low payment rate and affect Municipality's financial stability negatively.

Annexure A below reflects the Municipality's audited Statement of Financial Position for the year 2010/11, indicating the total net assets amounts to R 210 million.

Annexure B below reflects the Municipality's audited Statement of Financial Position for the year 2011/12, indicating the total net assets amounts to R 2,275 billion. (See the restated amount). Subsequent to the increased assets value, the depreciation has also increased drastically, in such a way that should the total depreciation be used to determine any cost reflective tariffs, it will be unaffordable for the entire community.

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In order to address the above, the Municipality decided to follow the guidelines highlighted in the National Treasury Circular 58 when preparing its budget, as outlined in the following paragraph.

“To facilitate this, the depreciation detail required on Supporting Table SA1 has been modified as follows:

Description	Ref	2008/9	2009/10	2010/11	Current Year 2011/12				2012/13 Medium Term Revenue & Expenditure Framework		
		Audited Outcome	Audited Outcome	Audited Outcome	Original Budget	Adjusted Budget	Full Year Forecast	Pre-audit outcome	Budget Year 2012/13	Budget Year +1 2013/14	Budget Year +2 2014/15
R thousand											
Depreciation & asset impairment											
Depreciation of Property, Plant & Equipment											
Lease amortisation											
Capital asset impairment											
Depreciation resulting from revaluation of PPE	10										
Total Depreciation & asset impairment	1	-	-	-	-	-	-	-	-	-	-

The ‘Total Depreciation and asset impairment’ taken through to Table A4 excludes ‘Depreciation resulting from the revaluation of PPE’ associated with the adoption of the ‘revaluation model’ with the implementation of GRAP 17. The depreciation related to the ‘cost model’ of assets will thus still be taken through to Table A4 (Budgeted Statement of Financial Performance).

As regards the treatment on the Statement of Financial Position: ‘Depreciation resulting from the revaluation of PPE’ must be debited against the ‘Revaluation reserve account’.”

Below is the Municipality’s budget extract:

FS191 Setsoto - Supporting Table SA1 Supporting detail to 'Budgeted Financial Performance'

Description	2012/13	2013/14	2014/15	Current Year 2015/16			2016/17 Medium Term Revenue & Expenditure Framework		
	Audited Outcome	Audited Outcome	Audited Outcome	Original Budget	Adjusted Budget	Full Year Forecast	Budget Year 2016/17	Budget Year +1 2017/18	Budget Year +2 2018/19
R thousand									
Depreciation & asset impairment									
Depreciation of Property, Plant & Equipment	213,475	263,680	261,822	276,864	252,723	252,723	256,023	33,573	35,587
Lease amortisation	-	-	-	-	986	986	550	550	550
Capital asset impairment	-	-	-	-	-	-	-	-	-
Depreciation resulting from revaluation of PPE	-	-	-	251,582	223,000	223,000	223,000	-	-
Total Depreciation & asset impairment	213,475	263,680	261,822	25,282	30,709	30,709	33,573	34,123	36,137

Note that the Municipality budget correctly for depreciation per individual line item, as disclosed in table SA1 above. With the amount of depreciation that was allocated and financed through the depreciation reserve or accumulated surplus account, the total depreciation carried forward to table A1 (Summary) are reduced with the depreciation resulting from revaluation of PPE.

FS191 Setsoto - Table A1 Budget Summary

Description	2012/13	2013/14	2014/15	Current Year 2015/16			2016/17 Medium Term Revenue & Expenditure Framework		
	Audited Outcome	Audited Outcome	Audited Outcome	Original Budget	Adjusted Budget	Full Year Forecast	Budget Year 2016/17	Budget Year +1 2017/18	Budget Year +2 2018/19
R thousands									
Employee costs	128,148	133,588	154,017	159,569	161,123	161,123	173,039	178,223	188,917
Remuneration of councillors	11,082	9,432	9,884	10,354	10,354	10,354	10,714	11,357	12,038
Depreciation & asset impairment	213,475	263,680	261,822	25,282	30,709	30,709	33,573	34,123	36,137
Finance charges	1,265	1,041	919	3,227	1,779	1,779	1,745	1,637	1,324
Materials and bulk purchases	83,260	52,562	53,594	67,561	67,561	67,561	74,000	75,911	80,466
Transfers and grants	8,133	3,877	2,607	13,180	13,750	13,750	2,763	2,929	3,104
Other expenditure	114,118	151,624	133,820	126,826	134,077	134,077	145,160	135,796	142,279
Total Expenditure	559,480	615,804	616,663	405,999	419,352	419,352	440,992	439,975	464,266

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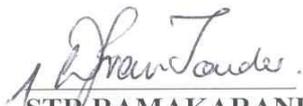
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There has always been a misunderstanding between the Municipality and Auditor General on the treatment of depreciation followed by the Municipality and the interpretation of Circular 58. The Auditor General only accept table A1 as the budget amount and do not consider table SA1 as an annexure that informs the budget summary table.

The Municipality therefore find it necessary to inform you about the challenge that it experience and humbly request your urgent intervention in the matter. It should also be noted that the amount is material and may have a negative impact on the Municipality's audit outcome.

The municipality thank you in advance for your positive guidelines in this matter and your earliest reply will be highly appreciated.

Yours faithfully


STR RAMAKARANE
MUNICIPAL MANAGER

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ANNEXURE A

Setsoto Local Municipality

Annual Financial Statements for the year ended 30 June 2011

Statement of Financial Position

	Note(s)	2011 R	2010 R
Assets			
Current Assets			
Inventories	5	1 744 376	1 281 881
Other financial assets	4	10 006 881	14 367 857
Trade and other receivables from exchange transactions		4 536	-
Other receivables from non-exchange transactions	6	1 100 387	2 044 056
VAT receivable	7	6 829 677	2 435 440
Consumer debtors	8	64 085 621	53 645 956
Other asset		3 573	3 573
Cash and cash equivalents	9	4 300 406	3 656 199
		88 075 457	77 434 962
Non-Current Assets			
Property, plant and equipment	3	210 513 554	323 154 016
Other financial assets	4	1 131 714	1 106 770
Other asset		8 439	12 012
		211 653 707	324 272 798
Non-Current Assets		211 653 707	324 272 798
Current Assets		88 075 457	77 434 962
Non-current assets held for sale (and) (assets of disposal groups)		-	-
Total Assets		299 729 164	401 707 760

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ANNEXURE B

Setsoto Local Municipality Statement of Financial Position as at 30 June 2012

		2012	Restated 2011
	Note		
Assets			
Current Assets			
Inventories	3	1,616,233	1,744,376
Investments	4	-	10,006,881
Trade and Other Receivables from Exchange Transactions	5	66,508,234	59,622,343
Other receivables from non-exchange transactions	6	12,388,707	22,172,631
VAT receivable	7	41,163,561	17,731,372
Current Portion of Receivables	8	3,573	3,573
Cash and cash equivalents	9	6,791,111	4,300,406
		128,471,419	115,581,582
Non-Current Assets			
Investment property	10	14,635,448	16,058,925
Property, plant and equipment	11	2,156,383,140	2,275,383,854
Intangible assets	12	638,948	651,501
Investments	4	1,956,694	1,131,714
Non Current Receivables	8	4,866	8,439
		2,173,619,096	2,293,234,433
Total Assets		2,302,090,515	2,408,816,015

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