
Approach to reserves

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I Our approach to reserves

Reserves are by their nature an allocation/portion of Council's accumulated surplus. The primary reason that Council uses and identifies reserves is to declare that this portion of the accumulated surplus is earmarked for a purpose. This approach provides readers and the community with transparency about Council's intentions.

In the interests of transparency, the detail on reserves is provided in the notes to the annual financial statements. For 2016/17 this information is included in the Balance Sheet and explanatory note 29. Provided below is a summary of that information.

From the Balance Sheet	Actual 30 June 2017
Total Equity	617,481,127
Made up of:	
Accumulated surplus	243,247,634
Reserves	374,233,494

From note 29	
Reserves are made up of:	
Asset revaluation reserve	338,276,875
Other reserves	35,956,619

In note 29 we advise of our intention to use the balance of Other reserves (\$35,956,619) for a range of identified purposes (see appendix B):

- some of which are subject to statutory and/or contractual obligations:
 - Car parking reserve \$54,118
 - Resort and recreation reserve \$3,127,928
 - Capital lease commitments \$603,555
 - Native vegetation offset reserve \$47,909
 - Specific development contributions \$685,644
- Some of which are required to complete projects unfinished at 30 June 2017:
 - Constrained works (carry forward) \$5,369,848
- Some of which are recognition of revenue received prior to 30 June 2017 which is budgeted for use in 2017/18:
 - VGC grant received in advance \$2,902,970
- Some of which have been quarantined for specific purposes:
 - Drainage reserve \$8,400
 - Future sustainability fund \$35,645
 - Landfill rehabilitation \$4,129,985
 - LGFV sinking fund \$4,177,355
 - Long service leave \$4,662,651
 - Non-standard street lighting reserve \$165,629
 - Art in public places \$103,635
 - Highball development \$1,500,000
 - Skate park \$165,000

- With the remainder being available to fund future projects and activities:
 - Strategic works \$3,537,766
 - Unallocated surplus \$4,678,581

Reserves are then an allocation of accumulated surplus, whilst at the same time we balance that portion of accumulated surplus with elements of assets and liabilities. In that way reserves (from a local government perspective) are also a way to telegraph how council will fund/pay for future activities and quarantines funds for those activities. Much like an individual would put aside funds to spend on a holiday, replace a car, renovate a room, or purchase a new TV, reserves involve putting aside funds for projects or works that we know are coming up. Reserves are then also a funding mechanism.

So what about indicators like the working capital ratio (Liquidity ratio)? Focusing on working capital ratios etc. does not really provide any real sense about how council would fund its future activities, it simply provides us with a comparison between current assets that we have now, against current liabilities (which are obligations that we have now that have a basis in fact or contract). It misses the concept of having a plan to fund or pay for future activities and for that we use reserves.

As mentioned earlier, reserves are recognised in the equity area of the balance sheet but are balanced (offset) by a combination of various current and non-current assets along with current liabilities. For example, a reserve exists for landfill rehabilitation. This reserve is the allocation we have set aside to fund the future works on rehabilitating a landfill site. It is not the total amount of cash we need to do the works, yet. In simple terms it is council telegraphing that we are putting funds aside over the years so that when we do have to do the works we have the funds available to pay for it. This differs from the provision for landfill rehabilitation.

The provision for the landfill rehabilitation is the approximate value of doing the total works in the future and is a reflection of the future commitment, in today's dollars.

The reserve for Long Service Leave is of a similar nature, however its origins are that this reserve was until recent years required by regulation to be backed by a cash reserve.

Broadly, the approach by Council focuses on the likely cash inflows and outflows and discounts (or ignores) balance sheet items that are not actually cash, likely to have a cash impact, or are items that are covered by other mechanisms (which includes current borrowings).

On the following page is the summary table of the calculation to ensure that there are sufficient overall funds for the allocation we have available for reserves (the net position is expected to equal zero) – the detailed break-up is in appendix A.

Description	Actual 30 June 2017	Actual 30 June 2016
Cash and cash equivalents	38,167,216	26,341,606
Add current Trade and other receivables	4,277,140	4,561,018
Add accrued Income	592,658	223,674
Add non-current trade and other receivables	49,400	59,638
Less current trade and other payables	(3,473,759)	(3,094,719)
Less trust funds and deposits	(3,656,036)	(2,726,924)
Less other reserves	(35,956,619)	(25,364,292)
Net Surplus/ (Deficit) Position	0	0

More simply, it is based on the cash funds available, plus the funds we expect to receive for outstanding debts and accrued income, less the real expected outlays for suppliers and any trust funds or deposits held. The balance will be the total value of reserves.

This reconciliation is usually conducted as part of the end of financial year process to ensure that we have a sufficient allocation of funds to support the reserve balances included in the financial statements.

Note there is no inclusion of current borrowings in the calculation (because that payment is budgeted for each year as part of council operations) and no inclusion of provisions (in part because they are either budgeted for already like borrowings or to include them would be to double count for the activity). Importantly, ratios like liquidity are focused on contractual obligations for outlays only in the following year, they do not help to explain anything beyond one year ahead, they also do not provide any assistance in understanding how council intends to fund its future activities beyond the following year.

Ultimately, our current approach provides absolute clarity around the intention of funds that council either has or is expected to have and allows for council to maximise the benefit of those funds. Reserves are also an important element in ensuring that through the course of each year council has sufficient funds to pay the bills when they are due to be paid.

The current approach then is to treat council funds from a global or holistic approach, understanding that council's funds and its balance sheet need to work for council, so maximising the possible returns and minimising cost of funds, producing the most efficient outcome, whilst providing transparency for the intentions of council.

To simply follow the standard accounting approach of treating all cash outside of contractually restricted funds as unallocated or freely available for spending would be to mislead the community into perceiving that all unrestricted funds were simply spare cash.

2 Are there alternatives?

There are two (2) other competing perspectives cited when it comes to council's cash and reserves.

2.1 Pure accounting approach

The pure accounting approach to reserves and cash considers all cash, all council funds as just one "bucket" with no clearly articulated purpose other than to meet contractual obligations that may be realised at a particular point in the future. It is heavily focused on treating the business of council almost as if it was expected to cease trading at a point in time, applying the overarching question, does it have the cash to pay its bills? Council is however a perpetual entity with no such end date.

The pure accounting approach allows for council to maximise returns, but when coupled with focusing on working capital ratios and the like, it fails to adequately articulate what is likely to really occur. For example, will next year's debt repayments actually be made from last year's cash in the bank?

One of the other key failings of this approach is that it is not clear about the purpose of council's funds, it gives no sense of why council has cash in the bank.

This approach requires extensive long term plans with a high level of detail in order to understand the purpose of funds that council may have at any one point in time and fails to adequately address when council would like to forecast or highlight funds for non-capital projects or activities, for example setting aside funds for the High Ball development at the Wonthaggi Senior Campus. So, whilst this approach may maximise returns and is simple to administer, it is significantly deficient in terms of transparency to non-accountants

2.2 Pre-accrual accounting approach

The second approach is to isolate reserves into separate bank accounts and to make those accounts not part of council's available funds. This approach provides an opportunity for an increased level of

transparency for the community with regard to why council has funds and clearly telegraphs the future intentions of council.

The separate bank account approach (or jam tin accounting as it used to be termed) is however an anachronism from the past that fails to holistically understand and maximise the value of council's funds.

As applied in NSW, this approach places significant restrictions on the availability of reserve funds and results in Council's having to raise additional funds that have no other purpose than to support liquidity through the course of the year. Further this approach has a significant impact of the cost of managing council's funds, provides for lower returns on investments and comes at a greater administrative burden.

The current approach then is one of a trying to ensure the maximum transparency, whilst maximising the possible returns with the most efficient outcomes. A compromise or happy medium of approaches, without the failings of either.

3 Appendices

3.1 Appendix A

Data sourced from Balance Sheet	30 June 2017	30 June 2016
Cash and cash equivalents		
Cash on hand	5,650	5,800
Cash at bank	6,661,566	4,130,660
Term deposits	31,500,000	22,205,145
	<hr/> 38,167,216	<hr/> 26,341,606
Current Trade and other receivables		
Rates debtors	2,216,258	2,665,401
Provision for doubtful debts - rates debtors	(41,816)	(419,661)
Special rate scheme	728,826	1,008,698
Infringement debtors	260	389
Other debtors	1,373,612	1,306,191
	<hr/> 4,277,140	<hr/> 4,561,018
Other financial assets		
Shares in community bank (exclude this item)	<hr/> -	<hr/> -
Inventories		
Inventories held for sale (exclude this item)	<hr/> -	<hr/> -
Other assets		
Accrued income	592,658	223,674
Prepayments (exclude this item)	<hr/> 592,658	<hr/> 223,674
Non-current Trade and other receivables		
Special rate scheme	-	10,238
Loans and advances to community organisations	49,400	49,400
	<hr/> 49,400	<hr/> 59,638
Trade and other payables		
Accrued expenses	(1,025,751)	(1,518,648)
Prepaid income	(60,400)	(21,650)
Trade payables	(2,387,607)	(1,554,421)
	<hr/> (3,473,759)	<hr/> (3,094,719)
Trust funds and deposits		
Refundable deposits	(67,871)	(68,392)
Fire services levy	(568,326)	(513,611)
Retention amounts	(2,419,283)	(1,988,423)
Other refundable deposits	(600,556)	(156,499)
	<hr/> (3,656,036)	<hr/> (2,726,924)
Other reserves		
Statutory reserves	(3,182,046)	(1,960,475)
Contractually restricted reserves	(1,337,108)	(695,125)
Identified reserves	(18,549,513)	(16,539,907)
Discretionary reserves	(12,887,952)	(6,168,785)
	<hr/> (35,956,619)	<hr/> (25,364,292)
	<hr/> (0)	<hr/> 0

3.2 Appendix B

Reserve	Balance at 30 June 2017	Description/purpose
Art in Public Places	103,635	Provision for funds to be allocated to the development and installation of major public art installations across the municipality.
Capital Lease Commitments	603,555	Where Council has leases that include a capital contribution obligation this reserve is to retain the annual allocation towards that contribution less any payments made.
Car Parking	54,118	Statutory reserve to be used for the development of car parking from specific developer contributions.
Constrained Works (Carry Forward)	5,369,848	This reserve is to recognise the funds allocated and received in prior financial periods that are committed to unfinished projects.
Drainage	8,400	Developer contributions towards drainage as part of planning agreements.
Future Sustainability Fund	35,645	These funds are to ensure allocations for specific future expenditures and where they aid in the future financial sustainability of the Bass Coast Shire.
Highball development	1,500,000	These funds have been set aside to fund the future highball development at the Wonthaggi Senior Secondary College.
Landfill Rehabilitation	4,129,985	This reserve is to fund the rehabilitation the waste disposal sites.
LGFV Sinking Fund	4,177,355	To fund the repayment of LGFV bonds as the bonds come due for payment.
Long Service Leave	4,662,651	The purpose of this reserve is to ensure that the nominal long service leave balances owing to employees are fully funded and maintained.
Native Vegetation Offset	47,909	Funds sourced from certified Native Vegetation Offset Schemes and utilised to fund ongoing maintenance of Offset Reserves.
Non-standard Street Lighting	165,629	Developer contributions towards non-standard lighting installed and collected as part of planning agreements towards non-standard light renewal.
Resort & Recreation	3,127,928	Statutory reserve to be used for the development of recreational reserves and public open space, sourced from specific developer contributions.

Reserve	Balance at 30 June 2017	Description/purpose
Skate Parks	165,000	These funds have been set aside via council resolution for future works on municipal skate park facilities.
Specific Development Contributions	685,644	To capture funds provided by developers for future specific projects in accordance with planning agreements.
Strategic Works	3,537,766	These funds are intended for strategic works and acquisitions of new or expanded assets that are of an intergenerational nature.
VGC grant received in advance	2,902,970	Victorian Grants Commission funding in relation to the next financial year paid in advance.
Unallocated Surplus	4,678,581	These funds are the funds that remain unallocated at the year end.