



LOCAL GOVERNMENT CODE OF ACCOUNTING PRACTICE & FINANCIAL REPORTING

SUBMISSION RELATING TO DISCLOSURE OF REVENUE RESERVES

1. Introduction

The NSW Code of Accounting Practice was introduced concurrently with the adoption of Australian Accounting Standard AAS 27 “Financial Reporting by Local Governments” effective from 1 January 1993. Pursuant to clause 18 of the Local Government (Financial Management) Regulation 1999 the Code is a prescribed standard for the purposes of section 413 (3) of the Local Government Act 1993 (as amended).

The Code is updated regularly and the current edition includes update #9 issued May 2001. All extracts from the Code in this document have been taken from that update.

The key provisions of the Code in relation to reserves are contained in Chapter 8 “Accounting for Equity” and to a lesser extent in Chapter 5.8 “Notes - Minimum Contents - Restricted Assets”. Examples of preferred disclosure are given in Appendix 1, particularly the “Statement of Changes in Equity” and “Note 6 - Cash Assets & Investments”.

Other jurisdictions have not issued similar documents (although we understand that the Northern Territory is in the course of preparing one), preferring to require that Councils comply with AAS 27 and regulating for additional disclosures where desired.

2. Current Provisions - NSW

2.1 Capital Reserves

The only capital reserve permitted by the Code is the **Asset Revaluation Reserve** as set out in *policy 8.1.3*. Indeed, this is probably the only capital reserve applicable to Local Government as other capital reserves met in commerce, such as *share premium reserve*, do not exist.

2.2 Revenue Reserves

Policy 8.1.2 of the Code reads as follows:



“Revenue reserves (cash funds set aside at the discretion of council) under internal arrangements for specific purposes must be cash funded and disclosed in the notes to the financial statements. Separate disclosure of revenue reserves within Equity should not be provided.”

The disclosures contained in the **Statement of Changes in Equity** are therefore as follows:

	Accumulated Surplus	Asset Revaluation Reserve	Council Equity Interest	Outside Equity Interest	Total Equity
Balance at beginning of the reporting period	103,070	20,309	123,379	54	123,433
Change in Net Assets recognised in the Statement of Financial Performance	(859)		(859)	26	(833)
Adjustment due to compliance with revised Accounting Standards	1,393		1,393	27	1,420
Transfers to Asset Revaluation Reserve					
Transfers from Asset Revaluation Reserve					
Cash Contributions by Outside Equity Interests				53	53
Cash Distributions to Outside Equity Interests				(54)	(54)
Other Adjustments to Outside Equity Interests				(25)	(25)
Balance at end of reporting period	98,604	20,309	118,913	81	118,994

(Shaded cells are not permitted to show any values.)

Any revenue reserves are an undisclosed component of the Accumulated Surplus.

Policy 5.8.1 of the Code requires:

“The notes to the financial statements shall include details of the council’s cash (excluding any cash overdrafts) and investments dissected into current and non-current together with details of those internal and external restrictions imposed upon them.”

These disclosures are made in Note 6 which usually comprises two pages, and an example of which is given on the following pages.



	2001 \$'000		2000 \$'000	
	Current	Non-Current	Current	Non-Current
CASH ASSETS				
Cash on Hand and at Bank		248	206	
Deposits at Call				
Short Term Deposits & Bills, etc	30		29	
Blank line	220	3,000	3,858	
Total Cash Assets	250	3,248	4,093	0
INVESTMENT SECURITIES				
Term Deposits		250		100
Bills of Exchange				
Treasury Corporation				
NCDs, FRNs				
Managed Funds	9,000	1,000	6,500	500
Other				
Total Investment Securities	9,000	1,250	6,500	600
TOTAL CASH ASSETS & INVESTMENT SECURITIES	9,250	4,498	10,593	600

Cash Assets comprise highly liquid investments with short periods to maturity subject to insignificant risk of changes of value. Cash Assets subject to restrictions that are not expected to be discharged during the next reporting period are classified as Non-Current.

The permitted forms of investment in financial instruments of the Council are defined in an order made by the Minister of Local Government on 16 November 2000, and may broadly be described as "Trustee Securities". Accordingly, credit risk is considered to be insignificant. Deposits and Bills are with, or have been accepted by, banks and credit unions and bear various rates of interest between b% and c% (2000 - d% and e%). NCDs, FRNs and Managed Funds are all with organisations with credit ratings that comply with the Minister's Order and bear various rates of rates of return between f% and g% (2000 - h% and i%).

RESTRICTED CASH AND INVESTMENTS SUMMARY

	2001 \$'000		2000 \$'000	
	Current	Non-Current	Current	Non-Current
EXTERNAL RESTRICTIONS				
- Included in liabilities	166	0	827	0
- Other	2,470	1,100	8,392	0
Total External Restrictions	2,636	1,100	9,219	0
INTERNAL RESTRICTIONS				
- Included in liabilities	598	0	0	0
- Other	1,846	500	1,224	500
	2,444	500	1,224	500
TOTAL UNRESTRICTED	4,170	2,898	150	100
TOTAL CASH & INVESTMENTS AVAILABLE	9,250	4,498	10,593	600



Note 6 - CASH ASSETS & INVESTMENT SECURITIES (cont)

	Note	2001		2000	
		\$'000		\$'000	
		Current	Non-Current	Current	Non-Current
EXTERNAL RESTRICTIONS					
Included in liabilities					
Unexpended Loans		166		827	
RTA Advances					
Self Insurance Claims					
Other					
		166	0	827	0
Other					
Developer Contributions	17	456		412	
RTA Contributions					
Unexpended Grants	14	522		494	
Water Supply funds		921	100	2,670	
Sewerage funds		400	1,000	4,497	
Domestic Waste Management		171		319	
Other					
		2,470	1,100	8,392	0
Total External Restrictions		2,636	1,100	9,219	0

External Restrictions arise pursuant to section 409(3) of the Local Government Act, the Local Government (Financial Management) Regulation 1999 and other applicable legislation. Further information relating to Developer Contributions is provided in Note 17 and Unexpended Grants in Note 14. Amounts raised by special rates (eg. Water & Sewer) or for Domestic Waste Management may only be used for those purposes.

INTERNAL RESTRICTIONS

Included in liabilities

Employee Leave Entitlements		598			
Other					
Construction of Buildings		283			
Replacement - Plant & Vehicles		711	500		500
Office Equipment		10		9	
Sinking Funds		72		153	
Unexpended FAGs Reserve		168		457	
Historical Buildings Restoration		222		170	
Future Election Expenses		5		5	
Land Projects Reserve		277		209	
Recreation Reserve Development		11		8	
Library Construction Reserve		50		125	
Public Risk Insurance		5		5	
Miscellaneous Items		9		8	
Sewer Replacement Reserve		23		75	
Subtotal		1,846	500	1,224	500
Total Internal Restrictions		2,444	500	1,224	500

Internal Restrictions arise pursuant to resolutions of Council to set aside reserves of cash resources either relating to liabilities recognised in these reports or to fund future expenditure for the stated purpose. Such reserves are not permitted to exceed the amounts of cash assets and cash investments not otherwise restricted.



The new definition of *current assets* in Australian Accounting Standard AAS 36 “Statement of Financial Position”¹ introduces the concept of **non-current cash assets** in relation to restricted cash, where the relevant restriction is not expected to be discharged within the next reporting period. Generally this can be determined from the current Management Plan, itself a public document.

The distinction currently made between internal and external restrictions “*included in liabilities*” and “*other*” is not reflected in any other area of the statements.

3. Discussion

3.1 The Nature of Revenue Reserves

Within the context of Local Government, revenue reserves can be regarded as rates that have been raised in advance of requirement (and allocated to a specific future purpose). Indeed, given the requirement that revenue reserves be cash funded, this can be restated as

rates raised in advance of requirement, and received in cash.

For example, a Council with \$1,000,000 in revenue reserves and a rates & annual charges outstanding percentage of 5% has raised (at least) \$1,052,631 rates in advance of requirement, of which \$1,000,000 has been received in cash.

Current disclosure requirements ignore this aspect of the accumulation of excess revenue reserves.

3.2 The Purpose of Reserves

We submit that appropriate purposes of Reserves would include:

3.2.1 The reservation of cash to meet unexpected levels of payment of liabilities recognised in the accounts, such as employee leave liabilities.

3.2.2 As a method of spreading the cash impact of the replacement of major items more evenly over a series of budget periods, such as plant replacement or sewer infrastructure renewal.

3.2.3 As a method of accumulating the necessary resources to fund a major capital investment that is significantly beyond the ability of the Council to fund in any single budget period. For this type of reserve, we consider it essential that the project be specifically named, and that there be a reasonable timeframe for implementation.

In the example given above, the purposes of the several reserves have all been taken from the Annual Financial Statements of NSW Councils, although the list as shown does not represent the reserves for any specific Council. We submit the following comments on some of the reserves listed.

Future Election Expenses

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1. *current asset* means an asset that:
 - (a) ...
 - (b) ...; or
 - (c) is cash or a cash-equivalent asset which is not restricted in its use beyond twelve months or the length of the operating cycle whichever is greater

[Extracted from ICAA Members' Handbook December 2000 issue, AAS 36.]



We suggest that this is an inappropriate reserve in that expenditure of much greater amount than this will be incurred at least every four years; more often if casual vacancies occur on Council. The amount is clearly insignificant in relation to total expenditure.

Recreation Reserve Development, Miscellaneous Items

The amounts of these reserves are also clearly insignificant in relation to total budgeted expenditure - it could be suggested that these reserves are merely attempts to create “hollow logs” within Council’s financial structure.

Public Risk Insurance

The Council annually insures for this purpose at a premium far in excess of the amount in this reserve. To some extent, therefore, this reserve appears to be for the purpose of insuring the insurance, in which case the amount is totally inadequate for the purpose. It should be noted that a Council that has a known potential liability arising from the failure of the HIH Insurance Group would normally have accounted for that as a creditor or as a provision.

Unexpended FAGs Reserve

This may be described as the original “hollow log” and often seems to be used as a device to disguise poor operational planning. FAGs grants, when received, are available for use by the Council without restriction. We suggest that in most cases such reserves could be named “Unexpended Rates Reserve” with equal accuracy.

3.3 Transfers To and From Reserves

We submit that the gross amounts transferred to and from each reserve in each reporting period forms “information useful to users for making and evaluating decisions about the allocation of scarce resources”. Indeed, it discloses the actual methods of allocation of scarce resources between the current and future reporting periods, and hence is particularly significant.

This information is not currently disclosed, but would be mandatory in accordance with AAS 36 para 8.8(b) if revenue reserves were disclosed within equity.

3.4 Cash Funding of Reserves

The requirement for cash funding of reserves is a characteristic of almost all Australian jurisdictions.

Confirmation that all reserves are cash funded at reporting date is a legitimate type of reporting requirement, but does not of itself require that all reserves be listed in the Note relating to Cash Assets & Investments - a summary would suffice.

3.5 Reserves & Restricted Assets - a confusion of terms

Confusion exists amongst practitioners within the industry as to whether “reserves” are a legitimate management and policy tool - the more so because they are not disclosed as such in the annual financial statements. Some practitioners suggest that the term “reserves” is no longer permitted, and insist on using the term “restricted assets” which tends to further add to the confusion especially among non-practitioners.



Reserves are an essential tool in the preparation of budgets and management reports. Elected members and non-financial executives, in particular, experience and occasionally express incomprehension at the apparent conflict in treatment.

3.6 Interstate Practice

So far as I have been able to ascertain, most common practice in other States is to disclose revenue reserves within equity - this certainly applies to the Annual Financial Statements that I have inspected from Northern Territory, South Australia and Victoria.

Commercial practice, too, is that where revenue reserves are separately disclosed, the disclosure is made within equity.

We submit that consistency throughout all jurisdictions, and with commerce, is an appropriate aim except where there are compelling reasons applicable only to NSW local government for a departure from most common practice.

4. Submission - for consideration

We submit that

- 4.1 Revenue reserves should be disclosed as part of equity.
- 4.2 The gross amounts transferred to and from each reserve should be disclosed, with the totals of transfers for all reserves shown as transferred from and to accumulated surplus.
- 4.3 Total revenue reserves should be disclosed as a single line item as a restriction in Note 6, apportioned between current - and non-current in accordance with AAS 36 (see page 5 above).
- 4.4 The distinction between internal and external restrictions "*included in liabilities*" and "*other*" should be deleted.
- 4.5 Delete policy statement 6.9.3.

A possible format for consideration could be:

	Balance 1/7/2000	2001				Balance 30/6/2001
		Net Result for Year	Transfers To	Transfers From	Adjustments	
Accumulated Surplus	101,846	(859)	659	1,879	1,393	96,160
Revenue Reserves						
(here list each individual reserve)						
Subtotal Revenue Reserves	1,224		1,879	659		2,444
Asset Revaluation Reserve	20,309					20,309
Total Council Equity Interests	123,379	(859)			1,393	118,913
			Cash Contributions	Cash Distributions		
Outside Equity Interests	54	26	53	54	2	81
Total Equity	\$123,433	\$(833)	\$53	\$54	\$1,395	\$118,994

(Shaded cells are not permitted to show any values. We have tried to reduce the number of these as much as possible.)



RESTRICTED CASH AND INVESTMENTS

	2001 \$'000		2000 \$'000	
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EXTERNAL RESTRICTIONS				
Unexpended Loans	166		827	
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5. For further consideration

Although the Australian Accounting Standards require that the nature and amount of each increase and decrease in equity be disclosed (refer AAS 36 para 8.8), the requirement for a *Statement of Changes in Equity* is introduced by the Code.

In the absence of a *Statement of Changes in Equity*,

5.1 the nature and amount of each increase and decrease in Council equity could be disclosed in a Note.

5.2 that Note could disclose the description of the nature and purpose of each reserve as required by AAS 36 para 8.8(b)(i).

5.3 the nature and amount of each increase and decrease in outside equity could be disclosed in the Note relating to *Joint Ventures and Associated Entities*, where this information is already disclosed in greater detail.