

# Policy



## Financial Reserves

Approved by Council: 19/06/2019

Council requires cash reserves to facilitate the ongoing provision of services that meet community expectations and agreed service levels with stakeholder Councils.

Safety

Teamwork

Accountability

Respect

### Background

Cash reserves are an important part of Council's financial strategy to ensure long term financial sustainability and capacity to provide quality services on an ongoing basis.

This policy provides agreed direction and control in respect to the type of reserves that are required and a target in terms of the amount of cash to be held in each reserve.

### Policy statement

Basic financial planning dictates that sufficient funding is available for current operating requirements, capital expenditure and debt servicing. Further, it is prudent to plan for unforeseen events that may impact Council's ability to maintain service levels.

To achieve these aims, reserves are accumulated in a manner that avoids significant fluctuations to the price path of Council's fees and charges and minimises the impact on customers.

The *Local Government Act 1993* provides that Council may apply funds for any purpose allowed by the Act or other Acts except where:

- a) money that has been received as a result of the levying of a special rate or charge may not be used otherwise than for the purpose for which the rate or charge was levied, and
- b) money that is subject to the provisions of the *Local Government Act 1993* or any other Act (being provisions that state that the money may be used only for a specific purpose) may be used only for that purpose.

Council must create a reserve where unexpended funds have to be applied for a particular purpose as required by an Act. Funds held in accordance with legislation are described as 'externally restricted reserves'. Funds held in reserve at the discretion of Council are described as 'internally restricted reserves'.

### Policy summary

An outline of this policy is as follows:

- Externally Restricted Reserves - description and purpose of each reserve
- Internally Restricted Reserves - overview and description of the reserves and targets
- Internally Restricted Reserves - description of budget shocks target
- Internally Restricted Reserves - detailed description of the reserve and target
- Policy responsibilities
- Appendix A - Scorecard of actual reserve balances compared to targets.

## Externally restricted reserves

Externally restricted reserves are mandatory by virtue of legislation. There is no target reserve balance as they are only raised on an as needed basis.

<b>Reserve name</b>	<b>Developer Contributions Reserve</b>
<b>Restriction type</b>	External.
<b>Purpose</b>	Capital contributions paid by property developers to Council. The auspice for this charge comes from section 64 of the Local Government Act which allows Council to exercise functions under the Water Management Act 2000. The funds are applied to asset expansion works conducted by Council in accordance with the adopted Development Servicing Plan.
<b>Target value</b>	No target - income variable depending on development within the County.
<b>Target rationale</b>	Not applicable.

<b>Reserve name</b>	<b>Trust Account</b>
<b>Restriction type</b>	External.
<b>Purpose</b>	Council requires bonds or security deposits to be paid with development applications and contract works.
<b>Target value</b>	No target - income variable depending development and construction activity.
<b>Target rationale</b>	Not applicable.

<b>Reserve name</b>	<b>Unexpended Grants Reserve</b>
<b>Restriction type</b>	External.
<b>Purpose</b>	Council receives grant funds for specific projects and purposes. It is common that grants will be expended across different financial years and this reserve allows unexpended grant funds to be isolated and retained for expenditure on the project for which the grant was received.
<b>Target value</b>	No target - income variable.
<b>Target rationale</b>	Not applicable.

Externally restricted reserves may be raised within each Fund although typically they will only apply to Bulk Water, Flood Mitigation (unexpended grants) and Weeds Bio (unexpended grants).

## Internally restricted reserves

Internally restricted reserves are created at the discretion of Council and they are designed to meet a range of circumstances. The reserves in this policy have principally been created based on the different activities undertaken by Council.

Council operations can be segregated into discreet activities that, to some extent, operate independently of each other. The primary activities, referred to as 'Funds', are Flood Mitigation, Weeds Bio, Retail Water, Richmond Water Laboratories, Commercial Properties, Bulk Water and Fleet Management.

Each Fund has a unique financial strategy and the intent is that the Fund is financially sustainable over the long term. A reserve per Fund enables the cash surplus or deficit of each Fund to be isolated to that Fund and the retention of cash reserves allows that Fund to plan for the future and manage budget shocks.

Each Fund will have one internal reserve only, except Bulk Water. Those Funds with a single internal reserve may use the reserved cash for any purpose relevant to the Fund – it may be related to budget shock or asset improvement for example.

Due to the size and complexity of the Bulk Water Fund, there are six separate reserves:

1. Buildings and Structures Reserve
2. Assets and Programs Reserve
3. Employee Leave Entitlements Reserve
4. Electricity Reserve
5. Office Equipment and ICT Reserve
6. Greenhouse Gas Abatement Reserve.

Other sub reserves may be created to track cash movements, however, they will be incorporated into a nominated reserve for formal reporting purposes. Primarily this will relate to works carried forward and essentially a holding account is required to transfer funds forward to the next year to enable the completion of works that have been approved and funded by Council but not completed at year's end.

#### Internally Restricted Reserve Targets

Target reserve balances should be viewed from the perspective of a preferred position. In many years the preferred position may not be achievable due to either different Council priorities or financial performance does not enable the target to be achieved. There needs to be a degree of flexibility when considering target reserve balances.

All Funds have one internal reserve only, except Bulk Water Fund which has six reserves. The targets set out in this policy are based on the following:

<b>Reserve Name</b>	<b>Type of Target</b>
Flood Mitigation	Budget Shocks
Weeds BIO	Budget Shocks
Retail Water	Budget Shocks
Richmond Water Laboratories	Budget Shocks
Commercial Properties	Budget Shocks
Fleet Management	Budget Shocks
Bulk Water Combined	Budget Shocks
Bulk Water Buildings and Structures	Arbitrary value based on historical assessment
Bulk Water New & Existing assets	One year of depreciation
Bulk Water Employee Leave Entitlement	A % of the liability based on staff age profile
Bulk Water Electricity	5 months pumping Wilsons River
Bulk Water Office Equipment & ICT	10% of estimated replacement value
Bulk Water Greenhouse Gas Abatement	No target specified
Whole Organisation	Budget shocks

All Funds have a reserve target referred to as the 'Budget Shocks Target'. In respect to Bulk Water Fund, the combined value of all Bulk Water Reserves are compared against the Budget Shocks Target. Bulk Water Fund also has a target for each individual reserve, except the Greenhouse Gas Abatement Reserve.

### **Budget Shocks Target**

It is prudent that each Fund should maintain reserves that are on hand in the event of budget shocks. A budget shocks reserve target will be established that is the minimum desired level for the sum total of all internal reserves for the Fund.

If, for example the budget shocks target indicates that a particular Fund should have \$2 million on hand, the total of all reserves held by the Fund, whether it be for asset renewal, leave entitlements or a specific purpose reserve will preferably be not less than \$2 million. The only exclusion is that reserves that have funds specifically committed, such as a works carried forward reserve, must not be included when calculating whether internal reserves equal the budget shocks reserve target.

The fact that the target represents the minimum level is particularly relevant in respect to those Funds with only one reserve. Flood Mitigation and Retail Water for example have a large number and value of assets to maintain and at different times reserves may need to be accumulated for asset management purposes in excess of the budget shocks target.

The budget shock target is designed to ensure that the business has sufficient funds on hand to function as per normal when events occur, typically unforeseen, that have a detrimental impact on the Fund. For example, income is less or expenses are greater than anticipated.

The target level of the funds on hand will be assessed in accordance with the following guidelines. Each transaction type will be assessed as reliable, moderate or unreliable. The transaction types are:

- Variability of operating income
- Variability of capital income
- Variability of operating expense
- Variability of capital expense.

If a transaction type is assessed as reliable it receives a score of 1, moderate 2 and unreliable 3. Depending on the score for the Fund the target reserve balance will be the equivalent number of months of operating expense. For example, if a Fund is assessed as being completely reliable it will receive a total score of 4 and the target reserve balance will be 4/12ths of annual operating expense for the Fund. If a Fund is assessed as being completely unreliable it will receive a score of 12 and the target reserve balance will be equal to one year of operating expense.

The rationale being that the Fund can continue normal operations for a given percentage of a year by using cash reserves. This length of time will enable a recovery strategy to be put in place such as external borrowings, price increases, cost savings etc.

## List of Internally Restricted Reserves

<b>Reserve name</b>	<b>Flood Mitigation Reserve</b>
<b>Restriction type</b>	Internal - There is one internal reserve for the Fund.
<b>Purpose</b>	Isolate cash available to Flood Mitigation to enable a continuity of operations to meet the needs and expectations of Council and the community.
<b>Target</b>	Equal to five months annual operating expense. Annual operating expense based on the last complete financial year of operations.
<b>Target value</b>	See Appendix A: Scorecard.
<b>Target rationale</b>	Target based on assessment of overall income and expense reliability as per the Budget Shocks Target rationale. See Appendix A for results.

<b>Reserve name</b>	<b>Weed Biosecurity Reserve</b>
<b>Restriction type</b>	Internal.
<b>Purpose</b>	Isolate cash available to Weed Biosecurity to enable a continuity of operations to meet the needs and expectations of Council and the community.
<b>Target</b>	Equal to four months annual operating expense. Annual operating expense based on the last complete financial year of operations.
<b>Target value</b>	See Appendix A: Scorecard
<b>Target rationale</b>	Target based on assessment of overall income and expense reliability as per the Budget Shocks Target rationale. See Appendix A for results.

<b>Reserve name</b>	<b>Retail Water Supply Reserve</b>
<b>Restriction type</b>	Internal - There is one internal reserve for the Fund.
<b>Purpose</b>	Isolate cash available to Retail Water Supply to enable a continuity of operations to meet the needs and expectations of Council and the community.
<b>Target</b>	Equal to eight months annual operating expense. Annual operating expense based on the last complete financial year of operations.
<b>Target value</b>	See Appendix A: Scorecard.
<b>Target rationale</b>	Target based on assessment of overall income and expense reliability as per the Budget Shocks Target rationale. See Appendix A for results.

<b>Reserve name</b>	<b>Richmond Water Laboratories Reserve</b>
<b>Restriction type</b>	Internal - There is one internal reserve for the Fund.
<b>Purpose</b>	Isolate cash available to Richmond Water Laboratories to enable a continuity of operations to meet the needs and expectations of Council and the community.
<b>Target</b>	Equal to six months annual operating expense. Annual operating expense based on the last complete financial year of operations.
<b>Target value</b>	See Appendix A: Scorecard.
<b>Target rationale</b>	Target based on assessment of overall income and expense reliability as per the Budget Shocks Target rationale. See Appendix A for results.

<b>Reserve Name</b>	<b>Commercial Properties Reserve</b>
<b>Restriction type</b>	Internal - There is one internal reserve for the Fund.
<b>Purpose</b>	Isolate cash available to Commercial Properties to enable a continuity of operations to meet the needs and expectations of Council and the community.
<b>Target</b>	Equal to eight months annual operating expense. Annual operating expense based on the last complete financial year of operations.
<b>Target value</b>	See Appendix A: Scorecard.
<b>Target rationale</b>	Target based on assessment of overall income and expense reliability as per the Budget Shocks Target rationale. See Appendix A for results.

<b>Reserve Name</b>	<b>Fleet Management Reserve</b>
<b>Restriction type</b>	Internal - There is one internal reserve for the Fund.
<b>Purpose</b>	Isolate cash available to Fleet Management to enable a continuity of operations to meet the needs and expectations of Council and the community.
<b>Target</b>	Equal to 4 months annual operating expense. Annual operating expense based on the last complete financial year of operations.
<b>Target value</b>	See Appendix A: Scorecard.
<b>Target rationale</b>	Target based on assessment of overall income and expense reliability as per the Budget Shocks Target rationale. See Appendix A for results.

<b>Reserve Name</b>	<b>Bulk Water Budget Combined Reserve Value</b>
<b>Restriction type</b>	Internal - There are five internal reserves for the Fund being: Buildings Reserve, Assets and Programs Reserve, Employee Leave Entitlements Reserve, Insurance and Electricity Reserve and ICT/Office Equipment Reserve.
<b>Purpose</b>	Isolate cash available to Bulk Water to enable a continuity of operations to meet the needs and expectations of Council and the community.
<b>Target</b>	Equal to six months annual operating expense. Annual operating expense based on the last complete financial year of operations. The total of all available reserves is combined to compare to the budget shocks target.
<b>Target value</b>	See Appendix A: Scorecard.
<b>Target rationale</b>	Target based on assessment of overall income and expense reliability as per the Budget Shocks Target rationale. See Appendix A for results.

<b>Reserve Name</b>	<b>Bulk Water - Buildings and Structures Reserve</b>
<b>Restriction type</b>	Internal.
<b>Purpose</b>	Isolate cash for future renewal and replacement of non-commercial buildings and structures.
<b>Target value</b>	\$200,000.
<b>Target rationale</b>	Value intended to be sufficient to assist with emergency works or reduce external borrowing for replacement of assets.

<b>Reserve Name</b>	<b>Bulk Water - Assets and Programs Reserve</b>
<b>Restriction type</b>	Internal.
<b>Purpose</b>	Isolate cash for renewal and replacement of existing assets and to provide for the purchase/construction of a new and expanded asset base.
<b>Target</b>	One year's depreciation.
<b>Target value</b>	Based on the 2018/19 budget - \$5,000,000.
<b>Target rationale</b>	Value intended to be sufficient to assist with emergency works or reduce external borrowing for new or existing assets.

<b>Reserve name</b>	<b>Bulk Water - Employee Leave Entitlement Reserve</b>
<b>Restriction type</b>	Internal.
<b>Purpose</b>	Isolate cash for the payment untaken leave that has been accrued.
<b>Target</b>	Calculated % of the liability based on age of employees.
<b>Target value</b>	Based on the 2016/17 Annual Financial Statements - \$700,000.
<b>Target rationale</b>	Target calculation based on employee's age e.g. if over 60 years then 100% of liability is to be cash funded. If under 45 then 10% is cash funded. See Financial Reserves Procedure for details.

<b>Reserve name</b>	<b>Bulk Water - Electricity Reserve</b>
<b>Restriction type</b>	Internal.
<b>Purpose</b>	Isolate cash for the payment of abnormally high electricity expenses.
<b>Target</b>	Five months of the cost to pump water from the Wilsons River Source.
<b>Target value</b>	Based on peak usage and adjustment for new electricity rates the current estimate to pump water from the Wilsons River for 5 months is \$1,000,000.
<b>Target rationale</b>	Electricity cost to pump water from Wilson's River is very high (approx. \$50,000/week). Hence use of this water source is avoided where possible therefore only minimal recurrent budget for this cost. Reserve target looks to accommodate 5 months of 'extra' pumping to cover a drought scenario.

<b>Reserve name</b>	<b>Bulk Water - Office Equipment and ICT Reserve</b>
<b>Restriction type</b>	Internal.
<b>Purpose</b>	Isolate cash for the replacement and expansion of existing equipment including unforeseen emergencies.
<b>Target</b>	10% of the estimated replacement cost of office equipment and Information Technology hardware and software.
<b>Target value</b>	Current estimated replacement value as determined by ICT Manager is \$5 million hence target value is \$500,000.
<b>Target rationale</b>	The percentage-based target allows the target value to adjust to movement over time and 10% of the estimated replacement cost is considered reasonable to meet both budget shocks and provide seed funding for planned replacements.

<b>Reserve name</b>	<b>Bulk Water - Greenhouse Gas Abatement Reserve</b>
<b>Restriction type</b>	Internal.
<b>Purpose</b>	Isolate cash to enable new energy saving measures to be implemented that will reduce Council's emissions.
<b>Target</b>	No target specified. Variable depending on energy thence dollar savings from energy saving measures implemented.
<b>Target value</b>	No value specified.
<b>Target rationale</b>	Not applicable.

### Policy responsibilities

<b>Task</b>	<b>Position/Stakeholder</b>	<b>Frequency</b>
Implementation	Group Manager Corporate and Commercial	Ongoing
Monitoring of policy and completion of scorecard	Finance Manager	Annually
Review of Policy	Group Manager Corporate and Commercial	Once during the term of each Council

### Contact officer

Finance Manager.

### Related documents

#### Policies

N/A

#### Procedures

Financial Reserves procedure

#### Legislation

*Local Government Act 1993*

#### Other

Scorecard.

<b>Office use only</b>	File no.: 172	Next review date: (4 years)	
Version	Purpose and description	Date adopted by Council	Resolution no.
2	Financial Reserves Policy	19/06/2019	42/19



**Appendix A: Reserves Policy Scorecard**

Date Reviewed:

Jan-19

<b>Internal Reserves compared to Budget Shocks Target</b>									
The target reserve balance is a percentage of the Funds annual operating expenses. The percentage is based on the reliability of the Funds financial transactions. Where the transactions are reliable the reserve target is a lower percentage than if the transactions are unreliable.									
Reliability Assessment									
Reliable	1 month of annualised operating expense as contingency								
Moderate	2 months of annualised operating expense as contingency								
Unreliable	3 months of annualised operating expense as contingency								
Reliability Rating	Flood Mitigation	Weeds Bio	Retail Water	RWL	Commercial Property	Fleet	Bulk Water Combined	Whole Organisation	
Operating Income	1	1	3	2	1	1	1	1	1
Operating Expense	2	1	3	2	1	1	2	2	2
Capital Income	1	1	1	1	1	1	1	1	1
Capital Expense	1	1	1	1	3	1	2	2	2
Reliability Total (in months)	5	4	8	6	6	4	6	6	6
2017/18 Operating Expense	1,642,000	1,266,300	2,201,394	697,000	306,800	901,200	17,883,900	24,898,600	
Reliability Rating	5 over 12	4 over 12	8 over 12	6 over 12	6 over 12	4 over 12	6 over 12	7 over 12	
Target Reserve Balance	684,000	422,000	1,468,000	349,000	153,000	300,000	8,942,000	12,449,000	
Actual Reserve Balance 30/6/18	2,031,300	1,280,700	606,900	346,300	1,208,600	1,417,000	25,982,500	32,873,300	
Result	Pass	Pass	Fail	Fail	Pass	Pass	Pass	Pass	
<b>Bulk Water Reserves and Targets</b>									
<b>Bulk Water Buildings and Structures Reserve</b>									
Target Reserve Balance									200,000
Actual Reserve Balance 30/6/18									637,500
Result									Pass
<b>Bulk Water - Assets and Programs Reserve</b>									
Reserve Target equal to 1 years depreciation									
Target Reserve Balance; based on 2018/19 forecast									5,000,000
Actual Reserve Balance 30/6/18									20,760,400
Result									Pass
<b>Bulk Water - Employee Leave Entitlement Reserve</b>									
Reserve Target is 29% of the accrued liability (see sheet in Wiki 2019/20 LTFP 'employee leave calculation')									
Target Reserve Balance; based on 2018/18 audited statements									513,000
Actual Reserve Balance 30/6/18									1,839,300
Result									Pass
<b>Bulk Water - Electricity Reserve</b>									
Reserve Target is estimated cost of 5 months electricity cost for Wilson's River Source (see Financial Reserves Procedure for calculation)									
Target Reserve Balance; based on Wilsons River historical cost									1,000,000
Actual Reserve Balance 30/6/18									1,968,000
Result									Pass
<b>Bulk Water Office Equipment and Computer Reserve</b>									
Reserve Target is 10% of estimated replacement cost									
Target Reserve Balance; estimated by IT Manager at \$5 million									500,000
Actual Reserve Balance 30/6/18									777,300
Result									Pass
<b>Bulk Water Greenhouse Gas Abatement Reserve</b>									
No reserve target applicable									
Target Reserve Balance									Nil
Actual Reserve Balance 30/6/18									Nil
<b>External Reserves and their balances as at 30/6/18</b>									
Bulk Water unexpended grants									2,963,600
Flood Mitigation Unexpended Grants									353,400
Weeds Bio unexpended grants									93,500