

## West Gippsland Libraries Transition to a Not-For-Profit Entity – Accounting Implications

### *Report Prepared in consultation with:*

- Pitcher Partners Accountants
- Russell Kennedy Lawyers
- All Member Councils Chief Financial Officers
- Council Director Board Representatives
- WGL Chief Executive Officer

### **Overview**

This report extends on the previous briefing report provided to Council in April 2021 pertaining to the requirements for West Gippsland Libraries (WGL) to transition to a company limited by guarantee, Not-For-Profit (NFP). This follows changes to the *Local Government Act 2020* (the Act) that come into effect from 1 July 2021. Significant due diligence has been undertaken by WGL over the past 12 months to 2 years with the involvement of all member Councils.

On 7 May 2021, the WGL Board resolved to adopt the new NFP Constitution of Myli – My Community Library Ltd written by Russell Kennedy Lawyers in consultation with the WGL Board. This was the **first step** in a series of legislative requirements that the WGL Board and Member Councils (collectively) need to undertake to make the entity transition required under the Act.

The **second step** is for the WGL Board to adopt the legal and accounting procedure in a resolution that will enable the formal transition to occur. This briefing report outlines the proposed accounting treatment and rationale for Council's consideration.

The **final step** in the legislative process is the adoption of the same resolution (drafted by Russell Kennedy Lawyers) by all three Member Councils at the Ordinary Meeting in July 2021 that executes the following functions:

- That Council participate in the formation and become a founding member of Myli – My Community Library Ltd;
- Adopt the Constitution of Myli – My Community Library Ltd as recommended by the WGL Board;
- Assesses the risk pursuant to section 111 of the Local Government Act 2020 as completed by Pitcher Partners;
- Novate the existing Library Agreement to Myli – My Community Library that maintains all the existing provisions (including annual funding) with the exception of those clauses where equivalent matters are now contained in the Constitution;
- Appoint the Board Directors to Myli – My Community Library Ltd (that maintains the existing Members on the Board);
- Adopt the accounting treatment required for the transfer of assets to Myli – My Community Library Ltd; and
- Enact the dissolution and winding up of WGL upon completion of the above processes.

### **Why now?**

The April briefing report to Council highlighted the many reasons that substantiate the importance of Council making the above decisions in July 2021. Furthermore, WGL has been having preliminary discussions with other Councils who have shown an interest in joining the new NFP. One incentive for Council making the decision in July 2021 is any new Council that joins the NFP would contribute to the cost sharing of the existing Member Councils annual financial contribution. Without the NFP, this is unable to occur.

### Due diligence

Significant due diligence has been undertaken over the past three years. As previously outlined to Council in April 2021, the four project areas are:

- Legal – Completed;
- Risk – Completed;
- Naming – Completed; and
- Accounting – Addressed in this report.

### Accounting Implications to Council

WGL engaged Pitcher Partners for two purposes:

1. Complete the assessment of the total investment involved in forming Myli – My Community Library Ltd, the total risk exposure and ensure that its total risk exposure does not exceed its total investment pursuant to section 111(1)(a) of the Act.
2. Advise on the accounting implications to member Councils derived from the transition to Myli – My Community Libraries Ltd.

It should be noted that Pitcher Partners are not an audit service provider for any of the member Councils and therefore do not have a conflict of interest.

The process that has been undertaken pertaining to the accounting implications are as follows:

- Pitcher Partners in consultation with Russell Kennedy Lawyers developed an Accounting Memo advising of three possible accounting treatments to transition from the Library Corporation to the NFP.
- The Executive Director of Pitcher Partners met with the three Council CFO's, three Council Directors (who preside on the WGL Board) and the WGL CEO to talk through the three options and reach consensus on the best accounting treatment for now and future financial years.
- The Executive Director of Pitcher Partners was able to answer all questions asked by the CFO's and Council Directors.
- There was agreement amongst Council CFO's and Directors that the non-current asset stated on Council's balance sheet reflected changes in the carrying value year on year and did not translate to a realisable cash asset. For example:
  - Books are recognised as an asset at cost and do not have a resale value.
  - E-resources are licenses and are not convertible to a saleable or cash asset, nor can they be separately distributed to individual member Councils.
  - The building asset owned by WGL is headquarters for staff and is required to conduct business.

In simple terms, yet not to underestimate the complexity of the accounting transactions, the three options available are:

<b>Accounting Options</b> – Options outlined below are separate to ongoing annual contributions for service delivery under the Library Agreement.	
<b>Option 1</b> – Financial obligation <ol style="list-style-type: none"> <li>i. Distribute the net assets back to each member Council.</li> <li>ii. This would require Council to account (for at least a short period) for its proportion of each asset and liability previously presented in the WGL financial statements.</li> <li>iii. Once the NFP is created Council would then transfer</li> </ol>	This option is <b>not supported</b> because: <ul style="list-style-type: none"> <li>• It creates significant accounting complexities at the time of transition and would require Council CFO's and accounting departments to take on short</li> </ul>

<p>the net assets to the NFP via a <b>financial obligation</b> (e.g. similar to a loan or promissory note arrangement) and record a <b>financial asset</b> (receivable) with settlement required in the event that a member Council exits the arrangement.</p> <p>iv. Such a settlement would be prompted only by agreed terms and conditions (contingent event).</p> <p>v. Council would be required to apply the measurement requirements of <i>AASB 9 Financial Instruments</i>.</p> <p>vi. In future years Council would be required to test the financial asset for impairment at each reporting date, and in the event that an impairment occurs, record an impairment loss in the profit or loss.</p>	<p>term accounting for assets and liabilities previously undertaken by WGL.</p> <ul style="list-style-type: none"> <li>• Significant accounting complexities to WGL.</li> <li>• Ongoing impairment assessments with possible fluctuations in Councils financial reports year on year.</li> <li>• Provides a financial benefit to only one Council (if only one chose to leave) therefore leaving impairment implications to the remaining Councils.</li> </ul>
<p><u>Option 2 – Transfer obligation</u></p> <p>vii. Distribute the net assets back to each member Council as outlined in option 1 above.</p> <p>viii. This would require Council to account (for at least a short period) for its proportion of each asset and liability previously presented in the WGL financial statements.</p> <p>ix. Once the NFP is created Council would then transfer the net assets to the NFP via a <b>transfer obligation</b> (obligation to return assets to members) and record an <b>intangible asset</b> with assets required to be returned in the event that a member Council exits the arrangement.</p> <p>x. Such a settlement would be prompted only by agreed terms and conditions (contingent event).</p> <p>xi. Council would record the intangible asset in accordance with <i>AASB 138 Intangible Assets</i> and the principles of <i>AASB 15 Revenue from Contracts with Customers</i> and then apply accounting treatment of 'refund obligations' and 'rights of returned goods'.</p> <p>xii. In future years Council would be required to assess the recoverability of the intangible asset in accordance with <i>AASB 136 Impairment of Assets</i> at each reporting date, and in the event that an impairment occurs, record an impairment loss in the profit or loss.</p>	<p>This option is <b>not supported</b> because:</p> <ul style="list-style-type: none"> <li>• It creates significant accounting complexities at the time of transition and would require Council CFO's and accounting departments to take on short term accounting for assets and liabilities previously undertaken by WGL.</li> <li>• Significant accounting complexities to WGL.</li> <li>• Ongoing impairment assessments with possible fluctuations in Councils financial reports year on year.</li> </ul>
<p><u>Option 3 – Gift Council assets to NFP</u></p> <p>xiii. By far the simplest means to provide the NFP with the net assets required to operate by way of contributing/gifting the net assets.</p> <p>xiv. As a NFP this would extinguish any claim Council currently has to net assets.</p> <p>xv. Council would recognize a non-cash gift expense in the profit or loss only once and equal to the amount currently recognized in Council's balance sheet as a non-current asset.</p> <p>xvi. In past years when a library corporation has disbanded they have recognized a write down of the assets in the profit or loss statement.</p>	<p>This is the <b>supported option</b> because:</p> <ul style="list-style-type: none"> <li>• Simplest and lowest cost to apply the accounting treatment.</li> <li>• Does not shift accounting responsibilities back to Council during transition.</li> <li>• Does not create ongoing impairment risks for member Councils.</li> <li>• Does not jeopardise the ongoing cash flow and financial sustainability of the NFP.</li> <li>• Investment in facilities within each municipality boundaries will be managed through a facilities reserve exclusive for each</li> </ul>

	member Council.
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### Accounting Recommendation

There was consensus among the Council CFO's and Directors for **Option 3** and that a gift of Council's assets to the NFP was the best option and significantly reduced the complexity and workload for all parties. It also provided simplified accounting for member Councils on an ongoing basis and demonstrated a commitment to the long-term sustainability of the organisation.

Under this option, member Councils would recognise a gift expense equivalent to the amount currently recognised on their balance sheet and would no longer carry a non-current asset for library services. Ongoing accounting treatment for member Councils would be simplified to recognising an expense equal to the annual contribution for library service delivery each year.

The Council and WGL Auditors have already highlighted this matter in the current years Financial Audit Strategy. Their audit procedures for the financial year are seeking clarification on intended accounting treatment following the WGL Board's adoption of the new NFP's Constitution in May 2021.

Collective agreement on accounting treatment is required from all three Member Councils prior to the WGL Board adopting the final resolution at their Ordinary Board Meeting being held on Friday 25<sup>th</sup> June 2021. Member Councils will then adopt the final resolution at their Ordinary Council Meeting in July 2021.

It is intended that the accounting treatment will be presented as outlined below.

### Resolution Accounting Procedure Extract

*(Drafted by Russell Kennedy Lawyers in consultation with Pitcher Partners and External Auditors)*

#### MYLI – MY COMMUNITY LIBRARY LTD ESTABLISHMENT

*That, pursuant to section 110(1) and section 111 of the 2020 Act and having assessed the total investment involved and total risk exposure and ensured the total risk exposure does not exceed the total investment and that risk management frameworks are in place, Council:*

- (a) participate in the formation of a beneficial enterprise to be known as; and*
- (b) become a founding member of,*

*Myli – My Community Library Ltd (Company), being:*

- (c) a public company limited by guarantee;*
- (d) a not-for-profit and charitable institution to be registered with the Australian Charities and Not-for-profits Commission; and*
- (e) a public library recognised by the Australian Taxation Office,*

*on the terms of the Myli – My Community Library Ltd constitution .....*

#### GIFT OF WGRLC ASSETS

*That, pursuant to section 10 of the 2020 Act, Council enter into a gift and transfer deed between Bass Coast Shire Council, Baw Baw Shire Council, South Gippsland Shire Council, WGRLC and the Company (Gift and Transfer Deed) which provides in general terms, that with effect at 11:59pm on 30 June 2022:*

- a) Council is one of the ultimate owners of WGRLC, and is therefore one of the ultimate owners of WGRLC's business, assets and liabilities;*
- b) in order to restructure WGRLC and replace it with the Company, Council wishes to gift Council's interests in WGRLC, and therefore Council's interests in WGRLC's business, assets and liabilities, to the Company (except that any transfer of land will be subject to WGRLC following the procedure in section 189 of the 1989 Act);*

- c) *so as to give effect to Council's gift, Council directs and authorises WGRLC to transfer in specie all its business, asset and liabilities to the Company pursuant to sections 196(4)(d) and (e) of the 1989 Act and any other power enabling WGRLC to do so.*

### Policy and legislative implications

#### Local Government Act

Policy and legislative requirements have been outlined in this report. In summary, the Local Government Act 2020 removes Library Corporations (sec 196 LGA 1989) from the Act and gives a 10-year sunset provision prior to a forced windup/liquidation by the Local Government Minister. This provision comes into effect from 1 July 2021. Councils will be required to establish a new entity and in this case the Not-For-Profit entity has been selected (as briefed in April 2021) under the beneficial enterprises section 110 of the LGA 2020.

#### Beneficial enterprises

Process before participating in beneficial enterprises:

Legislative requirement	Assurance/Compliance
(1) A Council must in participating in a beneficial enterprise under section 110—	Assessment completed by Pitcher Partners. Refer to attachment 1.
(a) assess the total investment involved and the total risk exposure and ensure that its total risk exposure does not exceed its total investment; and	
(b) if section 110(1)(a), (b) or (c) applies, ensure that the corporation is a limited corporation; and	The corporation is a company limited by guarantee as outlined in attachment 1 and the Constitution.
(c) have regard to the risks involved; and	<a href="#">Risk Management Strategy</a> and risk assessment adopted by the WGL Board 7 <sup>th</sup> May 2021.
(d) establish risk management arrangements; and	<a href="#">Risk Management Strategy</a> adopted by the WGL Board 7 <sup>th</sup> May 2021.
(e) implement regular performance monitoring and reporting arrangements in relation to the beneficial enterprise; and	Regular performance reporting framework will continue under new NFP. <a href="#">Reported to the Board quarterly.</a>
(f) ensure that any changes to the operation or purpose of the beneficial enterprise are reported to the Council; and	Changes to the Constitution must comply with clause 10.2 of the Constitution and at AGM of the Members (the Councils).
(g) identify and manage any risks associated with any changes to the operation or purpose of the beneficial enterprise.	Risk Appetite adopted as part of the Risk Management Strategy. Risks will be monitored and assessed on an ongoing basis in accordance with the strategy and Constitution.
(2) A Council must report on the operations and performance of each beneficial enterprise in its annual report.	This is consistent with current practice of WGL with Member

	Councils.
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External audit implications

The VAGO Audit Strategy 2021 identifies the LGA changes and its implications on the current financial year to Member Councils and WGL.

**Conclusion**

WGL has been working through the requirements of the changes to the LGA for the past three years. Significant due diligence has been undertaken over the past 12 to 18 months and WGL has worked closely with lawyers, Russell Kennedy, and accountants, Pitcher Partners, to ensure that all due diligence and legislative requirements have been met.

It is recommended that Council support the resolution that recommends Member Councils gift its assets in WGL to the new NFP, Myli – My Community Library Ltd.