

RESERVES

What are they?
Why do we need them?

What are reserves?

- Supply to be used in an emergency
- Provision for unexpected event
- Saving for a goal

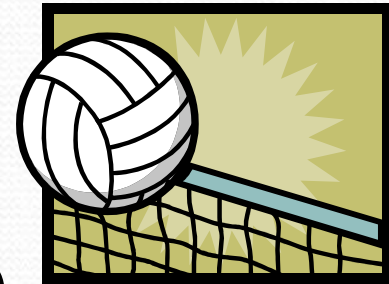
Why do we need them?

- To manage an unusual situation
- To achieve an objective

What are reserves?

Sports teams have reserves. Why?

- If a player gets injured
- For strategic advantage (impact player)
- To develop a young up and coming player by exposing them to the game without the pressure of playing in the starting line up



What are reserves?

Companies have reserves for the same reasons

- Extraordinary costs
- To develop and grow the company to ensure its future existence
- To be able to pursue new opportunities without affecting the normal operations of the company
- Directors have a duty of care, skill and diligence in managing the affairs of the company

FINANCIAL RESERVES

2 types of reserves:

- Non Distributable
- Distributable

NON DISTRIBUTABLE RESERVES

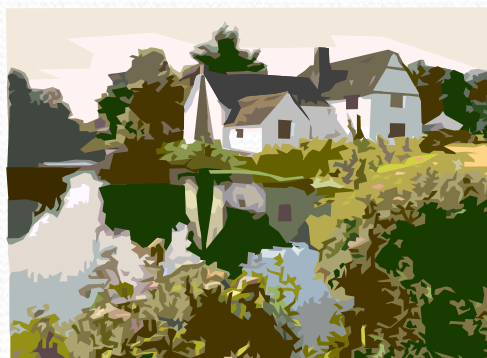
- Reserves you cannot use
- Required by International Financial Reporting Standards (IFRS)
- Compulsory – no choice
- Difference between what you paid for an asset and what the asset is worth i.e. a revaluation of the asset

Non Distributable Reserve

- You buy a house for R 200 000



- After 1 year your house is worth R300 000



Non Distributable Reserve

- In terms of IFRS a company must show the current market value of their assets (R300 000), not the cost (R200 000)
- The difference between what you paid for it and what you could sell it for is R100 000.00
- You don't have this money in your bank account now but you know that if you sold your house you would make a profit of R100 000.00
- To do this a non distributable reserve is created for the difference between what was paid and what the asset is worth

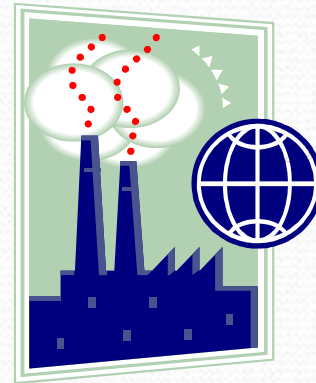
Non Distributable Reserve

- The company may only use this reserve if it sells the asset and makes a profit in selling it
- This is called a realised gain
- It is important to remember that this reserve represents a future profit and is not available to the company at the date of the balance sheet
- Much like the increase in value of the house does not mean more money in your pocket

Non Distributable Reserves

The reserve can also decrease if 2 years after you bought the house:

- They build a huge power station next to your house



- Suddenly you can only sell your house for R250 000
- If you were a company the non distributable reserve would now be R50 000 (R250 000-R200 000) in year 2, not R100 000 as it was in year 1 (R300 000 – R200 000)

Distributable Reserves

- money that a company puts aside to ensure that it can meet both planned and unplanned financial commitments
- built up over time
- considered sound business practice
- it is a requirement of King 3 which governs the duties of directors and is included in the Companies Act
- ensures that the company will be around in future years and will not have to close its doors if it experiences bad times

Distributable Reserves

Lets use the house example again

- Every month you pay the bond on your house
- You use all your income each month to cover your living expenses
- There is a terrible storm
- Your house is flooded
- You need to find the money to repair the damage



Distributable Reserves

- Because you have used all your income you do not have money to pay for the repairs
- You have to borrow money to fix the damage or live in a damaged house
- Both options have negative implications
- If you borrow money you will have to pay interest – more expenses
- If you don't fix the damages the value of your house will be less
- To prevent this, it would be prudent to **reserve** or place a little money in savings each month

Distributable Reserves

- In the same way companies need to keep some of their earnings in good times to ensure that when there are bad times they are able to meet unexpected expenses e.g. if a large customer goes out of business and stops paying its invoices
- The way a company saves is by keeping some of its earnings as **reserves**
- This is regardless of whether a company has shareholders or members

SAMRO & Reserves

Every year the Board of Directors of SAMRO decides on the reserve allocations

- Social and Cultural amounts are confirmed
 - Fund SRAF & Funeral Benefit for members (social)
 - Fund SENA – music education (cultural)
- What happens to the balance?
 - a portion is taken to General Reserve
 - a portion is taken to Development Fund
 - the Board then declares the distribution
 - if the increase in the distribution is below inflation money is taken from the reserves to increase the distribution

SAMRO & Reserves

General Reserve

- To ensure growth in distributions, even in bad years
- To lessen the impact of extraordinary expenses on distributable income

Development Fund

- To provide funding for development of SAMRO
- IT systems
- Revenue growth opportunities