POLICY

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Policy title: **FINANCIAL RISK MANAGEMENT**

Directorate: ORGANISATIONAL SERVICES

Branch: FINANCE

Policy objective: To provide a written record of:

(a) risks that Council is exposed to through Council's operations that are relevant to financial management

(b) control measures adopted to manage these risks

(c) the duties of employees responsible for carrying out an activity relating to financial management.

Policy scope:

Section 164(1) of the Local Government Regulation 2012 states that a local government must keep a written record stating the following:

(a) the risks the Local Government's operations are exposed to, to the extent they are relevant to financial management

(b) the control measures adopted to manage the risks

(c) the duties of each local government employee who is responsible for carrying out an activity relating to financial management.

This policy provides practical steps to address these requirements.

Definitions:

TERM	**DEFINITION**
Asset consumption ratio	Measures the written down value of infrastructure assets as a percentage of gross replacement cost providing an indication of the average age (or consumption) of infrastructure assets at a point in time. The higher the percentage, the older the average asset age and the sooner expected replacement.
Asset sustainability ratio	Expresses net capital expenditure on renewal and replacement of existing assets as a percentage of the optimal level for such expenditure or depreciation as shown in the Council's Infrastructure and Asset Management Plan. This measure can assist in identifying the potential decline or improvement in asset condition and standards. A percentage less than 100 on an ongoing basis indicates that capital expenditure levels are not being optimised so as to minimise whole of life cycle costs of assets (having regard to the Infrastructure and Asset Management Plan) or that assets may be deteriorating at a greater rate than spending on their renewal or replacement.

TERM	DEFINITION
Interest coverage ratio	Measures net interest expense as a percentage of total operating revenue. This is a calculation of Council's ability to meet its interest payments on outstanding debt. The lower the interest coverage ratio, the larger the debt burden on Council.
Net financial liabilities ratio	Expresses Net Financial Liabilities as a percentage of Total Operating Revenue. Net Financial liabilities are the excess of total liabilities over current assets. This measure allows interested parties to readily equate the outstanding level of the Council’s financial obligations against the level of one-year’s operating revenue. The measure also indicates the capacity of the Council to meet its financial obligations from revenue streams. Where the ratio is falling, it indicates that the Council’s capacity to meet its financial obligations from revenue streams is strengthening. Conversely, where this ratio is increasing, it indicates that the Council’s capacity to meet its financial obligations is deteriorating.
Operating surplus/(deficit)	Operating surplus/(deficit) is Council's Net Result excluding capital revenue and expenditure. A negative ratio indicates that current period revenues are insufficient to meet current year expenditures and that the shortfall is funded either through capital contributions or an erosion of Council capital.
Operating surplus ratio	Expresses operating surplus as a percentage of operating revenue. This measure provides an indication of the extent of ratepayer and other operational contributions towards the funding of Council capital expenditure and debt redemption. A negative ratio indicates that current period revenues are insufficient to meet current year expenditures and that the shortfall is funded either through capital contributions or an erosion of Council capital.
Working capital ratio	Expresses current assets as a percentage of current liabilities. This measure provides an indication of short-term liquidity. Current assets and current liabilities are those assets and liabilities with an expected redemption of less than twelve months. The higher this ratio, the more capable is Council of meeting its short-term obligations.

Policy statement:

1. **Financial management principles**

Financial management principles shall be developed in support of priorities tabled in Council's corporate plan. Management principles shall ensure that:

(a) Council is financially sustainable and long-term financial sustainability is achieved.

(b) Infrastructure is effectively and efficiently provided, developed, maintained and disposed.

(c) Budgets and other financial information are reported upon in a consistent and accurate fashion.

(d) Council has a considered position on service delivery, and its roles and responsibilities in relation to each of its services.

(e) Council has a considered position on the funding of services and has suitable resources to enable it to evaluate the strategic benefit of all its services.

(f) An equitable, transparent and accountable rating system is in place.

(g) Achievement of Council's strategic objectives is facilitated through effective management of borrowings and financial assets.

(h) There are systems and procedures in place that improve the efficiency and effectiveness of Council services in order to:

 (i) recognise and manage risk

 (ii) encourage enhanced performance.

(i) The integrity of financial systems and reports are safeguarded.

2. Financial management risk strategies

The following strategies shall be developed and maintained in support of financial management principles:

Principle 1: Council is financially sustainable and long-term financial sustainability is achieved

(a) The long-term financial plan adopted by Council focuses on achieving, at least, a break-even operating result:

 (i) Council shall adopt a long term Financial Plan, for a period of at least 10 years, which ensures that each year's projected operating revenue is sufficient to meet that year's operating expenses, unless Council has formally resolved that it is financially prudent for it not to do so.

 (ii) There are clear links between Council's Strategic Management Plans (including the long-term financial plan), its annual business plan and its annual budget.

 (iii) An observable process shall be implemented that links the ongoing development of each of the following documents:

  a. corporate plan

  b. long-term financial plan

  c. Assets and Services Management Plan (the results of which are reflected in the long-term financial plan)

  d. annual business plan

  e. annual budget.

 (iv) The long-term financial plan is to include four standard financial reports:

  a. income statement

  b. balance sheet

  c. cash flow statement

  d. key financial performance measures/indicators including at least those in requirement 1.4 below.

(b) Council shall report on key sustainability measures/indicators:

(c) Council shall provide explanatory material in its annual report on the following measures/indicators of financial sustainability including commentary on variations from targets:

- asset sustainability ratio
- asset consumption ratio
- interest coverage ratio
- working capital ratio
- operating surplus/(deficit)
- operating surplus ratio
- net financial liabilities ratio

Principle 2: infrastructure is effectively and efficiently managed

(a) Council has a clear understanding of infrastructure condition, maintenance, refurbishment and replacement needs:

(i) Council shall undertake regular assessment of infrastructure assets, including their condition, maintenance, refurbishment and replacement needs.

(b) Council shall be able to clearly demonstrate the link between infrastructure assets and service delivery:

(i) Council shall undertake regular assessment of infrastructure requirements to support current and future service delivery to be compared with Council's stock of infrastructure in order to plan for future development requirements.

(c) Council undertakes regular review of the Assets and Services Management Plan:

(i) Council shall review its Infrastructure and Asset management Plan at least annually.

(d) Council ensures that annual capital expenditure programs for renewal and replacement of assets closely match the infrastructure and asset management plan:

(i) The asset sustainability ratio (capital expenditure/ optimal level of capital expenditure) for the previous year's expenditure shall be 100% (plus or minus 10%) indicating that optimum levels of capital expenditure are being undertaken to maintain service delivery.

(e) Council must record accurate infrastructure asset values and depreciation costs. Council shall ensure that:

(i) Its assets are revalued annually by at least applying a suitable price escalator with a more rigorous review of asset valuations (conducted on a 'fair value' accounting basis) occurring at intervals of no more than 5 years.

(ii) Useful lives for each of its asset classes are regularly reviewed and informed by the Infrastructure and Asset Management Plan, and having due regard to the useful lives of similar assets of other councils.

(f) 'Unit rates' have been developed from documented costing policies

(g) Infrastructure assets are recognised under the following categories:

(i) Capital renewal - renewing an asset to extend its serviceability but not providing a higher level of service (e.g. resealing a road).

(ii) Capital upgrade - renewing the asset to provide a higher level of service - e.g. sealing an unsealed road.

(iii) Capital expansion - providing a new asset - e.g. extending a footpath to an area where one did not exist previously.

(iv) Maintenance - does not upgrade or renew the asset, but enables an asset to deliver its defined level of service over its planned lifespan - e.g. repair potholes.

Principle 3: budgets and other financial information are reported on in a consistent and accurate fashion

(a) Budgets and financial reports are prepared on an accrual basis:

(i) Council shall adopt all budgets and financial reports on an accrual basis consistent with accounting treatments in annual financial statements.

(b) Summary budget information is presented in a uniform and comparable basis:

(i) Council shall present summary information on its annual budget in a format set out in its budget manual.

(ii) This shall include information on key financial performance and position measures/indicators.

Principle 4: Council has a considered position on levels of service, and its roles and responsibilities in relation to each of its services

(a) There is a policy framework for the assessment of provision of services:

(i) Council shall have a policy on the provision of services and its roles and responsibilities in relation to those services.

(ii) Know the cost of providing existing levels of service:

a. Council shall have a system which produces clear information on the cost of current council levels of service, including fully attributed lifecycle cost/ benefit analysis.

(iii) Determine the cost of providing an additional service.

a. Any new service proposed shall undergo a rigorous cost/benefit analysis and must align to strategic priorities.

Principle 5: Council has a considered position on the funding of services and has suitable resources to enable it to evaluate the strategic benefit of all its services

(a) Council has a funding policy:

(i) Council has adopted a funding policy that clearly sets out Council's funding strategies for the major categories of its services.

(b) Council funds are obtained and used in a strategic and appropriate manner:

(i) Council is able to assess the operational and strategic revenue and cost implications of service delivery decisions.

Principle 6: an equitable, transparent and accountable rating system is in place:

(a) The impact of changes in the distribution of the burden of rates is fully understood, and consideration is given to moderate any significant adverse impacts on individual ratepayers:

(i) Modelling shall be undertaken of the rating options for all issues which have a significant impact on the distribution of the burden of rates and presented as a report to Council before the annual rating decisions are made.

(ii) The link between the long-term financial plan and annual budget and rating decisions can be clearly demonstrated:

a. The impact of the outcomes of the long-term financial plan shall be taken account of in consideration of rating options in 6.1.

(iii) Revenue to be raised through rates is reported in a consistent and transparent manner:

a. Council shall publish rates information in a manner described in Council's budget manual.

Principle 7: achievement of Council's strategic objectives is facilitated through the effective management of borrowings and financial assets.

(a) Council actively manages its borrowings:

(i) Council shall undertake the following actions in relation to borrowings:

a. Forecast and monitor long term capital expenditure programs that are required to be funded by loan funds.

b. Limit external loan funds required for new capital works to:

- new road works and other works-related capital programs;
- new capital projects that create future income streams from which debt management shall be financed; and
- new capital projects that create assets with a durable life of greater than two (2) years.

c. Structure new loans to the maximum term allowable for the class of asset acquired.

d. Obtain borrowings from the Queensland Treasury Corporation (QTC) only.

e. The annual extent of new borrowings shall be approved by Council through the borrowing policy and as part of the annual budget process.

f. A five-year external borrowing schedule shall be provided in Council's borrowing policy and updated annually.

(b) Council actively manages its financial assets and financial liabilities:

(i) Council shall manage financial risk elements encompassed in the risk types listed below:

a. Credit risk - Credit risk exposure refers to the situation where Council may incur financial loss as a result of another party to a financial instrument not discharging their obligations (e.g. unpaid rates).

b. Liquidity risk - Liquidity risk refers to the situation where Council may encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.

c. Interest rate risk - Interest rate risk is the risk of a loss due to a variation in interest rates on investments or borrowings.

(c) Council shall undertake the following steps to minimise financial risks:

(i) Credit risk

a. Develop a collection policy for overdue rates and accounts receivable.

b. Undertake disposal of property where rates remain unpaid as provided for in the *Local Government Act 2009*. Rates are levied quarterly in advance and are secured against the property under s.74 of the Local Government (Finance, Planning and Reporting) Regulation 2010.

c. Limit investment of surplus funds to "authorised investments" as defined in the *Statutory Bodies Financial Arrangement Act 1982* as amended or direct investments with licensed banks limited by credit rating and type as specified in Council's investment policy.

(ii) Liquidity risk

a. Ensure that Council's long-term financial plan caters for the repayment of Council borrowings and ensure that sufficient funds are available to fund planned expenditures.

(iii) Interest rate risk

a. The source of Council borrowing is restricted to the Queensland Treasury Corporation.

b. Council's Treasury function shall manage cash allocation on a daily basis to maximise Council return and minimise risk exposure.

Principle 8.1: there are systems and procedures in place that improve the efficiency and effectiveness of Council's recognition and management of risk.

(a) Council has an established risk management policy framework.

(b) Council shall at least every two years undertake a review of strategic financial risks and have a plan to manage them.

(c) Council has an established prudential management framework:

(i) Council annually certifies compliance with the following legislative requirements of the *Local Government Act 2009* (the Act) and the Local Government Regulation 2012 (the Regulation):

a. Maintain a register of delegations per section 260 (Local government delegations register) of the Act, which has been reviewed by Council at least once per year.

b. Prepare and adopt policies on contracts and tenders as described in part 3, division 2 of the Regulation.

c. Develop and adopt a five-year corporate plan per section 166 of the Regulation.

d. Have a budget and annual operational plan per part 2, division 3 of the Regulation.

e. Ensure that appropriate policies, practices and procedures of internal controls are implemented and maintained.

f. Have an Audit Committee, appoint an internal auditor and undertake an internal audit annually per section 207 of the Regulation.

g. Review the performance of investments annually as part of the budget process.

h. Ensure that all borrowings are approved by Council through the budget process.

i. Ensure that all expenditure not approved as part of the budget is subject to separate Council approval.

j. Council shall maintain a strong system of internal control:

- The system of internal control shall be documented and shall identify individuals responsible for its maintenance and implementation.
- All material financial risks shall be identified and presented to Council along with how they are to be managed.

Principle 8.2: there are systems and procedures in place that encourage enhanced performance

(a) Clear, useful and measurable key performance measures and indicators shall be used to evaluate performance:

(i) A suite of key performance measures/indicators shall be established and adopted by Council.

(b) Key performance measures/indicators shall include sustainability measures/ indicators listed under principle 1.

(c) The key performance measures/indicators to evaluate performance shall be publicly available:

(i) Council's annual report shall include explanatory information about its performance, including variations from targets, using the measures/ indicators pursuant to item 8.2.1.

(d) A transparent process shall be maintained for improving the effectiveness and efficiency of Council operations:

(e) A transparent and rigorous process shall be implemented for the ongoing assessment of the efficiency and effectiveness of Council's operations and shall be reported in Council's annual report.

Principle 9: the integrity of financial systems and reports are safeguarded

(a) The Audit Committee shall have a clearly defined charter that sets out the composition, roles and responsibilities of Councils Audit Committee.

(b) Council shall be able to demonstrate the independence of the external audit role.

(c) There shall be a clearly defined external audit policy which includes:

(i) the appointment and removal of the external auditor

(ii) the performance of the external auditor

(iii) auditor independence

(iv) provision of non-audit related services

(v) external audit responsibility

(vi) audit delivery and reporting.

(d) There shall be an active internal audit program supported by appropriate policy.

(e) There is a clearly defined internal audit policy which includes:

(i) the preparation of the internal audit plan and program

(ii) an internal audit charter and objective

(iii) internal audit scope and operating principles

(iv) independence

(v) access to information and confidentiality

(vi) relationships with departmental managers and employees

(vii) reporting requirements and the role of the Audit Committee in relation to internal audit.

Management responsibility

Council management shall develop relevant processes and procedures identifying officers responsible for the carrying out of activities and controls in support of this policy.

Related Policies/Legislation/Other Documents:

DOC ID	DOCUMENT TYPE	DOCUMENT NAME
-	Legislation	*Local Government Act 2009*
-	Legislation	Local Government Regulation 2012
-	Legislation	*Statutory bodies Financial Arrangement Act 1982*