

Issue Paper

ISSUE Financial Management

1. Issue Name

Financial Management

2. Contributors

Kerry Phillips Manager Financial Services, Ray Turner General Manager Corporate Services
Corporate Finance Team

3. Issue Definition and Scope

Four areas of focus have been identified by the Corporate Financial Team and the General Manager Corporate Services for review in relation to this issue;

1. FINANCIAL SUSTAINABILITY
2. LINKAGE BETWEEN FINANCIAL MANAGEMENT AND ASSET MANAGEMENT
3. CAPITAL FUNDING
4. USER PAYS

This paper endeavours to identify emerging issues, data and facts and industry direction in relation to financial management focusing on the above 4 areas of focus for consideration by Council in the development of the overall Corporate Plan.

4. Executive Summary

Financial Sustainability is an issue being addressed across the industry nationally.

RSC have been monitoring progress against this background for a number of years and frameworks have been established and priorities set to ensure that Council continues to monitor this essential financial management strategy.

Linkage between asset management and financial management is being focussed upon as a priority across Queensland. It has been addressed as an issue in depth in Victoria, SA and Tasmania and, Queensland will leverage from the work already undertaken. RSC is already in a strong position in relation to this issue with the development and adoption of the Total Asset Management Plan for Council and the development of Individual Asset Management Plans for key asset groups.

It is anticipated that as with initiatives that are in place with respect to monitoring financial sustainability, RSC in relation to an asset management framework will have developed a framework ahead of any Departmental policy or legislation that the State Government may impose.

Capital funding and the impact of items such as depreciation and the proposed regime of infrastructure charges has the potential to impact on Council's requirement of the general rate to fund future capital investment.

Depreciation is a significant area for RSC to explore due to the impact of changes in valuations in recent times across most classes of assets.

The Queensland Audit Office is still focusing on reviewing unfunded depreciation. RSC is currently in a position where depreciation is partially unfunded. This is on the basis that our method of depreciation across some classes should be considered for reassessment and perhaps shifting in favor of condition based depreciation which potentially would reduce the annual financial impact. A shift to such a method requires asset management plans to be sufficiently developed to support the move and requires an on going commitment by Council to fund the necessary maintenance of data to support the continued requirements of this treatment.

The new IPA scheme provides for the establishment of Priority Infrastructure Plans (PIPS) and provides for a regime of charging under the introduction of an Infrastructure Charging Schedule in association with trunk infrastructure networks. Charging may be in association with;

Water Cycle - water supply, sewerage, collecting water, treating water, stream managing, disposing of waters and flood irrigation

Transport infrastructure – roads, vehicle lay bys, traffic control, public parking facilities, cycle ways, pathways and ferry terminals

Local Community Land – Public parks infrastructure, land suitable for community facilities, community halls and centres, public recreation centres, public libraries.

Principles of charging – must be plan based, reflect efficient costs and equitably apportioned. Limited to establishment costs for upgrading/extending or creating new works – not rehabilitation or maintenance.

RSC, in the short term, has been committed to setting fees and charges with reference to user capacity to pay, community service obligations, cost recovery principles, benchmarking of similar services and statutory limitations. In the long term Council will strive towards "**User Pays**" principles, ensuring the costs associated with each service are clearly defined and costed.

There has also been some pressure on the general rating strategy to consider identifying classes of expenditure currently funded by the general rate for more direct charging e.g. libraries and road maintenance.

Pressure to more appropriately cost fees and charges has emerged in recent years in response to the National Competition Policy and the revised requirements in respect to the development of the revenue policy, the revenue statement and the establishment of register of regulatory fees.

5. Regional Cooperation

FINANCIAL SUSTAINABILITY

Across local government nationally concerns have been raised about the financial sustainability of Councils in general. In particular in both NSW and SA extensive reviews have been undertaken and a program of amalgamation has ensued to create environments to support financial sustainability.

The Minister for the Department of Local Government, Planning, Sport and Recreation has opened discussion to look at such an opportunity for Queensland, focusing in particular on remote Councils, however the SE corner via the network of CEOs has commenced exploring the opportunities for shared service potential including, IT services, procurement and procurement training.

LINKAGE BETWEEN ASSET MANAGEMENT AND FINANCIAL MANAGEMENT

Information has been sourced from Caboolture Shire Council regarding their recently established asset management team. The success of this multidisciplinary group will provide Council with the opportunity to review their experience in terms of facilitating the ELG initiative to establish a Corporate Asset Information Team within RSC.

It is expected that there will be vast opportunities to share information regarding this issue through the implementation of the strategies identified by LGAQ in their position paper "Asset Management - backroom to the boardroom." (further detail is provided in the background/discussion section of the paper).

CAPITAL FUNDING

Logan, Gold Coast and Beaudesert Councils have already moved to condition based depreciation for their road assets. Caboolture, are currently like RSC, reviewing the situation with a likelihood of shifting.

All Councils will be impacted by the imposition of the IPA infrastructure planning and charging regime throughout the planning period.

USER PAYS

Regionally, Logan is well advanced with respect to their development of user pays and the support of ABC. In addition, RSC have leveraged from work developed some years ago by Maroochy.

From an industry standing most of the pressure has subsided in relation to this issue, however it is an opportunity for RSC to improve, catch up and position Council with more transparent material to assist in developing the "User Pay" option.

6. Background/Discussion

FOCUS AREA 1 - FINANCIAL SUSTAINABILITY

The current Corporate Plan for Council has the following strategic priority;

"Ensure the long-term financial viability of the Shire and provide public accountability in financial management."

Financial sustainability as a concept has emerged in response to the pursuit of long-term financial viability for Local Government.

Issues challenging Councils in securing financial sustainability include;

- (i) Huge infrastructure on going maintenance and replacement costs
- (ii) Intergenerational equity – who should pay for the future status of infrastructure
- (iii) Cost shifting from other tiers of government
- (iv) Impact of the aging population on the programs and asset acquisitions of the future – shift from physical infrastructure to community health and well - being – socially driven.

Across local government nationally concerns have been raised about the financial sustainability of Councils in general. In particular in both NSW and SA extensive reviews have been undertaken and a program of amalgamation has ensued to create environments to support financial sustainability. Debt funding has also come under scrutiny and pressure as many elements of government strive to return budgeted surpluses, placing pressure on local government to consider the cost of debt and the issue of intergenerational debt.

More recently the Minister for the Department of Local Government, Planning, Sport and Recreation has opened discussion to look at such an opportunity for Queensland, focusing in particular on remote Councils, however the SE corner via the network of CEOs commenced exploring opportunities to consider shared service potential across a number of areas including, IT (there is a project already running with SEQ CIOs) procurement (contract management as a sub-element initiative) and procurement training.

Opportunities to enhance financial management include;

- (i) Reviewing and calculating accurate levels of depreciation
- (ii) Treasury Management – pursuit of more profitable investment opportunities and enhanced appreciation of cash flow

Council has over the past three years implemented a framework to enhance focus on long term financial sustainability parts of which have subsequently been included in the new Local Government Finance Standard 2005.

These include;

- (i) the establishment of a Financial Strategy in February 2003 which focuses on short, medium and long-term financial viability out to 10 years. This document has been the cornerstone of the subsequent development of the 10 year financial model and the table of Financial Stability ratios which is currently relied on to assist Council in understanding the complete ramification of their financial decision making.
- (ii) Four year rating strategy – developed June 2004 and subsequently supported in the development of the rate model for 2005/06.
- (ii) Corporate Governance review framework is under development for release June 2005 which will provide management with data with respect to compliance with governance controls
- (iii) The inclusion of Global Reporting Initiative (GRI) indicators in Councils annual reporting over that past two years goes beyond looking at only financial sustainability and focuses on the requirement to measure and report upon a framework of total sustainability. CPA Australia and the University of Sydney have commenced work on a framework for the future with respect to reporting overall sustainability.

RSC sees the attainment of targets established within the framework as an indication that the long term financial health of the organisation is strong. Anticipated failure in any of the targets will initiate a review of proposed decisions with a view to realignment to the targets or a shift in policy.

FOCUS AREA 2. - LINKAGE BETWEEN ASSET MANAGEMENT AND FINANCIAL MANAGEMENT

Issues challenging Councils in managing the linkage between asset management and financial management;

1. Age, condition and volume of infrastructure assets
2. Understanding and managing the true life cycle cost
3. The requirement of both a strategic and operational focus to manage
4. Integration of asset management tools i.e. Maximo and SMEC

RSC has currently linked asset management with financial management in the Corporate Plan 2002 - 2006 via the objective;

"To manage the corporate assets that supports the operational objectives of the organisation"

In the very short term, it was envisaged within the Long Term Financial Strategy of Council adopted February 2003 that Council would;

- A) Survey and evaluate all Council assets
- B) Maintain a register of significant assets, their condition and a plan for their future
- C) Review and prioritise short-term capital programs to ensure asset management plans are achieved.

RSC is well underway in achieving the short term strategies.

In the medium to long term, the objective of actually optimising resource utilisation was envisaged. Along with the maintenance of a strategically focussed asset management system and review and prioritisation of long- term capital programs to ensure asset management plans are achieved. Council are on the cusp of fulfilling these expectations.

The Local Government Association of Queensland has just launched a position paper "ASSET MANAGEMENT - from the backroom to the boardroom" which sets the scene for some enhanced direction in relation to asset management in the Local Government sector in Queensland. It is planned for a Local Government Asset Management Steering Group and State Government Reference Group to form. The strategy forward for this group is to develop the following in relation to the asset management message that they need to convey;

1. Communication plan - providing insight into material available to assist
2. Education plan - the key plank of which is to develop a Queensland version of the STEP program which uses Total Management Plans and Strategic Asset Management Plans as a platform to establishing an effective asset management framework and which in large part RSC has developed or has under development.
3. Regional Engagement Plan - looking at training initiatives and policy development and feedback with respect to delivery of initiatives
4. System/Process Improvement Plan- focus on system integration issues financial/technical
5. Policy development plan
6. Evaluation plan- pre STEP roll out and post STEP roll out

FOCUS AREA 3 – CAPITAL FUNDING

Items such as depreciation and the proposed regime of infrastructure charges have the potential to impact on Council's requirement of the general rate to fund future capital investment.

Depreciation is a significant area for RSC to explore due to the impact of changes in valuations in recent times across most classes of assets.

SA Local Government Financial Management Group commissioned a review across SA councils with respect to depreciation and found average rates varying from 2% to 12.2% of net value of depreciable assets - this review was conducted across 68 councils in July 2004. In comparison RSC for 2004/2005 was 2.9%.

The Queensland Audit Office is still focusing on reviewing unfunded depreciation. RSC is currently in a position where depreciation is partially unfunded. This is on the basis that our method of depreciation across some classes should be considered for reassessment and perhaps shifting in favour of condition based depreciation which potentially would reduce the annual financial impact. A shift to such a method requires asset management plans to be sufficiently developed to support the move and requires an on going commitment by Council to fund the necessary maintenance of data to support the continued requirements of this treatment.

Consideration also needs to be given to whether depreciation for accounting purposes need be applied to pricing, i.e. it is feasible to have different methods of depreciation for each and still comply with pricing requirements under the National Competition Policy guidelines.

A briefing note has been prepared and circulated by Financial Services in relation to changes to depreciation methodologies and the implementation of recommendations is on the agenda for further discussion in the new financial year.

Logan, Gold Coast and Beaudesert councils have already moved to condition based depreciation for their road assets. Caboolture are currently like RSC reviewing the situation with a likelihood of shifting.

The new IPA scheme provides for the establishment of Priority Infrastructure Plans (PIPS) and provides for a regime of charging under the introduction of an Infrastructure Charging Schedule in association with trunk infrastructure networks. Charging may be in association with;

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Transport infrastructure – roads, vehicle lay bys, traffic control, public parking facilities, cycle ways, pathways and ferry terminals

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Principles of charging – must be plan based, reflect efficient costs and equitably apportioned. Limited to establishment costs for upgrading/extending or creating new works – not rehabilitation or maintenance. The quality of the outcome for Council will rely heavily on data collection, forward planning and the ability to accurately determine full costs that can be passed on.

All Councils will be impacted by the imposition of the IPA infrastructure planning and charging regime throughout the planning period

FOCUS AREA 4 - USER PAYS

RSC in the short term has been committed to setting fees and charges with reference to user capacity to pay, community service obligations, cost recovery principles, benchmarking of similar services and statutory limitations. In the long term Council will strive towards "User Pays" principles, ensuring the costs associated with each service are clearly defined and costed.

There has also been some pressure on the general rating strategy to consider identifying classes of expenditure currently funded by the general rate for more direct charging e.g. libraries and road maintenance.

Pressure to more appropriately cost fees and charges has emerged in recent years in response to the National Competition Policy and the revised requirements in respect to the development of the revenue policy, the revenue statement and the establishment of a register of regulatory fees.

RSC have responded to this pressure by appropriately structuring water and utility charges to align 100% with National Competition Policy requirements. Type 3 business units, such as Caravan Parks, Child Care and Cemeteries are still refining their pricing in response to the recommendations that have been provided under the National Competition Policy framework. Across Council the establishment of Activity Based Costing (ABC) has provided the architecture to assist management in establishing full cost price for activities which may align to products and services for charging. This foundation has been instrumental in supporting the establishment of the register of regulatory fees which can only be charged at full cost price. For budget 2005/2006 managers across the organisation have developed ABC further to place themselves in a position where they could provide transparency over the full inclusion or discounted inclusion of full costs in their prices. This process is a maturing one and RSC has met milestones established in the Long Term Financial Strategy to date. The 10 year financial model provides for a shift between the proportion of general rate and user pay fees and charges in the future years. The refinement of the cost visibility will be integral in determining where opportunities for margin or volume growth may be apparent.

Council's on-going support and resourcing of Activity Based Costing is critical. The platform to take ABC forward has been developed in recommendations provided by John Perkins in his ABC review report of June 2005.

Regionally, Logan is well advanced with respect to their development of user pays and the support of ABC. In addition, RSC have leveraged from work developed some years ago by Maroochydhore.

From an industry standing most of the pressure has subsided in relation to this issue, however it is an opportunity for RSC to improve, catch up and position Council with more transparent material to assist in developing the "User Pay" option.

Operational Requirements

FINANCIAL SUSTAINABILITY

It is planned that Council continue to utilise the frameworks established with respect to financial sustainability and throughout the planning period continue to review and modify to reflect emerging best practice.

LINKAGE BETWEEN FINANCIAL MANAGEMENT AND ASSET MANAGEMENT

RSC is in a strong position with regard to compliance to the proposals emerging from Department's initiative however Council should maintain resourcing and momentum to establish the culture of support for the long-term.

CAPITAL FUNDING

A briefing note has been prepared and circulated by Financial Services in relation to changes to depreciation methodologies and the implementation of recommendations is on the agenda for further discussion in the new financial year.

Council will be developing their Infrastructure charging schedules for the first time during the planning period, it is anticipated that the introduction of this regime will impact materially on the future decisions of Council with respect to capital investment and funding sources.

USER PAYS

Council's on-going support and resourcing of Activity Based Costing is critical to the costing of services that may be opened up to more extensive application of user pays. The platform to take ABC forward has been developed in recommendations provided by John Perkins in his ABC Review report of June 2005.

RESEARCH AND CONSULTATION

Media Monitor advices from DLGPS&R- 1 July 2004- 31 May 2005

LGA SA Independent Inquiry into the Financial Sustainability of Local Government- April 2005

Hawker Report – cost shifting

LGAQ Discussion Paper - Size, Shape and Sustainability of Queensland Local Government - March 2005

LGAQ Queensland Local Government "Asset Management from the backroom to the boardroom" - position paper - 2 June 2005

Department for Victorian Communities- Sustaining Local Assets - Local government asset management policy statement - December 2003

Department for Victorian Communities - Asset Management Policy, Strategy and Plan - Guidelines for Developing Asset Management Policy, Strategy and Plan - August 2004

SA Local Government Financial Management Group - Infrastructure Asset Accounting Policy Review - prepared by Team Synergy Management Consultants - July 2004

Review of Asset Management - Research results - prepared by Dr Penny Burns for the Australian Local Government Association

ABC Review Redland Shire Council - prepared by John Perkins Value Focused Consulting Group- June 2005

IPA Infrastructure Guideline – Infrastructure Charging Schedules– prepared by Department of Local Government, Planning, Sport and Recreation – October 2004

IPA Infrastructure Guideline – Priority Infrastructure Plans - – prepared by Department of Local Government, Planning, Sport and Recreation – October 2004