

Local Government

Improving Financial Sustainability through Risk Management



Many Councils understand that risk is inevitable and have implemented systems and processes to manage them. Councils appreciate the value of risk management when looking to minimise the likelihood and impact of things going wrong. But did you know that risk management offers a lot more?

Managing council-wide risks and improving financial sustainability are not mutually exclusive activities. In fact, risk management can also be used by Councils to help achieve their strategic objectives.

In this article, we look at the importance of financial sustainability and outline strategies to incorporate good risk management into the strategic planning process to support Council's objectives including financial sustainability.

The importance of financial sustainability

According to the Independent Inquiry into the Financial Sustainability of NSW Local Government, more than a quarter of NSW Councils were unsustainable under current funding arrangements. It also found NSW Councils faced a \$5.3 billion backlog in infrastructure works, and an annual shortfall of \$500 million.

Achieving and/or improving financial sustainability is important. It enables Councils to better achieve their strategic objectives by enabling them to do more with their funds like access more resources, provide better services and enhance Councils resilience to unforeseen events.

Financial sustainability is an outcome

Let's start by stating the obvious. Financial sustainability is an outcome or goal. It is the end result of hard work and many systems and processes including but not restricted to:

- Understanding stakeholder needs;
- Sound strategic/business planning;
- Prudent financial management;
- Ongoing oversight, monitoring and control systems;
- Competent/capable people; and
- Sound risk management

All these factors must be integrated and aligned to achieve the desired outcome – financial sustainability.

Imagine the outcome if a Council sets strategic plans without understanding community needs? What do you think would happen to a Council with grand plans, a lot of funds but poor oversight and control systems?

A question of alignment

All Councils have strategic plans, business plans, financial processes and risk management. But how well are they all aligned and integrated?

Integration and alignment ensures all the activities work coherently together to achieve the ultimate goal. For example, business plans identify important initiatives, they should be stress tested, monitoring ensures the initiatives remain on track and capable people make things happen.

We believe that re-aligning the risk management framework to strategic

planning will help Councils achieve their objectives

Many organisations align their strategies to business plans and periodic monitoring, but most fail to incorporate risk management for various reasons:

1. Risk is not adequately defined

To most of us, risk is something that is undesirable and should be generally avoided or passed to the insurer. It is often perceived as a negative and considered in terms of the possibility of danger, loss, damage, injury or any other adverse consequences.

However, a better definition of risk is contained in the AS/NZS:4360 standard on Risk Management. It defines risk as the chance of something happening that will have an impact upon objectives.

Clearly, there is an opportunity to apply risk management thinking to strategic objectives like financial sustainability.

2. The context of risk management is not appropriate

Our 2006 Council-wide Risk Management (CWRM) survey revealed that 56% of Councils mainly focus risk management efforts on insurance related risks and 78% had not identified all their risks.

Limiting the context restricts risk management thinking within Council and inhibits true council-wide risk management to support meeting Council objectives including financial sustainability.

3. The risk management framework is ineffective;

The systems and process to address, analyse and treat risks may not be working effectively or they may not be well integrated into the planning process due to a “one-sided” risk approach.

Ineffectiveness may be caused by a number of factors including poor training, unskilled resources, poor processes and lack of information.

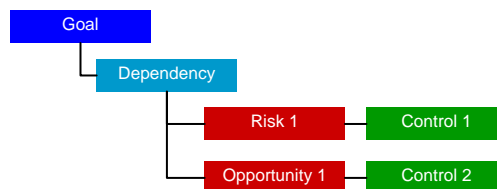
4. Risk managers are not involved in the strategic planning process

Risk managers can play an important role in the strategic planning process at two levels. They can review the organisations plans and assess the potential risks. Also, they can realign the risk management framework to help Council meet their objectives.

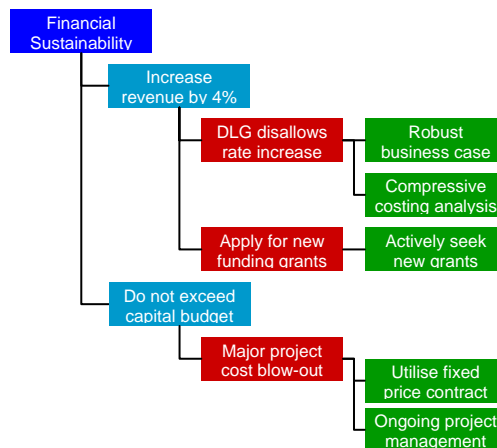
An alternative approach is to apply risk management to objectives or goals. This approach is consistent with AS/NZS:4360 and fits perfectly with definition of risk management – “the chance of something happening that will have an impact upon objectives”.

Using this approach, Councils need to set goals, determine dependencies and then identify risks and opportunities that could impact their goals.

The ‘goal’ is ultimately the objective that a Council is trying to achieve. The ‘dependencies’ are the activities or things that must go ‘right’ to achieve their goals. Diagrammatically, it looks like this.



If you apply the above framework to financial sustainability, it could look like this.



Rethinking risk management

Councils currently manage their risks by managing the potential impact via insurance and managing the likelihood by implementing internal controls.

They achieve this by looking at activities, (assets or processes), assessing exposure, determining risks and implementing controls to mitigate the risk. Diagrammatically, it looks like this.



This approach is commonly known as the exposure analysis approach because it involves the identification of risks that could affect assets. It is a perfectly good way to manage risk. However it may be limited in its application when looking to use risk management to help Councils achieve goals like financial sustainability.

Whilst this is a relatively simple example, it highlights the linkages between goals, dependencies, risks, opportunities and controls. It also allows Councils to split goals into sub-goals to help them break down larger goals into smaller, more manageable components.

Key advantages of this approach

It's not always possible to anticipate everything that can go wrong.

Councils can spend months or years identifying possible risks, but how much value does this process really add?

This approach has a number of benefits:

- More realistic business orientation as Councils start with their goals, not risks and controls,
- Councils goals are clearly documented and can be reconciled to the strategic plan, business plan and risk management framework.
- All dependencies are linked to goals, risks and opportunities.
- Risks that impact dependencies are considered, analysed and managed;
- Controls are identified for both risks and opportunities;
- Aligned to risk-based audit methodology as auditors can assess the effectiveness of controls to manage risk.

We understand end-to-end risk management

InConsult has the expertise to assist Councils manage both risk and opportunities. If you have any queries regarding risk management or financial sustainability, please contact:

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