**ENTREPRENEURIAL POWERS**

**Ministerial Guideline**

***Local Government Victoria***

*Level 14, 1 Spring Street*

*Melbourne, Vic, 3000*

*(03) 9208 3430*

 

**Guideline for Entrepreneurial Powers**

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***Local Government Act 1989 – Section 193(5D)***

Entrepreneurial Powers Ministerial Guideline

# *Background*

The *Local Government (Democratic Reform) Act 2003* (the Democratic Reform Act) was passed by the Parliament in late November 2003. Section 89 of the Democratic Reform Act amended section 193 of the *Local Government Act 1989* (the LG Act), introducing a new requirement that councils undertake certain risk management processes when proposing to engage in entrepreneurial ventures.

Section 89 of the Democratic Reform Act was proclaimed on 29 October 2004.

Section 193(5D) of the LG Act (as amended) provides that the Minister for Local Government may make Guidelines on:

* the total investment involved and the total risk exposure; and
* the risk assessment report (including appropriate reporting arrangements) prepared by an appropriately qualified person.

The purpose of these Guidelines is to guide compliance with respect to the determination of the total investment involved and the total risk exposure, and the need for a Risk Assessment Report. In particular, the Guidelines cover the following:

* Assessment of the proposed entrepreneurial venture (the enterprise) to determine if it falls within the scope of section 193 of the LG Act.
* Assessment of the total investment involved and the total risk exposure (for the purposes of the Guidelines, this sum will be referred to as the ‘Value of Enterprise’).
* Determination of the types of qualifications and skills the person preparing the Risk Assessment Report or the Appropriately Qualified Person should hold/have.
* The contents of the Risk Assessment Report.

Councils should be aware that these Guidelines do not address the other legal requirements in section 193 of the LG Act (for example issues of retrospectivity, audit requirements, exemptions from other provisions of the LG Act, etc) or other legislation, both Victorian (for example *Associations Incorporation Act 1981*, *Trustee Act 1958, Trustee Companies Act 1984*, *Partnership Act 1958, Corporations (Victoria) Act 1990,* etc), and Commonwealth (for example *Corporations Act 2001*, *Income Tax Assessment Act 1997*, etc).

# *Types of Entrepreneurial Ventures*

Section 193 of the LG Act is broad with a wide variety of enterprises falling within its scope. The types of enterprises varies from low risk – participation in incorporated associations – to

high risk ventures such as the establishment of wholly owned subsidiary companies, land development joint ventures and the like. The structure of these enterprises**1** has also varied:

* incorporated associations;
* proprietary limited and publicly listed companies;
* incorporated and unincorporated joint ventures;
* charitable trusts;
* profit share arrangements;
* companies limited by guarantee with or without a shareholding; and
* companies with a limited liability with or without a shareholding.

# *Participating in the Enterprise*

Once a council has determined that its proposed enterprise falls within the scope of section 193 of the LG Act, it needs to determine the following before it participates in the enterprise:

* the Value of Enterprise;
* if it needs to consider a Risk Assessment Report prepared by an appropriately qualified person; and
* if the approval of the Minister for Local Government or the approval of both the Minister for Local Government and the Treasurer are needed.

# *Value of Enterprise*

The determination of the ‘Value of Enterprise’ is an important step as this will determine what process the council needs to follow in order to participate in its proposed enterprise (see the next section - ‘Need for a Risk Assessment Report’).

The Value of Enterprise comprises the **total investment** involved. Where the proposed enterprise involves both an investment and a risk exposure, the Value of Enterprise will need to include the value of the **total risk exposure**.

## *Total Investment*

It is envisaged that the **total investment** might include:

* any net expenditures on preparatory activities including legal fees, financial/commercial consultant fees, patent/copyright establishment costs, etc that may not be recouped from the enterprise at a later stage;
* in-kind contributions towards preparatory activities including staff time, other council resources, etc, where they are relevant to the proposed enterprise; would otherwise be

1 A list of councils which have previously been granted approval under section 193 of the LG Act by the Minister for Local Government and the Treasurer to participate in an enterprise is attached. This list is not exhaustive and is only intended to given an indication of the types of enterprises that councils have previously participated in or are currently participating in.

avoidable**2**; and are material or significant enough to influence the decision making process;

* the proposed initial capital contribution to the enterprise;
* any on-going committed recurrent monetary contributions; and
* any committed recurrent in-kind contributions including staff time, other council resources, etc.

In instances where the proposed enterprise will involve contributions over a period of more than one year, the **total investment** should be determined on a *‘Present Value’***3** *basis, using an appropriate discount rate*.

## *Total Risk Exposure*

**Total risk exposure** might include:

* losses (potential and realised) arising from failures during the concept design and/or development stages of the proposed enterprise;
* in the case where the proposed enterprise includes a design, construction and operation of a facility – risks associated with design, construction (e.g. cost/timelines under estimated), performance (e.g. poor performance of sub-contractors), operating (e.g. under estimation of cost of service provision), termination (e.g. default of facility operator), technology (e.g. technological change/asset obsolescence), residual value (e.g. assets procured specifically for a contract which are no longer required at the end of the contract), and so on;
* financial and/or commercial liabilities or losses as a result of the enterprise performing below expectations or projections;
* any future committed contingency capital contributions;
* financial and/or commercial liabilities or loss as result of failure of the enterprise including the loss of any capital not already accounted for, accrued trading losses, trade debtors, unpaid creditors, legal action taken against the enterprise and/or councils, etc;
* environment risks; and
* expenditures that maybe incurred as a result of the wind-up of the enterprise for example legal costs, guarantees, limited liabilities etc.

It is advisable for councils to also refer to best practice guidance**4** to assist with the identification of risk, determination of the value of the risk exposure, consideration of unquantifiable aspects of risk, and the transfer of risk to parties better placed to manage these risks.

2 Avoidable costs are defined as costs related to an activity that would not have been incurred had that particular activity not been undertaken.

3 The Department of Treasury and Finance (DTF) has previously issued guidelines on this matter:

* + *Investment Evaluation Policy and Guidelines*, 1996;
  + *Gateway Initiative Business Case Development Guidelines*, August 2003
  + *Partnerships Victoria: Use of Discount Rates in the Partnership Process*, July 2003.

4 Best practice guidance can be found in:

* + DTF, *Partnerships Victoria: Risk Allocation and Contractual Issues*, June 2001; and
  + Standards Australia, *Risk Management*, AS4360:1999

# *Need for a Risk Assessment Report*

Councils only need to consider a Risk Assessment Report where the ‘Value of Enterprise’ exceeds whichever is the greater of $100,000 or 1% of the council's revenue from rates in the preceding financial year.

Where the ‘Value of Enterprise’ is less than whichever is the greater of $100,000 or 1% of the council's revenue from rates in the preceding financial year, then the decision to proceed with the enterprise is wholly the responsibility of that council. It will be reasonable to expect that in these cases, councils will have a formal internal mechanism to assess the risk it will be exposing itself to by participating in the proposed enterprise.

# *Preparation of a Risk Assessment Report*

The LG Act requires that a Risk Assessment Report must be considered by the council where the ‘Value of Enterprise’ exceeds whichever is the greater of $100,000 or 1% of the council's revenue from rates in the preceding financial year.

Although the LG Act does not specify who may prepare a Risk Assessment Report, it does specify that this report must be prepared by an appropriately qualified person.

Generally, a council’s participation in an enterprise will expose it to varying degrees of commercial, financial and non-financial risk. It would thus be prudent that the person selected by the council to prepare the Risk Assessment Report will hold qualifications, expertise, and experience relevant to the type of the proposed enterprise. The types of qualifications, expertise, and experience may include (but are not limited to):

* financial and commercial business planning and reporting;
* financial, commercial, legal and other risk assessment and management;
* project planning and management; and
* specific areas of expertise relevant to the particular enterprise.

# *Contents of a Risk Assessment Report*

The Risk Assessment Report should be viewed as a tool that will assist a council to make a fully informed decision in relation to a proposed enterprise.

In preparing the Risk Assessment Report, consideration should be given to the type of enterprise, the ‘Value of Enterprise’ and the level of risk to the council. The breadth of the content and complexity of the Risk Assessment Report should be commensurate with the size of the council’s overall investment and level of risk to which the council will be exposed.

The Risk Assessment Report, as the name suggests, should be a report to the council in which the risk to the council is assessed. It is therefore reasonable to expect that a Risk Assessment Report should address a variety of matters, including assessments of:

* the objectives of the proposed enterprise (including but not limited to economic, technological, social, planning, financial, environmental, and ecological value it can add), its alignment with the council’s own long term strategic direction and plans (including the Council Plan);
* the legal structure of the proposed enterprise, its capacity to reduce exposure to the risks associated with the proposed enterprise, and how well placed it is to deliver the objectives of the proposed enterprise;
* the methodology used to determine the ‘Value of Enterprise’ (i.e. the sum of the total investment involved and the total risk exposure);
* the governance arrangements**5** for the proposed enterprise including (but not limited to) the appropriateness of existing council expertise and resources, delegations of authority, financial governance, project management, procurement policies and plans, audit (internal and external) arrangements, probity issues (including conflict of interests), etc in the context of the proposed enterprise;
* the business plan for the proposed enterprise (including any financial, resource allocation, design and development, marketing plans) and in particular the underlying assumptions (including critical risks, revenue/trading projections) related to project viability (financial, economic and otherwise), proposed management team, timelines, the capacity of the council to fund the project proposal and net impact on the council’s financial position;
* the analysis of the viability of the project proposal**6**, for example sensitivity analysis, SWOT analysis, Cost-Benefit analysis, etc and how robust these analyses and their underlying assumptions might be, an analysis of the impact of different procurement options might have on the viability of the proposed enterprise;
* the risk aversion, mitigation and management strategies**7** including whether the level of any insurances for public liability, professional indemnity, employers liability, motor vehicle, product liability, fire insurances, general risks, guarantees, etc is appropriate in the context of the proposed enterprise, and alternative procurement options if these can transfer risks to other parties better suited to managing these risks more effectively;
* the criteria/thresholds that have been developed to define what constitutes the success or failure of the proposed enterprise, and an assessment of the likelihood and impact of this occurring;
* the framework for monitoring and evaluating performance against pre-determined objectives including the appropriateness and objectivity of key performance indicators developed to evaluate – the achievement of the objectives of the proposed enterprise, the performance against the business plan, the appropriateness of the performance evaluation cycle;
* compliance with legislation (including but not limited to Best Value principles, investment powers of councils, procurement, sale of land, freedom of information, taxation), State/Commonwealth Government protocols (including but not limited to borrowings and Australian Loan Council) and policy (including but not limited to National Competition Policy);

5 For a guide to best practice, refer to the Standing Directions of the Minister for Finance under the

*Financial Management Act 1994*.

6 Reference should be made to existing best practice guidance including:

* + DTF *Gateway Initiative Business Case Development Guidelines,* August 2003.
  + DTF *Partnerships Victoria*, Guidance Material June 2001.
  + DTF *Investment Evaluation Policy and Guidelines*, 1996.

7 Reference should be made to existing best practice guidance including:

* + DTF, *Partnerships Victoria, Risk Allocation and Contractual Issues Guidance*, June 2001
  + Standards Australia, *Risk Management*, AS4360:1999
  + Standards Australia, *A basic introduction to managing risk*, HB 142-1999
  + Standards Australia, *Guidelines for Managing Risk in the Australian and New Zealand Public Sector*, HB143:1999
* any exemptions from other provisions of the LG Act sought by the council (bearing in mind that such exemptions are only available in instances where the councils is required to seek the approval of the Minister for Local Government, and the Treasurer if necessary, prior to participating in the proposed enterprise);
* the accountability framework**8** which would include a reporting regime, i.e. the form of reports (internal and external) – triple bottom line reports, financial statements, reports of operations including qualitative and quantitative assessments of performance, and the frequency of reporting to the council, the community and the Minister for Local Government;
* the proposed exit strategy should the council decide to divest itself of its investment in the proposed enterprise should it fail to perform as anticipated or should the proposed enterprise itself fail and be wound-up; and
* where necessary, the community/public consultation undertaken in the context of the proposed enterprise including the council’s response to any wider community concerns.

# *Approval of the Minister for Local Government and the Treasurer*

In addition to considering a Risk Assessment Report, councils will need the approval of the Minister for Local Government for any proposed enterprise where the ‘Value of Enterprise’ exceeds whichever the greater of $500,000 or 5% of the council's revenue from rates in the preceding financial year. In addition to the Minister for Local Government’s approval, councils will also require the approval of the Treasurer where the ‘Value of Enterprise’ exceeds $5 million.

In these circumstances, councils will be expected to formally seek ministerial approval. Local Government Victoria, in conjunction with the Department of Treasury and Finance, has developed a standard application form to the Minister/s. The standard application form includes a list (not exhaustive) of the types of documents that Councils will be expected to append to the application form. Detailed explanatory notes have also been prepared to assist councils to complete the application form.

Completed application forms are to be submitted to Local Government Victoria.

Copies of the standard application form and explanatory notes are available from Local Government Victoria.

8 For a guide to best practice, refer to the Standing Directions of the Minister for Finance under the

*Financial Management Act 1994*.

# *Recommended Background and Resource Material*

*Local Government Act 1989* and *Local Government (Democratic Reform) Act 2003.*

Local Government Division, *Risky Business Discussion Paper, Improving Councils’ Management of Entrepreneurial Risk,* November 2000.

Local Government Division, *Improving Risk Management in Municipal Enterprises – Report on Consultation with Councils on the Discussion Paper “Risky Business” and Suggestions for Revisions to Section 193 of the Local Government Act 1989,* February 2001.

Auditor-General of Victoria, *Report on Ministerial Portfolios 1997*. Auditor-General of Victoria, *Report on Ministerial Portfolios 1998*. Auditor-General of Victoria, *Report on Ministerial Portfolios 1999*.

# *Recommended Best Practice Guidance*

Department of Treasury and Finance, *Gateway Initiative Business Case Development Guidelines,* August 2003.

Department of Treasury and Finance, *Partnerships Victoria Guidance Material,* June 2001:

* *Overview*
* *Practitioners’ Guide*
* *Risk Allocation and Contractual Issues*
* *Public Sector Comparator Technical Note*

Department of Treasury and Finance, *Investment Evaluation Policy and Guidelines,* 1996. Local Government Department, Victoria, *Guidelines for Municipal Enterprises,* 1988.

Standards Australia, *Risk Management* AS4360:1999

Standards Australia, *A basic introduction to managing risk* HB 142-1999

Standards Australia, *Guidelines for Managing Risk in the Australian and New Zealand Public Sector,* HB143:1999

Standards Australia, *Guide to control assurance and risk management,* HB 254-2003 Standards Australia, *Risk financing guidelines,* HB 141-1999

Standards Australia, *Environmental risk management - Principles and process,* HB 203-2000 Standards Australia, *Business continuity management,* HB 221:2003

# *Examples of Councils and their Municipal Enterprises*

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| **Council/s** | **Municipal Enterprise** | **Description** |
| Banyule, Darebin, Whittlesea, and Yarra City Councils | Darebin Creek Association | Incorporated Association concerned with the management of the Darebin Creek. |
| Boroondara City Council | Foundation Boroondara | Charitable foundation aimed at encouraging community contribution to the social, environmental and economic well being of the City. |
| Cardinia Shire Council | Lakeside at Pakenham | Joint venture residential property development with Delfin Lend Lease |
| Darebin City Council | Darebin Central Creek Grasslands | Residential property development in conjunction with the State Government |
| Darebin City Council | Community Power Ltd | Participation in a Not for Profit company not having a share capital that is limited by guarantee aimed at encouraging reductions in use of energy. |
| Frankston City Council | Carrum Downs Community Financial Services Pty Ltd | Investment in a Pty Ltd company. |
| Greater Bendigo City Council | Bendigo Community Telco Pty Ltd | Acquisition of shares in a Pty Ltd company. |
| Greater Dandenong City Council | Dandenong Saleyards Residential Development. | Residential property development joint venture with VicUrban |
| Greater Shepparton City Council | Parkside Gardens Estate | Residential property development joint venture with VicUrban |
| Greater Shepparton City Council and Strathbogie and Moira Shire Councils | Electronic Trade Facilitation Centre | Shareholding in a Pty Ltd Company established to facilitate exports of fresh stone fruit grown in the region. |
| Greater Shepparton City Council and Strathbogie, Moira, and Campaspe Shire Councils | Foodbowl Regional Telco | Participation in a Pty Ltd Company and a Trust established though a company limited by guarantee to offer improved services and competitive pricing throughout the region. |
| Hobsons Bay City Council | Laverton and Altona Meadows Community Bank Pty Ltd. | Investment in a Pty Ltd company. |

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| **Council/s** | **Municipal Enterprise** | **Description** |
| Knox City Council | Leisureworks Boronia | Profit share arrangement with the YMCA, the facility manager under contract. |
| Knox City Council | Waterford Valley Golf Course | Retirement Village/Golf Course development with Primelife Corporation Limited. |
| Melbourne City Council | CityWide Service Solutions Pty Ltd | Establishment and participation in a Pty Ltd Company that provides cleansing, parks & gardens, road making services to local government.. |
| Melbourne City Council | Sustainable Development Investment Fund | Establishment of a Trust Fund that will support projects which promote sustainable development and be economically sustainable itself. |
| Melbourne City Council | Queen Victoria Market Pty Ltd | Establishment of a Pty Ltd company to manage the Market on behalf of the Council. |
| Melbourne City Council | Wholesale Fish Market Pty Ltd | Establishment of a Pty Ltd company to manage the Market on behalf of the Council. |
| Melbourne City Council | New City Library | Joint venture with the Centre for Adult Education to establish and operate a new library facility ion the CBD. |
| Port Phillip and Stonnington City Councils | Streetsahead Cleaning Services | Unincorporated joint venture between the Councils to provide street cleansing services. |
| Yarra Ranges Shire Council | Museum Of Lillydale Trust | Establishment of a charitable trust to receive donations, gifts, bequests for the Museum from members of the public whilst keeping such donations at arms length from the Council. |