Strategic policy

2023/24 Derivatives Policy

Corporate Plan reference:	S28 - Financial and procurement services – financial and procurement management and governance, ensuring effective business management and legislative compliance, coordination and development of Council's budget process, administration of financial systems, sundry debtors, accounts payable, financial and asset accounting, treasury, procurement, contract and supply functions.
Endorsed by Council on:	22 June 2023 Reference Number:
Manager responsible for policy:	Chief Financial Officer, Business Performance Group

Policy statement

This policy outlines the minimum requirements for statutory bodies to manage and administer derivative transactions. A derivative is a financial contract that derives its value from an underlying asset, commodity, liability or index as defined under the *Statutory Bodies Financial Arrangements Act 1982* (SBFA Act).

When used prudently, derivatives can offer efficient and effective methods for reducing certain financial risks and achieving cash flow and budget certainty. In accordance with section 54 of the SBFA Act, a local government may only enter into a derivative transaction for the purpose of hedging underlying exposures (e.g. foreign currency, commodity price and interest rate risks).

This policy is to be read and complied with in accordance with:

- Part 7, Division 1 of the SBFA Act
- Information Sheet 3.18 Derivative Transactions in the Financial Accountability Handbook
- Council's Investment and Debt policies

Policy scope

This policy applies to all derivative transactions undertaken by Sunshine Coast Council.

Principles

Sunshine Coast Council will manage risk in hedging all major exposures, in part or in full. The extent of the hedged amount will be determined given due regard to the certainty of the exposure.

Use of derivatives

Foreign exchange risk:

- Transacting in Australian dollars (A$s) for goods primarily manufactured overseas carries risks. For fixed price procurement contracts, foreign exchange risk margins are usually embedded into the transaction. Alternatively, suppliers often build in exchange rate variation clauses which means that the A$ payment amount is unknown until the payment date and may be materially higher. Departments and statutory bodies are required to manage their foreign exchange (FX) price risks in accordance with the Financial Accountability Handbook (Information Sheet 3.18) and/or in consultation with Treasury and Queensland Treasury Corporation (QTC) as appropriate.

Derivatives may also be appropriate to manage interest rate and commodity exposures:

- Interest rate risk arises when either borrowing costs or investment returns are affected by changes to the underlying level of interest rates.
- Commodity price risk exists where changes in the price of a physical commodity (e.g. fuel) impact upon a business's cost structure and cash flows.

A framework for risk management

Risk management involves taking deliberate action to reduce the amount of a given risk to an acceptable level and requires:

- Establishment of risk appetite
- Identification of risks or exposures
- Quantification of the level of risk
- Evaluation of exposures
- Management of the risks:
    - Will the exposure be hedged?
    - How much should be hedged?
    - When should the exposure be hedged?
    - What sorts of products can be utilised?
- Performance monitoring

Policy details

Authority

In January 2020, a General Approval was issued under Part 9 of the SBFA Act for all prescribed statutory bodies to enter into derivative transactions through QTC. For Local Governments, a prescribed statutory body means it is listed in Schedule 8 of the *Statutory Bodies Financial Arrangements Regulation 2019* as a body that may enter into derivative transactions.

Derivative requirements

The General Approval is subject to the following conditions:

a) The statutory body must have a risk management policy for derivative transactions in accordance with the guidance contained in Information Sheet 3.18 Derivative Transactions in the Financial Accountability Handbook (formerly contained in the *Derivative Transactions Policy Guidelines*).

b) The statutory body must conduct all derivative transactions entered into under the General Approval through QTC.

c) The derivative transaction must be for the purpose of hedging foreign exchange or interest rate risks that arise in the normal course of business.

d) The derivative transaction must be related to either:

- foreign currency, or
- interest rates on a current or future borrowing position.

e) For foreign currency derivative transactions:

- For any transaction when QTC Supply Chain Payment Solution (SCPS) is used, there is no restriction on the term and value limit of the derivative transaction; and
- For any transactions when the SCPS is not used, the underlying transaction being hedged must be below a limit of AUD $25 million per transaction and the term of the derivative transaction must be less than two (2) years and one (1) month.

f) For interest rate derivatives:

- the value hedged by the derivative transaction must not exceed the proposed loan amount, and
- the term of the derivative transaction must not exceed two (2) years and one (1) month.

Outside these parameters, a specific approval must be applied for from Queensland Treasury.

Dual currency pricing

Procurement officers must identify the opportunity to transact in a foreign currency. This includes:

- ensuring that provisions are included in tender and contract documentation that dual currency quotes are required where relevant. A dual currency quote is a quote in AUD along with an alternative quote in the supplier's preferred currency. This applies to both local and overseas suppliers.
- providing the supplier's dual currency quotes to QTC for advice on the lowest AUD outcome on proposed transactions.

Supply Chain Payment Solution (SCPS)

QTC has developed the SCPS to assist Queensland Government clients mitigate the impact of supplier embedded foreign exchange risk margins and currency fluctuation clauses. The solution enables statutory bodies to continue recording Australian dollar payables while achieving cost saving benefits from contracting in a foreign currency. This is achieved by QTC becoming responsible for the relevant payment obligation and derivative execution.

Reporting

Section 55 of the SBFA Act requires a statutory body that enters into derivative transactions to provide reports to the Treasurer and Minister who administers the SBFA Act, at the times prescribed under a regulation, containing:

- details sufficient to identify the transaction
- a statement about the underlying exposure the statutory body is hedging
- the stated purpose of the derivative transaction, including details of the Treasurer's approval and compliance with any approved conditions, and
- details of any realised or unrealised gains or losses from transactions

QTC will provide regular reports including outstanding derivatives transactions and any realised or unrealised gains. Local governments will be responsible for reviewing the information and lodging the report.

The QTC reports do not remove the need for statutory bodies to account for the derivative in their financial statements. QTC will provide monthly derivative reports including the A$ mark-to-market values.

Other considerations

- consider the overall appropriateness of any derivative transaction including the organisation's capacity to put in place the appropriate management, control and accountability systems
- understand the appropriate roles and responsibilities of Council, senior management, finance/treasury and QTC in relation to derivative transactions.

Measurement of success

Council will provide regular reports to the Treasurer, Minister and Council as per the Reporting section of this policy.

Definitions

Council Employee - the CEO, senior contract employees, contract employees, award employees, casual employees, part-time employees, contractors, contingent workers, agency casual and volunteers

FX – foreign exchange

Hedge – a hedge is a strategy that seeks to limit risk exposures in financial assets

QTC – Queensland Treasury Corporation

SBFA Act - Statutory Bodies Financial Arrangements Act 1982

SCPS – Supply Chain Payment Solution

Statutory Body – includes Council

Policy commitment

Council employees and Councillors covered in the scope of this policy consistently demonstrate and uphold the intent, objectives and principles of this policy. Nothing in this policy requires or authorises an employee of Council or Councillor to act in any way that is contrary to law. Any instances of non-compliance will be managed in accordance with any relevant codes of conduct, policies and legislation dealing with conduct and/or disciplinary action.

Related legislation, policies, strategies and documents

All individuals engaged in dealings within the scope of this policy are required to fulfil the ethical and behavioral obligations as defined in legislation. In the event of an inconsistency between any provision of this policy and any provision of the following related legislation, policies, strategies and documents, the provisions of the related legislation, policies, strategies and documents shall prevail, unless the CEO or Council expressly waive a provision of this policy by prior agreement. For further assistance please contact the Manager of Corporate Governance.

Other documents

- Australian Accounting Standard (AASB) 9 *Financial Instruments*
- AASB 7 *Financial Instruments: Disclosures*

Version control:

Version	Reason/ Trigger	Change (Y/N)	Endorsed/ Reviewed by	Date
1.0	e.g. Create new			10/05/2023
	e.g. Review			