Introduction

2.001 In Article No. 7 of our first report for 1998,[1] we referred to the start of a new financial management regime for local authorities from 1 July 1998. As indicated in that report, nine local authorities elected to take advantage of the provisions allowing earlier implementation from 1 July 1997 – "the early nine".[2] The first full financial year under the new regime for these nine authorities ended on 30 June 1998. The following comments summarise the issues and experiences arising from these nine local authorities implementing the requirements of Part VIIA of the Local Government Act 1974 (the Act).[3]

2.002 The 1998 report noted that all nine authorities had met the statutory deadlines for adopting the long-term financial strategy, funding and borrowing policies, and annual plan. The next legislative timing requirement was to report against those documents in the 1997-98 annual report.

2.003 In order to do this, and also to demonstrate prudent financial management (as required by section 122B of the Act), local authorities first needed to prepare comprehensive asset management plans for key infrastructural assets. Such plans provide key information necessary for inclusion in the long-term financial strategy (which is required by section 122K), and result in sufficient information to effectively manage the assets. Asset management plans also enable local authorities to reliably assess future funding needs.

2.004 There were some difficulties in applying the existing authoritative accounting standards (SSAP-3: *Accounting for Depreciation* and SSAP-28: *Accounting for Fixed Assets*) to infrastructural assets. As we noted last year,[4] the Accounting Standards Review Board agreed with our criteria for minimum acceptable accounting for infrastructural assets, and determined that they would be applicable until such time as a new financial reporting standard becomes effective.[5]

1 Parliamentary paper B.29[98a], pages 61-68.

2 Regional Councils – Wellington, West Coast.
City Councils – Dunedin, Porirua.
District Councils – Masterton, Opotiki, Rodney, Waipa, Western Bay of Plenty.

3 As inserted by the Local Government Amendment Act (No. 3) 1996.

4 Parliamentary paper B.29[98a], pages 58-59.

5 Accounting Standards Review Board letter to local authorities dated 25 November 1997 which accompanied Release 5 *Application of Standards to Local Authorities*.

2.005 In addition, the Audit Office developed ten criteria which reflected the essential characteristics of a good asset management plan.[6] The criteria were designed as guidelines, to supplement existing accounting standards.

Asset Management Plans

2.006 The main difficulty experienced by the early nine was preparing their asset management plans to the required standard. Key challenges they faced were:

- Identifying all asset components within the infrastructure network.
- Ascertaining the age and condition of the components.
- Assessing the remaining useful life of existing asset components.
- Determining the valuation of assets for inclusion in the financial records.
- Calculating the amount of decline in service potential (depreciation) for the financial period.
- Linking the underlying data to asset management plans, and linking the asset management plan information to the financial records and thus to the financial statements.

2.007 Due to the general lack of infrastructural asset information in most local authorities, the early nine found that they had to commit significant financial and human resources to the tasks listed in paragraph 2.006. In addition, the deadlines were extremely tight in order to reflect this information in their 30 June 1998 annual reports and to meet the statutory reporting deadline of 30 November.

2.008 Despite these pressures, all but one of the early nine achieved an acceptable standard within the prescribed time. Waipa District Council did not have comprehensive infrastructural asset information and consequently a qualified audit opinion was issued. (See Part 3 of this report for further discussion on Waipa District Council.[7])

6 *Audit Criteria for Acceptable Accounting for Infrastructural Assets.*

7 Pages 19-24.

2.009 Although the other eight local authorities achieved the requirements, all have recognised that further improvement is desirable. They will be working on this over the next few years and we will monitor their progress.

Other Infrastructural Asset Issues

Accounting Policies

2.010 In the past many local authorities have adopted a "pure renewals" accounting policy, where expenditure which restores service potential is treated as an expense in the Statement of Financial Performance. Under the new regime, they must properly identify capital works (including both renewal and new capital) as distinct from maintenance works. Under generally accepted accounting practice (GAAP), which the Act requires to be followed, all capital works must be capitalised as assets and reported in the Statement of Financial Position.

2.011 Many local authorities do not have formal policies on identification and treatment of capital, renewal and operational expenditure. To comply with GAAP, the early nine had to assess their expenditure in accordance with the GAAP definitions. For some of the nine, this necessitated making significant adjustments to the financial information reflected in their annual reports. This issue was particularly difficult for roading expenditure, where traditionally Transfund New Zealand has treated some capital expenditure (for example – reseals) as maintenance for subsidy purposes.

Asset Valuations

2.012 Many local authorities have infrastructural assets recorded at valuations which, on completion of the asset management plans, have proven to be incorrect. This situation has arisen because:

- existing valuations were based on incomplete and inaccurate data;

- the methodology adopted was to value the total network rather than the individual components of the network; and
- the "pure renewals" approach had been adopted (see paragraph 2.010 above).

2.013 Some local authorities are addressing this issue by revaluing infrastructural assets based on the better information now reflected in their asset management plans.

Legislative Disclosure Requirements

2.014 The Act requires local authorities to meet a number of specific disclosure requirements in their annual reports. These are:

- Reporting the extent to which the objectives and provisions of the long-term financial strategy, funding policy, investment policy and borrowing management policy have been met – section 122V.
- Reporting information in respect of debt – including balances, interest costs, the amount of secured debt, and changes to the borrowing management policy – section 223E(3)(h), (i), and (j).
- Reporting information on equity securities, and financial interests of the local authority in any local authority trading enterprise – section 223E(3)(g).
- Including a statement that all statutory requirements regarding financial management and borrowing have been complied with – section 122X.

2.015 All of the early nine complied with these requirements.

Conclusion

2.016 In our view, the early nine have performed well overall and have provided a good example for the remaining local authorities that are required to comply with the new financial management regime in time for their 1998-99 annual reports.