Introduction

3.001 As noted in paragraph 1.004, we issued a qualified audit opinion on the financial statements of the Waipa District Council (the Council) for the year ended 30 June 1998.

3.002 The audit opinion was qualified in a number of respects. In our view, the Council did not have sufficiently reliable information about its infrastructural assets to:

- prepare a reliable long-term financial strategy;
- make a reasonable estimate of costs which require funding;
- calculate decline in service potential; and
- determine asset values.

3.003 By explaining the basis of our opinion we aim to:

- inform other local authorities of the importance of asset management plans; and
- illustrate how such plans link through to the financial statements and our audit opinion on those statements.

Generally Accepted Accounting Practice

3.004 The audit opinion noted the specific departures from generally accepted accounting practice described in the following paragraphs.

Charging Depreciation

3.005 The Council had not developed adequate asset management plans or other appropriate information systems to determine and monitor the age, condition and components of its infrastructural assets. Adequate asset management plans or other appropriate information systems are necessary to reliably measure the decline in service potential (depreciation) of a local authority's infrastructural assets, and to ensure reliable reporting of the carrying value of those assets. Because the Council did not have adequate infrastructural asset management plans for 1997-98 or other appropriate information systems, it was unable to determine the depreciation charge on its infrastructural assets.

3.006 The failure to charge depreciation on infrastructural assets was a departure from Statement of Standard Accounting Practice No. 3: *Accounting for Depreciation* (SSAP-3), which requires depreciation to be charged in each accounting period. If depreciation had been properly recorded, the effect on the financial statements would have been to decrease the surplus for the period and the accumulated surplus as at 30 June 1998 by the amount of the depreciation. The carrying value of the infrastructural assets would also have been reduced by a similar amount.

Capitalising Additions to Assets

3.007 The Council had also not adopted an appropriate accounting policy for capitalising additions to its infrastructural assets. Expenditure that increased the service potential of those assets had been incorrectly treated as an expense in the Statement of Financial Performance.

3.008 That accounting treatment was a departure from Statement of Standard Accounting Practice No. 28: *Accounting for Fixed Assets* (SSAP-28), which requires expenditure that is expected to increase the service potential of fixed assets to be capitalised. If the Council had correctly capitalised this expenditure, the effect on the financial statements would have been to increase the surplus for the period and the accumulated surplus as at 30 June 1998. The carrying value of the infrastructural assets and the amounts reported in the schedule of capital expenditure would also have been increased by a similar amount.

3.009 The departure from SSAP-28 also resulted in a departure from Financial Reporting Standard No. 10: *Statement of Cash Flows* (FRS-10), which requires payments to acquire assets to be disclosed as an investing activity. The Council had treated the expenditure which had increased the service potential of infrastructural assets as operating cash flows. The effect of correctly classifying these cash flows would have been to increase the surplus in cash flows from operating activities for the period, and to increase the deficit in cash flows from investing activities.

Quantification

3.010 Because the Council did not have adequate infrastructural asset management plans or other appropriate information systems, we were unable to quantify the effect of these departures from SSAP-3, SSAP-28 and FRS-10. The lack of adequate information on the quantity, existence and condition of infrastructural assets also meant that we were unable to confirm the carrying values of the sewerage, roading, water and stormwater assets.

Legislative Requirements

3.011 In addition to a qualified audit opinion, our audit report referred to the following legislative breaches.

3.012 Section 122L of the Local Government Act 1974 (the Act) requires each local authority to include in its long-term financial strategy *the estimated expenses, including an allowance for the cost of debt servicing and for the decline in service potential of assets, necessary to meet the identified needs of the local authority over the period of the strategy*.

3.013 Without adequate infrastructural asset management plans or other appropriate information systems, the Council did not have sufficiently reliable information on which to base its long-term financial strategy or to measure the costs necessary to determine its funding policy. Specifically, the Council did not have sufficiently reliable financial projections for its utilities (sewerage, water, and stormwater systems) or for its roading. In our opinion, therefore, the Council had not fully complied with the principles of financial management set out in section 122C of the Act.

More Than a Technical Accounting Issue

3.014 The decision to issue an audit opinion with such significant qualifications was not taken lightly. The Controller and Auditor-General was personally involved and approved the opinion wording. The Assistant Auditor-General responsible for local government attended the Council meeting at which the financial statements were tabled, to present the opinion personally and discuss its implications. We also advised the Minister of Local Government and the Department of Internal Affairs of the qualifications.

3.015 What we want to emphasise to readers of this report is that the qualified audit opinion represented more than breaches of generally accepted accounting practice and other legislative requirements. While those obligations are important, of equal importance was that the Council did not have reliable information with which to manage its assets. The significant consequence was that the Council's decisions could not have been as soundly based as they should have been. A local authority's assets – particularly its infrastructural assets – are critically important to its community, and decisions about those assets need to be as well-informed as possible.

Where To From Here for the Council?

3.016 At the time of issuing our 1998 audit report, we asked the Council for a written assurance that it would take action to address the deficiencies – in order to ensure that we could issue an unqualified opinion on future financial statements. We received that assurance.

3.017 The Council informed us that it had since 30 June 1998:

- developed asset management plans for its infrastructural assets;
- revalued those assets (as at 1 July 1998);
- determined to provide for depreciation on those assets in 1998-99 and later years; and
- worked with the auditor through a preliminary sample audit, to identify areas of modification or further development which would avoid a qualified opinion on the 30 June 1999 financial statements.