

Engineering a financial seachange

By **Chris Champion, National CEO,
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Community infrastructure is generally accepted as being in a state of decline. IPWEA is seeking to engineer a financial seachange.

Engineers Australia has produced a series of infrastructure report cards that highlight the poor state of community infrastructure.

The report cards highlight concerns that significant parts of Australia's infrastructure are ageing and nearing the end of their economically useful lives. There is concern that current planning and political processes do not provide the necessary long-term focus.

The value of local government infrastructure assets in Australia is estimated at \$150 billion. These assets are being consumed at a rate in the order of \$3 billion per annum (assuming a 2% average depreciation rate).

Consumption of assets as reported by depreciation is a significantly higher proportion for local government than for any other level of government or the private sector. The public sector is generally more capital asset intensive than the private sector - and asset consumption is therefore proportionally greater. Depreciation expense in the

local government sector is a major component of a council's operating budget and can be in excess of 25% of total revenue.

Asset values and depreciation therefore have far greater significance in local government - or should! The management and reporting of infrastructure assets in local government is even more critical than in state government and the private sector. We need to get it right.

Unfortunately current practice is less than perfect. The quality of infrastructure reporting in financial accounts is poor. Few practitioners can confidently put up their hand if asked whether the value and condition of their community's assets are adequately represented in their organisation's financial accounts.

Nationally we adopt different methods for valuing our assets. Australian Accounting Standard AAS27 was implemented through state regulations which saw each state implementing it in a different way.

Some states use historic cost while others are using current replacement value or fair value. There can be significant variations in valuation and



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depreciation even between neighbouring councils with a similar asset base.

We need to engineer a financial seachange. We need to ensure that managing infrastructure is an essential part of doing business.

Sustainability as an Issue

The Tasmanian Auditor General's 2004 Report to Parliament discussed the implications of the choice of valuation methods for property plant & equipment assets in financial reporting. The report noted that a number of councils deemed the carrying value of assets to be at cost and that many had not revalued assets following initial recognition. This was during a period when inflation had increased 30% over a ten year period. In such cases, carrying values of infrastructure assets are no longer representative of fair value.

A recent - and I believe leading - study of financial sustainability of South Australian councils by the LGASA has found that "significant operating deficits predominate among councils, and there appears to be substantial infrastructure renewal/replacement backlogs". The report concludes that "26 of South Australia's 68 councils appear unsustainable over the medium to long term. Only about one third of SA councils are in a moderately comfortable position."

Data deficiencies were also highlighted in the SA report. Comparability of asset lives was difficult. Five yearly as opposed to annual revaluations gave rise to discontinuities in annual depreciation. Lack of comparability and consistency in accounting approach was noted.

The SA report has made many recommendations for improvement. It includes that council CEOs and senior managers accept responsibility for putting in place

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systems to achieve and maintain financial sustainability and accountability. This Inquiry, commissioned by the LGASA, is gaining widespread interest. The NSW LG&SA has commissioned a similar 'Independent Inquiry into Financial Sustainability of NSW Local Government'.

Local government is going to be increasingly expected or required to undertake long-term financial planning based on sound asset management planning. In New Zealand long-term financial plans are audited and this may be the eventual direction in Australia.

Decision-makers need to comprehend the whole-of-life cost of infrastructure. As professionals we need to ensure that information is available to allow informed decision-making. The initial capital cost of a project may only represent 20% of the total cost of providing that infrastructure over the life of the asset. We need to adequately plan for the maintenance, disposal and ongoing operating costs of infrastructure.

Local government needs to move from annual budgeting to decisions that take

into account long-term consequences of resource allocation. The way forward will be closer integration of the technical with the financial.

IPWEA National Asset Condition & Financial Reporting Guidelines

To address these issues, IPWEA is undertaking the first stage development of new National Infrastructure Asset Financial Reporting Guidelines. This first stage investigation is jointly funded with the assistance of the Commonwealth Department of Transport and Regional Services (DOTARS).

The objectives of the new financial guidelines include:

- providing best practice guidelines for engineering and accounting practitioners to value and depreciate infrastructure assets to improve the accuracy of financial reports;
- providing enhanced management information to allow better decision-making;
- providing a reference for Auditors in auditing of councils' financial reports;
- increasing the confidence levels of

local government financial reports and encouraging councils to take a long-term view to providing services from infrastructure assets;

- improving the integrity of data used by national and state road funding authorities, Grants Commissions - and importantly councils themselves.

This IPWEA project is attracting interest and support from the accounting and auditing professions, state departments of local government, local government associations, and Commonwealth departments of Treasury, Finance & Administration.

The SA Inquiry into local government sustainability is a glimpse into the future. To date insufficient regard has been given to reporting and resourcing infrastructure. We have a new opportunity to ensure adequate investment in community infrastructure.

This new IPWEA project is an opportunity to engineer a financial seachange. We will keep you informed of its progress. ▲

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