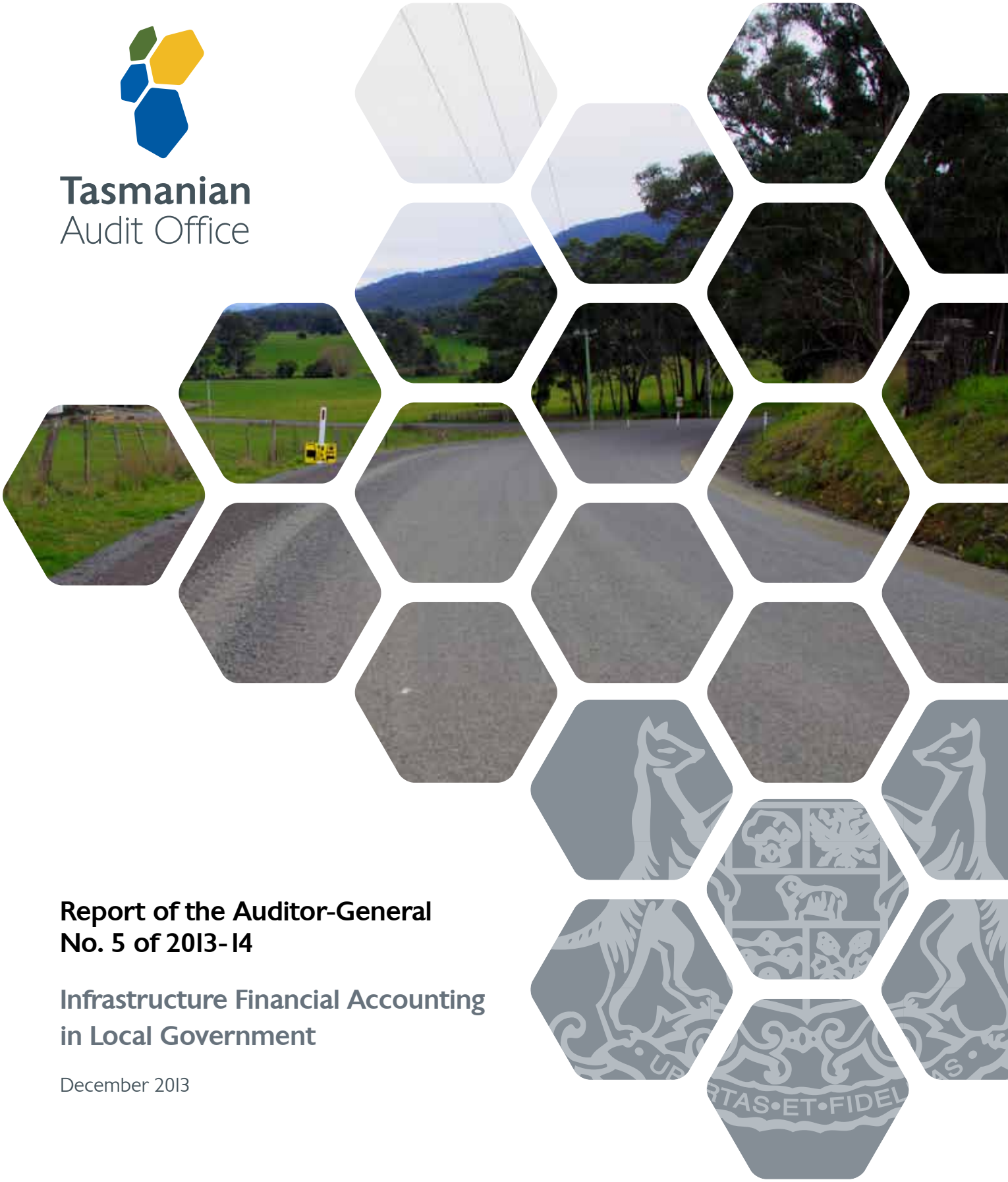
Tasmanian
Audit Office



Report of the Auditor-General No. 5 of 2013-14

Infrastructure Financial Accounting in Local Government

December 2013

Strive · Lead · Excel | To Make a Difference

The Role of the Auditor-General

The Auditor-General's roles and responsibilities, and therefore of the Tasmanian Audit Office, are set out in the *Audit Act 2008* (Audit Act).

Our primary responsibility is to conduct financial or 'attest' audits of the annual financial reports of State entities. State entities are defined in the Interpretation section of the Audit Act. We also audit those elements of the Treasurer's Annual Financial Report reporting on financial transactions in the Public Account, the General Government Sector and the Total State Sector.

Audits of financial reports are designed to add credibility to assertions made by accountable authorities in preparing their financial reports, enhancing their value to end users.

Following financial audits, we issue a variety of reports to State entities and we report periodically to the Parliament.

We also conduct performance audits and compliance audits. Performance audits examine whether a State entity is carrying out its activities effectively and doing so economically and efficiently. Audits may cover all or part of a State entity's operations, or consider particular issues across a number of State entities.

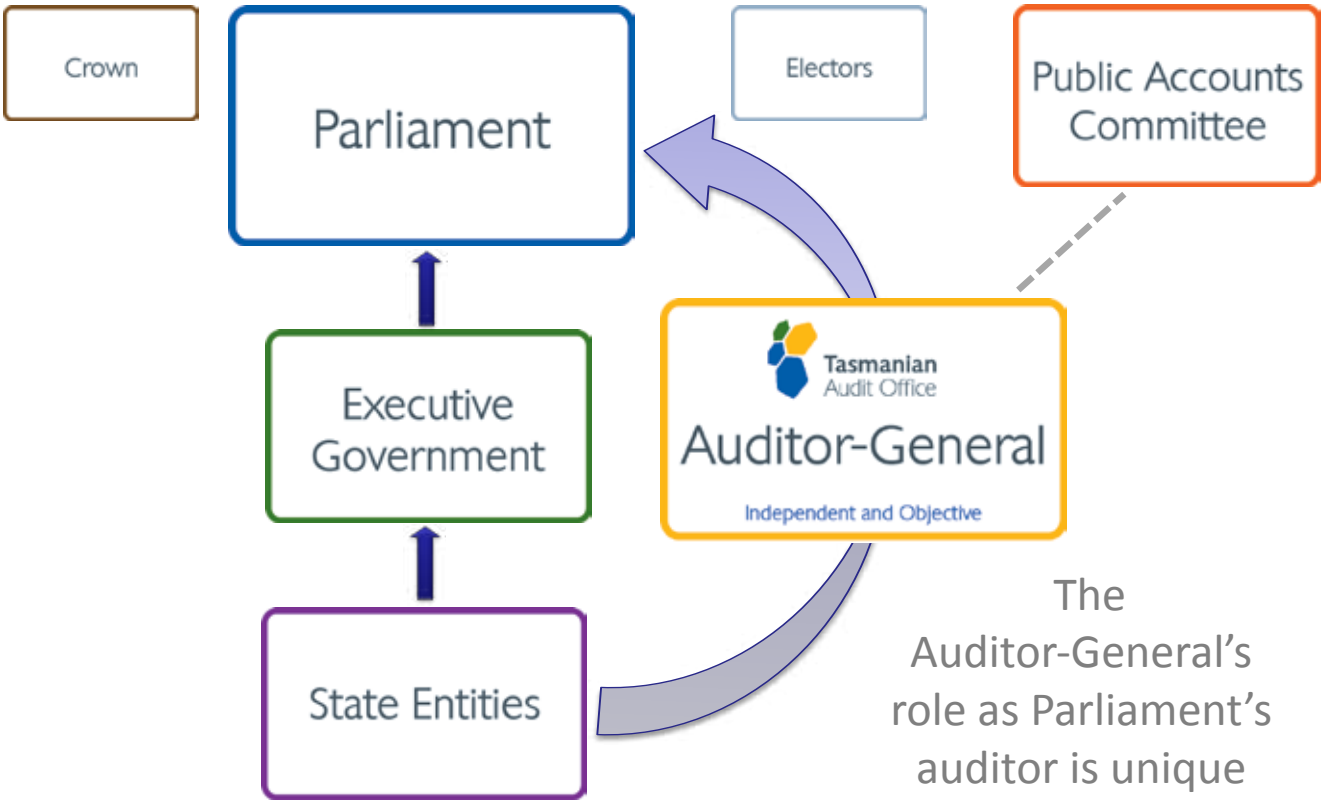
Compliance audits are aimed at ensuring compliance by State entities with directives, regulations and appropriate internal control procedures. Audits focus on selected systems (including information technology systems), account balances or projects.

We can also carry out investigations but only relating to public money or to public property. In addition, the Auditor-General is now responsible for state service employer investigations.

Performance and compliance audits are reported separately and at different times of the year, whereas outcomes from financial statement audits are included in one of the regular volumes of the Auditor-General's reports to the Parliament normally tabled in May and November each year.

Where relevant, the Treasurer, a Minister or Ministers, other interested parties and accountable authorities are provided with opportunity to comment on any matters reported. Where they choose to do so, their responses, or summaries thereof, are detailed within the reports.

The Auditor-General's Relationship with the Parliament and State Entities



2013
PARLIAMENT OF TASMANIA

REPORT OF THE AUDITOR-GENERAL
No. 5 of 2013-14

Infrastructure Financial Accounting in Local Government

DECEMBER 2013

Presented to both Houses of Parliament in accordance with the requirements of Section 23 of the Audit Act 2008

© Crown in Right of the State of Tasmania December 2013

Auditor-General's reports are available from the Tasmanian Audit Office, Hobart. This report and other recent reports published by the Office can be accessed via the Office's home page. For further information please contact:

Tasmanian Audit Office

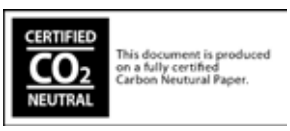
GPO Box 851
Hobart
TASMANIA 7001

Phone: (03) 6226 0100, Fax (03) 6226 0199

Email: admin@audit.tas.gov.au

Home Page: http://www.audit.tas.gov.au

ISSN 1327 2608



Tasmanian Audit Office

Level 4, Executive Building, 15 Murray Street, Hobart, Tasmania, 7000
Postal Address GPO Box 851, Hobart, Tasmania, 7001
Phone: 03 6226 0100 | Fax: 03 6226 0199
Email: admin@audit.tas.gov.au
Web: www.audit.tas.gov.au

16 December 2013

President
Legislative Council
HOBART

Speaker
House of Assembly
HOBART

Dear Mr President

Dear Mr Speaker

REPORT OF THE AUDITOR-GENERAL

No. 5 of 2013-14: Infrastructure Financial Accounting in Local Government

This report has been prepared consequent to examinations conducted under section 23 of the *Audit Act 2008*. It followed completion of a compliance examination which assessed whether or not councils' asset valuation and depreciation practices complied with Australian Accounting Standards in particular AASB 116 *Property, Plant and Equipment*.

Yours sincerely

H M Blake
Auditor-General

FOREWORD

In my Report No. 4 of 2012-13, Volume 4 Part I, Local Government Authorities 2011-12 (Report No. 4), I noted that in recent years a number of councils, as part of asset revaluations, had introduced the concept of residual values for long-lived infrastructure assets, particularly roads. From discussions with council management and engineers, it became apparent that there were differing views regarding the definition, use and validity of residual values in the valuation and depreciation of infrastructure assets for financial reporting purposes.

I flagged in Report No. 4 my intention to appoint an independent expert to review depreciation methods, including use of residual values, by Tasmanian councils.

This Report is the outcome of the independent expert's work. The objective of this Report is to provide workable and cost effective approaches to road asset valuations and depreciation which are appropriate for financial reporting and are compliant with relevant Australian Accounting Standards. The Report contains 23 recommendations which will help to ensure that Tasmanian councils establish consistent and transparent depreciation and valuation practices.

While the Report's focus is road assets, the recommendations apply similarly to other long-lived assets.

It also includes a suggested common road hierarchy which the Local Government Division of the Department of Premier and Cabinet can use as the basis for further consultation with councils.

The project was overseen by a steering committee comprising both engineering and accounting staff from a range of councils, representatives of the Local Government Division, the Local Government Association of Tasmania, an engineer from the Department of Infrastructure, Energy and Resources and my staff. I am grateful for the contribution made by all members of the steering committee.

H M Blake
Auditor-General
16 December 2013

TABLE OF CONTENTS

FOREWORD **4**

INTRODUCTION **6**

COMMENTS AND SUBMISSIONS RECEIVED **12**

Appendix 1 - Expert's Report 13
Appendix 2 - Comments and Submissions Received 75
Appendix 3 - Glossary 98
Appendix 4 - Acronyms and Abbreviations 102
Appendix 5 - Recent Reports 103

Vision and Purpose 104

INTRODUCTION

BACKGROUND

In May 1998 the Auditor-General tabled Special Report No 26 *Capitalisation and reporting of Road Assets in Tasmania* which contained five recommendations aimed at improving recording, managing and reporting road related assets. In the main those recommendations were taken up by Tasmania's 29 councils resulting in improved financial reporting.

However, in recent years, we have noticed a number of councils, as part of revaluations, introduce the concept of 'residual values' for long-lived infrastructure assets, particularly roads. This resulted in a reduction in annual depreciation charges and improvements in road consumption and asset sustainability ratios. This was the subject of the Residual Values Chapter in the Auditor-General's Report to Parliament in November 2012 (Report No. 4 of 2012-13). After considering the situation, we flagged an intention to appoint an independent expert to review depreciation methods, including use of residual values, by Tasmanian councils. The two main concerns that arose regarding the use of residual values, in the context of infrastructure assets, particularly roads, were:

1. It ignores the fact that at some point in time, the asset may no longer be required and its function may be decommissioned due to obsolescence.
2. Compliance with Australian Accounting Standards in particular AASB 116 *Property, Plant and Equipment* (AASB 116).

At the same time, we acknowledged the position put to us that certain components of road infrastructure assets do not depreciate and the requirements of AASB 116 may result in depreciation expenses being over-stated.

These factors led to our conclusion that independent expert advice was needed. In collaboration with the Local Government Division of the Department of Premier and Cabinet we appointed an independent expert to review depreciation and revaluation practices, including use of residual values, by local government councils in Tasmania. It was agreed that the expert would also consider a proposed common road hierarchy. This work was conducted pursuant to section 23(d) of the *Audit Act 2008* as an examination of compliance by Tasmanian councils with Australian Accounting Standards.

To oversee the expert's work we formed a Steering Committee which included engineering and accounting personnel from:

- a number of Tasmanian councils
- Local Government Division
- Local Government Association of Tasmania
- Department of Infrastructure, Energy and Resources
- our Office.

We are grateful for the time and effort taken by all members of the Steering Committee.

COMPLIANCE OBJECTIVE

The objective of this compliance examination was to assess whether or not councils' asset valuation and deprecation practices complied with Australian Accounting Standards in particular AASB 116 *Property, Plant and Equipment*.

Particular attention was paid to:

- examining classification/definition of road asset components (to achieve consistency in recognition)
- treatment of earthworks – ensure consistency in recognition and depreciation (if applicable)
- basis for determining replacement rates – it may be reasonable that costs vary, but the underlying components of calculating replacement costs should be consistent
- basis of determining useful lives (asset components) as well as the remaining life of road assets (impact on accumulated depreciation)
- definition, appropriateness and determination of residual values – consider definitional issues between engineers and accountants
- basis of road condition assessments:
    - can visual inspections of road assets provide an appropriate base for determining remaining useful life?
    - how to reconcile accounting treatments in relation to depreciation of road assets (straight line basis for example) with the actual condition of the roads?
- capitalisation versus expensing road re-sheeting costs – should road re-sheeting costs be capitalised and the roads depreciated (renewal accounting)
- identification of any other current recognition and depreciation approaches that do not comply with Australian accounting standards
- the treatment of land under roads constructed after 1 July 2008 – land under roads are currently treated as immaterial by the majority of councils
- frequency of revaluations and indicators to trigger revaluations:
    - indexation or full revaluation?
    - maximum period that indexation can be applied before full revaluations are needed?
- financial statement disclosures.

COMPLIANCE CONCLUSIONS

We concluded that asset management practices of councils complied with Australian Accounting Standards but that some alteration to existing practices in councils are required.

Broadly, the changes to current practice involve:

- a reduced reliance on residual values to affect the depreciable amount of infrastructure assets
- a greater reliance on cost based fair value assessments to establish current replacement costs
- a greater use of componentisation to reflect assets with different estimated useful lives.

RECOMMENDATIONS

The expert made following 24 recommendations which have been accepted and endorsed by the Office. The expert's full report is included as Appendix 1.

<table>
<tr><th>Number</th><th>Recommendations</th></tr>
<tr><td rowspan="2">1</td><td>The components of a road asset should be identified and recognised at fair value and should be separately valued and depreciated over their useful lives. Components of road assets can include:

Urban road components
• Earthworks (where material)
• Retaining walls (where material)
• Pavement sub-base^
• Pavement base
• Sealed wearing surface
• Kerb and channel (x2)
• Footpaths (x2)
• Bridges
• Culverts★
• Traffic management and protection devices
• Landscaping (where material)

Rural road components
• Earthworks (where material)
• Retaining walls (where material)
• Pavement sub-base^
• Pavement base
• Sealed/unsealed wearing surface
• Bridges
• Culverts★
• Traffic management/ protection devices</td></tr>
<tr><td>Note:
^ where pavements are managed as separate components
★ where not recognised in road earthworks or as separate stormwater drainage assets</td></tr>
<tr><td>2</td><td>Assets should be recognised at cost based on a modern equivalent asset. Donated or contributed assets should be recognised at fair value in accordance with Accounting Standards. Periodic revaluations of infrastructure assets should be based on the amount required currently to replace the service capacity of the asset.</td></tr>
<tr><td>3</td><td>Residual values for property, plant and equipment assets be recognised only where the estimated amount to be received from disposal of the asset is greater than the cost of disposal of the asset.</td></tr>
<tr><td>4</td><td>Assets subject to planned 'optimal' renewal methods be componentised to recognise the different useful lives estimated for each part of the asset. The componentised assets be revalued as modern equivalent assets being the cost that is required currently to replace the service capacity of an asset.</td></tr>
</table>

Number	Recommendations
5	Useful lives should be assigned to all infrastructure related assets with the exception of land and certain earthworks with the characteristics of land. The assessment of useful life should be based on engineering reviews of expected physical wear and tear and technological and commercial obsolescence of the asset.
6	Useful lives should be reviewed annually to ensure that the value of depreciation calculated and recognised remains relatively accurate and to support ongoing asset renewal planning.
7	Road earthworks assets established with an unlimited useful life should be reviewed annually for obsolescence and if any earthworks asset is assessed as having a remaining useful life, changes be made to recognise the remaining useful life.
8	The condition of assets is only one of several factors that should be used to predict the remaining useful life of assets used for calculating depreciated replacement cost and depreciation. Condition should not on its own be used to directly determine the value of depreciation or depreciated replacement cost.
9	Councils should adopt a consistent, systematic methodology to grade and report on the condition of infrastructure.
10	Assets that have an expected useful life should be depreciated over the estimated useful life in a manner that represents the pattern of consumption of future economic benefits embodied in the asset. The consumption of future economic benefits is related to the consumption of service potential and not to the physical condition of assets.
11	The depreciation method should be assessed annually to ensure that it continues to represent the underlying pattern of consumption of future economic benefits embodied in the asset.
12	Road and other assets should be derecognised (written off) when the asset is replaced or renewed.
13	Councils: • recognise resheeting of unsealed roads as capital expenditure • with a relatively small expenditure on resheeting unsealed roads should consider capitalisation of unsealed road resheeting as a network asset(s) for resheeting completed in the reporting period • the network asset(s) for each period should be depreciated over the estimated useful life and derecognised at the end of the useful life.
14	Councils should prepare and adopt a policy for revaluation, defining the criteria to be used in determining whether the carrying amount differs materially from that which would be determined using fair value at the end of the reporting period. The policy should include the method of assessing fair value and the source information to be used.

Number	Recommendations
15	Councils should undertake an annual review of accounting estimates as required by Australian Accounting Standards, to be approved by the General Manager. The review should include the useful life, residual value and depreciation methods applied, whether there is a material difference between the carrying value of assets recorded at fair value with that determined using fair value and whether there are any indications of impairment of assets The rationale and documented support for any action or non-action taken should be part of the information provided.
16	Councils should undertake an annual review of the currency and accuracy of asset registers and the General Manager should report the rationale and documented support for any decision to revalue or not revalue to the audit committee and/or the council.
17	The value of capital renewal and capital new/upgrade expenditure by asset class should be disclosed in financial statements.
18	The residual values for infrastructure assets should be disclosed in the financial statements.
19	Management assessments and decisions which impact the financial statements should be supported by appropriate and sufficiently reliable, precise and detailed documentation.
20	The five financial ratios shown below, indicating the financial sustainability of councils together with explanations of variances from expected benchmarks, should be disclosed in council financial statements: • Operating surplus ratio, • Asset sustainability ratio, • Asset renewal funding ratio, • Road asset consumption ratio, • Net financial liabilities ratio.
21	An integrated approach to financial management should be supported by the development of financial management strategies in conjunction with the development of the long-term financial plan as a single integrated financial planning document.
22	Councils recognise the value of all land under roads at fair value in accordance with Australian Accounting Standard 1051 Land Under Roads, regardless of when the land was acquired. Councils should approach the Tasmanian Valuer-General to determine and agree a process of valuing land under roads in each municipal area and to facilitate a regular revaluation of land under roads.
23	The Local Government Division consider, after consultation with relevant stakeholders, adopting the proposed local road hierarchy for use by all councils.

TIMING

The audit plan for this compliance examination was finalised on 15 April 2013 with the expert engaged on 1 May 2013. A draft report was provided to the Office in August 2013. A final report was received from the expert in November 2013 with this Report finalised on 11 December 2013.

RESOURCES

The total cost of this compliance examination, including the use of the expert, was $39 138.

COMMENTS AND SUBMISSIONS RECEIVED

We engaged extensively with councils and key stakeholders during the review. The review was assisted by a Steering Committee comprising representatives from six councils, Local Government Division of Department of Premier and Cabinet, Local Government Association of Tasmania and the Department of Infrastructure, Energy and Resources. Presentations on the progress of the review and its outcomes were made at various forums.

In accordance with section 30(2) of the *Audit Act 2008*, a copy of this Report was provided to all councils even though no single council was subject to this compliance examination. Following completion of our draft report, we wrote to all Mayors seeking their comments and received responses from the following councils:

- Break O'Day
- Huon Valley
- Latrobe
- Kentish
- Kingborough.

Overall, the responses we received, both formal and informal, were positive. While some of the recommendations were viewed by some councils as onerous and unnecessary, they mirror requirements of Australian Accounting Standards. Adherence to our recommendations will ensure that councils continue to comply with the relevant financial reporting framework.

A number of councils expressed their concerns with recommendation 22, which recommends that councils should elect to recognise the value of all land under roads. Concerns were about increased cost and workload. However:

- the recommendation provides for a group approach which should reduce costs
- the most economical way for this to be addressed is for the Valuer-General to supply councils with unit values which would then be applied to an area of road networks to arrive at the value of land under roads. This approach has worked successfully with another Tasmanian State entity.

Comments received and our responses, where applicable, are detailed in Appendix 2. The comments and submission provided are not subject to audit nor the evidentiary standards required in reaching an audit conclusion. Responsibility for the accuracy, fairness and balance of those comments rests solely with those who provided a response or comment.

A summary of findings, with a request for comments or submissions, was also provided to the Minister for Local Government and the Treasurer.

APPENDIX 1 - EXPERT'S REPORT: REVIEW OF INFRASTRUCTURE FINANCIAL ACCOUNTING IN LOCAL GOVERNMENT

Tasmanian Audit Office

REPORT

Review of Infrastructure Financial Accounting in Local Government

Unsealed Road Meander Valley Council

Jeff Roorda & Associations

September 2013 v.1.1

TABLE OF CONTENTS

1. SUMMARY AND RECOMMENDATIONS 17

1.1 Introduction 17

1.2 Asset Identification and Recording 17

1.3 Valuation 18

1.4 The Valuation and Use of Residual Values 19

1.5 Useful Lives and Remaining Useful Lives 20

1.6 Depreciable Amount and Depreciation Methods 21

1.7 Current and Emerging Asset Management Practices 22

1.8 Area of Regulatory Support 23

1.9 Land Under Roads 25

1.10 Proposed Common Road Hierarchy 25

2. THIS REPORT 26

3. BACKGROUND AND OBJECTIVES 26

3.1 Background 26

3.2 Objectives 27

3.3 Outcomes 28

4. ASSET IDENTIFICATION AND RECOGNITION 28

4.1 Introduction 28

4.2 Discussion 29

4.3 Road Earthworks 32

4.4 Derecognition 33

4.5 Scenario Treatments – Asset Recognition 33

4.6 Summary 34

4.7 Recommendations 35

5. VALUATION 35

5.1 Introduction 35

5.2 Discussion 36

5.3 Summary 40

5.4 Recommendations 40

6. THE VALUATION AND USE OF RESIDUAL VALUE 41

6.1 Introduction 41

6.2 Discussion 41

6.3 Scenario Treatments - Valuation 43

6.4 Summary 46

6.5 Recommendations 46

7. USEFUL LIVES AND REMAINING USEFUL LIVES 46

7.1 Introduction 46

7.2 Discussion 47

7.3 Scenario Treatments – Useful Life 53

7.4 Summary 54

7.5 Recommendations 55

8. DEPRECIABLE AMOUNT AND DEPRECIATION METHODS 56

8.1 Introduction 56

8.2 Discussion 56

8.3 Summary 57

8.4 Recommendations 58

9. CURRENT AND EMERGING ASSET MANAGEMENT PRACTICES 58

9.1 Derecognition of Replaced and Disposed Assets 58

9.2 Recognition of Road Re-Sheeting 59

9.3 Scenario Treatments – Rural Road Resheeting 60

9.4 Revaluation Frequency 61

9.5 Relevant Indices 62

9.6 Scenario Treatments – Revaluation Indices 62

9.7 Revaluation Process 62

9.8 Summary 63

9.9 Recommendations 64

10. AREAS OF REGULATORY SUPPORT 64

10.1 Recommendations 66

11. OTHER MATTERS 67

11.1 Land Under Roads 67

11.2 Proposed Common Road Hierarchy 67

11.3 Recommendations 69

12. ATTACHMENTS 72

12.1 Methodology for the Review of Useful Lives 72

13. References 74

TABLES

Table 1: Typical Road Components 30

Table 2: Scenario Treatments - Asset Recognition 34

Table 3: Perspectives on Recognition and Valuation of Infrastructure Assets 37

Table 4: Scenario Treatments - Valuation 43

Table 5: Estimated Useful Lives of Roads Related Infrastructure 49

Table 6: IPWEA National Condition Grading 52

Table 7: Scenario Treatments - Useful Life 53

Table 8: Scenario Treatments - Unsealed Road Resheeting 60

Table 9: Scenario Treatments - Revaluation Indices 62

Table 10: Tasmanian State Road Hierarchy 67

Table 11: Proposed Local Road Hierarchy 68

Table 12: Proposed Urban Local Road Hierarchy 70

Table 13: Proposed Rural Local Road Hierarchy 71

Table 14: Multi-Criteria Test for Useful Life 73

FIGURES

Figure I: Typical Road Segments 29

Figure II: Typical Components within Road Segments 30

Figure III: Typical Rural Road Renewal and Widening Methods - Meander Valley Council 32

Figure IV: Road Earthworks Component 33

Figure V: Road Asset Components recognising Planned Recycling Renewal Treatments 42

Figure VI: Planned Obsolescence of Road Earthworks due to Realignment of Bass Highway, Sisters Hills 49

Figure VII: Asset Consumption Methodology for Straight Line Depreciation Pattern 57

Figure VIII: Valuation Calculation Methodology using a Straight Line Pattern 63

1. SUMMARY AND RECOMMENDATIONS

1.1 Introduction

Jeff Roorda and Associates (JRA) is pleased to be able to provide this report to the Tasmanian Audit Office. This report represents a review of a number of specific matters relating to the financial accounting for infrastructure assets undertaken by Tasmanian local governments, which includes:

1. Current replacement cost, segmentation and componentisation
2. The valuation and use of residual values
3. Useful lives and remaining useful lives
4. Fair value measurement
5. The depreciable amount and depreciation expense
6. Current and emerging asset management practices

Advice on each of these matters is included in this report. The report also comments on potential areas for regulatory support and the nature of that support.

1.2 Asset Identification and Recording

This report has been developed to address current and emerging issues in local government asset management and financial accounting and reporting. In addressing each of the matters under consideration, it has been necessary to consider, in an iterative process, the requirements of the Australian Accounting Standards, the asset management practices of local governments in Australia and the need to support long term planning processes of councils.

This report indicates that asset management practices of councils can be supported by the Australian Accounting Standards, however some alteration to existing practices in councils will be required.

Broadly, the changes to current practice involve:

- a reduced reliance on residual values to affect the depreciable amount of infrastructure assets,
- a greater reliance on cost based Fair Value assessments to establish current replacement costs, and
- a greater use of componentisation to reflect assets with different estimated useful lives.

Where an asset can be seen as being comprised of a number of component assets of different useful lives, each component should be separately identified, valued and depreciated. A maintenance profile needs to be established to support the estimated useful life assigned to the asset, as this will support subsequent assessments as to whether expenditure on the asset is in the nature of maintenance or capital renewal.

Greater use of segmentation will support asset management practices in councils where the segments align with the asset management intentions for the assets. Financial accounting practice and long term financial planning should align with asset management practice and intent.

While a common and consistent approach to asset categorisation may be useful for financial accounting and reporting purposes, in practice it is more useful for asset managers to be able to pursue effective and efficient asset management practices supported by asset management systems. A detailed regulatory approach to asset categorisation would be likely to result in the separation between the asset register and asset management systems becoming greater.

Greater use of componentisation of assets will alleviate some of the current financial accounting issues that are being experienced, as this process will allow for the recognition of non-depreciable components and other components with extremely long useful lives while also making provision for the future potential obsolescence of the assets.

Recommendation

1. **The components of a road asset should be identified and recognised at Fair Value and should be separately valued and depreciated over their useful lives. Components of road assets can include:**

Urban road components

- **Earthworks (where material)**
- **Retaining walls (where material)**
- **Pavement sub-base^**
- **Pavement base**
- **Sealed wearing surface**
- **Kerb and channel (x2)**
- **Footpaths (x2)**
- **Bridges**
- **Culverts***
- **Traffic management and protection devices**
- **Landscaping (where material)**

Rural road components

- **Earthworks (where material)**
- **Retaining walls (where material)**
- **Pavement sub-base^**
- **Pavement base**
- **Sealed/unsealed wearing surface**
- **Bridges**
- **Culverts***
- **Traffic management/protection devices**

Note ^ where pavements are managed as separate components

*** where not recognised in road earthworks or as separate stormwater drainage assets.**

1.3 Valuation

Current replacement cost should take account of modern equivalent assets in determining the values for use in financial accounting and long term financial planning. Asset managers in councils are indicating that the costs to renew the utility/future economic benefit is likely to be less than currently recorded current replacement costs. Asset managers are seeking to use the lower renewal values as the depreciable amount, through a variety of mechanisms. However in many instances, it is not a like-for-like renewal of the asset, with perceived innovative practices and /or alternative materials being used to renew the utility /future economic benefit.

In order for these lesser value approaches to renewal to be recognised as the current replacement cost of the asset, councils are required to demonstrate:

1. That the renewal represents a modern equivalent asset, and
2. The renewal represents an extension or renewal of the utility /future economic benefit associated with the currently held asset.

Unless both of these criteria are met, the lesser values cannot be used as the current replacement cost of the asset. Where the criteria are not met, it is possible that the practice in question is:

- an upgrade associated with an existing asset and should be capitalised as incurred, or
- represents a maintenance activity associated with an existing asset and should be expensed as incurred.

All costs incurred in constructing or acquiring the asset should be capitalised. This includes the initial costs of survey works, cuttings, earthworks, clearing, formation and gravel. Those costs such as initial earthworks and cuttings that will not need to be re-performed when the asset is renewed should be recorded as a separate component of the asset with a separate unlimited useful life.

Assets should be recognised at cost, where cost is incurred or Fair Value.

A cost approach to periodic revaluation based on the amount that would be required currently to replace the service capacity of the asset (often referred to as current replacement cost) recognises the

ongoing role of local government in infrastructure management and renewal. Local governments should be planning for renewal from the time of acquisition or creation of the asset. Valuations based on the amount required to replace the service capacity of the asset (often referred to as current replacement cost) provide more accurate estimates of depreciation and future capital renewal expenditure projections, without the use of residual values to affect depreciable amounts.

Recommendations

2. **Assets should be recognised at cost based on a modern equivalent asset. Donated or contributed assets should be recognised at fair value in accordance with Accounting Standards. Periodic revaluations of infrastructure assets should be based on the amount required currently to replace the service capacity of the asset.**

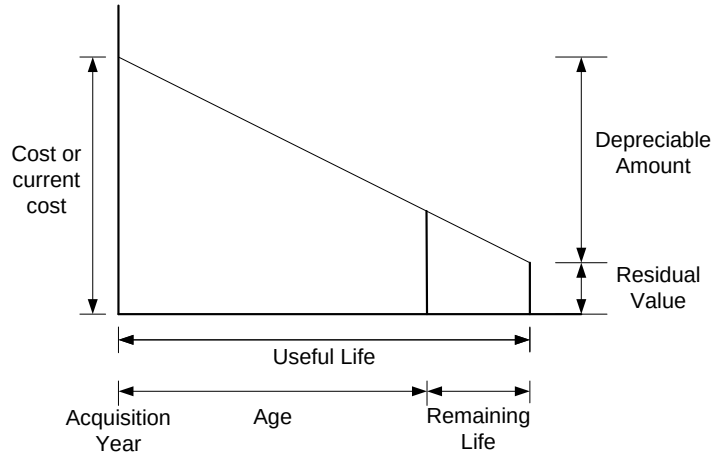
1.4 The Valuation and Use of Residual Values

There has been a desire by councils to determine the value of the depreciable amount for many long-life infrastructure assets on the basis of current estimates of the actual future cost of renewal. This literal view of residual value being used to record 'optimum' renewal practices where the cost for renewal of the asset is less than the cost to replace the asset is not consistent with the Accounting Standards. Residual values should only be used where an asset has a potential market for its disposal, e.g. fleet and plant. While the desire to utilise residual values more broadly is understood, other mechanisms that more closely align with the Accounting Standards are preferred.

The values placed on residual values should reflect estimated amounts to be obtained at the time of disposal of the asset. In this way, the depreciable amount for assets that have a net disposal value will reflect the economic benefit to be consumed by the council over the useful life of the asset.

As asset management practices continue to evolve in the pursuit of operational efficiencies and more effective renewal practices, it is important that council finance managers are able to match those practices with the financial accounting requirements. Largely, this will be achieved by appropriate consideration of current replacement cost, segmentation and componentisation, periodic reviews of estimated useful lives and an ongoing consideration of future potential obsolescence.

The figure below illustrates each of the key values associated with accounting for infrastructure, property, plant and equipment that also combine to calculate depreciation expense. Decision-making processes within councils must consider which of these elements or combination of elements provides the means to value and account for the asset management practice.



Recognition of 'optimum' renewal values in lieu of recognising a residual value can be achieved in two steps:

1. Componentisation – to recognise assets as separate components that have different useful lives identified by planned renewal practices, and
2. Re valuation as modern equivalent assets – recognise assets at the cost to replace the service capacity of the asset based on the next planned renewal of the asset.

Revaluation with values based on modern equivalent assets recognises the asset value based on the council's estimate of the resources required to provide the level of service agreed with its community, as should be detailed in its asset management plans and funded in a long-term financial plan.

This approach will provide more detailed and more accurate information for asset renewal planning and financial reporting.

Recommendations

3. **Residual values for property, plant and equipment assets be recognised only where the estimated amount to be received from disposal of the asset is greater than the cost of disposal of the asset.**

4. **Assets subject to planned 'optimal' renewal methods be componentised to recognise the different useful lives estimated for each part of the asset. The componentised assets be revalued as modern equivalent assets being the cost that is required currently to replace the service capacity of an asset.**

1.5 Useful Lives and Remaining Useful Lives

The assessment of useful life is to be based on engineering reviews of the expected physical wear and tear and technical obsolescence of the particular earthworks and a consideration of commercial obsolescence and legal or other limits on the use of the earthworks.

Useful lives should be assigned to all infrastructure related assets with the exception of land and certain earthworks with the characteristics of land.

Extremely long useful lives can be assigned to assets in order to adequately allow for potential future obsolescence.

The depreciable amount of road earthworks that have limited useful lives are to be allocated on a systematic basis, based on best estimates of those useful lives. Difficulty in estimating the useful life of an asset does not justify non-depreciation of the asset.

An expected range of useful lives for road asset components can be established. While this does provide a useful guide, specific assets may lead to the establishment of useful lives outside of these parameters. Councils should document the evidence and assessment used to establish the expected useful lives and remaining useful lives. Useful lives must be reviewed annually to ensure that the value of depreciation calculated and recognised remains relatively accurate and to support ongoing renewal planning.

Condition information is used in technical technical management systems to predict the time until a certain condition intervention point is reached and for planning maintenance, rehabilitation and replacement of items of property, plant and equipment. Condition measures physical defects in an asset. Condition has a limited relationship with asset consumption, which measures the consumption of future economic benefits embodied in the asset.

For councils, the future economic benefits from infrastructure assets are the provision of goods and services in accordance with the council's objectives.

Condition, however can be used to predict remaining physical life of an asset and as input into determining the useful lives of assets.

Councils use many method of assessing condition depending on their needs and resources. The 1 (very good) to 5 (very poor) condition gradings from the International Infrastructure Management Manual is promoted by the Institute of Public Works Engineering Australasia to provide a consistent systematic methodology for grading and reporting condition of infrastructure assets for individual councils and aggregated for State and national condition reporting.

Recommendations

It is not recommended that the use of a common hierarchy and standard useful lives for infrastructure assets be mandated, but rather be seen as a default position. Councils should be able to take approaches to asset management that reflect the reality of the council, its environment, its established service levels and associated technical standards and community expectations.

5. **Useful lives should be assigned to all infrastructure related assets with the exception of land and certain earthworks with the characteristics of land. The assessment of useful life should be based on engineering reviews of expected physical wear and tear and technological and commercial obsolescence of the asset.**

6. **Useful lives should be reviewed annually to ensure that the value of depreciation calculated and recognised remains relatively accurate and to support ongoing asset renewal planning.**

7. **Road earthworks assets established with an unlimited useful life should be reviewed annually for obsolescence and if any earthworks asset is assessed as having a remaining useful life, changes be made to recognise the remaining useful life.**

8. **The condition of assets is only one of several factors that should be used to predict the remaining useful life of assets used for calculating depreciated replacement cost and depreciation. Condition should not on its own be used to directly determine the value of depreciation or depreciated replacement cost.**

9. **Councils should adopt a consistent, systematic methodology to grade and report on the condition of infrastructure.**

1.6 Depreciable Amount and Depreciation Methods

Asset managers recognise that a large proportion of an asset may be, in effect, non-depreciable. While aspects of the asset may appear non-depreciable, potential future obsolescence must be considered and factored in to current thinking. This is achieved by placing very long estimated useful lives on those components believed to be effectively non-depreciable, e.g. 100 years considering obsolescence.

Land, and earthworks with the characteristic of land, are the only assets that should be recognised as non-depreciable. This approach allows asset managers to effectively manage assets while also ensuring that the associated financial accounting is consistent with the Australian Accounting Standards, by appropriate consideration of current replacement cost, residual values, componentisation, estimated useful lives and obsolescence.

The depreciation or non-depreciation of road earthworks is to be reviewed each year to ensure depreciation of the assets reflects the most recent assessment of the useful lives of the earthworks assets.

The consumption of future economic benefits is often not directly related to the physical condition or age of an asset and is more associated with the role or utility of the asset. The consumption of

future economic benefits is related to the consumption of service potential and not to the physical condition of assets.

If the pattern of consumption is relatively constant, the straight-line method of depreciation is appropriate. Where the pattern of consumption is not linear over time, then an alternative depreciation method may be appropriate.

Councils should assess the depreciation method on a periodic basis to ensure it continues to represent the underlying pattern of consumption of the economic benefits of the assets.

Recommendations

10. **Assets that have an expected useful life should be depreciated over the estimated useful life in a manner that represents the pattern of consumption of future economic benefits embodied in the asset. The consumption of future economic benefits is related to the consumption of service potential and not to the physical condition of assets.**

11. **The depreciation method should be assessed annually to ensure that it continues to represent the underlying pattern of consumption of future economic benefits embodied in the asset.**

1.7 Current and Emerging Asset Management Practices

Infrastructure assets are to be recognised when the asset is placed into service. Infrastructure assets are to be derecognised when the asset is replaced or renewed at the end of its expected useful life.

Resheeting of unsealed roads can be capitalised by either recognition as an individual asset or by recognition of resurfacing undertaken in a reporting period as a network asset. A new asset can be created for each reporting period (e.g. resheeting in 2013-14), and the network asset derecognised at the end of its useful life.

Re-sheeting of unsealed road assets should be recognised as capital expenditure either against individual assets for councils with significant expenditure on re-sheeting unsealed roads or as a network asset (e.g. roads re-sheeted in 2013-14, etc.) for councils with a less significant level of expenditure (e.g. $50 000 per annum) on re-sheeting unsealed roads. A council may choose to establish separate network assets to recognise different unsealed roads resheeting management practices (e.g. major roads resheeted on a 3 year cycle, minor roads resheeted on a 6 year cycle). Network assets could also be used to recognise resheeting expenditure as an asset as a first stage to recognising resheets as a component asset of a road segment.

Councils should adopt a revaluation policy defining the criteria to be used in determining whether the carrying amount differs materially from that determined using fair value at the end of the reporting period. The policy should include the method of assessing fair value that can include the indices detailed in Section 9.4.

Depreciation methods should be reviewed to determine whether they allocate the depreciable amount of an asset over its useful life in a manner that reflects the pattern of consumption of future economic benefits. Methods based on condition assessments may not follow this methodology.

Recommendations

12. **Road and other assets should be derecognised (written off) when the asset is replaced or renewed.**

13. **Councils:**
    - **recognise resheeting of unsealed roads as capital expenditure**
    - **with a relatively small expenditure on resheeting unsealed roads should consider capitalisation of unsealed road resheeting as a network asset(s) for resheeting completed in the reporting period**
    - **the network asset(s) for each period should be depreciated over the estimated useful life and derecognised at the end of the useful life.**

14. **Councils should prepare and adopt a policy for revaluation, defining the criteria to be used in determining whether the carrying amount differs materially from that which would be determined using fair value at the end of the reporting period. The policy should include the method of assessing fair value and the source information to be used.**

1.8 Area of Regulatory Support

Australian Accounting Standard AASB 116 *Property, Plant and Equipment* requires an annual review of useful life, residual value and depreciation method. AASB 136 *Impairment of Assets*, states, 'An entity shall assess at the end of each reporting period whether there is any indication that an asset may be impaired.' (AASB 136.9)

While the Accounting Standards mandate such a review, further encouragement through the use of Government regulation may be necessary, in the form of a mandatory requirement for a review of all infrastructure related estimates to be undertaken annually, and adopted by the Council General Manager. The rationale and documented support for any decision to revalue or not revalue should be part of the schedule provided.

In order for all infrastructure related values to be perceived as reasonably accurate, greater scrutiny of the financial asset register is needed. This can be supported through an increase in the level of scrutiny applied by internal audit functions and audit committees of councils and this can be mandated via Regulation. The outcomes of all annual reviews undertaken by internal audit should be provided to external audit for review and scrutiny.

Another area of regulatory support is in respect of disclosures in annual financial statements or annual reports. In common with other Australian States, disclosures of financial sustainability ratios for the current financial year and nine following financial periods adds significant information and context to a suite of financial statements. As a minimum, the financial statements should disclose, in conjunction with the AASB 116 Property, Plant and Equipment required disclosures, the value of renewal and new /upgrade capital expenditure by asset class for the period.

Management assessments and decisions which impact the financial statements should be supported be appropriate and sufficiently reliable, precise and detailed documentation.

The Tasmanian Audit Office reported on 5 financial indicators to assess council's financial sustainability.

- Operating surplus ratio,
- Asset sustainability ratio,
- Asset renewal funding ratio (when the data is available),
- Road asset consumption ratio,
- Net financial liabilities ratio.

Reporting these ratios in a council's financial statements together with explanations of variations from expected benchmarks, would provide additional information on financial sustainability to the community.

Annual financial statements currently do not disclose the residual values associated with the reported asset classes. Where residual values are used, the notes to the financial statements should disclose this.

Financial management strategies need to be developed that draw from integrated approaches to planning, underpinned by a focus on financial sustainability and supported by longer term planning. It is not sufficient for Long Term Financial Plans to present scenarios and forecasts alone. The move to regulate the development of financial management strategies is supported. To ensure that the development of financial management strategies (FMS) are not seen as a planning process separate and distinct from the long term financial plan (LTFP), the LTFP and FMS should be developed and released as a single planning document.

Recommendations

15. **Councils should undertake an annual review of accounting estimates as required by Australian Accounting Standards, to be approved by the General Manager. The review should include the useful life, residual value and depreciation methods applied, whether there is a material difference between the carrying value of assets recorded at fair value with that determined using fair value and whether there are any indications of impairment of assets. The rationale and documented support for any action or non-action taken should be part of the information provided.**

16. **Councils should undertake an annual review of the currency and accuracy of asset registers and the General Manager should report the rationale and documented support for any decision to revalue or not revalue to the audit committee and/or the council.**

17. **The value of capital renewal and capital new/upgrade expenditure by asset class should be disclosed in financial statements.**

18. **The value of capital renewal and capital new/upgrade expenditure by asset class should be disclosed in financial statements.**

19. **Management assessments and decisions which impact the financial statements should be supported by appropriate and sufficiently reliable, precise and detailed documentation.**

20. **The five financial ratios shown below, indicating the financial sustainability of councils, together with explanations of variances from expected benchmarks, should be disclosed in council financial statements:**
    - **Operating surplus ratio,**
    - **Asset sustainability ratio,**
    - **Asset renewal funding ratio,**
    - **Road asset consumption ratio,**
    - **Net financial liabilities ratio.**

21. **An integrated approach to financial management should be supported by the development of financial management strategies in conjunction with the development of the long-term financial plan as a single integrated financial planning document.**

1.9 Land Under Roads

AASB 1051 *Land Under Roads* requires that land under roads acquired after the end of the first reporting period ending on or after 31 December 2007 is accounted for under AASB 116 *Property, Plant and Equipment*. AASB 116 contains a comparison with the corresponding International Accounting Standard IAS 16 *Property, Plant and Equipment*.In Tasmania, the relevant State legislation indicates that control lies with the local governments, and therefore councils should value and report land under roads. It is recommended that councils elect to recognise all land under roads at fair value in accordance with AASB 1051 *Land Under Roads*. To facilitate and simplify the valuation process, councils should liaise with the Tasmanian Valuer-General with the aim of providing councils with a unit value for land under roads controlled by each local government for recognition and disclosure in annual financial statements. This will provide recognised and justifiable values in an efficient manner.

Recommendation

22. Councils recognise the value of all land under roads at fair value in accordance with Australian Accounting Standard 1051 *Land Under Roads*, regardless of when the land was acquired. Councils should approach the Tasmanian Valuer-General to determine and agree a process of valuing land under roads in each municipal area and to facilitate a regular revaluation of land under roads.

1.10 Proposed Common Road Hierarchy

A suggested local road hierarchy for Tasmania is shown below with further details in Tables 12 and 13.

Category	Title	Function Description
6	Local Arterial	Major link for traffic flow within urban areas, between towns, major tourist destinations and industrial areas
7	Local Collector	Link from local arterial roads and local roads
8	Local Street	Access for properties and link to collector roads
9	Local Access	Access for properties
10	Local Minor	Local roads maintained by the local authority
11	Other roads	Other roads not maintained by the local authority
12	Road Reserves	Non-constructed/maintained road reserves

This proposed road hierarchy is developed for consideration by the Local Government Division and consultation with key stakeholders such as the Local Government Association of Tasmania and engineering practitioners to ensure that any adopted local road hierarchy meets the needs of all councils.

Recommendation

23. The Local Government Division consider, after consultation with relevant stakeholders, adopting the proposed local road hierarchy for use by all councils

2. THIS REPORT

Jeff Roorda and Associates (JRA) was engaged on the instructions of the Tasmanian Audit Office (TAO) to undertake a review of current asset management and asset accounting practice in Tasmanian local government.

The results of JRA's work, including the assumptions and qualifications made in preparing the report, are set out in this report dated September 2013 ('Report'). You should read the Report in its entirety including the applicable scope of the work and any limitations. A reference to the Report includes any part of the Report. No further work has been undertaken by JRA since the date of the Report to update it.

The Report has been prepared for the use of the TAO and the Local Government Division of the Department of Premier and Cabinet only.

JRA has consented to the Report being published electronically on the TAO website for informational purposes only. The Report may not be used or relied upon by any other party without the prior written consent of JRA.

JRA disclaims all liability in relation to any other party who seeks to rely upon the Report or any of its contents.

JRA has acted in accordance with the instructions of the TAO in conducting its work and preparing the Report. JRA makes no representations as to the appropriateness, accuracy or completeness of the Report for any other party's purposes.

In preparing the Report, JRA has relied on data and information provided to it. JRA has not independently verified the information provided to it and therefore makes no representations or warranties regarding the accuracy and completeness of the information.

No duty of care is owed by JRA to any recipient of the Report in respect of any use that the recipient may make of the Report.

JRA disclaims all liability, and take no responsibility, for any document issued by any other party in connection with the Project.

The material contained in the Report is copyright and copyright in the Report itself vests in the TAO. The Report cannot be altered without prior written permission.

The analysis, interpretations and views expressed are those of the authors.

3. BACKGROUND AND OBJECTIVES

3.1 Background

A number of councils in Tasmania, as part of revaluations, introduced the concept of residual values for long-lived infrastructure assets, particularly roads. This has resulted in a reduction in annual depreciation charges and improvements in road consumption ratios.

During 2011-12 audits, the Tasmanian Audit Office noted a number of instances where the proposed residual values were significant and materially affected the asset balance and depreciation expense in financial statements. In a number of cases and following discussions with councils, the proposed residual values were not applied.

At 30 June 2012, at least 11 of the 29 Tasmanian councils used some form of residual value for road infrastructure assets.

From discussions with council management and engineers, it became apparent that there are differing views regarding the definition, use and validity of residual values in the valuation of infrastructure assets, such as roads, for financial reporting purposes.

In the Audit Office view, the use of residual values, as it relates to infrastructure assets, ignores the fact that at some point in time, the asset may no longer be required and its function may be decommissioned because it became obsolete. The point in time when this decommissioning takes place could be difficult to determine and may only become evident when the asset is actually nearing the end of its useful life. However, it is important to attempt to replicate the functional, economic, technical and commercial obsolescence over the life of the asset (AASB 116.56), instead of recognising a large write-down immediately preceding the decommissioning of the asset. The Audit Office believes that the residual balance should be depreciated on some basis, even if over an extended useful life, to ensure the calculation of depreciation complies with the requirements of Australian Accounting Standard AASB 116.

Some councils disagree with this view because it is considered that certain components of road infrastructure assets do not depreciate and the requirements of AASB 116 result in depreciation expenses being over-stated. Additionally, AASB 13 Fair Value Measurement will apply to all councils for the year ending 30 June 2014, with comparatives for the year ending 30 June 2013. The impacts of this Standard, if any, also need to be considered.

The Audit Office considered the current situation and wish to appoint an independent expert to review depreciation practices, including the use of residual values, by local government councils in Tasmania.

In addition, this review will also examine ways of achieving better consistency and transparency in depreciation and revaluation practices across all 29 councils.

3.2 Objectives

The objective of this review is to determine the appropriate approaches to road asset depreciation in accordance with Australian Accounting Standards and to establish consistent and transparent depreciation and revaluation practices of local government councils in Tasmania.

Particular attention needs to be placed on:

- examine classification/definition of road asset components (to achieve consistency in recognition),
- treatment of earthworks. Ensure consistency in recognition and depreciation (if applicable),
- basis for determining replacement rates. It may be reasonable that costs vary, but the underlying components of calculating replacement costs should be consistent,
- basis of determining useful lives (of asset components) as well as the remaining useful life of road assets (impact on accumulated depreciation),
- definition, appropriateness and determination of residual values. Consider definition issue between engineers and accountants,
- basis of road condition assessments. Can a visual inspection of road assets provide an appropriate base for determining remaining useful life? How do we reconcile the accounting treatment in relation to depreciation of road assets (straight line basis) with the actual condition of the roads?
- capitalisation versus expensing of road re-sheeting costs. Should road re-sheeting costs be capitalised and the roads depreciated. (renewal accounting),
- identification of any other current recognition and depreciation approaches that do not comply with Australian Accounting Standards,
- the treatment of land under roads constructed after 1 July 2008. (currently treated as immaterial by the majority of councils),
- frequency of revaluations and indicators to trigger revaluation (indexation or full revaluation). Review a maximum period that indexation can be applied to revaluations,
- financial statement disclosures.

3.3 Outcomes

The Outputs to be delivered by the Road Depreciation Review are:

A joint accounting/engineering report that:

- defines and provided consistent classifications for all road component assets (Section 4.2)
- identifies individual components of the replacement cost of road infrastructure (across all types of roads and associated assets) (Section 4.2),
- identifies the appropriate accounting treatment for earthworks (Sections 4.3, 7.2.1),
- defines residual value, as accepted by both accountants and engineers, which complies with Australian Accounting Standards (Section 6.2),
- provides guidelines for the application of residual values, only where appropriate (Sections 6.2-4)
- includes standard depreciation rate ranges to be applied across all councils (Section 7.2.2)
- provides a consistent approach to determining remaining useful life of road assets that identifies the factors that determine useful life of the road assets and defines how the factors are used in determining depreciation expense (Section 7.2.3),
- defines the components necessary to complete condition based assessment of roads (Section 7.2.5)
- defines a consistent approach to the depreciation of unsealed roads and the treatment of gravel road resheeting (Section 9.2)
- identifies revaluation indicators to trigger (indexation or full revaluation). Determines a maximum period that indexation can be applied to revaluations (Section 9.4)
- identifies appropriate financial statement disclosures (Section 10)
- identifies a consistent approach to the treatment of land under roads acquired after 1 July 2008 (Section 11.1),
- proposes a draft road hierarchy format for local roads in Tasmania (Section 12.1).
- The joint engineering and accounting report will form the basis of:
- a report by the Auditor-General to Parliament, and
- Local Government Office guidelines for road asset accounting and reporting in local government.

4. ASSET IDENTIFICATION AND RECOGNITION

4.1 Introduction

'Capital' is a broadly applied term that means 'productive capacity'. An initial and important determination for asset managers and finance managers is whether the transaction in question, regardless of value, represents an addition to, or renewal of, the productive capacity of the council.

Whether an item of expenditure is capitalised depends on a number of individual assessments that relate to current policy determinations and previous decisions made in respect of the infrastructure assets of council previously capitalised.

Expenditure determination and classification involves two essential considerations:

1. Is the expenditure part of the maintenance profile of the asset to allow it to reach its estimated useful life? If so, the expenditure is maintenance, regardless of value. This determination is unique to each asset and each council. Councils may choose extended useful (productive) lives for assets on the basis of an extended periodic works program to support the asset throughout

that life. The extended useful life decreases annual depreciation expense and results in expenditure that might otherwise be capital being regarded as maintenance.

2. Does the expenditure meet the capitalisation threshold, extend the useful life of the asset or renew the economic benefit (productive capacity) associated with an existing asset? If so, the expenditure is capital. If not, it is maintenance.

Where a transaction or event is capital in nature, the establishment of the depreciable value of an asset is then a primary concern of asset managers and finance managers. Planning and forecasting for infrastructure renewal requires reasonably accurate values for the expected cost of replacement, and the expected timeframe for that renewal. The value of the depreciable amount is achieved through separate considerations of current replacement cost and estimated residual value.

This section of the report discusses the determination process, and consequential capitalisation considerations in terms of segments and componentisation. The ongoing valuation of assets is discussed in the following section of this report and a later section of the report discusses the appropriate use of residual values.

4.2 Discussion

Segments and Components are different ways of considering the asset being managed. Segments and components represent:

- segments - the identification of a number of individual assets with a common function or purpose that are managed discretely by the asset management process, e.g. segments of road within a road network,
- components – the identification of different types of assets within a single, larger asset that exhibits different useful lives and are managed discretely by the asset management process, e.g. Road earthworks, pavement, wearing surface (seals), kerbs, footpaths, etc.).

Figure I below shows a typical segment of an urban street.

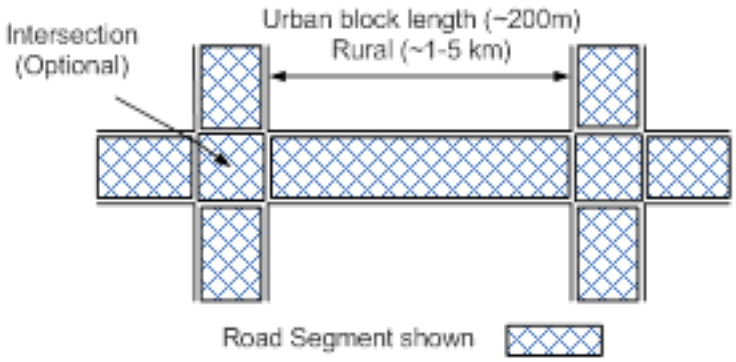


Figure I: Typical Road Segments

Where assets are recorded at the component level, the key data required for asset valuation and depreciation – year of acquisition, 'cost' or revalued amount, depreciable amount, useful life and method of depreciation is easily obtained. This process may be modelled using simple, cost effective methods and easily accommodated within accounting systems.

The component of a road asset within a segment identified under this process is *unit of account* used for financial reporting purposes. Table 1 and Figure II show typical components within a segment of an urban street and a rural highway.[1]

[1] IPWEA, 2009, AIFMG, Sec 12.4.1, p.12.16.

Table 1: Typical Road Components

Road Category	Typical Road Components
Urban roads	Earthworks (where material) Retaining walls (where material) Pavement sub-base^ Pavement base Sealed wearing surface Kerb and channel (x2) Footpaths (x2) Bridges Culverts★ Traffic management and protection devices Landscaping (where material)
Rural roads	Earthworks (where material) Retaining walls (where material) Pavement sub-base ^ Pavement base Sealed/unsealed wearing surface Bridges Culverts★ Traffic management/protection devices

Note: ^ where pavements are managed as separate components.

★ where not recognised with road earthworks or as separate stormwater drainage assets.

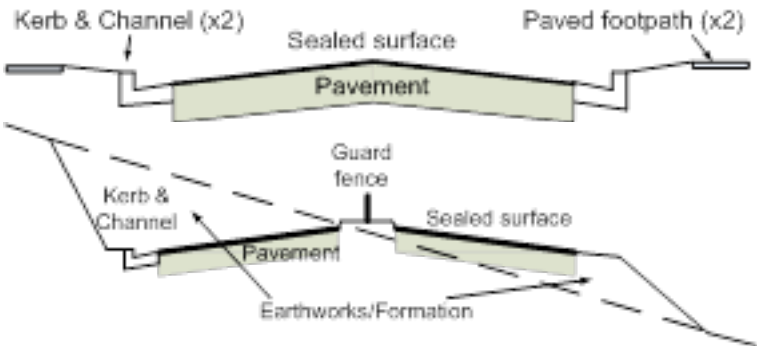


Figure II: Typical Components within Road Segments

To identify the components of a complex asset, the council must assess whether the component:

- can be separately *identified* and *valued* and *able to be separated from the complex asset*, and
- requires *replacement at regular intervals* during the life of the complex asset to which it relates, or be subject to obsolescence, and
- exceeds the entity's capitalisation threshold, *and*
- has a *significant value* in relation to the total cost of the complex asset, and

- has a different estimated useful life from the complex asset so that failure to depreciate it separately would result in a *material difference* in the annual depreciation expense for that complex asset.[2]

Where the asset is recognised at the complex asset level (i.e. comprised of multiple components), identification of useful life, residual value and depreciable amount becomes a more difficult and costly process requiring sophisticated modelling for partial renewals as well as justification of supporting data and processes.

The recording and financial reporting of road and other assets is further complicated by experience that the road pavement asset identified in the asset register is rarely subject to complete replacement at the end of its useful life. This is due to improved asset management renewal methods including:

- repair of isolated pavement failures with regular resurfacing/resealing,
- recycling of the upper 50% of the pavement base leaving the subbase untouched, or
- adding a 100-150 mm pavement layer to an existing pavement on rural roads or roads unconstrained by levels.

The third case is illustrated in an example from Meander Valley Council. The council's practice of 'reconstructing' and widening existing rural sealed roads is illustrated in Figure III.

Rural Sealed Road before Renewal

Rural Sealed Road Renewal Upgrade

[2] Based on Queensland Treasury, 2012, NCAP 2, pp 2-3..

The reconstruction and widening methodology for rural sealed pavements is shown below.

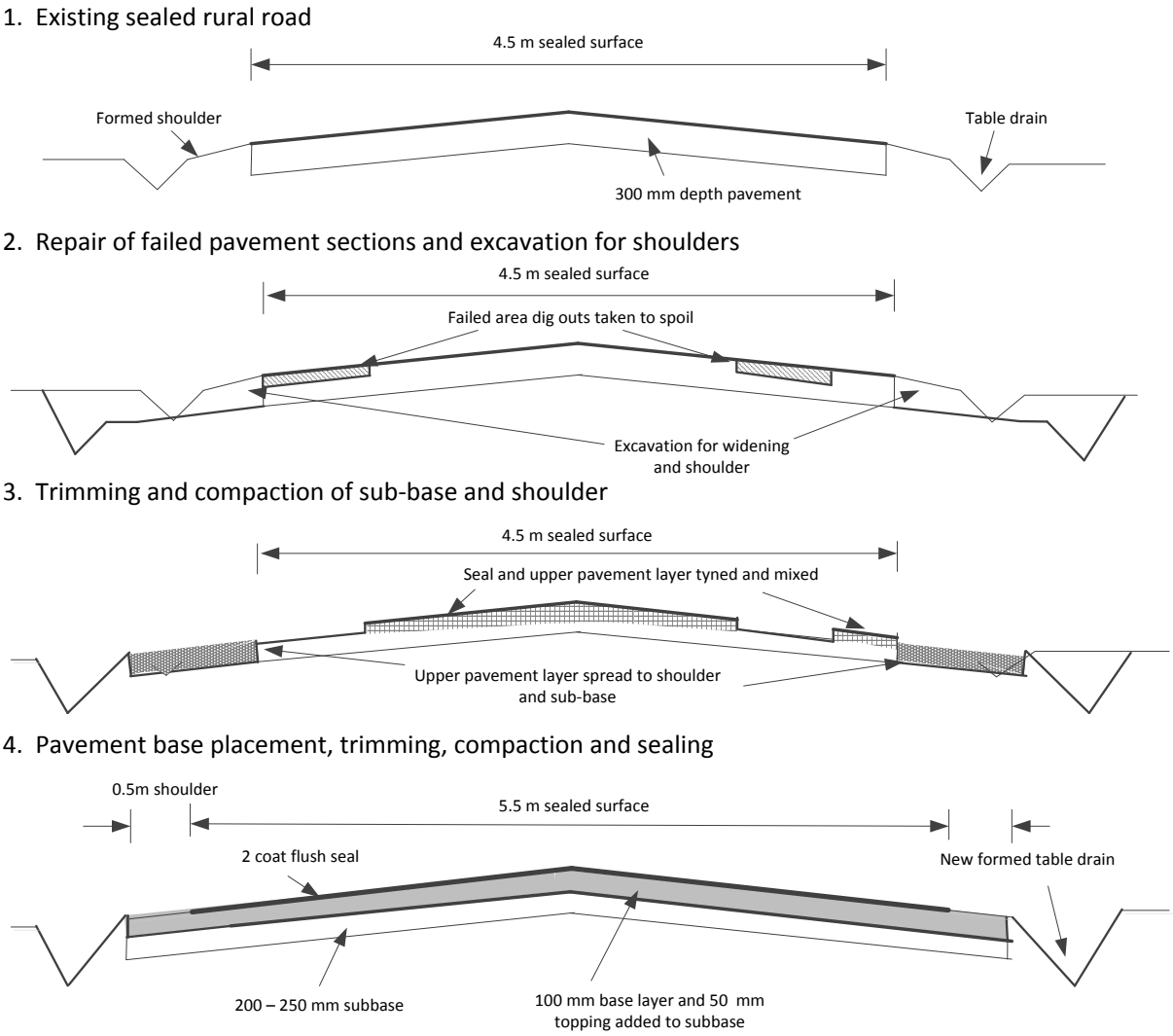


Figure III: Typical Rural Road Renewal and Widening Methods - Meander Valley Council

The existing sealed road pavement is retained and becomes part of the road subbase. Future reconstructions will follow the same methodology adding to the depth and useful life of the road pavement.

4.3 Road Earthworks

Road earthworks that are assessed as having the characteristics of land should be considered to be non-depreciable assets. All other assets of council should be considered to be depreciable assets.

For the period that the earthworks/formation asset remains in service and provides the required stream of future economic benefits, its current replacement cost reflects its future economic benefits and it may be considered to have an unlimited life.

This is illustrated in Figure IV showing the earthworks/formation asset recognised as a separate component.

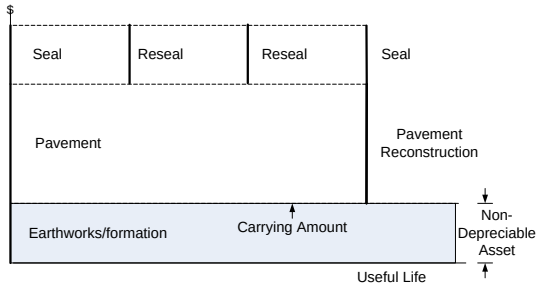


Figure IV: Road Earthworks Component

Source: IPWEA, 2009, AIFMG, Figure 12.11.1, p 12.50.

Councils are to assess which of the road earthwork assets have a limited useful life. End of life for the earthwork assets may be recognised when the council becomes aware that the earthworks asset will become obsolete, and then depreciates the carrying amount of the asset over the asset's remaining useful life.

A similar approach to depreciation of the carrying amount would be undertaken for other components of the existing road to become obsolete such as sealed surface, pavement and drainage, etc.

4.4 Derecognition

A complimentary process to recognition of an asset is derecognition at the expiration of the useful life of an asset. When an asset is replaced or disposed of, the remaining carrying amount of the asset is to be written off. A gain or loss on disposal is valued with reference to any amount obtained at the time of disposal.[3] This is an essential part of financial management of infrastructure assets and the ongoing completeness and accuracy of the asset register.

4.5 Scenario Treatments – Asset Recognition

This report includes a number of different scenarios associated with current and emerging practice in local government and provides a proposed solution that is consistent with Australian Accounting Standards. The scenarios are included within relevant sections of the report.

3. AASB 2009, AASB 116.67, p.27.

Table 2: Scenario Treatments - Asset Recognition

Scenario	Solution
A council has constructed a new urban road asset.	**Recognition at Cost** – The road is identified by earthworks, pavement, surface, kerb and channel and footpath components. Each component asset is recognised at its cost as it provides future economic benefits to the council. **Useful life** – the new component assets are established with expected useful lives.
A council has recognised earthworks of a road as an asset, has determined that there are no indicators of obsolescence for the earthworks and considers that the earthworks will have an unlimited life.	**Recognition at Cost** – The earthworks component is recognised as an asset at its cost. **Useful life** – The earthworks assets are established with an unlimited life. The council reviews earthworks assets with an unlimited life at each reporting date, to identify any indicators of obsolescence and where indicators are present, determines and applies an expected useful life for affected earthworks assets.
A council has recognised earthworks of a road as an asset and has determined that the road earthworks will have a limited life.	**Recognition at Cost** – The earthworks component is recognised as an asset at its cost. **Useful life** – The new earthworks assets are established with expected useful lives.
A council undertakes reconstruction of its rural sealed pavements by dig-out of failed areas and shoulder to be widened, reuse and reshaping of existing pavement material, addition of 100-150 mm of new material, trimming compaction and sealing.	**Recognition at Cost** – The pavement reconstruction cost is added to the carrying value of the existing pavement asset as it increases the service potential of the pavement asset. The new flush seal is recognised as an asset at its cost. The remaining value of the existing flush seal is written off. **Useful life** – The useful life of the renewed pavement asset is extended by the expected increase in useful life (e.g. 50 years). The new flush seal asset is established with an expected useful life.

4.6 Summary

Where an asset can be seen as being comprised of a number of component assets of different useful lives, each component should be separately identified, valued and depreciated. A maintenance profile needs to be established to support the estimated useful life assigned to the asset, as this will support subsequent assessments as to whether expenditure on the asset is in the nature of maintenance or capital renewal.

Greater use of segmentation for linear assets and components will support asset management practices in councils where the components align with the asset management intentions for the assets. Financial accounting practice and long term financial planning should align with asset management practice and intent.

Greater use of componentisation of assets will alleviate some of the current financial accounting issues that are being experienced, as this process will allow for the recognition of non-depreciable components and other components with extremely long useful lives.

4.7 Recommendations

1. The components of a road asset should be identified and recognised at Fair Value and should be separately valued and depreciated over their useful lives. Components of road assets can include:

Urban road components

- **Earthworks (where material)**
- **Retaining walls (where material)**
- **Pavement sub-base^**
- **Pavement base**
- **Sealed wearing surface**
- **Kerb and channel (x2)**
- **Footpaths (x2)**
- **Bridges**
- **Culverts***
- **Traffic management and protection devices**
- **Landscaping (where material)**

Rural road components

- **Earthworks (where material)**
- **Retaining walls (where material)**
- **Pavement sub-base^**
- **Pavement base**
- **Sealed/unsealed wearing surface**
- **Bridges**
- **Culverts***
- **Traffic management/protection devices**

Note ^ where pavements are managed as separate components

*** where not recognised in road earthworks or as separate stormwater drainage assets**

5. VALUATION

5.1 Introduction

As discussed in the previous section, planning and forecasting for infrastructure renewal requires reasonably accurate values for the expected cost of renewal. This section of the report discusses the concepts associated with establishing current replacement cost.

Infrastructure assets and other items of Property, Plant and Equipment are valued at fair value, which for specialised non-financial assets of councils is represented by depreciated replacement cost. The replacement cost of an asset is the cost of replacing it with a substantially identical new asset or a modern equivalent asset. The modern equivalent asset is a notional asset with which an existing asset's service potential would be restored using the latest technology or innovation currently available.

Current replacement cost is the cost of the future economic benefits expected to be derived from use of the asset, estimated as the current cost of the future economic benefits of the most appropriate replacement facility. The replacement value can also be seen as the current cost to substitute an entire asset with a new or equivalent asset without enhancement of capabilities.

A modern equivalent asset replicates an existing asset with the most cost effective asset performing the same level of service. Modern equivalent assets exist for:

- macadam road pavement,
- hand placed stone kerb and channel (with no heritage replacement requirement),
- woodstave water pipeline,
- glazed earthenware sewer pipeline.

Considerations of the appropriateness of the use of residual values arises from councils seeking to reduce the value of the depreciable amount to more appropriately reflect, in the council's view, the likely future replacement cost at the time of the renewal.

The challenge arises when a council believes that the renewal of the asset will be achieved for less than the current recorded cost of replacement (current replacement cost). Reflecting this lower replacement value in the asset register and financial statements requires consideration of a number of factors.

5.2 Discussion

Current replacement cost should take account of modern equivalent assets in determining current values for use in financial accounting and long term financial planning. Asset managers in councils are indicating that the costs to renew the utility/future economic benefit of many assets is likely to be less than currently recorded current replacement costs. Asset managers are seeking to use the lower renewal values as the depreciated amount. However in many instances, it is not a like-for-like renewal of the asset, with perceived innovative practices and/or alternative materials being used to renew the utility/future economic benefit of the assets.

Current replacement cost values require a consideration of the purpose of the asset in terms of function and utility and the future economic benefits arising from use of the asset. A renewal of an asset represents a renewal of the utility of the asset and its future economic benefits.

In order to be recognised as a renewal, asset managers should be required to demonstrate and document that the proposed renewal practice will result in the renewal of the utility of the asset and its future economic benefits.

In order for these lesser value approaches to renewal to be recognised as the current replacement cost of the asset, councils are required to demonstrate:

1. That the renewal represents a modern equivalent asset, and
2. The renewal represents an extension or renewal of the utility/future economic benefit associated with the currently held asset.

Unless both of these criteria are met, the lesser values cannot be used as the current replacement cost of the asset. Where the criteria are not met, it is possible that the practice in question is:

- an upgrade to an existing asset and should be capitalised as such, or
- represents a maintenance activity and is expensed as incurred.

Asset managers will continue to evolve current work practices associated with the management of the assets of councils. The nature of the work practices and the effect on the utility and estimated useful lives of assets will need to be carefully considered to ensure that the practices are appropriately recognised and valued in the financial statements.

Examples of current practice include:

- road resurfacing
    - replace a 2 coat seal with single coat seal
- pavement - recycling existing pavement material
    - stabilisation with lime, cement or bitumen
    - topping up pavement material (where not constrained by fixed levels)
- pipelines – relining existing pipes to restore the utility of the asset

These practices may be considered as the application of modern equivalent assets.

Generally, the construction of infrastructure assets includes initial earthworks, design costs and other expenditure that may last for an indefinite period, may never need replacing, or lasts for periods in excess of the life of the core component of the overall asset.

An extension of the discussion involves a consideration of the extent to which the costs incurred in constructing the asset are initially capitalised. In some instances, current practice is for non-recurring costs to be expensed at the time of asset creation or acquisition, including the initial costs of survey works, cuttings, earthworks and clearing. In some cases, donated assets are also not capitalised on the basis of the non-recurring nature of the transaction.

Table 3 presents the different perspectives on the recognition and valuation of infrastructure assets.

Table 3: Perspectives on Recognition and Valuation of Infrastructure Assets

	Accounting	Valuation
Brownfield	The initial recognition of assets involves expensing those costs that are considered to be 'sunk' one-off costs for components that are expected to have an unlimited useful life (such as earthworks and formation for road works) and capitalising only those costs associated with the ongoing renewal of the asset. Periodic revaluations are based on modern equivalent assets to replace or renew the assets recognised.	The unit valuation rates are based on the cost to replace the asset in its existing 'brownfield' (developed) location. This valuation approach is based on the specific location of the asset. As a result, existing works are taken into account in establishing asset values.
Greenfield	The initial recognition and subsequent revaluation of assets involves the capitalisation of all costs including those one-off costs for components that are expected to have an unlimited useful life (such as earthworks and formation for road works). Periodic revaluations are based on modern equivalent assets to replace or renew the assets recognised.	The unit valuation rates are based on the cost to acquire/construct the asset in a 'greenfield' (undeveloped) location. This valuation approach does not assume a specific location of the asset. As a result, existing works are not taken into account in establishing asset values.

Included below are relevant extracts from AASB 116 'Property, Plant and Equipment'.

AASB 116.16

The cost of an item of property, plant and equipment comprises:

(a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates;

(b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management; and

(c) the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

AASB 116.20

Recognition of costs in the carrying amount of an item of property, plant and equipment ceases when the item is in the location and condition necessary for it to be capable of operating in the manner intended by management.

AASB 116.31

After recognition as an asset, an item of property, plant and equipment whose fair value can be measured reliably shall be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations shall be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period.

AASB 116.43

Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately.

AASB 116.55

Depreciation of an asset begins when it is available for use, that is, when it is in the location and condition necessary for it to be capable of operating in the manner intended by management.

Commentary

AASB 116 requires that all costs associated with establishing an asset ready for use in its intended location are capitalised. In establishing the initial cost, all costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended are included. This would suggest, at least for the initial acquisition or construction, that a Greenfield Accounting approach (capitalisation of all costs) to asset recognition is intended, regardless of the level of componentisation applied.

Asset revaluation is a process to ensure that the values attributed to assets continue to represent current replacement costs as established under fair value principles. Local governments need information on the stock of infrastructure assets that is as current as possible.

All assets recognised should therefore be established with estimated useful lives reflecting the expected utility of the asset to the council. Periodic revaluations will revalue the asset based on modern equivalent assets using fair value principles and include an assessment of the remaining useful life. Where any asset or component will not be renewed at the end of its useful life, it will be derecognised at the end of its useful life.

A council needs to raise sufficient revenue to be able to sustain its productive capacity in the long term. Any components that are capitalised but are not part of an envisaged renewal program should be capitalised in the first instance and the estimated useful life established considering future replacement/renewal/disposal and obsolescence

The initial costs to create or acquire an asset are legitimate costs associated with the establishment of the productive capacity of the asset, and these costs are then written off (depreciated) over an estimated useful life. If the costs are considered to be non-recurring, the components in question may then be considered to be either a) non-depreciable or b) non-renewable.

Costs such as initial earthworks and cuttings that will not need to be re-performed when the asset is renewed would be recorded as a separate component of the asset with separate unlimited useful life and not subject to renewal. Donated earthworks assets would also be treated in this way where any

donated earthworks assets would be recognised at fair value, recorded as a separate component and not form part of a renewal program for the asset.

Other donated assets would be recognised at fair value and recorded as a separate component with an estimated useful life.

5.2.1 Fair Value Measurement

In May 2011, the Australian Accounting Standards Board (AASB) issued a new financial reporting standard AASB 13 *Fair Value Measurement*.

The operative date is financial reporting periods beginning on or after 1 January 2013. For most Australian local governments, this translates to financial statements for the year ending 30 June 2014.

In the Australian Accounting Standards, 'fair value' is defined as:

> '... the amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arm's length transaction.'

A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.

Level 2 inputs are other than quoted prices included within level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 inputs are unobservable inputs for the asset or liability.

For many local government assets that are 'specialised' in nature, market evidence might not be available. Such specialised assets may include infrastructure such as roads and stormwater drainage, land under infrastructure and specialised plant such as that used in waste and recycling facilities, sewerage plants, and historical or cultural assets.

AASB 116 recognises the specialised nature of some assets and provides for an income or depreciated replacement cost approach to be used to determine fair value. If no active market is available, depreciated replacement cost is the most likely alternative.

AASB 13 provided guidance on application of the cost approach valuation technique.

AASB 13.B8

The cost approach reflects the amount that would be required currently to **replace the service capacity of an asset** (often referred to as current replacement cost). (emphasis added).

AASB 13.B9

From the perspective of a market participant seller, the price that would be received for the asset is based on the cost to a market participant buyer to acquire or construct a substitute asset of comparable utility, adjusted for obsolescence. That is because a market participant buyer would not pay more for an asset than the amount for which it could replace the service capacity of that asset. Obsolescence encompasses physical deterioration, functional (technological) obsolescence and economic (external) obsolescence and is broader than depreciation for financial reporting purposes (an allocation of historical cost) or tax purposes (using specified service lives). In many cases the current replacement cost method is used to measure the fair value of tangible assets that are used in combination with other assets or with other assets and liabilities.

The primary purpose of the Standard is to reinforce the need for assets to be based on observable market values to the greatest extent possible and to indicate in the notes to the financial statements the basis upon which the assets of the council have been valued (level 1, 2 or 3). This enables readers of the financial statements to understand the extent to which market values are used or internally generated values are used.

Fair value measurement does not in itself alter the concepts associated with current replacement cost or modern equivalent assets.

5.3 Summary

Current replacement cost should take account of modern equivalent assets in determining current values for use in financial accounting and long term financial planning. Asset managers in councils are indicating that the costs to renew the utility/future economic benefit is likely to be less than currently recorded current replacement costs. Asset managers are seeking to use the lower renewal values as the depreciable amount. However in many instances, it is not a like-for-like renewal of the asset, with perceived innovative practices and /or alternative materials being used to renew the utility /future economic benefit.

In order for these lesser value approaches to renewal to be recognised as the current replacement cost of the asset, councils are required to demonstrate:

1. That the renewal represents a modern equivalent asset, and
2. The renewal represents an extension or renewal of the utility /future economic benefit associated with the currently held asset.

Unless both of these criteria are met, the lesser values cannot be used as the current replacement cost of the asset. Where the criteria are not met, it is possible that the practice in question is:

- an upgrade to an existing asset and should be capitalised as such, or
- represents a maintenance activity and is expensed as incurred.

Recognition of lower renewal cost is discussed in Section 6.

All costs incurred in constructing the asset should be initially capitalised. This includes the initial costs of survey works, cuttings, earthworks, clearing, formation and gravel. Those costs such as initial earthworks and cuttings that will not need to be re-performed when the asset is renewed would be recorded as a separate component of the asset with a separate unlimited useful life and not subject to renewal. Donated earthworks assets would also be treated in this way where any donated earthworks asset would be recognised at fair value, recorded as a separate component and not form part of a renewal program for the asset.

In terms of periodic revaluations in accordance with fair values, it would be expected that councils utilise unit rates based on a cost approach recognising the amount that would be required currently to replace the service capacity of the asset (often referred to as current replacement cost) considering the specific location and productive capacity of the asset. Local governments should be planning for renewal from the time of acquisition or creation of the asset. The Accounting Standards require a consideration of all costs associated with establishing the service capacity of the asset in its intended location. Renewal planning by councils should then also be based on a consideration of the renewal of the service capacity of the asset in its intended location.

5.4 Recommendations

2 Assets should be recognised at cost based on a modern equivalent asset. Donated or contributed assets should be recognised at fair value in accordance with the Accounting Standards. Periodic revaluations of infrastructure assets wshould be based on the cost approach, the amount required currently to replace the service capacity of the asset.

6. THE VALUATION AND USE OF RESIDUAL VALUE

6.1 Introduction

Of late, there has been a desire by councils to determine the value of the depreciable amount for many long-life infrastructure assets on the basis of current perceptions of the actual future cost of renewal. A literal interpretation of residual value has been used as the instrument to achieve a reduction in the value of the depreciable amount.

Previous sections of this report have discussed the use of current replacement cost, modern equivalent assets, segmentation and componentisation to reflect various depreciable and non-depreciable aspects of council infrastructure assets. This section discusses the appropriate use of residual values to affect the depreciable amount.

6.2 Discussion

In accordance with the Australian Accounting Standards, the residual value of an asset is the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.

There is a view among some local government practitioners that a 'residual' value is also applicable for infrastructure where the cost of renewal is less than the cost of replacement. In this situation the difference between the full replacement cost and the cost to reinstate the service function of the asset is loosely described within councils as a residual value.

A 100% residual value is often applied to road earthworks as a method of recognising the non-depreciable nature of the earthworks assets. The useful life of road earthworks is discussed in Section 7.2.1

Councils are seeking to recognise a non-depreciable value in certain renewal/restoration methodologies such as recycling/stabilising existing road pavements or relining existing storm-water pipelines, where the cost to renew/restore the service capacity in an asset is less than the cost to replace the asset.

Councils are looking to ensure that assets are appropriately depreciated and are looking to use residual values as the mechanism to achieve this.

These renewal methods represent 'optimal' renewals. Examples of 'optimal renewals include but are not limited to:

- restoring the service capacity of a sealed road pavement by recycling existing pavement materials. This may include the addition of stabilising materials such as cement, lime or bitumen,
- restoring the service capacity of a rural road pavement, where levels are not critical, by tyning/scarifying the surface, adding 100 – 150 mm of new pavement material, trimming, compacting and sealing,
- restoring the service capacity of pipelines by inserting a structural liner inside the pipe.

For these 'optimal' renewal methods, the non-depreciable value is regarded as the difference between the cost to restore the service capacity or future economic benefits of the asset (or component) and the current replacement cost of the asset (or component) calculated under fair value principles.

The key aspect to this is 'the residual value of an asset is the estimated amount that an entity **would currently obtain from disposal** of the asset …' (emphasis added). The Accounting Standard goes on to say that residual values are generally not material in value.

An alternative view that might be offered is that the residual value is determined by the estimated value that transfers in from the asset subject to renewal. Internal transfers of value are not recognised by the Accounting Standards for financial reporting purposes, and it would not be appropriate to recognise a residual value as being a value remaining in an asset at the time of its renewal.

In practice, a strict interpretation of the 'estimated amount that would be obtained from disposal' suggests that:

- Only land should be regarded as a non-depreciable asset or component; and
- Residual values can only be assigned to those assets where the council can obtain an amount on disposal, e.g. fleet, plant and equipment.

In order for the asset management practices to correlate with the Australian Accounting Standards, there is a need for councils to separately identify the shorter term useful lives from the longer term useful lives without relying on residual values and incorrectly classified non-depreciable components. An example of the componentisation for a complex road asset where a council has planned to renew a road pavement by recycling and adding stabilising material after 50 year life is:

1. Surface $40 000 – depreciated over 25 years
2. Pavement base (short life) $50 000 (150 mm base to be recycled after 50 years) – depreciated over 50 years
3. Pavement sub-base (long life) $50 000 – depreciated over 100 years to allow for potential obsolescence

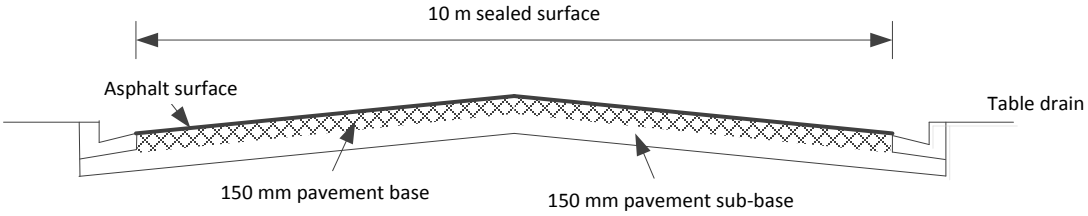


Figure V: Road Asset Components recognising Planned Recycling Renewal Treatments

This approach avoids the use of residual values as a surrogate for non-depreciable components while also appropriately allowing for future obsolescence to be recognised without a one-off and significant charge to the Statement of Comprehensive Income at that time.

The approach taken by individual councils will be dependent on the extent of the evidence available. A very long estimated useful life based on the expectation of periodic replacement of key components can be used where appropriate evidence is available to support the assertion. In the absence of such evidence, shorter useful lives should be used.

Where residual values are used for an asset with an active sale market, the residual value of an asset shall be reviewed at least at the end of each annual reporting period.

As discussed previously, an increased reliance on componentisation, the use of appropriate useful lives (to manage potential future obsolescence) and revaluation based on the amount required currently to replace the service capacity of the asset cost as documented in the organisation's AM Plan, a **modern equivalent asset value**, will achieve similar if not identical outcomes to the current practice of using residual values to affect the depreciable amount.

6.3 Scenario Treatments - Valuation

A number of different scenarios associated with current and emerging practice in local government are shown below with proposed solutions that are consistent with Australian Accounting Standards.

Table 4: Scenario Treatments – Valuation

Scenario	Solution
A council's asset management plan states that future renewal of urban sealed road pavements will be conducted by recycling of the of the pavement base (top 50%) material. The asset management plan provides evidence of the planned renewal method by recycling and estimated useful lives of the base until recycling is required. The estimated cost of recycling of the pavement base is less than the cost to replace (reconstruction of) the existing pavement base material. The value of the modern equivalent asset for the pavement base asset is based on recycling of the existing base materials with addition of stabilising binder material.	**Recognition at Cost** – The road pavement is recognised as two component assets at their cost, the pavement base planned to be recycled at a future date and the pavement sub-base. **Useful Life** – The two pavement assets are established with expected useful lives, the pavement base asset being a short lived asset with a life until pavement recycling is planned (50 years) and the pavement sub-base asset established with direct reference to the council's planned approach to asset management. If the long useful life estimate is based on the expectation of certain maintenance activities, this must be documented. Should these expected maintenance activities not occur as planned, the estimated useful life will require immediate revision. **Revaluation** – the pavement base asset is revalued at the cost to replace the service capacity of the asset (cost of planned renewal by recycling). The pavement sub-base is revalued to the cost to replace the asset – the modern equivalent asset.
A council's asset management plan states that new roads will be initially surfaced with a two coat flush seal and resealed with a single coat seal at 18 year intervals.	**Recognition at Cost** – Two coat seals are recognised at their cost. **Useful life** – New two coat seal assets are established with an expected useful life of 18 years. **Revaluation** – Two coat seals are revalued at the cost to replace the service capacity of the asset (cost of planned single coat reseal) – the modern equivalent asset.

Scenario	Solution
A council undertakes a reseal of a two coat seal with a single coat seal after 15 years.	**Recognition at Cost** – The single coat reseal is recognised as an asset at its cost. Any carrying value of the existing two coat seal is written off. **Useful life** – The new single coat reseal asset is established with an expected useful life of 18 years. **Revaluation** – The single coat seal is revalued at the cost to replace the service capacity of the asset (cost of planned single coat reseal) – the modern equivalent asset.
A council undertakes resurfacing of a two coat seal with a 30 mm asphalt overlay coat seal after 12 years.	**Recognition at Cost** – The asphalt overlay is recognised as an asset at its cost. Any carrying value of the existing two coat seal is written off as a loss on disposal. **Useful life** – The new asphalt overlay asset is established with an expected useful life of 30 years. **Revaluation** – The asphalt asset is revalued at the cost to replace the service capacity of the asset (cost of 30 mm asphalt overlay).
A council undertakes resurfacing of a two coat seal with a 50 mm asphalt overlay designed to increase strength and extend the life of the pavement by 20 years.	**Recognition at Cost** – The asphalt overlay is recognised as an asset at its cost. Any carrying value of the existing two coat seal is written off as a loss on disposal. **Useful life** – The new asphalt overlay asset is established with an expected useful life of 30 years. The expected useful life of the existing sealed pavement is extended by the expected 20 years. **Revaluation** – The asphalt asset is revalued at the cost to replace the service capacity of the asset (cost of 50 mm asphalt overlay).

Scenario	Solution
A council received a contributed road asset with minimal earthworks, from a property developer valued at $80/m2. Its asset management plan provides to renew the sealed road pavement by recycling existing pavement base layers (top 50%) at an estimated cost of $20/m2.	**Recognition at Fair Value** – The contributed sealed pavement is recognised as two component assets at fair value, the pavement base expected to be recycled at a future date at a cost of $20/m2 and the pavement sub-base (50% of depth) as 50% of the contributed value ($40/m2). **Useful Life** – The two pavement assets are established with expected useful lives, the pavement base asset being a short lived asset with a life until pavement recycling is planned (40 – 50 years) and the lower pavement asset established with direct reference to the council's planned approach to asset management (e.g. 100 years) **Revaluation** – The pavement base asset is revalued at the cost to replace the service capacity of the asset (cost of planned renewal by recycling $20/m2) – the modern equivalent asset. The pavement sub-base is revalued to the cost to replace the asset ($40/m2).
A council has an existing road that was renewed by recycling and stabilising the pavement base (top 150 mm 40 years ago. The asset management plan shows the pavement is to be fully reconstructed in 5 years' time. The cost of the pavement reconstruction is estimated at $80/m2.	**Recognition at Fair Value** – The pavement was recognised as two component assets; the pavement base valued at $20/m2 a useful life of 50 years and the pavement sub-base valued at $40/m2. **Useful Life** – the pavement base asset was established with expected useful lives, the pavement base asset having a useful life of 50 years and the pavement sub-base with a useful life of 100 years. **Revaluation** – The pavement base asset is revalued at the cost to replace the service capacity of the asset (cost of planned reconstruction $40/m2 – 50% of $80/m2) – the modern equivalent asset. The pavement sub-base is revalued to the cost to replace the asset ($40/m2). The useful lives are changed to reflect the change in expected useful life made by the decision to reconstructs the pavement in 5 years' time. The useful life of the pavement base is changed from 50 – 45 years. The useful life of the sub-base is changed from 100 years to 45 years.

6.4 Summary

This literal view of residual value is not supported by the Accounting Standards that clearly suggest that residual values are appropriate for use when a council can obtain an amount on disposal, e.g. fleet and plant.

The values placed on residual values should reflect estimated amounts that could be obtained at the time of disposal of the asset. In this way, the depreciable amount for assets that have typically shorter useful lives and an active market for disposal will reflect the economic benefit to be consumed by the council over the useful life of the asset.

Residual values have been used to recognise 'optimal' renewal practices by asset managers. This is where the estimated cost to replace the service capacity of an asset is less than the cost to replace the asset. It is good management practice to develop low cost renewal treatments to ensure services can continue to be provided where needed in the most cost-effective manner.

Recognition of 'optimum' renewal values in lieu of recognising a residual value can be achieved in two steps:

1. Componentisation – to recognise assets as separate components that have different useful lives identified by planned renewal practices, AND
2. Revaluation based on modern equivalent assets – value assets at the cost to replace the service capacity of the asset being the next planned renewal of the asset in the organisation's asset management plan.

Revaluation with values based on a modern equivalent asset recognises the asset value based on the council's estimate of the resources required to provide the level of service agreed with its community, as detailed in its asset management plans.

This approach will provide more accurate information for asset renewal planning and financial reporting.

6.5 Recommendations

3. Residual values for property, plant and equipment assets be recognised only where the estimated amount to be received from disposal of the asset is greater than the costs of disposal of the asset.

4. Assets subject to planned 'optimal' renewal methods be componentised to recognise the different useful lives estimated for each part of the asset. The componentised assets be revalued as modern equivalent assets being the cost that is required currently to replace the service capacity of an asset.

7. USEFUL LIVES AND REMAINING USEFUL LIVES

7.1 Introduction

AASB 116 Property, Plant and Equipment defines useful life as:

(a) the period over which an asset is expected to be available for use by an entity; or

(b) the number of production or similar units expected to be obtained from the asset by an entity.

Further, the Standard states that:

'The future economic benefits embodied in an asset are consumed by an entity principally through its use. However, other factors, such as technical or commercial obsolescence and wear and tear while an asset remains idle, often result in the diminution of the economic benefits that might have been obtained from the asset. Consequently, all the following factors are considered in determining the useful life of an asset:

(a) expected usage of the asset. Usage is assessed by reference to the asset's expected capacity or physical output.

(b) expected physical wear and tear, which depends on operational factors such as the number of shifts for which the asset is to be used and the repair and maintenance programme, and the care and maintenance of the asset while idle.

(c) technical or commercial obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or service output of the asset.

(d) legal or similar limits on the use of the asset, such as the expiry dates of related leases.

The useful life of an asset is defined in terms of the asset's expected utility to the entity. The asset management policy of the entity may involve the disposal of assets after a specified time or after consumption of a specified proportion of the future economic benefits embodied in the asset. Therefore, the useful life of an asset may be shorter than its economic life. The estimation of the useful life of the asset is a matter of judgement based on the experience of the entity with similar assets.'

This section of the report discusses the importance of the establishment and ongoing review of the estimated useful lives of the assets of councils.

7.2 Discussion

The establishment of a useful life and remaining useful life is directly related to a council's capitalisation and maintenance definitions and policies.

The capital or maintenance discussion continues to lack clarity, with many councils still making decisions based on funding source or expenditure value. To promote greater consistency, the following simple principles generally apply:

- when an asset is purchased or constructed, it has at that time an expected useful life to the council.
- reaching that useful life assumes a certain level of repairs and maintenance over the life of the asset.
- expenditure on an existing asset to support it in reaching its useful life is recurrent / operational expenditure.
- expenditure on an existing asset that increases its useful life is renewal capital expenditure.
- expenditure that renews service potential and restores useful life is capital expenditure and occurs concurrently with the writing off of the existing asset that is being renewed /replaced.

If an asset is expected to be used by an entity beyond an 'ideal' or preferred replacement timeframe, the extended period is the useful life which should be used.[4]

Depreciation is directly related to the estimated useful life of an asset being managed by a council. Should the useful life not reflect the actual period of use of the asset by the council, depreciation will be either over-stated (useful life too short) or under-stated (useful life too long).

[4] Based on Queensland Treasury, 2012, NCAP 6, p.5.

Sustainability evaluations assess the extent to which a council's planned renewal program approximates depreciation expense over a ten-year period. It is important therefore that the useful lives used to develop the renewal program are also used to calculate depreciation expense.

Useful life should be derived from actual local data where assets have been renewed or show sufficient distress to enable remaining life to be determined. Where this data is not available, organisations need to use the best available estimates of remaining life and asset age to determine useful life. Useful life may be estimated from the elapsed life plus the estimated remaining life of the asset.

Using the sealing and re-surfacing of a road as an example.

An existing road has a two coat flush seal, with the seal regarded as a separate asset in the asset register with a useful life of 15 years. The asset management plan indicates that the road seal will be resealed every 18 years to maintain a satisfactory level of service and on this basis, the seal asset has a useful life of 18 years.

Expenditure on the seal to ensure that it reaches its estimated useful life of 18 years is maintenance. The renewal /replacement of the seal is capital expenditure, as it renews/extends the estimated useful life of the asset.

The asset manager determines that the most appropriate estimate of useful life is 18 years based on a satisfactory level of service and in conjunction with the finance manager, changes the useful lives of two coat flush seal assets from 15 years to 18 years in the asset register.

7.2.1 Road Earthworks

In other cases, councils are also seeking to regard assets such as road earthworks as a non-depreciable asset. Unfortunately, this practice does not allow for any potential future obsolescence of the asset.

Urgent Issues Group Interpretation UIG 1055 Accounting for Earthworks provides guidance on consideration of obsolescence for earthworks assets.

- Some roads and the associated earthworks may have limited useful lives due to the connection to an operation or activity (such as a mine) with a limited useful life. These roads would become obsolete when the activity reached the end of its useful life.
- Commercial obsolescence occurs as the asset become redundant due to a fall in demand for its services. For example, road earthworks may become obsolete when a road is realigned or is replaced by a new access or bypass road.

Councils are required to identify which of the road earthworks are depreciable and which are non-depreciable as a result of the similarities between land and certain types of earthworks. Examples include:

Any assessment that certain road earthworks do not have a limited useful life is to be based on engineering reviews of the estimated useful life of earthworks, including expected physical deterioration and technical obsolescence and after consideration of commercial obsolescence factors.[5]

The process of establishing useful lives and remaining useful lives must assess and consider any planned obsolescence of an asset. Depreciation generally deals with gradual declines in the value of existing capital assets due to aging. Unexpected obsolescence on the other hand, generally reflects a sudden and sharp decline in the value of these assets that may result from events such as the introduction of new assets that are based on a superior technology.

For road assets, planned obsolescence can occur when a council, or other authority, determines that a road is incorrectly located to cater for planned developments in the connecting area. Figure VI shows an example of planned obsolescence of road earthworks when an existing highway is realigned leaving the earthworks assets of the existing highway alignment to be depreciated over their expected remaining useful life.

[5]. AASB UIG Interpretation 1055 Accounting for Road Earthworks.

Figure VI: Planned Obsolescence of Road Earthworks due to Realignment of Bass Highway, Sisters Hills.

7.2.2 Estimates of Useful Life

Table 5 provides a range of estimated useful lives for road related infrastructure components.

Table 5: Estimated Useful Lives of Roads Related Infrastructure

Infrastructure Component	Lower Estimate (yrs)	Upper Estimate (yrs)
Road earthworks in the nature of land	Non-depreciable	
Road earthworks assessed as depreciable	Subject to individual assessment	
Road pavement (non-componentised)		
- Arterial Roads	30	50
- Collector Roads	40	60
- Local Roads	50	100
Road pavement base		
- Arterial Roads	30	50
- Collector Roads	30	60
- Local Roads	50	100
Road pavement sub-base^		
- Arterial Roads	50	80
- Collector Roads	60	100
- Local Roads	80	100
Road flush seals	10	30
Road asphalt surfacings	20	30
Concrete bridges	60	100
Timber bridges	20	50
Road kerb and channel	50	80
Road culverts	50	100
Streetscapes	10	50
Paved footpaths	50	80
Sealed footpaths	20	30

Note: ^ where pavements are managed as separate components.

The table provides an expected range of useful lives for road asset components. While this provides a useful guide, the individual circumstances of councils and specific assets may lead to the establishment of useful lives outside of these parameters. Councils should document the evidence and assessment used to establish the expected useful lives and remaining useful lives for assets assessed as having a useful life beyond the expected ranges in Table 5.

The actual estimated useful lives for road infrastructure can vary significantly from these ranges, depending on a variety of factors, including:

- expected service level,
- usage and functionality,
- terrain,
- environmental conditions, and
- original build quality.

7.2.3 Periodic Assessments of Remaining Useful Life Estimates

In practice in local government, the following factors influence the determination of the useful life and remaining useful life of an asset:

- condition of the asset in terms of physical deterioration
- function – an assessment of whether the asset continues to provide the required level of service (LOS) or whether there has been a change in consumer preferences
- capacity/utilisation – an assessment of whether the asset has reached its capacity limit
- cost and efficiency – an assessment of whether the asset has become or is likely to become too expensive to operate
- safety/compliance – an assessment of whether the asset remains safe to use and continues to meet existing legislative requirements
- location – an assessment of whether the asset is now in the wrong place due to changed conditions or other factors
- obsolescence – an assessment of whether the asset is still required or permitted to be used.

The remaining useful life is, together with depreciable amount and depreciation method, one of the key determinants of annual depreciation expense.

The useful life of an asset is defined in terms of the asset's expected utility to the entity. The asset management policy of the entity may involve the disposal of assets after a specified time or after consumption of a specified proportion of the future economic benefits embodied in the asset. Therefore, the useful life of an asset may be shorter than its economic life. The estimation of the useful life of the asset is a matter of judgement based on the experience of the entity with similar assets.[6]

Determination of the useful life of an asset should be based on past experiences and planned replacement programs as outlined in an asset management plan.

If an asset is expected to be used by an entity beyond an 'ideal' or 'optimum' replacement timeframe, the extended period is the useful life which should be used.[7]

The useful life of an asset is to be reviewed at least at the end of each annual reporting period.[8]

The Attachments to this report include an overview of an approach that can be taken to reviewing useful lives.

6. AASB 116.56-57, pp. 23-24.
7. Queensland Treasury, 2012, NCAP 6, p.5.
8. AASB 116.51, p.22.

7.2.4 Obsolescence

The Australian Accounting Standards require a consideration of obsolescence in determining fair value (AASB 13 Fair Value Measurement 13.B9).

Obsolescence can occur as a result of four factors:

1. Technology changes – existing assets may have been designed on the basis of expected access to supporting technologies, e.g. a mobile telephony 2G service.
2. Regulatory changes – Technical standards used to design the asset have been upgraded and the existing asset no longer meets the technical standards.
3. Social or economic changes – consumer preferences may evolve to demand products based on clean energy, making existing dirty energy products obsolete. Price shifts also influence consumer behaviors and a significant drop in demand can make a service obsolete.
4. Changes in values or behaviours of users or owners – an existing asset may be functionally fit for purpose but consumer preferences have evolved and patronage has declined sharply. Business demands can mean that a system designed for 98% service availability is made obsolete when users demand 99% service availability.

Obsolescence represents an inability to meet changing performance requirements for infrastructure.

7.2.5 Condition Assessments

UIG 1030 established that condition assessments are not a substitute for the depreciation of an asset in accordance with the Accounting Standards.

As noted previously, condition is one factor among many others that is used to determine the remaining useful life of an asset.

The UIG consensus can be expressed as a series of statements on the expectations of UIG. These are:

Depreciation is to be calculated with direct reference to the depreciable amount,

Depreciation expense is to be determined with consideration of technical and commercial obsolescence, such as potential changes in consumer demand, and related factors which can influence the consumption or loss of future economic benefits during the reporting period,

Expenditure on maintenance is to be separately identified and expensed,

Expenditure that enhances an asset is to be separately identified and capitalised,

The major components of complex assets are to be identified and depreciated separately to reliably determine the depreciation expense of the reporting period.

There is often confusion about the use of asset condition as a measure of depreciation. Condition is a measure of asset deterioration often measured by the number of defects or failures or by visual assessment of the appearance of the asset against images of standard condition. Condition assessment systems vary from very detailed video recording of roads, automatic identification of distress types and extent and analysis to produce detailed condition assessment reports and recommended actions, to visual assessment against condition definitions and images and in some cases individual assessments.

The condition assessment system used depends on the needs of individual organisations and available resources. Consistency in condition assessments over time varies with objective assessment methods (measurements using defined criteria) that are generally more consistent than subjective methods (visual assessment using condition definition/pictures).

Condition information is used in technical management systems to predict the time until a certain condition intervention point is reached and for planning maintenance, rehabilitation and replacement of items of property, plant and equipment.

Condition systems for road assets generally measure (or estimate) the number of surface defects (potholes) and pavement defects (rutting, shoving, cracking, etc.). As the road assets age, the number of defects increases at an increasing rate due to wear and tear from usage of the asset.

Condition measures physical defects in the asset. Condition has a limited relationship with asset consumption which measures the consumption of future economic benefits embodied in the asset.

For councils, the future economic benefits from infrastructure assets are the provision of goods and services in accordance with the council's objectives.

Condition, however can be used to predict remaining physical life of an asset and as input into determining the useful lives of assets. There is however no direct relationship between asset condition and the value of depreciation. The straight line depreciation method is appropriate for the majority of local government assets as these assets generally have a constant rate of consumption over the estimated useful lives. The rate at which the future economic benefits are consumed is an entirely different concept to an ongoing assessment of the condition of the asset.

There are a number of condition rating and grading systems. The Institute of Public Work Engineering Australasia (IPWEA) has adopted the 1 (very good) to 5 (very poor) condition grading from the International Infrastructure Management Manual. Table 6 shows the condition grading.

Table 6: IPWEA National Condition Grading

Condition Grading	Description of Condition of the Asset
1	**Very Good:** only planned maintenance required
2	**Good:** minor maintenance required plus planned maintenance
3	**Fair:** significant maintenance required
4	**Poor:** significant renewal/rehabilitation required
5	**Very Poor:** physically unsound and/or beyond rehabilitation

IPWEA is promoting the 1-5 condition grading as a national grading for reporting asset condition trends at State and National levels.[9] Councils and other organisations are encouraged to use the most appropriate condition assessment systems for their needs but be able to report condition of assets in a nationally consistent manner, being the 1 (very good) – 5 (very poor) gradings.

The Australian Local Government Association has adopted the 1-5 grading for its National State of the Assets reporting of infrastructure condition, function and capacity/utilisation.[10]

[9.] IPWEA, 2012, Table 6, p. 31.
[10.] ALGA, 2012, Table 3.1, p.10.

7.3 Scenario Treatments – Useful Life

A number of different scenarios associated with current and emerging practice in local government are shown in Table 7 with proposed solutions that are consistent with Australian Accounting Standards.

Table 7: Scenario Treatments - Useful Life

Scenario	Solution
A council has been asked to take over responsibility for an access road through mountainous country serving a new mine. The mine has an expected life of 20 years.	**Recognition at fair value** – Assets are identified at component level and recognised at their fair value (brownfield current replacement cost) **Useful life** – All road assets are established with expected useful lives.
A council has been asked to take over responsibility for a new access road serving a new rural residential subdivision.	**Recognition at fair value** – Assets are identified at component level and recognised at their fair value (brownfield current replacement cost) **Useful life** – Two pavement assets and road seal asset are established with expected useful lives. Earthworks assets is established with unlimited useful life as the earthworks serving the new road will be required to provide access to new residents for the foreseeable future.
A council's local road is to be closed following construction of a new State Highway bypass of a town.	**Useful life** – The road pavement and seal assets were established with expected useful lives when recognised. The earthworks asset was established with an unlimited useful life when recognised. The council reviews the expected remaining life to road closure and changes the useful life of all assets to reflect the expected remaining useful life.
A council has 30% of its road sealed surface assets fully depreciated.	**Useful life** – the council uses an 'industry standard' useful life of 10 years for road sealed surfaces. Funding availability allows resurfacing at an average 18 year cycle, to provide an acceptable level of service. The council reviews the expected useful life of sealed surfaces and changes the useful life of sealed surfaces to reflect the actual useful life of 18 years.

Scenario	Solution
A council has to consider obsolescence factors in determining expected useful life of road assets.	**Useful life** – the council develops an obsolescence consideration procedure for road assets as: Technological changes Are there any technology factors (new technology, quality, availability, etc.) affecting remaining useful life of road assets such as pavement materials, bitumen, timber bridge materials (bridges cannot be maintained), availability or quality changes, etc.? Regulatory changes Is there any regulatory change affecting remaining useful life of road assets such as increase in vehicle load limit and heavy vehicle access approved routes (road pavements widths and capacity), increased lighting standards (existing lighting becomes non-compliant), etc.? Social or economic changes Are there any social or economic factors affecting remaining useful life of road assets such as changes to heavy vehicle access routes, availability of additional funding for upgrade of existing assets, lack of funding to maintain existing assets necessitating closure and/or disposal of an asset? Changes in values or behaviour of users or owners Are there any changes in values or behaviours affecting remaining useful life of road assets such as community demands for upgrade of existing assets, change in operating systems by major transport operator (e.g. upgrade to B Double milk trucks or closure of operations), changes in agricultural land usage from grazing to intense cropping, etc.

7.4 Summary

The depreciable amount of road earthworks that have limited useful lives are to be allocated on a systematic basis, based on best estimates of those useful lives. Difficulty in estimating the useful life of an asset does not justify non-depreciation of the asset.

The assessment of useful life is to be based on engineering reviews of the expected physical wear and tear and technical obsolescence of the particular earthworks and on consideration of commercial obsolescence and legal or other limits on the use of the earthworks.

Useful lives should be assigned to all infrastructure related assets with the exception of land and certain earthworks with the characteristics of land.

Extremely long useful lives can be assigned to assets in order to adequately allow for potential future obsolescence.

An expected range of useful lives for road asset components can be established. While this does provide a useful guide, specific assets may lead to the establishment of useful lives outside of these parameters. Councils should document the evidence and assessment used to establish the expected useful lives and remaining useful lives to justify and substantiate the determination of useful lives.

Useful lives must be reviewed annually to ensure that the value of depreciation calculated and recognised remains relatively accurate and to support ongoing renewal planning.

Management assessments and decisions which impact the general purpose financial statements should be supported by appropriate and sufficiently reliable, precise and detailed documentation.

Condition information is used in technical management systems to predict the time until a certain condition intervention point is reached and for planning maintenance, rehabilitation and replacement of items of property, plant and equipment. Condition measures physical defects in an asset. Condition is not a direct measure of consumption of future economic benefits of an asset.

Condition, however can be used to predict remaining physical life of an asset and as input into determining the useful lives of assets.

Councils use many method of assessing condition depending on their needs and resources. The 1 (very good) to 5 (very poor) condition grading methodology adopted by the Institute of Public Works Engineering Australasia[11] and Australian Local Government Association[12] provide a national consistent methodology for reporting condition of infrastructure assets at individual council and aggregated State and national levels.

7.5 Recommendations

5. **Useful lives should be assigned to all infrastructure related assets with the exception of land and certain earthworks with the characteristics of land. The assessment of useful life should be based on engineering reviews of expected physical wear and tear and technological and commercial obsolescence of the asset.**

6. **Useful lives should be reviewed annually to ensure that the value of depreciation calculated and recognised remains relatively accurate and to support ongoing asset renewal planning.**

7. **Road earthworks assets established with an unlimited useful life should be reviewed annually for obsolescence and if any earthworks asset is assessed as having a remaining useful life, changes be made to recognise the remaining useful life.**

8. **The condition of assets is only one of several factors that should be used to predict the remaining life of assets used for calculating depreciated replacement cost and depreciation. Condition should not, on its own be used to directly determine the value of depreciation or depreciated replacement cost.**

9. **Councils should adopt a consistent, systematic methodology to grade and report on the condition of infrastructure.**

[11] IPWEA, 2012, Table 6, p. 31.
[12] ALGA, 2012, Table 3.1, p. 10.

8. DEPRECIABLE AMOUNT AND DEPRECIATION METHODS

8.1 Introduction

As previously observed, the establishment of the depreciable value of an asset is a primary concern of asset managers and finance managers. The value of the depreciable amount is achieved through separate considerations of current replacement cost and estimated residual value.

Current replacement cost and residual values have been discussed previously in this report.

Methods of depreciation are related to the pattern of consumption associated with individual assets and that is the primary focus of the discussion in this section of the report.

8.2 Discussion

In accordance with Australian Accounting Standards, the depreciable amount of an asset is to be allocated over asset's useful life in a manner reflecting the pattern of consumption of future economic benefits. The recognition of this consumption is referred to as depreciation.

A class of property, plant and equipment is a grouping of assets of a similar nature and use in a council's operations. Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately.

The *depreciable amount* of an asset shall be allocated on a systematic basis over its useful life.

Depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated.

The future economic benefits embodied in an asset are consumed by an entity principally through its use. However, other factors, such as technical or commercial obsolescence and wear and tear while an asset remains idle, often result in the diminution of the economic benefits that might have been obtained from the asset. In many cases, a diminution of future economic benefits is recorded as a change in useful life. Useful life and changes to useful life are discussed in Section 7.

The depreciation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed.

The key elements associated with the financial accounting for infrastructure assets and in calculating depreciation expense are:

- Asset value/current replacement cost – the asset cost is estimated using the dimensional information in the asset register inventory and the unit rate for replacement/renewal of the particular asset e.g. for a footpath, the dimension would likely be the area in square metres, and the unit rate would be the $/m2 rate for construction. Dimension multiplied by the unit rate will provide the asset cost.
- Useful Life – the period over which an asset is expected to be used by the council and its economic benefits consumed.
- Estimated Remaining Useful Life – The time remaining until an asset ceases to provide the required service level or economic usefulness. Age plus estimated remaining useful life is estimated useful life.
- Residual Value – The estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.
- Pattern of Consumption – The pattern of consumption of the economic benefits (depreciation method) must reflect the pattern in which the future economic benefits are expected to be consumed by the council.

The consumption of benefits is unrelated to the physical condition or age of an asset and is associated with the role or utility of the asset. If the purpose/role of a road asset is to allow

motorists to travel a segment in safety at a specified level of service for a period of 12 years, the asset manager must assess the pattern associated with the consumption of this benefit by motorists (i.e. usage of the road by motorists). If the pattern of consumption is constant, the straight-line method of depreciation is appropriate.

Where the pattern of consumption is not linear, or roughly equal over time, then an alternative depreciation method may be appropriate.

Other methods may be used where the consumption is related to the productive activity of the asset (e.g. the asset is capable of producing 10 000 widgets and annual depreciation is related to the number of widgets produced) or accelerated methods that recognise a greater proportion of depreciation early in the life of the asset with the rate of depreciation slowing as the asset ages.

Information Technology (IT) assets for instance has better functionality in the early years and also become obsolete relatively quickly due to technological developments. Using an accelerated depreciation method such as reducing balance to depreciate IT equipment would ensure that higher depreciation is charged in the earlier years of its operation.

The asset consumption (for a straight line pattern) is represented in Figure VII.

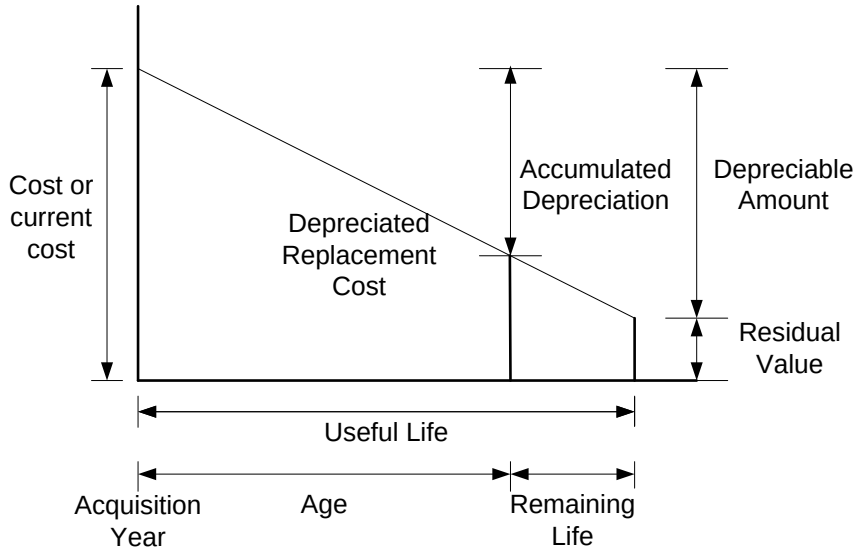


Figure VII: Asset Consumption Methodology for Straight Line Depreciation Pattern.

8.3 Summary

Asset managers recognise that a large proportion of an asset may be, in effect, non-depreciable. While aspects of the asset may appear non-depreciable, potential future obsolescence must be considered and factored in to current thinking. This is achieved by using componentisation and placing very long estimated useful lives on those components believed to be effectively non-depreciable, e.g. 100 years considering obsolescence.

Land, and earthworks with the characteristic of land, are the only assets that should be recognised as non-depreciable assets.

The approach recommended allows asset managers to effectively manage assets while also ensuring that the associated financial accounting is consistent with Australian Accounting Standards, by appropriate consideration of current replacement cost, residual values, componentisation, estimated useful lives and obsolescence.

The depreciation or non-depreciation of road earthworks is to be reviewed at least each year, to ensure depreciation of the assets reflects the most recent assessment of the useful lives of the earthworks assets.[13]

Realignment of roads is an infrequent event, generally limited to major highways and arterial roads subject to significant growth. Most local roads will never be realigned due to acceptable vertical and horizontal alignment, low traffic growth and limitations on funding.

The depreciation method chosen must reflect the pattern in which the future economic benefits are expected to be consumed by the council.

The consumption of benefits is often not directly related to the physical condition or age of an asset and is more associated with the role or utility of the asset. The consumption of future economic benefits is related to the consumption of service potential and not to the physical condition of assets.

If the pattern of consumption is relatively constant, the straight-line method of depreciation is appropriate. Where the pattern of consumption is not linear over time, then an alternative depreciation method may be appropriate.

Councils should assess the depreciation method on a periodic basis to ensure it continues to represent the underlying pattern of consumption of the economic benefits of the assets.

8.4 Recommendations

10. **Assets that have an expected useful life should be depreciated over the estimated useful life in a manner that represents the pattern of consumption of future economic benefits embodied in the asset. The consumption of future economic benefits is related to the consumption of service potential and not to the physical condition of assets.**

11. **The depreciation method should be assessed annually to ensure that it continues to represent the underlying pattern of consumption of future economic benefits embodied in the asset.**

9. CURRENT AND EMERGING ASSET MANAGEMENT PRACTICES

9.1 Derecognition of Replaced and Disposed Assets

An emerging concept is council's continuing to recognise an asset with a useful life where there is evidence that the asset has been disposed of and should otherwise have been written off. This is occurring with pavement seals, where a single coat reseal is applied to replace a two-coat seal when the second seal reaches the end of its estimated useful life. There is evidence that councils are continuing to recognise the initial two coat seal as an operational asset with a remaining useful life and also recognising the single coat reseal as a discrete asset.

Asset managers may believe that the application of the new seal at the optimal time in the life of the road asset, which is prior to the expiration of the useful life of the existing second seal, is more effective asset management and prolongs and extends the life of the overall road asset.

It is difficult to assess the initial two coat flush seal as an operational asset once the single coat reseal is applied. If the initial two coat seal had any remaining future economic benefits, it would not need to be resealed. A road seal has no remaining future economic benefits once it is replaced with a reseal. The initial two coat seal should be derecognised (written off) as an asset when the reseal is applied.

[13] AASB, UIG Interpretation 1055 Accounting for Road Earthworks.

9.2 Recognition of Road Re-Sheeting

Whether road re-sheeting costs are to be capitalised or expensed depends in part on the asset management practice of each council as documented in the associated asset management plan.

Resheeting practices of Circular Head Council are illustrated below.

Unsealed roads are resheeted based on need, as identified in the Council's defect inspections. Prioritisation is based on defects analysis. These include potholing, loss of material, loss of shape and crossfall. Resheets start with light tyning of the unsealed surface, placement, trimming and compaction of a 50 mm wearing surface. Resheets are not consistent over a road segment and have a life of 3 – 5 years. Resheet budget is $850 000 for 476 km of unsealed roads. Resheeting is scheduled to include roads requiring resheeting within 12 months to minimise travel and establishment costs.

Unsealed road prior to resheeting.

Partially completed resheet, final trimming and compaction delayed by rain, to be completed when material dries.

Re-sheeting of a road that is not considered to extend or renew the useful life of the road should be considered to be maintenance. If however the re-sheeting extends or renews the useful life it would be regarded as capital and the existing asset renewed or replaced would be written off. The consideration should be:

1. Is the expenditure part of the maintenance profile of the asset to allow it to reach its estimated useful life? If so, the expenditure is maintenance, regardless of value.
2. Does the expenditure meet the capitalisation threshold, extend the useful life of the asset or renew the economic benefit (productive capacity) associated with an existing asset? If so, the expenditure is capital. If not, it is maintenance.

9.3 Scenario Treatments – Rural Road Resheeting

Table 8: Scenario Treatments - Unsealed Road Resheeting

Scenario	Solution
A council undertakes resheeting of its extensive unsealed road network on a planned cycle of resheeting unsealed road segments on a 5, 10 or 15 year cycle based on usage. Annual expenditure is >$500 000.	**Recognition at Cost** – The resheeting cost is recognised as a new asset. The carrying value of the replaced resheet asset is written off. **Useful life** – The new resheet asset is established with an expected useful life based on usage.
A council undertakes resheeting of its small length unsealed road network on a planned cycle of 3 – 5 years. Resheeting is applied to areas of segments as required. Annual expenditure is in the order of $50 000.	**Recognition at Cost** – The resheeting cost is recognised as part of a new network asset for all resheets undertaken in the reporting period. Location and details of resheets are recorded in a technical road resheets system. **Useful life** – The annual resheet network asset is established with an average useful life of 4 years. A new network asset is established for each reporting period and the existing network asset is written off.
A council's gravel sheeted unsealed roads are constructed of a 200 mm gravel pavement and 100 mm gravel wearing surface (sheet). Unsealed roads are resheeted over a 5 – 10 year cycle that requires very little repair/correction work to the pavement.	**Recognition at Cost** – The unsealed road is recognised as two component assets at their cost, the 100 mm wearing surface expected to be resheeted at a future date and the pavement. **Useful Life** – The two unsealed road assets are established with expected useful lives, the wearing surface component asset being a short lived asset with a life until resheeting is planned (5- 10 years) and the pavement asset established with direct reference to the council's planned approach to asset management (e.g. 100 years). If the long useful life estimate is based on the expectation of certain maintenance activities, this must be documented. Should these expected maintenance activities not occur as planned, the estimated useful life will require immediate revision.

Recognising resheeting as a network asset is a matter of judgement that depends on the management approach, materiality and cost/benefits circumstances specific for each council. Resheets should be recognised as a component asset of a road segment, similar to sealed wearing surfaces and pavements, however a council may choose, on the basis of materiality and cost/benefit

considerations, to recognise a network asset for relatively small resheeting expenditure in the reporting period. Three examples are shown below as guidance.

1. A council has a relatively small ($50 000) annual expenditure on resheeting unsealed roads carried out with road maintenance grading. Resheeting expenditure in a year is recognised as capital expenditure on a network asset established for resheeting work carried out in the financial year. Each year's network asset is depreciated over the estimated useful life for resheeting.
2. A council has a small to medium level of annual expenditure on resheeting unsealed roads carried out on a 3 year and 6 year cycle for major (e.g. collector/feeder) and minor (e.g. local/other) unsealed roads respectively. The council recognises resheeting expenditure in a year as two network assets established for major and minor unsealed roads. The major road resheeting network asset is depreciated over its useful life of 3 years and the minor road resheeting network asset is depreciated over its 6 year useful life.
3. A council has a relatively large annual expenditure on resheeting unsealed roads. Resheeting expenditure is currently expensed as maintenance. The council resolves to capitalise resheeting expenditure as a two-step process, initially as a single network asset depreciated over its estimated useful life and will move toward recognition as a component asset of the road asset segment over a two year period.

9.4 Revaluation Frequency

For assets recorded at fair value, revaluations are to be made with sufficient regularity to ensure that the carrying amount does not differ materially from that would be determined using fair value at the end of the reporting period.[14]

The extent to which currently recorded current replacement costs differ from fair value measurements on an annual basis can be difficult to assess without undertaking a complete independent valuation process. Fair value measurement requires that the local market values for replacement costs, including unit costs, be based on the market specific to the council.

The need to revalue assets is related to the financial impact associated with recognising or not recognising the financial impact on the Statement of Financial Performance. Depreciation expense is a primary component of the asset sustainability ratio and as a significant component of council operating statements, has a key influence on the operating surplus ratio. It is important therefore from a financial sustainability perspective that depreciation expense is regarded as reasonably accurate.

Depreciation expense for most councils represents 1.5% to 2% of the gross current replacement cost of the infrastructure base.

Rather than establishing a standard approach for all Tasmanian councils, a methodology that utilises standard indices tailored to local markets would achieve consistency with the fair value requirements. The frequency of the revaluations would be dependent on each council's financial position and the materiality of the impact on the operating surplus. This would be based on:

1. The council's gross current replacement cost of infrastructure assets
2. The historical average rate of depreciation for the council
3. The projected annual operating surplus
4. The aggregate value of all depreciation not recognised since the previous revaluation

Councils can identify the frequency of the revaluations based on the long term financial plan forecasts and expected movement in indices. An annual review would determine whether any change to the frequency was required.

[14] AASB, 116.31 p.19.

9.5 Relevant Indices

Councils have access to many indices to test for fair value revaluation. Councils should select the most appropriate index for their circumstances from the following:

1. Council internal estimating rates for standard items
2. Australian Bureau of Statistics (ABS) 6427 Producer Price Indexes, Australia
3. Bureau of Infrastructure, Transport and Regional Economics (BITRE) Road Construction and Maintenance Cost Index
4. Local Government Association of Tasmania (LGAT) Council Cost Index
5. Commercial cost indexes including Rawlinson's Construction Cost Guide and The Building Economist Building Cost Index

9.6 Scenario Treatments – Revaluation Indices

Table 9: Scenario Treatments - Revaluation Indices

Scenario	Solution
A council has reviewed the available cost indices appropriate to its asset base and has determined that on average, the current replacement cost should increase by 3%.	**Current replacement cost** – Council to estimate the value of the increase in depreciation if the revaluation is undertaken and consider this in terms of impact on operating surplus /deficit. If the impact is material, the revaluation should occur.

9.7 Revaluation Process

The process of revaluation involved determining the carrying value and depreciation expense for individual assets. This involves determining:

- Replacement cost (asset quality x unit valuation rate based on local market conditions)
- Residual value (net amount received from disposal of the asset at expected age and condition at end of life)
- Depreciable amount (replacement cost less any residual value)
- Useful life (period that the asset is expected to be available for use – must be greater than asset age)
- Asset age (current year less year acquisition)
- Accumulated depreciation (depreciable amount divided by useful life multiplied by asset age)
- Depreciated replacement cost (replacement cost less accumulated depreciation)
- Annual depreciation (depreciable amount divided by useful life.

The valuation calculation methodology (using a straight line pattern) is illustrated by Figure VIII.

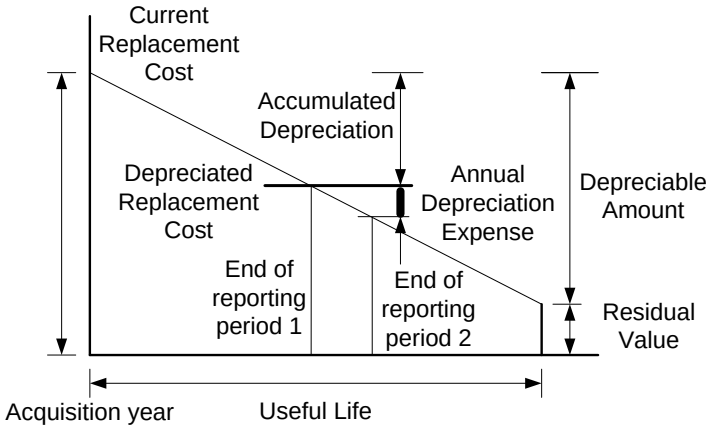


Figure VIII: Valuation Calculation Methodology using a Straight Line Pattern

Details of valuation methods for infrastructure assets are contained within Section 12.15 Valuation Methods of the Australian Infrastructure Financial Management Guidelines.[15]

9.8 Summary

Infrastructure assets are to be recognised when the asset is placed into service. Infrastructure assets should therefore be derecognised when the asset is replaced or renewed at the end of its expected useful life. Otherwise, there is the risk of asset being duplicated in the asset register.

Road assets including road surfaces/seals should be derecognised (written off) when the surface/seal is replaced at the end of its useful life.

Resheeting of unsealed roads can be capitalised by either recognition as an individual asset or by recognition of resurfacing undertaken in a reporting period as a network asset for councils with a relatively small expenditure on resheeting unsealed roads. A new asset can be created for each reporting period (e.g. resheeting in 2013-14), and the network asset derecognised at the end of its useful life. A council may choose to establish separate network assets to recognise different unsealed roads resheeting management practices (e.g. major roads resheeted on a 3 year cycle, minor roads resheeted on a 6 year cycle). Network assets could also be used to recognise resheeting expenditure as an asset as a first stage to recognising resheets as a component asset of a road segment.

Assets recognised at fair value under the revaluation model option in AASB 116 Property, Plant and Equipment must be carried at a revalued amount. Revaluations shall be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period.[16]

Councils should adopt a revaluation policy defining the criteria to be used in determining whether the carrying amount differs materially from that determined using fair value at the end of the reporting period. The policy should include the method of assessing fair value that can include the indices detailed in Section 9.4.

Valuation methods should be reviewed to determine whether they allocate the depreciable amount of an asset over its useful life in a manner that reflects the pattern of consumption of future economic benefits. Methods based on condition assessments may not follow this methodology.

15. IPWEA, 2009, Sect 12.15, pp.12. 78-97.
16. AASB 116.31, p.31.

9.9 Recommendations

12. Road and other assets be derecognised (written off) when the asset is replaced or renewed.

13. Councils:

- **recognise resheeting of unsealed roads as capital expenditure**
- **with a relatively small expenditure on resheeting unsealed roads should consider capitalisation of unsealed road resheeting as a network asset(s) for resheeting completed in the reporting period**
- **the network asset(s) for each period should be depreciated over the estimated useful life and derecognised at the end of the useful life.**

14. Councils should prepare and adopt a policy for revaluation defining the criteria to be used in determining whether the carrying amount differs materially from that which would be determined using fair value at the end of the reporting period. The policy should include the method of assessing fair value and source information to be used.

10. AREAS OF REGULATORY SUPPORT

Australian Accounting Standard AASB 116 Property, Plant and Equipment requires an annual review of useful life, residual value and depreciation method. AASB 136 Impairment of Assets requires 'An entity shall assess at the end of each reporting period whether there is any indication that an asset may be impaired.' (AASB 136.9)

Sec 12.10 of the Australian Infrastructure Financial Management Guidelines[17] (AIFMG) details a methodology to estimate asset useful lives based on sampling assets nearing the end of the estimated useful life and assessing the remaining useful life.

AIFMG Section 14.5 contains a template to document the useful life determination and provide evidence of the review of useful life for audit purposes.

At this time, Tasmanian councils may not appreciate the need for, or usefulness of, annual reviews of current replacement cost, residual values and remaining useful lives. It is evident that some councils associate the review of these estimates with the periodic independent revaluation process undertaken every five years.

It is also evident that some asset managers regard useful life as the original design life, possibly without an appreciation of the broader implications of the assessment of useful lives on depreciation and financial sustainability evaluations.

While the Accounting Standards mandate such a review, further encouragement through the use of Government regulation may be necessary, in the form of a mandatory requirement for a review of all infrastructure related estimates to be undertaken annually, and approved by the Council General Manager. The rationale and documented support for any decision to revalue or not revalue should be part of the schedule provided.

The current componentisation and hierarchies used by councils may not be adequate for current asset management practices. In some cases, this has led to the use of non-compliant approaches to the valuation of residual values as a means of determining the depreciable amount used to calculate depreciation expense.

While a common and consistent approach to asset categorisation may be useful for financial accounting and reporting purposes, in practice it is more useful for asset managers to be able to pursue effective and efficient asset management practices supported by asset management systems.

[17] IPWEA, 2009.

A detailed regulatory approach to asset categorisation would be likely to result in the separation between the financial asset register and asset management systems becoming greater.

In order for all infrastructure related values to be perceived as reasonably accurate, greater scrutiny of the financial asset register is needed. This can be supported through an increase in the level of scrutiny applied by internal audit functions and audit committees of councils and this can be mandated via Regulation. The outcomes of all annual reviews undertaken by internal audit should be provided to external audit for review and scrutiny.

Another area of regulatory support is in respect of disclosures in annual financial statements or annual reports. In common with other Australian States, disclosures of financial sustainability ratios for the current financial year and nine following financial periods adds significant information and context to a suite of financial statements. As a minimum, the financial statements should disclose, in conjunction with the AASB 116 Property, Plant and Equipment required disclosures, the value of renewal and new/upgrade capital expenditure by asset class for the period.

Management assessments and decisions which impact the financial statements should be supported be appropriate and sufficiently reliable, precise and detailed documentation.

The Tasmanian Audit Office reported on 5 financial indicators to assess council's financial sustainability.

- Operating surplus ratio – the ratio of operating surplus to total operating revenue expressed as a percentage,
- Asset sustainability ratio – the ratio of capital replacement and renewal expenditure to depreciation on existing assets expressed as a percentage.
- Asset renewal funding ratio – the ratio of asset replacement and renewal expenditure accommodated over a 10 year period in a long term financial plan to projected capital renewal and replacement expenditure identified in an asset management plan for the same period expressed as a percentage.
- Road asset consumption ratio – the ratio of depreciated replacement cost to current replacement cost expressed as a percentage.
- Net financial liabilities ratio – the ratio of total liabilities less liquid assets to total operating revenue expressed as a percentage.

In all instances, total operating revenue excludes revenues received for a capital purpose, e.g. capital grants and subsidies.

The ratios 'facilitate comparative assessment between councils and can be used to assess both short-term and long-term financial sustainability. The various ratios and observations reported below are only indicators of performance or of financial position. They should not be considered in isolation'.[18]

Experience in other jurisdictions, indicate three indicators are likely to be of most value for assessing and guiding performance. These indicators are the:

- Operating Surplus Ratio,
- Net Financial Liabilities Ratio,
- Asset Renewal Funding Ratio – preferably determined using a net present value calculation as recommended in the Australian Infrastructure Financial Management Guidelines.[19] Where decision makers are unfamiliar with net present value concepts, the ratio calculated with current values is likely to provide a worthwhile guide.

The Asset Renewal Funding Ratio relies on organisations having reliable asset management and long-term financial plans with reasonable quality data. In the absence of reasonable reliable data, the Asset Sustainability Ratio is recommended as a substitute. As the organisation's asset management matures, the Asset Renewal Funding Ratio will be more appropriate.[20]

18. TAO, 2012, p.30.
19. IPWEA, 2012, AIFMG Version 1.3, p.2.16.
20. IPWEA, 2012, LTFP Practice Note, p. 29-30.

Reporting these ratios in council's financial statements together with explanations of variations from expected benchmarks would provide additional information on financial sustainability to the community.

Annual financial statements currently do not disclose the residual values associated with the reported asset classes. Where residual values are used, the notes to the financial statements should disclose this.

It is also noted that Tasmania intends to implement an integrated planning and reporting regime, in common with other Australian States. It is also noted that Tasmania intends to require a financial management strategy to be developed as a component of the planning and reporting regime.

Financial management strategies need to be developed that draw from integrated approaches to planning, underpinned by a focus on financial sustainability and supported by longer term planning. It is not sufficient for Long Term Financial Plans to present scenarios and forecasts alone. The move to regulate the development of financial management strategies is supported. To ensure that the development of financial management strategies (FMS) are not seen as a planning process separate and distinct from the long term financial plan (LTFP), it is recommended that the LTFP and FMS are developed and released as a single planning document.

10.1 Recommendations

15. Councils should:

- **undertake an annual review of accounting estimates required by Australian Accounting Standards, to be approved by the General Manager. The review is to include the useful life, residual value and depreciation methods applied, whether there is a material difference between the carrying value of assets recorded at fair value with that determined using fair value and whether there are any indications of impairment of assets**
- **provide the General Manager with the rationale and documented support for any action or non-action taken.**

16. Councils should undertake an annual review of the currency and accuracy of asset registers and the General Manager should report the rationale and documented support for any decision to revalue or not revalue to the audit committee and/or the council.

17. The value of capital renewal and capital new/upgrade expenditure by asset class should be disclosed in the annual financial statements.

18. The residual values for infrastructure assets should be disclosed in the annual financial statements.

19. Management assessments and decisions which impact the financial statements should be supported by appropriate and sufficiently reliable, precise and detailed documentation.

20. The five financial ratios to be used to assess the financial sustainability of councils, and explanations of variances from expected benchmarks, should be disclosed in council financial statements are:

- **Operating surplus ratio,**
- **Asset sustainability ratio,**
- **Asset renewal funding ratio,**
- **Road asset consumption ratio,**
- **Net financial liabilities ratio.**

21. An integrated approach to financial management would be supported by the development of financial management strategies in conjunction with the development of the long-term financial plan as a single integrated financial planning document.

11. OTHER MATTERS

11.1 Land Under Roads

AASB 1051 Land Under Roads requires that land under roads acquired after the end of the first reporting period ending on or after 31 December 2007 is accounted for under AASB 116 Property, Plant and Equipment. AASB 116 contains a comparison with the corresponding International Accounting Standard IAS 16 Property, Plant and Equipment.

Land under roads is defined as land under roadways, and road reserves, including land under footpaths, nature strips and median strips.

A review of recognition practices within Tasmania and other States indicates inconsistent application of the Standard. It is rare for any council to recognise land under local roads acquired or controlled prior to 30 June 2008. In some circumstances land under local roads acquired after 30 June 2008 is recognised. In other jurisdictions, the local government sector has relied on State government legislation that indicates State control over land under roads and road reserves and has therefore not recognised any value for land under local roads.

Consistent with the requirements of the Standards, local governments must be able to indicate control over land under local roads and road reserves as a precursor to recognising the assets in the financial statements. Where relevant State legislation exists that may indicate that control lies with the State, the control criteria could be argued as not having been met.

In Tasmania, the relevant State legislation indicates that control lies with the local governments, and therefore councils should value and report land under roads. It is recommended that councils elect to recognise all land under local roads at fair value in accordance with AASB 1051 *Land Under Roads*. To facilitate and simplify the valuation process, councils should liaise with the Tasmanian Valuer-General with the aim of providing councils with a unit value for land under roads controlled by each local government for recognition and disclosure in annual financial statements. This will provide recognised and justifiable values in an efficient manner.

11.2 Proposed Common Road Hierarchy

The Department of Infrastructure, Energy and Resources has defined 5 road hierarchy categories for State Roads in Tasmania.

Table 10: Tasmanian State Road Hierarchy

Category	Title	Function
1	Trunk Roads	The primary freight and passenger roads connecting Tasmania
2	Regional Freight Road	Tasmania's major regional roads for carrying heavy freight
3	Regional Access Road	The main access roads to Tasmania's Regions, carrying less heavy freight traffic than Regional Freight Roads.
4	Feeder Road	Allowing safe travel between towns, major tourist destinations and industrial areas
5	Other Roads	The remainder of the State Roads

The State Road hierarchy categories are based on:

- measured use – for example, road count and survey data;
- current and planned function – including the role in connecting towns, cities, ports and airports;
- trends – such as the projected growth of population centres and changes in road counts over time; and
- strategy – for example, choosing a preferred route between roads that duplicate each other.

The DIER road categories reflect their usage by passenger vehicles, road freight transport and value in supporting cities, towns, tourism, and business.[21]

The majority of local roads would be classified as Category 5 with a small number classified as category 4. A suggested local road hierarchy for Tasmania is shown in Tables 11, 12 and 13.

Table 11: Proposed Local Road Hierarchy

Category	Title	Function Description
6	Local Arterial	Major link for traffic flow within urban areas, between towns, major tourist destinations and industrial areas
7	Local Collector	Link from local arterial roads and local roads
8	Local Street	Access for properties and link to collector roads
9	Local Access	Access for properties
10	Local Minor	Local roads maintained by the local authority
11	Other roads	Other roads not maintained by the local authority
12	Road Reserves	Non-constructed/maintained road reserves

Urban and rural, sealed and unsealed roads are defined by the Tasmania Grants Comission as:

Urban Sealed Road – A road usually but not necessarily within town boundaries, that has predominant frontage development either business or residential, often with kerb and guttering and/or footpath that has a running surface of bitumen in any form (e.g. flush seal or asphalt) or concrete. Note: All streets/roads within town boundaries are not necessarily urban; frontage development is the controlling factor.

Urban Unsealed Road – Any other road, usually with a running surface of gravel, but may include roads on natural surface, whether formed or cleared only (provided always that these latter roads are maintained by Council) that lie usually but not necessarily within town boundaries, that has a predominant frontage development either business or residential, often with kerb and guttering and /or footpath. Note: All streets/roads within town boundaries are not necessarily urban; frontage development is the controlling factor.

Rural Sealed Roads – A road that has a running surface of bitumen in any form (e.g. flush seal or asphalt) or concrete without predominant frontage development either within or outside town boundaries.

Rural Unsealed Roads – Any other road, usually with a running surface of gravel, but may include roads on natural surface, whether formed or cleared only (provided always that these latter roads are maintained by Council) without predominant frontage development either within or outside town boundaries.

[21] DIER, 2006, p.4.

The proposed Tasmanian local road hierarchy should enable further classification of local roads by

- Urban or rural – urban has predominant business or residential frontage development
- Sealed or unsealed – sealed has bitumen or concrete running surface. Unsealed may include natural surface or cleared only maintained by council.
- Maintained by council or not maintained by council.

Tables 12 and 13 show the proposed hierarchy applied to Urban and Rural roads.

The proposed road hierarchy does not include design, construction and maintenance performance criteria due to the variability in size, community priorities and expectations and available resources of Tasmanian councils. The performance criteria should be determined by individual councils to suit their own conditions.

This proposed road hierarchy is developed for consideration by the Local Government Division and consultation with key stakeholders such as the Local Government Association of Tasmania and engineering practitioners to ensure that any adopted local road hierarchy meets the needs of all councils.

11.3 Recommendations

22. Councils recognise the value of all land under roads at fair value in accordance with Australian Accounting Standard 1051 *Land Under Road*s, regardless of when the land was acquired. Councils should approach the Tasmanian Valuer-General to determine and agree a process of valuing land under roads in each municipal area and to facilitate a regular revaluation of land under roads.

23. The Local Government Division consider, after consultation with relevant stakeholders, adopting the proposed local road hierarchy for use by all councils.

Table 12: Proposed Urban Local Road Hierarchy

	Hierarchy Classification						
Parent Classification	**Local Arterial**	**Collector**		**Local Access**	**Other**		
Child Classification	6. Urban Arterial	7. Urban Collector	8. Urban Feeder	9. Urban Local Access	10. Other Minor	11. Other Roads	12. Urban Road Reserves
Function/ Description	Major link for traffic flow within urban areas	Link from local arterial roads and local roads	Access for properties and link to collector roads	Access for properties	Local roads maintained by the local authority	Other roads not maintained by the local authority	Non-constructed/ maintained road reserves
Running surface	Sealed	Sealed	Sealed	Sealed/ unsealed	Sealed/ unsealed	Sealed/ unsealed/ unformed	Unformed
AADT	>10 000 vpd	2 500 - 10 000 vpd	1 500 – 2 500 vpd	<1 500 vpd	<100 vpd		
AADTT / EHV	>1 000 AADTT &/or >10% EHV	250 - 1 000 AADTT or >10% EHV	150 - 1 000 AADTT or >10% EHV	<150 AADTT or <10% EHV	<10 AADTT or <10% EHV		
Carriageway Form	2 lanes	2 lanes	2 lanes	1 or 2 lanes	1 or 2 lanes		
Centerline Marking	Yes	Blind corners only	Blind corners only	None	None		
Heavy Vehicle Route	Yes	Yes	Yes	Local access only	Local access only		

AADT – Annual Average Daily Traffic

AADTT - Annual Average Daily Truck Traffic

EHV – Equivalent Heavy Vehicles (%)

Table 13: Proposed Rural Local Road Hierarchy

	Hierarchy Classification						
Parent Classification	**Rural Arterial**	**Collector**		**Local Access**	**Other**		
Child Classification	6. Rural Arterial	7. Rural Collector	8. Rural Feeder	9. Rural Local Access	10. Other Minor	11. Other Roads	12. Rural Road Reserves
Function/ Description	Major link for traffic flow between towns, major tourist destinations and industrial areas	Link from local arterial roads and local roads	Access for properties and link to collector roads	Access for properties	Local roads maintained by the local authority	Other roads not maintained by the local authority	Non-constructed/ maintained road reserves
Running surface	Sealed/ unsealed	Sealed/unsealed	Sealed/unsealed	Sealed/ unsealed/ unformed	Sealed/ unsealed/ unformed	Sealed/ unsealed/ unformed	Unformed
AADT	> 1,500 vpd	>500 - <1,000 vpd	>200 – <500 vpd	<200 vpd	<50 vpd		
AADTT / EHV	>300 AADTT &/or >20% EHV	100 - 300 AADTT or >20% EHV	40 - 100 AADTT or >20% EHV	<40 AADTT or <20% EHV	<10 AADTT		
Carriageway Form	2 lanes	2 lanes	2 lanes	1 or 2 lanes	1 or 2 lanes		
Centerline Marking	Yes	Site specific	Site specific	None	None		
Heavy Vehicle Route	Yes	Yes	Yes	Local access only	Local access only		

AADT – Annual Average Daily Traffic

AADTT - Annual Average Daily Truck Traffic

EHV – Equivalent Heavy Vehicles (%)

12. ATTACHMENTS

12.1 Methodology for the Review of Useful Lives

Councils that do not have asset condition data and reliable condition deterioration profiles can use local knowledge and experience on the operating and service performance with similar assets to revise useful lives using the following methodology for road assets.

1. establish a panel of persons with local expertise in operating, maintaining and managing the local road network.
2. identify the local factors that affect the useful life of the road network assets, e.g.:
    a. traffic volumes,
    b. heavy vehicle traffic volumes,
    c. environmental conditions (subgrade, rainfall, pavement materials, etc.),
3. review those factors which critically affect performance of the road network,
4. identify assets nearing the end of their life and group in like age groups; e.g.
    a. surfaces (10-15 yrs, 15-20 yrs, 20-25 yrs, >25 yrs),
    b. pavements (45-50 yrs, 50-55 yrs, 55-60 yrs, >60 yrs),
5. identify a sample of road assets representative of critical performance factors and age groups
6. inspect the sample of road assets and assess the remaining useful life of each asset by consensus, i.e. how long before replacement/ renewal treatment is required to maintain the agreed service levels and/or is approved in the council's works program,
7. add estimated remaining life to the age of each asset to give estimated useful life for each factor and age group,
8. document the process and make recommendations for any change to existing useful lives.[22]

Table 14 provides an overview of a multi-criteria test for determining remaining useful lives.

[22] IPWEA, 2009, AIFMG, Sec 12.10.2, p.12.44.

Table 14: Multi-Criteria Test for Useful Life

Remaining Life Determining Factor	Test	Example
Condition Functional suitability	**Function** Period until the asset no longer provides the required level of service or economic benefits. **Condition** Period until asset reaches condition intervention level for renewal	Bridge is unable to carry legal loadings within safety parameters. Road safety is comprised.
Capacity and utilisation	**Capacity** Period until the physical capacity of the asset is reached. **Utilisation** Period until the utilisation limits (high or low) of the asset are exceeded.	Traffic volumes are considerably different from those expected at time of design.
Cost and efficiency	**Cost and efficiency** Period until operating costs exceed acceptable limits.	Annual maintenance costs for a timber bridge exceed annualised life cycle costs of replacement bridge.
Safety and risk	**Safety** Period until asset is not able to provide safe services.	Safety incidents reach non-acceptable level or risk monitoring indicates unacceptable risk of asset failure.
Compliance	**Compliance** Period until the asset's usage no longer complies with existing and planned legislative/regulatory requirements.	Asset will not comply with new legislation to be enacted in 2 years' time, e.g. footpath access.
Location	**Location** Period until the location of the asset becomes unsuitable or causes economic inefficiencies.	Current road has been assessed in being in the incorrect location as a result of development activity in area.
Obsolescence	**Obsolescence** Changes to life relating to physical deterioration, functional (technological) obsolescence and economic obsolescence. Changes to environmental, safety and other legislation and regulations made the asset non-compliant requiring its retirement from service.	Asset becomes obsolete due to closure of industry that road was built to support, e.g., mine access, railway access.

Source: IPWEA, 2009, AIFMG Ver. 1.4, Table 12.10.2, p 12.47.

13. REFERENCES

AASB, 2009, AAS 116 Property, Plant and Equipment, Australian Accounting Standards Board, Melbourne, June 2009 (Compiled).

ALGA, 2012, National State of the Assets Pilot, November 2012, Australian Local Government Association, Canberra, http://alga.asn.au/?ID=206&Menu=44,69,188

DIER, 2006, Tasmanian State Road Hierarchy, Department of Infrastructure, Energy and Resources, Hobart, http://www.transport.tas.gov.au/__data/assets/pdf_file/0016/20734/DIER_Road_Hierarchy_2007.pdf

IPWEA, 2009, Australian Infrastructure Financial Management Guidelines, Institute of Public Works Engineering Australasia, Sydney, www.ipwea.org/AIFMG

IPWEA, 2011, International Infrastructure Management Manual, Institute of Public Works Engineering Australasia, Sydney, www.ipwea.org/iimm

IPWEA, 2012, NAMS.PLUS2 Asset Management Guidelines, Institute of Public Works Engineering Australasia, Sydney, www.ipwea.org/namsplus

Meander Valley Council, Road Hierarchy Urban and Rural Roads, Westbury.

McClurg, B, Eppell, T, Coonan, D. 2003, Four Level Road Hierarchy for Mackay, Proc. IPWEAQ State Conference, Mackay, Institute of Public Works Engineering Australasia, Queensland Division, Brisbane,

TAO, 2012, Report of the Auditor-General, No. 4 of 2012-13, Auditor-General's Report on the Financial Statements of State entities, Volume 4 Part 1 Local Government Authorities 2011-12, Tasmanian Audit Office, Hobart, http://www.audit.tas.gov.au/publications/reports/report2/index.html

APPENDIX 2 - COMMENTS AND SUBMISSIONS RECEIVED

INTRODUCTION

In accordance with section 30(2) of the *Audit Act 2008*, a copy of this Report was provided to all councils even though no single council was subject to this compliance examination.

The comments and submission provided are not subject to audit nor the evidentiary standards required in reaching an audit conclusion. Responsibility for the accuracy, fairness and balance of those comments rests solely with those who provided a response or comment.

COMMENTS PROVIDED BY BREAK O' DAY COUNCIL

From: Bob Hoogland
Sent: Monday, 25 November 2013 1:02 PM
To: Julie Bellette; Jara Dean; Rob Luciani
Cc: Des Jennings; David Doyle
Subject: RE: Reformatted LG Infrastructure Accounting Report - replaces previous emailed version

I note the issue of Lands Under Roads is raised with the concept of recognition at Fair Value.

At the recent Sustainability Forum, there was the suggestion that the fair value could be identified at the value of the land adjacent to roads.

I note that this would be a fair value only if the road ceases to be a road, at which time the value of the adjacent land becomes valid.

While it is a road, the value of the road is very different from its adjacent land.

The value of the land would be a market value, that is, what someone would pay for it. While it is "road", this is very theoretical because Council's cannot really sell roads and no-one would really buy them because they would then have Council's responsibility to maintain, manage and otherwise provide the service potential of a road. Theoretically, they could use toll gates or similar processes to make money from a road but as many Councils have found out, this is not practical in most jurisdictions.

Remember, we are talking about just the land, not the road, so the theoretical purchaser would have all the costs of road establishment to recover the costs of and this would impact on the value of the land in even a very high traffic volume, "productive" (eg providing access to a port, airport or city centre).

On this basis, I do not believe Land Under Road has a significant value and certainly not in jurisdictions other than large cities.

The Department (and others) should not confuse Land Under Roads with land that has ceased to function as a road, they are very different assets.

On this basis, Councils allocating resources either once or on an ongoing basis to chase hypothetical values is just a complete waste of those precious resources.

It would be a very good thing if the Audit Office and other relevant Departments would simply agree that these are not genuine measurable assets that need to be recognised

Bob H

Bob Hoogland

Corporate Services Manager | **Break O'Day Council**
t: 03 6376 7900 | f: 03 6376 1551 | m: 0428 599 579
e: bob.hoogland@bodc.tas.gov.au | w: www.bodc.tas.gov.au

OUR RESPONSE

In relation to Land Under Roads, recommendation 22 stipulates that councils should elect to recognise the value of all land under roads. The recommendation provides for a group approach which should reduce the cost. The most economical method is for the Tasmanian Valuer-General to supply councils with unit values which would then be applied to an area of road networks to arrive at the value of land under roads. This approach has worked successfully with another Tasmanian State entity.

COMMENTS PROVIDED BY HUON VALLEY COUNCIL

HUON VALLEY COUNCIL

2 DEC 2013

AUDIT OFFICE

From the Office of the Mayor

29 November 2013

Our Ref: 10/12
Your Ref:
Enquiries to: Robert Armstrong

H M Blake
Auditor-General
Tasmanian Audit Office
GPO Box 851
HOBART TAS 7001

Dear Mr Blake

Report of the Auditor General – Infrastructure Financial Accounting in Local Government

Thank you for your correspondence of 19 November 2013 regarding the draft report on Infrastructure Financial Accounting in Local Government.

I note your request for Council's comments on the draft report prior to tabling the report in Parliament.

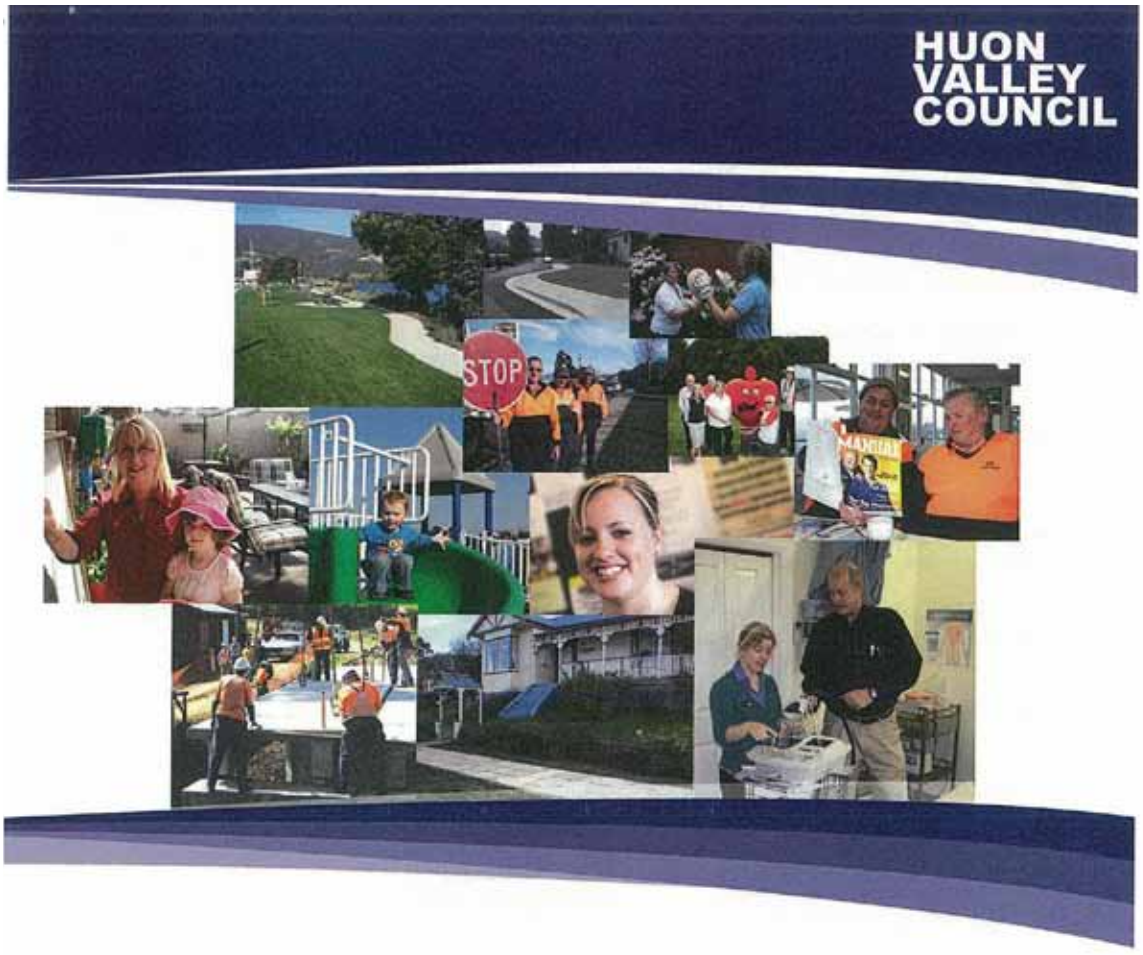
As requested please find attached our response entitled *Huon Valley Council Comments on Infrastructure Financial Accounting in Local Government.*

Kind regards

CR ROBERT ARMSTRONG
MAYOR

Enc. Huon Valley Council Comments on Infrastructure Financial Accounting in Local Government

Public Office | 40 Main Street, Huonville
Postal Address | PO Box 210, Huonville, 7109
Phone | (03) 6264 0300
Fax | (03) 6264 0399
email | hvc@huonvalley.tas.gov.au
www.huonvalley.tas.gov.au
ABN 77 602 207 026



Huon Valley Council Comments on Infrastructure Financial Accounting in Local Government

be part of something bigger...your community
www.huonvalley.tas.gov.au

Review of Infrastructure Financial Accounting in Local Government

Overall, the Huon Valley Council is in general agreement with the majority of the recommendations contained in the report. This Council effectively adopted the criteria contained in the original report in 1998. However, Council is of the view that the frequency of review of things such as depreciation rates, useful lives etc, is too frequent and should be undertaken as part of the revaluation process which should be undertaken at least every five years.

Whilst, Council is generally supportive of the recommendations, it is very mindful that some of the recommendations would require additional resources to implement and would impose an additional cost on the ratepayers, which we do not believe is completely warranted.

It would be useful if the recommendations implemented were robust enough to ensure there is sufficient consistency across the State, whilst still enabling some flexibility.

The Huon Valley Council also has some very strong concerns regarding the valuation of land under roads and the costs that could be incurred on behalf of its ratepayers, which we feel is difficult to justify, especially in these tough economic times.

It is disappointing to receive a request at such short notice on an important topic. It is difficult to be able to prepare a quantitative and meaningful response in such a short timeframe, especially where a number of officer's input is required.

Specific comments on each of the recommendations are as follows:

1. **The components of a road asset should be identified and recognised at fair value and should be separately valued and depreciated over its useful life. Components of road assets can include:**

Urban road components	Rural road components
Earthworks (where material)	Retaining walls (where material)
Retaining walls (where material)	Pavement sub-base ^
Pavement sub-base ^	Pavement base
Pavement base	Sealed/unsealed wearing surface
Sealed wearing surface	Bridges
Kerb and channel (x2)	Culverts *
Footpaths (x2)	Traffic management/protection devices
Bridges	
Culverts *	
Traffic management and protection devices	
Landscaping (where material)	

Comment

Agreed

The Huon Valley Council, as a result of recommendations contained in the original report in 1998, has been separately valuing and depreciating components of its road asset since 2000.

2. **Assets should be recognised at cost based on a modern equivalent asset. Donated or contributed assets should be recognised at fair value in accordance with the Accounting Standards. Periodic revaluations of infrastructure assets would be based on the amount required currently to replace the service capacity of the asset.**

Comment

The Huon Valley Council has been recording assets at current replacement cost and conducting periodic revaluations and conducting indexation of the current replacement cost in between revaluations.

However, Council does have some issues in this area as it relates to bridges renewal. For example, a timber bridge is deemed to have a useful life of 40 years whilst a concrete bridge has 80 years. In Council's assets all timber bridges are recorded at replacement cost in timber. The reality is that it is cheaper to replace those bridges in concrete as they have a life span of 80 years. It is now virtually impossible to get the standard of timber required to renew bridges in timber at a cost cheaper than concrete. Based on this it is reasonable to assume that the replacement cost of Council's timber bridges and annual depreciation is overstated as Council will only be replacing timber bridges in concrete.

The definition of modern equivalent asset needs to be flexible enough to take into account similar, but not like for like replace.

3. **Residual values for property, plant and equipment assets be recognised only where the estimated amount to be received from disposal of the asset is greater than the cost of disposal of the asset.**

Comment

Agreed.

The Huon Valley Council records its plant and equipment at cost.

4. **Assets subject to planned 'optimal' renewal methods be componentised to recognise the different useful lives estimated for each part of the asset. The componentised assets be re-valued as modern equivalent assets being the cost that is required currently to replace the service capacity of an asset.**

Comment

Agreed.

Refer to comments to Recommendation 1.

5. **Useful lives should be assigned to all infrastructure related assets with the exception of land and certain earthworks with the characteristics of land. The assessment of useful life should be based on engineering reviews of expected physical wear and tear and technological and commercial obsolescence of the asset.**

Comments

The Huon Valley Council's assets useful lives are based on historical data developed in house and industry related standards and where required engineering reviews are conducted. Overall, Council has tended to reflect accepted industry standards for useful lives.

6. **Useful lives should be reviewed annually to ensure that the value of depreciation calculated and recognised remains relatively accurate and to support ongoing asset renewal planning.**

Comment

Do not agree.

We do not believe that useful lives should be reviewed annually. This is an unnecessary impost and should only be reviewed as part of the revaluation of the asset. Council considers it sufficient to apply indices where deemed appropriate.

Whilst we support in some level of standardisation in useful lives we note the need for flexibility to reflect the practical reality of particular circumstances.

7. **Road earthworks assets established with an unlimited useful life should be reviewed annually for obsolescence and if any earthworks asset is assessed as having a remaining useful life, changes be made to recognise the remaining useful life.**

Comment

Do not agree.

We do not support that road earthworks assets established with an unlimited useful life be reviewed annually. This is an unnecessary impost and should only be reviewed as part of the revaluation of the asset.

8. **The condition of assets is only one of several factors that should be used to predict the remaining useful life of assets used for calculating depreciated replacement cost and depreciation. Condition should not on its own be used to directly determine the value of depreciation or depreciated replacement cost.**

Comment

Agreed.

The Huon Valley Council has engaged the services of ARRB to perform condition assessments of Council's road network. This assessment is utilised to assist in developing an asset replacement program based on a number of criteria including condition assessment. Council also relies on other

factors including historical data and experience, future demand and intervention levels. For example, the Huon Valley Council is of the view that if it regularly re-sheets its gravel road network then the other two road components (pavement and sub base) will be preserved. That is, Council believes that once a gravel road is re-sheeted it is brought back to pristine condition and the deterioration of the underlying road segments is stalled. This assessment is backed up by the fact that since this Council's inception in 1993 there has been negligible renewal of Council's pavement and sub base on unsealed roads without a negative impact on asset condition

Whilst acknowledging this, Council still has assigned these segments with a defined useful life, even though history has shown that the life assigned may be considered to be very conservative.

9. Councils should adopt a consistent, systematic methodology to grade and report on the condition of infrastructure.

Comment

Agreed.

As referred to above in Recommendation 9, Council does utilise external resources to perform condition assessments in between conducting internal assessments. Council has utilised ARRB to perform independent assessments in the years 2010 and 2013, where the results generally reconfirm internal assessment results.

10. Assets that have an expected useful life should be depreciated over the estimated useful life in a manner that represents the pattern of consumption of future economic benefits embodied in the asset. The consumption of future economic benefits is related to the consumption of service potential and not to the physical condition of assets.

Comment

Agreed.

We support that an asset should be depreciated over the estimated useful life in a manner that represents the pattern of consumption. We have difficulty in ascertaining how we would quantify the consumption of future economic benefit.

There probably needs to be more research done on how to establish such criteria.

11. The depreciation method should be assessed annually to ensure that it continues to represent the underlying pattern of consumption of future economic benefits embodied in the asset.

Comment

Do not agree.

The Huon Valley Council does not believe that the depreciation method should be assessed annually. If the depreciation method is based on accepted industry standards then it isn't necessary and should only be reviewed as part of the revaluation process.

12. Road and other assets should be derecognised (written off) when the asset is replaced or renewed.

Comment

Agreed.

The Huon Valley agrees with this recommendation.

13. Councils recognise re-sheeting of unsealed roads as capital expenditure. Councils with a relatively small expenditure on re-sheeting unsealed roads should consider the capitalisation of unsealed road re-sheeting as a network asset(s) for re-sheeting completed in the reporting period. The network asset(s) for each period should be depreciated over the estimated useful life and derecognised at the end of the useful life.

Comment

Do not agree.

In 2000, the Huon Valley Council, as part of the implementation of the 1998 Auditor-General's report and in consultation with officers from the State Audit Department, was able to demonstrate that it expended the equivalent of the depreciation cost on re-sheeting its unsealed road network. As a consequence all re-sheeting costs were expensed, which was approved and has been the current practice of this Council since 2000. We are at a loss to understand why this practice is no longer considered appropriate.

14. Councils should prepare and adopt a policy for revaluation, defining the criteria to be used in determining whether the carrying amount differs materially from that which would be determined using fair value at the end of the reporting period. The policy should include the method of assessing fair value and the source information to be used.

Comments

Agree.

The Huon Valley Council develops its revaluation criteria as part of its asset management plan.

15. Councils should annually review the depreciation method to ensure that the depreciable amount of an asset is allocated over its useful life in a manner that reflects the pattern of consumption of future economic benefits.

Comment

Do not agree.

The Huon Valley Council considers this to be unrealistic and unnecessary and firmly believes that reviews of depreciation should be undertaken as part of the revaluation process.

16. **Councils should undertake an annual review of accounting estimates as required by the Australian Accounting Standards, to be approved by the General Manager. The review should include the useful life, residual value and depreciation method of assets, whether there is a material difference between the carrying value of assets recorded at fair value with that determined using fair value and whether there are any indications of impairment of assets. The rationale and documented support for any action or non-action taken should be part of the information provided.**

Comment

Do not agree.

The Huon Valley Council believes that annual reviews of things such as useful lives, residual value & depreciation should be performed as part of the revaluation process and are unnecessary and not required annually.

17. **Councils should undertake an annual review of currency and accuracy of the asset registers and the General Manager report the rationale and documented support for any decision to revalue or not revalue to the audit committee and/or the council.**

Comment

Do not agree.

The Huon Valley Council has some 14 asset registers and asset management plans (Roads, Car Parks, Kerb & Channel, Bridges, Marine Facilities, Playgrounds, Street Furniture, Parks & Gardens, Sporting Facilities, Walking Tracks, Stormwater, Buildings, Information Technology & Plant) which are renewed on a regular basis. It is again considered unnecessary and a substantial financial and resource requirement to undertake this exercise annually. We firmly believe that this should be performed as asset management plans are revised.

18. **The value of capital renewal and capital new/upgrade expenditure by asset class should be disclosed in financial statements.**

Comment

Agreed.

This is the current practice adopted by the Huon Valley Council.

19. **The residual values for infrastructure assets should be disclosed in the financial statements.**

Comment

Agreed.

This is the current practice adopted by the Huon Valley Council.

20. Management assessments and decisions which impact the financial statements should be supported be appropriate and sufficiently reliable, precise and detailed documentation.

Comment

Agreed.

This is the current practice adopted by the Huon Valley Council.

21. The five financial ratios used to assess the financial sustainability and explanations of variances from expected benchmarks should be disclosed in council financial statements:

- **Operating surplus ratio,**
- **Asset sustainability ratio,**
- **Asset renewal funding ratio,**
- **Road asset consumption ratio,**
- **Net financial liabilities ratio.**

Comment

Agreed.

However, there needs to be some guidelines established to ensure that there is consistency across Council's in their application of the ratios and over time. This is extremely relevant as there appears to be consistent movement and variances from year to year as to what should be above and below the line in the operating statement.

22. An integrated approach to financial management should be supported by the development of financial management strategies in conjunction with the development of the long-term financial plan as a single integrated financial planning document.

Comment

Agreed.

The Huon Valley Council has developed a 10 year Financial Management Plan which incorporates the issues contained in Recommendation 22.

23. Councils elect to recognise the value of all land under roads at fair value in accordance with Australian Accounting Standard 1051 Land Under Roads, regardless of when the land was acquired. The Local Government Association of Tasmania to coordinate a group approach by councils to the Tasmanian Valuer-General to determine and agree a process of valuing land under roads in each municipal area and to facilitate a regular revaluation of land under roads.

Comment

The Huon Valley Council sees little merit in applying such valuations. It would appear that it is required to appease the academics as opposed to the practical practitioners within the accounting profession. It would be unacceptable if Councils are required to obtain professional valuations at substantial costs to the ratepayers for a valuation which has limited benefit to the Council or the ratepayer. Council agrees that a coordinated approach is definitely required if implemented.

24. The Local Government Division consider, after consultation with relevant stakeholders, adopting the proposed local road hierarchy for use by Tasmanian councils.

Comment

Agreed.

Provided that the criteria developed do not include too many categories to make the development of the hierarchy to onerous to develop and maintain.

OUR RESPONSE

Huon Valley Council (Council) did not agree with a number of recommendations around annual reviews of depreciation components and methods. In relation to recommendations 6, 7, 11, (previous recommendation 15 which was deleted), 15 (previously recommendation 16) and 16 (previously recommendation 17), the recommendations reflect requirements of Australian Accounting Standards AASB 116 *Property, Plant and Equipment*. Specifically, paragraph 51 of AASB 116 requires entities to review the residual value and the useful life of an asset at least at the end of each annual reporting period and account for any changes. Paragraph 61 of AASB 116 requires entities to review the depreciation method applied to an asset at least at the end of each annual reporting period and change the method where there has been a significant change in the expected pattern of consumption of the future economic benefit embodied in the asset. Paragraph 31 requires revaluations to be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period. In order to make the assessment, an entity must review the currency of values recorded in the asset registers.

The General Manager is the person responsible for the preparation and fair presentation of the financial report in accordance with Australian Accounting Standards and Section 84 of the *Local Government Act 1993*. This is the reason the Report recommends at recommendation 15 (previously recommendation 16) the annual review of accounting estimates as required by the Australian Accounting Standards be approved by the General Manager.

Furthermore, Council did not agree with recommendation 13 that re-sheeting of unsealed roads is of a capital nature and should be recognised as an asset and depreciated over its useful life. Under accounting principles, expenditure which extends the useful life of an asset is of a capital nature as opposed to operating expenditure which simply maintains the service potential of the asset. Re sheeting of a road or a section of a road extends the useful life of the unsealed wearing surface. Where the service potential of the surface extends beyond 12 months, the cost of re-sheeting should be capitalised. Council's current practice of expensing re-sheeting costs, which is based on the argument that the cost of re-sheeting is equivalent to the depreciation cost, is an example of a depreciation method which does not comply with AASB 116. Interpretation 1030 *Depreciation of Long-Lived Physical Assets: Condition –Based Depreciation and Related Methods* specifically prohibits the use of a renewals method of accounting for financial reporting purposes. The renewals method assumes that the asset is in a steady state and that subsequent expenditure on the asset will not increase its future economic benefit, but will maintain it at existing levels. In this circumstance/situation, all expenditure on the asset is treated as maintenance expenditure and recognised as an expense in the period in which it is incurred, and an additional depreciation expense is not recognised.

In relation to land under roads, recommendation 22 (previously 23) stipulates that councils should elect to recognise the value of all land under roads. The recommendation provides for a group approach which should reduce the cost. The most economical method is for the Tasmanian Valuer-General to supply councils with unit values which would then be applied to an area of road networks to arrive at the value of land under roads. This approach has worked successfully with another Tasmanian State entity.

COMMENTS PROVIDED BY KENTISH COUNCIL

KENTISH COUNCIL

ABN: 31 828 311 570

TASMANIAN
29 NOV 2013
AUDIT OFFICE

KENTISH
Tasmania's Outdoor Art Gallery

Ref: Finance/Audit
CSF/AC

28 November 2013

Mr H M Blake
Auditor-General
Tasmanian Audit Office
GPO Box 851
HOBART TAS 7001

Dear Mr Blake

Report of the Auditor-General - Infrastructure Financial Accounting in Local Government

In response to your invitation to comment on the above report, Kentish Council provides the following comments.

Kentish Council is broadly supportive of the recommendations of the report by the Auditor-General and in general Council is supportive of attempts to improve consistency in financial accounting for infrastructure across the local government sector. However Council does have some concerns regarding the interpretation of some of the recommendations as illustrated in some of the examples in the report by Jeff Roorda and Associates (JRA).

Council's main issues with the content of the JRA report involve the definition of 'modern equivalent asset' and the valuation examples provided in the report. Council staff believe that a modern equivalent is a solution that could be applied now at a green-field site not a future treatment reliant on recycling in-situ materials. Single coat seals for example are not, in isolation, a modern equivalent to a two coat seal because they will only be effective when applied over an existing sealed surface. Furthermore, two coat seals are still modern practice for new road works. They have not and cannot be effectively replaced by one coat seals for new road works.

The examples on pages 34 and 35 of the JRA report advocate re-valuing a two coat seal to the cost of a one coat seal. Council staff believe that this method is not in accordance with the requirements of AASB 116 or the new AASB 13 because it ignores the value of the existing materials that are recycled to enable the renewal treatment to replace the service capacity of the asset.

P.O. Box 63 (69 High Street.) SHEFFIELD TASMANIA 7306.
Telephone: (03) 6491 2500 Facsimile: (03) 6491 1659 Email: council@kentish.tas.gov.au www.kentish.tas.gov.au

In the pavement valuation example at the top of page 36 of the JRA report, a developer spends $80 per m^2 on road pavement (presumably fair value at the time based on market transactions) but when the council takes over the road (probably only a couple of years later) it recognises it at $60m^2$. In this example 25% of the initial value of the asset has been "lost". Kentish Council staff would argue that this value is probably understated and that probably the 50% of the base can only be recycled at a cost of $20m^2$ by recycling around $20m^2$ worth of the existing material.

The financial effect of the revaluation recommended in these examples is that the value that councils were previously recording as residual values and which presumably would eventually have been either depreciated or written off to profit and loss on disposal will in most cases be initially written off against asset revaluation reserves with the first revaluation following initial construction / acquisition. It is understood that the approach recommended by JRA would, on renewal of the asset (and assuming no further re-cycling of existing materials) reverse the revaluation decrement previously charged to the asset revaluation reserve and depreciate the full value of the renewed asset over its useful life. Whilst this approach would give a similar depreciation result to the current methods using residual values, it would, in many cases report a lower asset value as outlined above. Kentish Council staff believe that (all other things being equal) a road that has been renewed to "as new" standard with particular specifications should in theory be of equal value to a new road constructed to the same specifications. The examples in the JRA report do not appear consistent with this.

Thank you for the opportunity to provide comment on your draft report. Council looks forward to continuing to work with other Tasmanian Councils, the Tasmanian Audit Office and the Local Government Division to further improve asset management and infrastructure financial accounting practices.

Yours sincerely

Cr Don Thwaites
Mayor

OUR RESPONSE

Both Latrobe and Kentish Councils questioned the definition of 'modern equivalent asset' and two examples provided in our expert's report. Specifically, the last example on page 45 (previously page 35) and the first example on page 46 (previously page 36). To better illustrate the application of the modern equivalent asset concept, we provided the following additional example:

Scenario	Solution
A council's asset management plan states that new roads will be initially surfaced with a two coat flush seal and resealed with a single coat seal at 18 year intervals.	**Recognition at Cost** – The 2 coat seal is recognised as two component assets, one reseal component equivalent to a single coat reseal at the reseal cost of $5.00/m2 and the second long life seal component as the difference between the 2 coat seal cost and the reseal cost ($8.00/m2 - $5.00/m2 = $3.00/m2). **Useful life** – The two seal component assets are established with expected useful lives, the reseal component asset having an expected useful life of 18 years and the long life seal component asset having a life of 50 years being the estimated time until pavement recycling or reconstruction is required or planned. **Revaluation** – The reseal component is revalued at the cost to replace the service capacity of the asset (cost of planned single coat reseal). The seal long life component asset is revalued at the difference between the 2 coat seal cost and the single coat reseal cost.

Each council should review our recommendations in light of current asset management practices. The recommendations and examples are provided to ensure asset management practices comply with Australian Accounting Standards.

Australian Accounting Standard AASB 13 *Fair Value Measurement* requires entities to use valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value. Valuation techniques should maximise the use of relevant observable inputs and minimise the use of unobservable inputs. Three widely used valuation techniques are the market approach, the cost approach and the income approach. The cost approach is the only relevant valuation technique for valuing infrastructure assets, because of the specialised nature of these assets. The cost approach reflects the amount that would be required currently to replace the service capacity of an asset, taking into consideration the cost to construct a substitute asset of comparable utility, adjusted for obsolescence. This is also consistent with requirements of AASB 116 *Property Plant and Equipment*, which defines fair value as *'the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.'*

In addition, paragraph 15.1 of AASB 116 states, *'…in respect of not-for-profit entities, where an asset is acquired at no cost, or for a nominal cost, the cost is its fair value as at the date of acquisition.'*

OUR RESPONSE - continued

On this basis, to recognise the asset for a value higher would not reflect depreciated replacement cost and consequently fair value.

We consider the financial effect of the revaluations recommended in the examples and the additional example provided allow council to carry road assets at an appropriate replacement value and that depreciation expensed against these assets will be sufficient to provide for their replacement.

COMMENTS PROVIDED BY KINGBOROUGH COUNCIL

Kingborough

TASMANIAN
- 3 DEC 2013
AUDIT OFFICE

29 November 2013

Our Ref: 10.85

Mr HM Blake
Auditor-General
Tasmanian Audit Office
GPO Box 851
HOBART TAS 7001

Dear Mr Blake

DRAFT REPORT TO PARLIAMENT ON INFRASTRUCTURE FINANCIAL ACCOUNTING

I write in reply to your letter dated 19 November 2013 in relation to the above-mentioned report.

You asked that any comments that Council may have be forwarded to you to allow them to be included within the report. On that basis I provide the following:

Kingborough Council supports the objectives of the report and is committed to ensuring that its accounting treatment of infrastructure assets is in accordance with Australian Accounting Standards.

It is our belief that Local Government in Tasmania requires a clear asset management framework in which to operate and this report is a step in the right direction towards a consistent approach. In particular recommendations 23 and 24 are clear in providing a proposed way forward and it is suggested that councils would benefit from other recommendations having similarly clearly stated action plans.

The report is generally in alignment with Council's current asset management practices, however there are likely to be some implications if the report is adopted. Council will need to consider the internal resourcing and system capabilities required to implement all aspects of the report, and we look forward to working with TAO staff in this regard.

Yours sincerely

STEVE WASS
ACTING MAYOR

kingborough.tas.gov.au
Civic Centre, 15 Channel Hwy, Kingston, Tasmania 7050 Locked Bag 1, Kingston Tasmania 7050
AusDoc: DX 70854 T: (03) 6211 8200 F: (03) 6211 8211 E: kc@kingborough.tas.gov.au

OUR RESPONSE

No further response is required.

COMMENTS PROVIDED BY LATROBE COUNCIL

Latrobe Council

Preserving the Past … Promoting the Present … Planning for the Future

Our Ref: Ref: Finance/Audit
Your Ref: CSF/AC
Phone: (03) 6421 4650
Fax: (03) 6426 2121 28 November 2013
Email:

Mr H M Blake
Auditor-General
Tasmanian Audit Office
GPO Box 851
HOBART TAS 7001

Dear Mr Blake

Report of the Auditor-General - Infrastructure Financial Accounting in Local Government

In response to your invitation to comment on the above report, Latrobe Council provides the following comments.

Latrobe Council is broadly supportive of the recommendations of the report by the Auditor-General and in general Council is supportive of attempts to improve consistency in financial accounting for infrastructure across the local government sector. Council does however have some concerns regarding the interpretation of some of the recommendations as illustrated in some of the examples in the report by Jeff Roorda and Associates (JRA).

Council's main issues with the content of the JRA report involve the definition of 'modern equivalent asset' and the valuation examples provided in the report. Council staff believe that a modern equivalent is a solution that could be applied now at a green-field site not a future treatment reliant on recycling in-situ materials. Single coat seals for example are not, in isolation, a modern equivalent to a two coat seal because they will only be effective when applied over an existing sealed surface. Furthermore, two coat seals are still modern practice for new road works. They have not and cannot be effectively replaced by one coat seals for new road works.

The examples on pages 34 and 35 of the JRA report advocate re-valuing a two coat seal to the cost of a one coat seal. Council staff believe that this method is not in accordance with the requirements of AASB 116 or the new AASB 13 because it ignores the value of the existing materials that are recycled to enable the renewal treatment to replace the service capacity of the asset.

170 Gilbert Street, (P.O. Box 63), LATROBE, Tas. 7307
Internet: www.latrobe.tas.gov.au

In the pavement valuation example at the top of page 36 of the JRA report, a developer spends $80 per m^2 on road pavement (presumably fair value at the time based on market transactions) but when the council takes over the road (probably only a couple of years later) it recognises it at 60m^2$. In this example 25% of the initial value of the asset has been "lost". Latrobe Council staff would argue that this value is probably understated and that probably the 50% of the base can only be recycled at a cost of 20m^2$ by recycling around 20m^2$ worth of the existing material.

The financial effect of the revaluation recommended in these examples is that the value that councils were previously recording as residual values and which presumably would eventually have been either depreciated or written off to profit and loss on disposal will in most cases be initially written off against asset revaluation reserves with the first revaluation following initial construction / acquisition. It is understood that the approach recommended by JRA would, on renewal of the asset (and assuming no further re-cycling of existing materials) reverse the revaluation decrement previously charged to the asset revaluation reserve and depreciate the full value of the renewed asset over its useful life. Whilst this approach would give a similar depreciation result to the current methods using residual values, it would, in many cases report a lower asset value as outlined above. Latrobe Council staff believe that (all other things being equal) a road that has been renewed to "as new" standard with particular specifications should in theory be of equal value to a new road constructed to the same specifications. The examples in the JRA report do not appear consistent with this.

Thank you for the opportunity to provide comment on your draft report. Council looks forward to continuing to work with other Tasmanian Councils, the Tasmanian Audit Office and the Local Government Division to further improve asset management and infrastructure financial accounting practices.

Yours sincerely,

Mike Gaffney (MLC)
Latrobe Mayor

OUR RESPONSE

Refer to the response from Kentish Council.

APPENDIX 3 - GLOSSARY

Amortisation

The systematic allocation of the depreciable amount of an intangible asset over its useful life.

Asset

A resource controlled by an entity as a result of past events, and from which future economic benefits are expected to flow to the entity.

Asset consumption ratio - roads

Depreciated replacement cost divided by Current replacement cost.

Asset renewal funding ratio

Future (planned) asset replacement expenditure divided by Future asset replacement expenditure (actual) required.

Asset sustainability ratio

Renewal and upgrade expenditure on existing assets divided by Depreciation on existing assets.

Asset useful life

The period over which an asset is expected to provide the entity with economic benefits. Depending on the nature of the asset, the useful life can be expressed in terms of time or output.

Asset valuation

The fair value of an asset on a particular date.

Audit Act 2008

An Act of the State of Tasmania that:

- ensures that the State has an Auditor-General with the necessary functions, immunities and independence
- provides for the independent audit of the public sector and related entities.

Auditor's opinion (or Auditor's Report)

Written expression within a specified framework indicating the auditor's overall conclusion on the financial reports based on audit evidence obtained.

Capital expenditure

Amount capitalised to the Statement of Financial Position (also referred to as the balance sheet) for expenditure on or contributions by a State entity to major assets controlled or owned by the entity, including expenditure on:

- capital renewal of existing assets that returns the service potential or the life of the asset to that which it had originally been commissioned
- capital expansion which extends an existing asset at the same standard to a new group of users.

Carrying amount

The amount at which an asset is recognised after deducting any accumulated depreciation (amortisation) and accumulated impairment losses thereon.

Contributed assets

Assets, usually property, plant and equipment, contributed to a State entity at no cost or are non-reciprocal.

Control

The capacity of an entity to dominate decision-making, directly or indirectly, in relation to the financial and operating policies of another entity so as to enable that other entity to operate with it in achieving the objectives of the controlling entity.

Cost

The amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction.

The Council

The group of councillors, who are the elected representatives of people who are residents in the council's municipality or ratepayers of the council.

(Current) Replacement cost

The cost an entity would incur to acquire the asset at the end of the reporting period.

Depreciation

The systematic allocation of the depreciable amount of an asset over its useful life.

Depreciated replacement cost

The current replacement cost of an asset less, where applicable, accumulated depreciation calculated on the basis of such cost to reflect the already consumed or expired future economic benefits of the asset.

Expense

Outflows or other depletions of economic benefits in the form of incurrence of liabilities or depletion of assets of the entity, other than those relating to contributions by owners, that results in a decrease in equity, or increase in a liability, during the reporting period.

Fair value

The amount for which an asset could be exchanged or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Financial report

Structured representation of financial information, which usually includes accompanying notes, derived from accounting records and intended to communicate an entity's financial performance over a period of time and its economic resources or obligations at a point in time in accordance with a financial reporting framework.

Financial statements

A complete set of financial statements comprises:

- a Statement of Financial Position as at the end of the period
- a Statement of Profit or Loss and Other Comprehensive Income for the period
- a Statement of Changes in Equity for the period
- a Statement of Cash Flows for the period
- Notes, comprising a summary of significant accounting policies and other explanatory information
- comparative information in respect of the preceding period
- a Statement of Financial Position as at the beginning of the preceding period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements.

An entity may use titles for the statements other than those used in the relevant accounting standard. For example, an entity may use the title 'Statement of Comprehensive Income' instead of 'Statement of Profit or Loss and Other Comprehensive Income'.

Financial sustainability

An entity's ability to manage financial resources so it can meet its spending commitments both at present and into the future.

Financial year

The period of 12 months for which a financial report is prepared.

Future economic benefit

The potential to contribute, directly or indirectly, to the flow of cash and cash equivalents to the entity. The potential may be a productive one that is part of the operating activities of the entity. It may also take the form of convertibility into cash or cash equivalents or a capability to reduce cash outflows.

Impairment loss

The amount by which the carrying amount of an asset exceeds its recoverable amount.

Land under roads

Land under roadways, and road reserves, including land under footpaths, nature strips and median strips.

Local Government Act 1993

An Act of the State of Tasmania that provides for local government and establishes councils to plan for, develop and manage municipal areas in the interests of their communities.

Material

Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.

Materiality

Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial report.

Net financial liabilities ratio

Liquid assets less Total liabilities divided by Total operating revenue.

Non-Financial Asset

Physical assets such as land, buildings and infrastructure.

Not-for-profit entity

An entity whose principal objective is not the generation of profit. A not-for-profit entity can be a single entity or a group of entities comprising the parent entity and each of the entities that it controls.

Operating surplus ratio (Underlying result ratio)

Net operating surplus divided by Total operating revenue.

Property, plant and equipment (including infrastructure)

Tangible items that:

- are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
- are expected to be used during more than one period.

Public sector entity

A department; a public hospital; a local government; a statutory body; an entity controlled by one, or more than one department, public hospital, local government or statutory body; or an entity controlled by a public sector entity.

Recoverable amount

The higher of an asset's net selling price and its value in use.

Residual value (of an asset)

The estimated amount that an entity would currently obtain from disposal of an asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.

Revaluation

Recognising a reassessment or restatement of values for assets or liabilities at a particular point in time.

State entity

A body, whether corporate or unincorporated, that has a public function to exercise on behalf of the State or is wholly owned by the State, as defined under the *Audit Act 2008*, including:

- an agency
- a council
- a Government Business Enterprise
- a State-owned company
- a State authority that is not a Government Business Enterprise
- the council, board, trust or trustees, or other governing body (however designated) of, or for, a corporation, body of persons or institution, that is or are appointed by the Governor or a Minister of the Crown
- a body or authority referred to in section 21, established under section 29 or 30, or continued under section 326, of the *Local Government Act 1993*
- the Corporation incorporated under section 5 of the *Water and Sewerage Corporation Act 2012*
- a body or authority in respect of which the Treasurer has made a determination under section 32A.

Steering committee

Provides oversight and strategic direction for key organisational processes or risk.

Value in use

The present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life.

Value in use (in respect of not-for-profit entities)

Depreciated replacement cost of an asset when the future economic benefits of the asset are not primarily dependent on the asset's ability to generate net cash inflows and where the entity would, if deprived of the asset, replace its remaining future economic benefits.

APPENDIX 4 - ACRONYMS AND ABBREVIATIONS

AADT	Annual Average Daily Traffic
AADT	Annual Average Daily Truck Traffic
AAS	Australian Accounting Standards
AASB	Australian Accounting Standards Board
ABS	Australian Bureau of Statistics
AIFMG	Australian Infrastructure Financial Management Guidelines
ALGA	Australian Local Government Association
BITRE	Bureau of Infrastructure, Transport and Regional Economics
CPI	Consumer Price Index
DIER	Department of Infrastructure, Energy and Resources
DORC	Depreciated Optimised Replacement Cost
EHV	Equivalent Heavy Vehicles
FMS	Financial Management Strategies
IAS	International Accounting Standard
IPWEA	Institute of Public Works Engineering Australasia
IT	Information Technology
JRA	Jeff Roorda and Associates
LGA	Local Government Area
LG	Local Government
LGAT	Local Government Association of Tasmania
LOS	Level of Service
LTFP	Long-term Financial Plan
TAO	Tasmanian Audit Office
UIG	Urgent Issues Group Interpretation (now Australian Accounting Interpretations)

APPENDIX 5 - RECENT REPORTS

TABLED	No.	TITLE
June	No. 9 of 2011-12	Volume 6 - Other State Entities 30 June 2011 and 31 December 2011
June	No. 10 of 2011-12	Public Trustee: management of minor trusts
June	No. 11 of 2011-12	Updating the Motor Registry System
June	No. 12 of 2011-12	Follow up of Special Reports 75-81
July	No 1 of 2012-13	Sale of TOTE Tasmania
October	No 2 of 2012-13	TasPorts: benefits of amalgamation - October 2012
November	No 3 of 2012-13	Volume 3 - Government Business Enterprises, State Owned Companies and Water Corporations 2011-12
November	No 4 of 2012-13	Volume 4 - Local Government Authorities 2011-12
November	No 5 of 2012-13	Volume 1 - Analysis of the Treasurer's Annual Financial Report 2011-12
November	No 6 of 2012-13	Volume 2 - Executive Legislature, Government Departments, other General Government Sector State entities and Superannuation Funds 2011-12
December	No 7 of 2012-13	Compliance with the *Tasmanian Adult Literacy Plan 2010-15*
March	No 8 of 2012-13	National Partnership Agreement on Homelessness
March	No 9 of 2012-13	Royal Derwent Hospital: site sale
May	No 10 of 2012-13	Hospital bed management and primary preventative health
May	No. 11 of 2012-13	Financial Statements of State entities: Volume 5 - Other State entities
May	No. 11 of 2012-13	Department of Health and Human Services - Output based expenditure (included in Financial Statements of State entities: Volume 5 - Other State entities)
August	No. 1 of 2013-14	Fraud control in local government
November	No. 2 of 2013-14	Volume 1 - Executive and Legislature, Government Departments, Tasmanian Health Organisations, Other General Government Sector State entities, Other State entities and Superannuation Funds
November	No. 3 of 2013-14	Volume 2 - Government Businesses, Other Public Non-Financial Corporations and Water Corporations
December	No. 4 of 2013-14	Volume 3 - Local Government Authorities

Auditor-General's reports are available from the Tasmanian Audit Office. These and other published reports can be accessed via the Office's homepage www.audit.tas.gov.au

Tasmanian Audit Office

Level 4, Executive Building, 15 Murray Street, Hobart, Tasmania, 7000
Postal Address GPO Box 851, Hobart, Tasmania, 7001
Phone: 03 6226 0100 | Fax: 03 6226 0199
Email: admin@audit.tas.gov.au
Web: www.audit.tas.gov.au

Our Vision

STRIVE I LEAD I EXCEL I TO MAKE A DIFFERENCE

Our Purpose

To provide independent assurance to the Parliament and Community on the performance and accountability of the Tasmanian Public sector

Availability of reports

Auditor-General's reports are available from the Tasmanian Audit Office, Hobart. This report and other recent reports published by the Office can be accessed via the Office's home page. For further information please contact the Office.

© Crown in Right of the State of Tasmania December 2013

Audit Mandate and Standards Applied

Mandate

Section 17(1) of the *Audit Act 2008* states that:

> 'An accountable authority other than the Auditor-General, as soon as possible and within 45 days after the end of each financial year, is to prepare and forward to the Auditor-General a copy of the financial statements for that financial year which are complete in all material respects.'

Under the provisions of section 18, the Auditor-General:

'(1) is to audit the financial statements and any other information submitted by a State entity or an audited subsidiary of a State entity under section 17(1).'

Under the provisions of section 19, the Auditor-General:

'(1) is to prepare and sign an opinion on an audit carried out under section 18(1) in accordance with requirements determined by the Australian Auditing and Assurance Standards

(2) is to provide the opinion prepared and signed under subsection (1), and any formal communication of audit findings that is required to be prepared in accordance with the Australian Auditing and Assurance Standards, to the State entity's appropriate Minister and provide a copy to the relevant accountable authority.'

Standards Applied

Section 31 specifies that:

'The Auditor-General is to perform the audits required by this or any other Act in such a manner as the Auditor-General thinks fit having regard to –

(a) the character and effectiveness of the internal control and internal audit of the relevant State entity or audited subsidiary of a State entity

(b) the Australian Auditing and Assurance Standards.'

The auditing standards referred to are Australian Auditing Standards as issued by the Australian Auditing and Assurance Standards Board.

Tasmanian
Audit Office

Phone (03) 6226 0100
Fax (03) 6226 0199
Email admin@audit.tas.gov.au
Web www.audit.tas.gov.au

Address Level 4, Executive Building
15 Murray Street, Hobart
Postal Address GPO Box 851, Hobart 7001
Office Hours 9am to 5pm Monday to Friday

Launceston Office
Phone (03) 6336 2503

Address 2nd Floor, Henty House
1 Civic Square, Launceston