
Report To:	Audit Committee	Date:	20 October 2015
Report By:	Chief Financial Officer	Report No:	FIN/99/15/AP/CM
Contact Officer:	Jan Buchanan	Contact No:	01475 712223
Subject:	Forthcoming Changes in Basis of Valuation of Highways Network Assets (HNA)		

1.0 PURPOSE

- 1.1 The purpose of this report is to give early advice to Elected Members of impending changes to the CIPFA Code of Practice on Local Authority Accounting in the United Kingdom.

2.0 SUMMARY

- 2.1 In the balance sheet of a local authority's annual accounts, highways network assets such as carriageways, footpaths, lighting columns and traffic lights are currently valued at depreciated historic cost (DHC) (or what it cost, written off in equal instalments over the assessed useful life).

The value of highways network assets (HNA) in Inverclyde Council's balance sheet is £43 million.

- 2.2 This valuation method is not consistent with how central government values its HNA. Its valuation basis is depreciated replacement cost (DRC) or in simple terms, how much it would cost to replace the asset on a new for old basis, written off on a "condition curve" basis. Since 2010, this methodology has been used for the provision of information for the Treasury's Whole of Government Accounts. A desktop assessment done by the Roads Service indicates that on this revised basis the value of HNA on the Council's balance sheet would rise to £208 million
- 2.3 CIPFA/LASAAC have been working over the last five years or so at a UK level with the professional bodies representing highways engineers in the development of the DRC valuation basis and periodically have given a steer on their approach, ahead of the issue of the detailed accounting policies in the 2016/17 Code of Practice. The central aim of the revised Code is that the same data should be used for asset management, financial management and financial reporting.

3.0 RECOMMENDATIONS

- 3.1 It is recommended that Members consider and note the progress made in preparation for the implementation of depreciated replacement cost for highways network assets.

4.0 BACKGROUND

- 4.1 In the balance sheet of a local authority's annual accounts, highways network assets such as carriageways, footpaths, lighting columns and traffic lights are currently valued at depreciated historic cost (DHC) or what it cost, written off in equal instalments over the assessed useful life.

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- 4.3 CIPFA/LASAAC have been working over the last five years or so at a UK level with the professional bodies representing highways engineers in the development of the DRC valuation basis and periodically have given a steer on their approach, ahead of the issue of the detailed accounting policies in the 2016/17 Code of Practice. The central aim of the revised Code is that the same data should be used for asset management, financial management and financial reporting.
- 4.4 These changes will not come into effect until the financial year 2016-2017. Nevertheless, the changes will inevitably involve considerable advance planning and preparatory work in the lead up to implementation. The most fundamental change will be a very significant increase in the value of transport infrastructure assets in the Annual Accounts. There will no direct effect upon reserves, council tax or the taxpayer as the impact will be absorbed by adjustments between the accounting basis and funding basis under regulations

5.0 PROGRESS

- 5.1 There are considerable practical challenges for a migration to the new basis of measurement given the sheer scale of HNA held by local authorities. Our Roads Service has been compiling and refining the local inventory of HNA assets using a sampling basis over the past five years. This broad-brush approach is very different to the well-established valuation methods for other assets of the council which have a much greater degree of individual precision.
- 5.2 An outline project plan was prepared by Finance and Roads staff last year in accordance with CIPFA guidance and in the Spring of this year this was discussed with external audit. More recently, the Council has responded to an invitation from CIPFA/LASAAC for Scottish local authorities to notify them of any TIA issues. This is attached at **Appendix 1** which also includes the proposals for actions to be taken by the Chief Financial Officer.

6.0 IMPLICATIONS

6.1 Finance

There are no direct financial costs to the Council as a result of the change in valuation method, all costs of performing the revaluation will be contained within existing budgets.

The revaluation will impact the Council's Balance Sheet, however, current estimations are that the Council's HNA will increase from £43m to £208m, increasing Property, Plant & Equipment from £422m to £587m. Unusable Reserves will similarly increase from the current deficit, largely as a result of the Pension Reserve, of £34m to a surplus reserve of £131m.

Financial Implications:

One off Costs

Cost Centre	Budget Heading	Budget Years	Proposed Spend this Report £000	Virement From	Other Comments
N/A					

Annually Recurring Costs/ (Savings)

Cost Centre	Budget Heading	With Effect from	Annual Net Impact £000	Virement From (If Applicable)	Other Comments
N/A					

6.2 Legal

There are no legal implications arising from this report.

6.3 Human Resources

There are no HR implications arising from this report.

6.4 Equalities

The report has no impact on the Council's Equalities policy.

6.5 Repopulation

There are no Repopulation implications arising from this report.

7.0 CONSULTATIONS

7.1 Environmental Services has been consulted in the preparation of this report.

8.0 LIST OF BACKGROUND PAPERS

8.1 None.

Appendix 1

Highways Network Assets (HNA) Valuation		
Issue	Guidance sought from CIPFA/LASAAC	Actions

Highways Network Assets (HNA) Valuation		
Issue	Guidance sought from CIPFA/LASAAC	Actions
<p>1. Demonstration of progress for the 2014-2015 audit and during the financial year 2015-2016</p>	<p>Clarity about the expectations of CIPFA/LASAAC, the professional accounting standard setters in Scotland.</p>	<ul style="list-style-type: none"> • An outline project has been prepared by Finance and Roads staff in accordance with LAAP Bulletin 100 and discussed with external audit as part of the 2014-2015 audit. • An initial examination has been made of the Council's Asset Register to identifying balances which relate to HNA and those which relate to non-HNA infrastructure. • The establishment of prior year comparatives (once the financial year 2015-2016 is completed) a key early milestone in the project plan. • LASAAC has been advised and has incorporated the development of further guidance into its work plan.
<p>2. Chief Financial Officer's (Section 95 Officer) responsibility for verification of the valuation</p>	<p>The valuation will be calculated locally using a nationally developed Valuation Model that has national rates for valuation and depreciation per CIPFA asset categories. The Roads department has been compiling and refining the local inventory of HNA assets using a sampling basis. This broad-brush method is very different to the well-established valuation methods for other assets of the council which have a much greater degree of individual precision. Guidance has been sought regarding the amount of verification that is expected of the s95 Officer for:</p> <ul style="list-style-type: none"> • Assumptions made in the Valuation Model about national rates, useful life of assets and depreciation. 	<ul style="list-style-type: none"> • The CFO will ensure that in the Annual Accounts for 2016-2017: <ul style="list-style-type: none"> ○ suitable accounting policies have been selected and applied consistently; ○ judgements and estimates have been made that are reasonable and prudent; ○ the Local Authority Accounting Code has been complied with; and ○ adequate accounting records are maintained • During 2015-2016 further work will be undertaken to clearly establish responsibility between council service for the satisfactory operation of the spreadsheet Valuation Model and SCOTS valuation toolkit. • An explanation of the HNA valuation process will be included in the accounting polices note in the 2016-2017 Annual Accounts.

Highways Network Assets (HNA) Valuation		
Issue	Guidance sought from CIPFA/LASAAC	Actions
	<ul style="list-style-type: none"> • Accuracy of inventory (i.e. carriageway length / asset numbers etc) • Classification of HNA assets by local Roads staff. • Annual impairment review by local Roads staff • Analysis of movements during the financial year under review. 	<ul style="list-style-type: none"> • A formal assurance on HNA valuations will be required from an expert engineer within the Council (similar to that already provided by the Council Valuer regarding his professional advice on land and buildings valuations) certifying that the HNA valuation has been done according to recognised professional standards. • CIPFA/LASAAC has been advised and has incorporated the development of further guidance into its work plan
3. Capital Expenditure	<p>Capitalisation and the Roads Asset Management Plan</p> <ul style="list-style-type: none"> • There is the potential for capital investment on an existing transport asset not adding £ for £ to its new replacement cost valuation. 	<ul style="list-style-type: none"> • Analysis of future investment programme to separately identify capital plans for infrastructure between HNA and non-HNA capital plans). • CIPFA/LASAAC has been advised and has incorporated the development of further guidance into its work plan re: <ul style="list-style-type: none"> ○ Clarification about future policy on capitalisation (ability to borrow) of expenditure on transport assets where there is no corresponding increase in the replacement value. ○ Clarification of application to historic capital spend.
4. Inventory	<p>Inventory accuracy and use of estimates</p> <ul style="list-style-type: none"> • A 100% check of the details of carriageway lengths/widths/condition etc. would be impracticable and not justifiable in terms of cost benefit. • A degree of sampling will be inevitable given the extent of the transport inventory, the lack of additional resources and the time available. 	<ul style="list-style-type: none"> • CIPFA/LASAAC has been advised and has incorporated the development of further guidance into its work plan re: <ul style="list-style-type: none"> • Clarification of the level and detail of inventory records • Clarification of the requirements and arrangements for verification of inventory records.

Highways Network Assets (HNA) Valuation		
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5. Impact on Financial Statements	Incorporation of information about gross replacement cost, depreciation and net value from stand-alone Valuation Model into the Council's corporate fixed asset register. The corporate fixed asset register calculates annual depreciation according to pre-set rules in the software and some manual intervention will be necessary to tie up values between the two sets of records.	<ul style="list-style-type: none"> • During 2015-2016 there will be a short life Officer Working Group established to examine the level of detail for HNA held in the Valuation Model inventory; how best to summarise this information and transfer it across into the corporate fixed asset register; and how best to compile working papers suitable for external and internal audit. • Depreciation in the corporate asset register will be manually applied for HNA, based on the engineer's depreciation calculation. • CIPFA/LASAAC has been advised and has incorporated the development of further guidance into its work plan.
6. Audit arrangements	<p>It seems efficient and reasonable for the national SCOTS Valuation Model and toolkit to be verified centrally by Audit Scotland. This would provide a welcome and consistent approach across Scottish local authorities and help minimise duplication of audit work. The rates common to all authorities could also be verified.</p> <p>An associated issue is that 2016-2017 will not just be the first year of the new valuation basis. It will be the first year of the new five-year audit appointments and inevitably there will be some loss of audit understanding and local knowledge as the Grant Thornton our current auditors depart. The handover by Grant Thornton to the incoming auditors will need to be carefully managed and should have nationally set ground rules.</p>	<ul style="list-style-type: none"> • CIPFA/LASAAC has been advised and has incorporated the development of further guidance into its work plan re: <ul style="list-style-type: none"> ○ Central verification by Audit Scotland and version control of the spreadsheet tools and the rates applied. ○ Early verification of the rates and spreadsheets. • We will work with Grant Thornton during 2015-2016 (the final year of their appointment) to establish protocols for the handover of audit work on HNA and the integrity and consistency of approach between outgoing and incoming auditors.