

# WORKING THROUGH THE GUIDELINES

## STRUCTURE

The Guidelines are set out in four parts.

**PART A** introduces the guidelines and gives the background to the guidelines, including the reasons for development of the guidelines.

**PART B** discusses the planning phase of infrastructure financial management, namely service planning, asset management and long-term financial planning.

**PART C** describes the regulatory framework covering financial reporting and auditing of financial reports.

**PART D** covers practical application of the above parts to valuation, accounting for infrastructure, financial reporting and planning, administration and implementation.

The guidelines are divided into 14 Sections covering the major issues involved in financial management of infrastructure being:

### PART A INTRODUCTION

1. Introduction
2. Sustainability

### PART B PLANNING

3. Service Planning
4. Infrastructure Asset Management Planning
5. Financial Planning
6. Reviewing a Service/Funding Gap

### PART C FINANCIAL REPORTING

7. Financial Reporting Framework
8. Principles of Disclosure in Financial Statements
9. Accounting for Property, Plant and Equipment
10. Accounting for Impairment
11. Auditing

### PART D APPLICATION

12. Accounting for Infrastructure
13. Administration and Implementation
14. Appendices

A list of References is included within each Section.

## CORE AND ADVANCED USERS

The guidelines are designed to cover the needs of ‘core’ (those beginning the process) and ‘advanced’ users. Moving from a ‘core’ approach to an ‘advanced’ approach is one of continuous improvement in priority areas.

The guidelines provide key points for each section to assist users in their implementation.

## PART A INTRODUCTION

### SECTION 1 INTRODUCTION

Section 1 introduces the reader to the concepts of infrastructure financial management commencing with infrastructure and financial sustainability studies undertaken in Australia over the last 10 years.

These studies identified deficiencies in service planning, asset management planning, long-term financial planning and financial reporting [Section 1.2].

The Australian Local Government and Planning Ministers Council have provided a national direction in their adoption of nationally consistent frameworks on financial sustainability covering three areas:

Framework 1 – Criteria for Assessing Financial Sustainability.

Framework 2 – Asset Planning and Management.

Framework 3 – Financial Planning and Reporting.<sup>1</sup>

All entities providing services from infrastructure are encouraged to take a long-term view to financial sustainability through the development of asset management plans for services from infrastructure and long term financial plan covering a period of 10 years [Section 1.3].

<sup>1</sup> LGPMC, 2007

Asset management plans, risk management plans and long-term financial plans provide the tools to look at future investments and consider levels of service, risks, costs and community needs and affordability in providing services [Section 1.4].

## **SECTION 2 SUSTAINABILITY**

Section 2 discusses the results and implications of the financial sustainability reports discussed in Section 1.

An organisation is sustainable if its infrastructure capital and financial capital is able to be maintained over the long-term. Financial sustainability for local governments is defined as being able to manage likely developments and unexpected financial shocks in future periods without having at some stage to introduce substantial and economically significant or socially destabilising income or expenditure adjustments.<sup>2</sup>

This section discusses how the objective of providing services from infrastructure in a financially sustainable manner is approached from an asset and financial management point of view.

The task of the asset managers is to provide present and future services required or sought by the community at the service level and cost that the community is willing to pay where cost is based on minimising life cycle cost for any given service level.

The finance manager has the same objective and to assist should prepare a long-term financial plan to indicate how the services needed by the community are to be funded in a financially sustainable, affordable and equitable manner.

The asset manager reports on sustainability in several ways including:

- projected trends in services and service levels, and
- future renewal funding positions.

The finance manager's financial reports disclose the entity's ongoing operating capability.

The financial management perspective is that of maintaining operating capacity, which requires maintaining both infrastructure and financial capital.

The asset manager's objective of achieving sustainable service delivery and the finance manager's objective of maintaining operating capability are one and the same [Section 2.4].

Performance measures are signals used to convey direction being taken by an entity and to assess whether desired outcomes are being met.

Financial indicators provide valuable information to assist managers achieve the position of sustainability. Eight financial indicators are recommended to guide organisations along the pathway to financial sustainability [Section 2.6].

## **PART B PLANNING**

### **SECTION 3 SERVICE PLANNING**

Service planning and delivery is about how an organisation, working with its partners, prioritises what services are needed to meet the needs of its customers/community.

Section 3 takes the reader through the service planning process with examples of how service planning is used in providing services from infrastructure.

The section covers service planning objectives and relating service planning to customer levels of service, [Section 3.4] and community engagement [Section 3.5].

It includes guidelines for assessing customer/community needs and the quantity and quality of infrastructure required to provide the required level of service [Section 3.6].

The financial sustainability of service delivery is addressed by considering the life cycle cost for new development proposals and services in all investment decisions [Section 3.7].

Service planning is essential for asset managers to know what services are to be provided, at what service level and what resources are required to sustain the service delivery.

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<sup>2</sup> QTC quoted in DLGPSR, 2007, p 22

## SECTION 4 INFRASTRUCTURE ASSET MANAGEMENT PLANNING

Section 4 discusses the infrastructure asset management planning process. Asset management planning is a process to ensure delivery of services from infrastructure is provided in a financially sustainable manner.

The infrastructure asset management planning process includes:

- asset management policy [Section 4.3.1],
- asset management strategy [Section 4.3.2],
- asset management plan [Section 4.3.3].

Guidance is given on

- the adoption of a ‘core’ or ‘advanced’ approach to asset management [Section 4.4],
- data quality assurance [Section 4.5], and
- developing expenditure projections for long-term financial plans [Section 4.6].

Linking asset management planning to long-term financial planning is an essential part of infrastructure financial management.

## SECTION 5 FINANCIAL PLANNING

Financial Planning is an essential component of optimally providing services from infrastructure. A financial plan is a plan for generating, spending and saving future income and raising and repaying borrowings as appropriate.

A financial plan seeks to efficiently and equitably accommodate ongoing funding of:

- existing services - operations, maintenance, asset renewal and upgrade, and
- new services and assets as required.

A financial plan includes an estimation of cash needs and a decision on how to raise the cash such as through operational savings, raising taxes, fees and charges or borrowings.

Section 5 covers the basics and essentials of financial planning including identifying the resources required to provide services, the relationship between asset management plans and long-term financial plans [Sec 5.5], when the resources are required, how the resources can be provided, selecting the most appropriate funding source, the role of borrowings [Sec 5.6] and when is it appropriate to borrow [Sec 5.7].

## SECTION 6 REVIEWING A SERVICE FUNDING GAP

The various infrastructure studies undertaken throughout Australia conclude that most organisations providing services from infrastructure will need to expend considerably more in future for asset maintenance, renewal and replacement than current income streams allow in order to maintain existing service levels from infrastructure. This shortfall is often referred to as a service funding gap.

A service funding gap may be addressed by:

- reviewing levels of service,
- improving efficiency,
- reviewing projected renewals,
- increasing funding [Section 6.3.3].

Identifying and quantifying any service funding gap is an essential part of asset management and long-term financial planning. This then provides the opportunity for service planners to engage with their communities and other stakeholders to prioritise service delivery and determine appropriate and sustainable service levels.

Section 6 covers the processes of managing a funding gap and options for moving towards sustainable service delivery. It includes case studies for:

- improving efficiency,
- sale of under-used assets,
- use of borrowings
- alternate income streams, and
- service partnerships [Sec 6.3].

## PART C FINANCIAL REPORTING

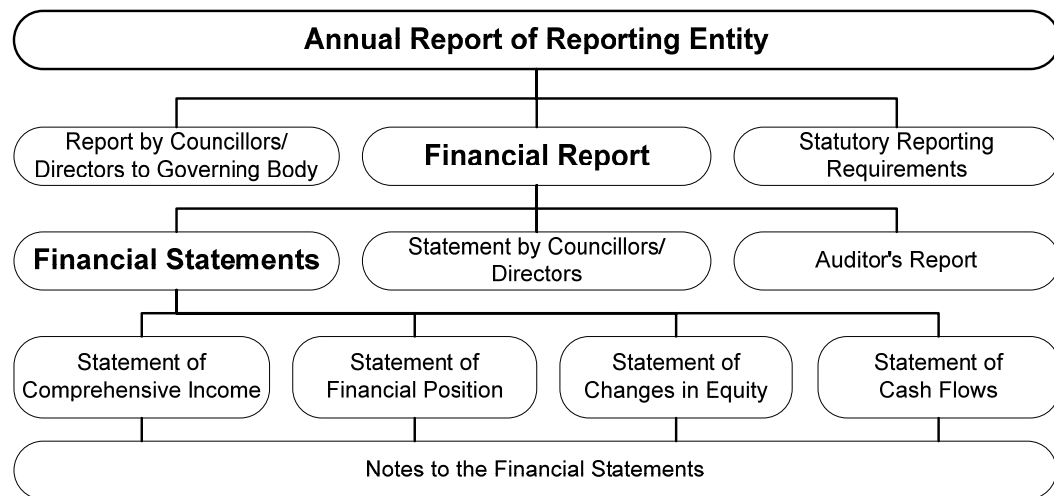
### SECTION 7 FINANCIAL REPORTING FRAMEWORK

Section 7 outlines the financial reporting framework prescribed in Australian Accounting Standards.

It is essential that key persons involved in providing services from infrastructure have an understanding of financial reports and their purpose of conveying information to stakeholders on the financial performance and position of entities.

An overview of the financial reporting framework is shown in Figure 1.

Figure 1: Financial Reporting Framework



Financial reports also show the results of management’s stewardship of the resources entrusted to it.

To meet this objective, financial reports provide information about an entity’s:

- (a) assets,
- (b) liabilities,
- (c) equity,
- (d) income and expenses, including gains and losses,
- (e) other changes in equity, and
- (f) cash flows.

This information, along with other information in the notes, assists users of financial reports in predicting the entity’s future cash flows and, in particular, their timing and certainty.

### SECTION 8 PRINCIPLES OF DISCLOSURE IN FINANCIAL STATEMENTS

The section discusses the principles underlying the disclosures in financial statements required by accounting standards and generally accepted accounting practice.

The financial statements, supported by notes to the financial statements provide information to assist users of financial reports to assess two major areas of the organisation’s performance:

- (a) management’s stewardship of the resources entrusted to it, and;
- (b) the timing and certainty of the entity’s future cash flows.

The disclosure principles are designed to ensure the accuracy and reliability of information provided in financial statements, for users to assess the areas of the organisation’s performance.

### SECTION 9 ACCOUNTING FOR PROPERTY, PLANT AND EQUIPMENT

Section 9 details the accounting requirements for property, plant and equipment assets contained within Australian Accounting Standards.

Property, plant and equipment are 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
- expected to be used during more than one period.

Infrastructure assets are classified as items of property, plant and equipment.

## SECTION 10 ACCOUNTING FOR IMPAIRMENT

A significant concern for preparers and users of financial statements is whether the values of the assets reported have been overstated.

Impairment occurs where the carrying amount of an asset is greater than its recoverable amount. Recoverable amount is the higher of an asset's fair value less costs to sell, and value-in-use.

Section 10 discusses the seven indicators of impairment and provides guidance for testing and assessing impairment of assets [Sec 10.3].

## SECTION 11 AUDITING

Section 11 provides an overview of the basic elements of the financial report auditing process and of the reporting obligations of the auditor.

The audit process, involving planning and evidence collection, is geared toward the expression of an opinion on the financial report.

The differences between accounting and auditing are examined to provide a basis for understanding how an audit is accomplished in conformity with Australian auditing standards. Most of the auditor's work in forming an opinion on the financial report consists of obtaining and evaluating evidence about the assertions in the financial report.

The auditor is required to express an opinion as to whether the financial report "gives a true and fair view" or "presents fairly", in all material respects, in accordance with an applicable financial reporting framework [Section 11.1].

This section contains details on:

- the financial audit process [Section 11.2],
- approach to audit of infrastructure assets [Section 11.4],
- role of the engineer/asset manager [Section 11.5],
- audit committees [Section 11.6], and
- corporate governance and the financial management of infrastructure [Section 11.7].

## PART D APPLICATION

### SECTION 12 ACCOUNTING FOR INFRASTRUCTURE

Section 12 applies accounting standards, generally accepted accounting principles, asset management and management reporting needs to accounting for infrastructure.

Organisations providing service from infrastructure are capital intensive. They often have a much higher ratio of assets to income than other organisations. Optimising asset management is more critical and more beneficial for such organisations.

The process of accounting for infrastructure is described [Sec 12.1].

The classification of assets is one of the most critical stages in asset accounting and asset management. [Sec 12.2]

In general terms, an asset represents the value of an investment made to provide future economic benefits to an entity. The future economic benefits may be in the form of cash or cash equivalents or for not-for-profit (including public sector) entities, the future economic benefits come from meeting the entity's objectives of providing goods and services. The asset is initially recognised [Sec 12.3] at its 'cost' when it is available for use or at its fair value at date of acquisition for assets acquired at no or nominal cost by not-for-profit entities.

#### Infrastructure to Provide Future Economic Benefits (from Horticultural Services)



Robert Clark Conservatory, Ballarat Botanical Gardens, Vic.

A complex asset is a property, plant and equipment item that is capable of disaggregation into significant components. The component is the *unit of account* for assets where the component is recognised in the asset register. Guidance is provided for identifying components of complex assets. [Sec 12.4]

While recording of numerous small value assets is required for asset management purposes, grouping and recording these assets as a network asset [Sec 12.5] can assist in meeting financial reporting requirements.

A capitalisation policy [Sec 12.6] sets the threshold for recognition of capital expenditure as assets. Where the cost of an asset falls below the capitalisation threshold, is it expensed.

Valuation of assets is discussed in Sec 12.7. Asset values are used for financial reporting and renewal planning.

An asset is said to be impaired when its *carrying amount* exceeds its *recoverable amount*. Entities are required to make an assessment at the reporting date each year, if there are any indicators that an asset may be impaired. If so, the entity is to estimate the recoverable amount and recognise any impairment loss. Examples are provided for external and internal indicators of impairment of infrastructure assets to assist in meeting the impairment testing requirement [Sec 12.8].

Included in the cost of an asset are associated overhead costs [Sec 12.9]. Guidance is provided to assist in identifying, costing and recognising engineering and corporate services indirect costs.

Sec 12.10 describes the useful life of an asset as the period that the asset is expected to provide services to the entity. It is generally the lesser of economic and physical life, although a multi-condition test should be applied in determining remaining and useful life. The guidelines give a method of determining remaining and useful life of assets based on the entity's experience with similar assets.

Residual value is 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 at the end of its useful life. Residual value may be recognised in infrastructure in certain circumstances such as where the asset has a salvage value and/or cost to renew an asset is less than the cost to replace the asset. Residual value may be used to relate the asset's asset management practices and procedures to its accounting treatment. A case study is used to illustrate this process [Section 12.11].

Fair Value is the best estimate of the price reasonably obtainable in the market at the date of valuation where a market exists. This is often not the case for existing infrastructure assets, in which case fair value is *depreciated replacement cost*. Sec 12.12 discusses fair value and how to calculate it.

The consumption of infrastructure and other assets is reported in financial statements as depreciation. Depreciation [Sec 12.13] is the systematic allocation of the depreciable amount of an asset over its useful life. The depreciation method used is to reflect the pattern in which the asset's future economic benefits are to be consumed by the entity.

There are at least 4 measures of asset consumption, each of which can be related to a method of depreciation:

- when consumption is constant over the useful life of the asset – straight line method,
- when consumption is greater in the early years and less in the later years – declining balance method,
- when consumption increases as the asset approaches the end of its useful life – output/service basis method,
- when consumption varies with outputs/service – units of production method.

Examples are provided on how to select the appropriate depreciation method.

Regular revaluation [Sec 12.14] is often mandated for infrastructure intensive organisations and is also a requirement with the adoption of the 'revaluation model' option under AASB 116 *Property, Plant and Equipment*.

The revaluation model requires an item of property, plant and equipment whose fair value can be measured reliably, to 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 are 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 reporting date.

When an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs is to be revalued.

Valuation methods are discussed in [Sec 12.15](#).

This section included commentary on:

- depreciated replacement cost methodology [\[Sec 12.15.2\]](#),
- assets withdrawn from use [\[Sec 12.15.12\]](#),
- heritage and cultural assets [\[Sec 12.15.13\]](#),
- land under roads [\[Sec 12.15.14\]](#),
- revaluations [\[Sec 12.15.15\]](#),
- commissioning a valuation [\[Sec 12.15.16\]](#),
- valuation reports [\[Sec 12.15.17\]](#), and
- disclosures [\[Sec 12.15.18\]](#).

## **SECTION 13 ADMINISTRATION AND IMPLEMENTATION**

Section 13 discusses the development and review of business processes to accommodate asset management, financial management and financial reporting.

Documented good business processes for infrastructure asset management and accounting can ensure that the necessary tasks are completed using procedures to simplify and make the tasks more efficient.

Examples are given for:

- reporting on level of service performance [\[Section 13.2\]](#),
- recording the cost of an asset [\[Section 13.3\]](#),
- incorporating levels of service into the budgeting process [\[Section 13.4\]](#), and
- presenting life cycle cost information [\[Section 13.5\]](#).

## **SECTION 14 APPENDICES**

Additional information is provided as appendices to support practitioners in implementing the recommendations of the guidelines.

This information is provided for:

- service planning guidelines covered in Section 3.6 [\[Sec 14.1\]](#),
- summary tables for a long-term financial plan proposed in Section 5.4 [\[Sec 14.2\]](#),
- infrastructure hierarchy examples described in Section 12.2 [\[Sec 14.3\]](#),
- example of a capitalisation policy to illustrate Section 12.6 [\[Sec 14.4\]](#), and
- a template to document assessment of asset condition and remaining/useful life discussed in Section 12.10.2 [\[Sec 14.5\]](#).