CT/15/78
Audit Committee
22 September 2015

Highways Network Asset Consultation
Report of the County Treasurer

Please note that the following recommendations are subject to confirmation by the Committee before taking effect.

1. Recommendations – it is recommended that members:

1.1. Approve the Authority's response to the Chartered Institute of Public Finance and Accountancy's (CIPFA's) invitation to comment on the 2016/17 Code of practice on local authority accounting in the United Kingdom (Appendix 3)

2. Background

2.1. The purpose of this report is to ask Members to consider and approve the Authority's response to CIPFA's invitation to comment on the 2016/17 Code of practice on local authority accounting in the United Kingdom with respect to transport infrastructure assets.

2.2. The proposals include fundamental changes to the Code as a result of the move to measuring the Highways Network Asset at Depreciated Replacement Cost. It will see the creation of a new Highways Network Asset (a network of components of transport infrastructure assets) and includes specific recognition, measurement and derecognition policies for these assets.

2.3. The Audit Committee at its meeting on 30th June 2015 considered the potential impact of revaluing the Authority's assets in line with CIPFA and government requirements. Highway assets would be valued at depreciated replacement cost, rather than as was previously the case, using historical costs and applying depreciation.

2.4. In accordance with the decision of the Audit Committee, the Chairman wrote to CIPFA and the Secretary of State for Communities and Local Government expressing the Committee's concerns over changes to CIPFA's Code of Practice, causing a significant increase in the value of the Council's highway infrastructure assets from £425 millions to an estimated value of £8 billions to £9 billions (carriageways). The letter to CIPFA is attached in Appendix 1 (The letter to the Secretary of State used similar wording and is not copied.)

2.5. The response from CIPFA (Appendix 2) referred to effective highways asset management but did not answer the Chairman's specific question – a justification of the significant increase in the Authority's asset values.

2.6. CIPFA's invitation to comment on the proposed changes to the Code of Practice 2016/17 has a closing date of 9th October. This provides another opportunity for the Authority to question the move to valuing the highways infrastructure asset at depreciated replacement cost and the significantly increased asset values.

2.7. The latest total estimated value of the Highways Network Asset has increased to almost £16 billions (when land values, lighting and traffic management are included).

3. Key Messages

3.1. In its invitation to comment on the Highways Network Asset CIPFA's four questions cover:
- 3.1.1. Recognition.
- 3.1.2. Measurement
- 3.1.3. Derecognition
- 3.1.4. Transition Arrangements

3.2. Recognition – CIPFA proposes that transport infrastructure assets should be recognised as a separate class of assets on the face of the balance sheet and that the network should be treated as a single asset. The Authority's draft response agrees with this proposal. All the elements that make up the network such as bridges, street lighting and traffic management exist for a single purpose and is consistent with other public sector entities that hold transport infrastructure (such as the Highways Agency). Otherwise it would cause unnecessary difficulties trying to separate out individual service flows within the highways network.

3.3. Measurement. We have taken the opportunity to reiterate the points made in the Chairman's letter (dated 24th July) to question the reliability of valuing the transport infrastructure assets at depreciated replacement cost and the significant increase in the value in the balance sheet (from £425 millions currently to a revised total of almost £16 billions). This revised vaulation basis does not help the user of the accounts to asset the Authority's net assets: the value of transport infrastructure assets will be many times greater than the aggregate value of all other assets in the balance sheet. There are proposals in the detail of the implementation (such as estimating depreciation using the aggregate cost of all capital replacements and reinstatements) that are helpful.

3.4. Derecognition. When parts of the transport infrastructure assets are replaced such as new road surfaces then the Code's proposals provide practical advice on how to estimate the value of the part being replaced. It suggests using the cost of replacement work can be used as an estimate, which we welcome as being a practical solution to what might have been a more complicated accounting and valuation process.

3.5. Transition. The revaluation reserve will be substantially increased on application of the new measurement requirements and anecdotal evidence has indicated that it might be difficult to split the new opening (depreciated historic cost) balance for transport infrastructure assets from the previous infrastructure asset class within property plant and equipment. CIPFA is proposing a transitional approach for the estimation of the split which will have to be applied retrospectively to 1 April 2015.

3.6. Grant Thornton has provided the following comments:

- 3.6.1. "..This is a challenging area that is expected to raise significant issues for authorities due to the size and complexity of the entries that will have to be made.

3.6.2. The proposals are creating concerns for many authorities (and auditors). This has resulted in a readiness survey from CIPFA for all local authorities.

3.6.3. We, and other audit firms, are members of a Working Group hosted by CIPFA and attended by NAO and relevant Government departments to discuss the way forward on this.

3.6.4. CIPFA's proposals are set out in the 2016/17 Code Consultation. We are still working on our response to the Code Consultation which is due for submission by 9 October.

3.6.5. Grant Thornton's internal briefing document on matters that auditors should be discussing with clients to assess progress and form a basis for subsequent discussions on how these should be addressed is being launched at the Audit Conference on 10 and 11 September. Liz Cave will share that with Devon as soon as it is available…."

6. Conclusion

5.1 In CIPFA's invitation to comment on proposed changes to the Code of Practice 2016/17 we have reiterated the points in the Chairman's letter of 24th July (Appendix 1) questioning the basis for the significant increase in value of transport infrastructure assets. We have also commented on the practical proposals to simplify the implementation of the changes.

Mary Davis
County Treasurer

Electoral Divisions: All

Local Government Act 1972

List of Background Papers

Contact for Enquiries: Angie Sinclair
Tel No: (01392) 38 0711 Room 196

Background Paper	Date	File Ref

There are no equality issues associated with this report

Appendix 1

County Treasurer
County Hall
Topsham Road
Exeter
EX2 4QD

Mr Ian Carruthers
Executive Director – Policy and Standards
CIPFA
77 Mansell Street
LONDON
E1 8AN

Tel: 01392 383310
Email: mary.davis@devon.gov.uk

24th July 2015

Dear Mr Carruthers

Re: CIPFA's Code of Practice on Transport Infrastructure Assets

We note with concern the additional time that officers at Devon County Council have spent and will continue to spend in preparing for the CIPFA Code of Practice on Transport Infrastructure Assets in the overall context of the imperative to reduce costs and make efficiencies in this time of austerity.

We note the significant increase in the value of our highway infrastructure assets from £425 million to around £8 billion to £9 billion as a result of changes to CIPFA's Code of Practice. On that basis we question the reliability of these revised asset values and we would like an explanation of how this increase is really justified please, especially when such assets, by their nature, could not really ever be sold off. The changes do not help the user of the accounts to assess the real net assets of the Authority. Does this create a true and fair view of the financial position of the Authority?

We consider the costs of this accounting exercise to outweigh the benefits of moving from a historic cost accounting to a theoretical current cost valuation for roads, bridges and other transportation assets.

Any practical steps and guidance to local authorities and auditors to limit the scale of the exercise (and hence reduce the costs) of this implementation would be appreciated.

In future, CIPFA should ensure that changes to how accounting standards are applied to the public sector are assessed to ensure that the practical benefits (such as relevance and transparency) outweigh the costs of implementation.

Yours sincerely,

Councillor Richard Edgell
Chair of the Audit Committee

Appendix 2

From: Scott, Alison [mailto:alison.scott@cipfa.org]
Sent: 17 August 2015 15:13
To: Mary Davis
Subject: R.Edgell - CIPFA's Code of Practice on Infrastructure Assets

Dear Mr Edgell,

Ian Carruthers has passed your letter of 24 July on to me and asked me to respond on his behalf.

When CIPFA was developing the Code of Practice on Infrastructure Assets its key objective was to use the same information required for effective asset management to provide the financial data for the Whole of Government Accounts and individual local authorities statements of accounts. The Code seeks to promote effective highways asset management underpinned by high quality data and has been developed working with the Highways Asset Management Finance Information Group (HAMFIG) to ensure that asset management remains at the heart of the code and is based wherever possible on data local authorities already possess and data that will help asset management. The Department for Transport has recognised the importance of asset management data for effective asset management and has committed to using the data in funding settlements moving forward.

At the same time CIPFA/LASAAC recognises the challenge the introduction of the new accounting arrangements will bring to some authorities and has continued to monitor preparedness and work with the audit community to ensure that the introduction is managed in as coordinated and cost effective manner as possible. We do believe however that obtaining a true value for the vital infrastructure assets held by councils will help to inform the debate about future resources and properly reflect the economic value of those assets. CIPFA will continue to work with local authorities and auditors towards a successful implementation of the new arrangements.

Yours sincerely

Alison Scott

Alison Scott, CPFA, BSc (hons.)

Head of Standards and Financial Reporting

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Appendix 3

Proposed response to CIPFA's invitation to comment on the 2016/17 Code of Practice on Local Authority Accounting in the United Kingdom

Question	**Authority's Response**
1. Do you agree with the proposed new Section 4.11 and the proposed amendments to section 4.1 of the Code for the definition, recognition and scope of the Highways Network Asset? If not, why not? What alternatives do you suggest?	We agree that transport infrastructure assets should be recognised as a separate class of assets on the face of the balance sheet and that the network should be treated as a single asset.
2. Do you agree with the proposed new Section 4.11 and the proposed amendments to section 4.1 of the Code for the measurement of the Highways Network Asset? If not, why not? What alternatives do you suggest?	There is no disagreement with the proposal that depreciation could be estimated from the capital replacements / reinstatements needed to restore the service potential over the useful life. This method of calculating depreciation is more meaningful than spreading inflated notional "replacement values" of our highway network asset over their useful lives. We expect a significant increase in the value of our highway network asset from £425 million to almost £16 billions (of which carriageways accounts for £10 billions) as a result of changes to CIPFA's Code of Practice. On that basis the Audit Committee questions the reliability of these revised asset values especially when such assets, by their nature, could not really ever be sold off. The changes do not help the user of the accounts to assess the real net assets of the Authority. We do not disagree with the proposal to reflect the movements in value of the asset due to condition will be by means of revaluation gains or losses and not reflected in charges for depreciation. The proposal to retain accumulated depreciation on revaluation of the asset is not consistent with the treatment of the Authority's other non-current assets – where it would be eliminated. This difference further underlines the fact that using depreciated replacement cost for highways infrastructure does not produce meaningful values in the same way that values are calculated for the Council's other land and buildings.

3.	Do you agree with the proposed new Section 4.11 and the proposed amendments to section 4.1 of the Code for the derecognition of components of the Highways Network Asset? If not, why not? What alternatives do you suggest?	It is a reasonable approach to use the cost of a replaced part such as the surface of road as an estimate of the value of the part it has replaced. However, this ignores the condition of the part that has been replaced but the improvement to the road will be recognised in a subsequent valuation or condition survey.
4.	Do you agree with the transitional provisions in the Code for the move to measurement of the Highways Network Asset at DRC? If not, why not? What alternatives do you suggest?	We agree with the discretion to allow estimates, where it is difficult to precisely calculate the new opening balance for transport infrastructure assets from the previous infrastructure assets class within property, plant and equipment.