SURREY
COUNTY COUNCIL

Audit & Governance Committee
26 Sep 2016

Highways Network Asset

Purpose of the report:

To inform the Committee about progress on the implementation of the Highways Network Asset for the Statement of Accounts for 2016/17. This is a fundamental change in the accounting treatment of infrastructure assets which will see the value of infrastructure assets held on the balance sheet increase from £364m as at 31 March 2016 to an estimated £30bn as at 31 March 2017.

Recommendations:

It is recommended that the Audit and Governance Committee notes that Surrey County Council is on target to implement the Highways Network Asset valuation requirements for the financial year 2016/17 in line with the required timetable.

Introduction:

1. The Council holds assets on its balance sheet in accordance with the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice. The long-term assets of the Council include £1,793m[1] of property, plant and equipment of which one component is infrastructure assets.
2. Infrastructure assets are currently held on the Council's balance sheet at historical cost in accordance with the CIPFA Code of Practice and are depreciated in accordance with the Council's accounting policies. For the 2016/17 financial year, CIPFA are introducing a change in how these assets are to be valued and shown in the Council's Statement of Accounts. Infrastructure assets will be re-grouped and classified as a single Highway Network Asset (HNA), which will be held on the balance sheet at depreciated replacement cost (DRC).
3. The Highways Network Asset (HNA) is a network and grouping of interconnected infrastructure components, expenditure on which is only recoverable by continued use of the asset created. The assets cannot be

[1] As at 31/03/16

transferred to another organisation so there is no prospect of sale or alternative use. The interconnected network is made up of carriageways, footways and cycle-tracks and the structures, street lighting and other components that are directly associated with them.

4. One of the main drivers for this change in accounting policy is to ensure consistency. Central government (Department for Transport) already use this valuation method for estimating the value of roads that they hold and maintain. One of the reasons the Whole of Government Accounts are qualified by their auditors is due to the discrepancy between central and local government in infrastructure valuations and the belief that local government highways assets are significantly undervalued in the consolidated government accounts.

Change in Valuation Methodology

5. DRC is a method of valuation defined in the CIPFA Code of Practice on Local Authority Accounting as the current cost of replacing an asset with its modern equivalent asset, less deductions for physical deterioration and obsolescence. It is generally used where there is no active market for the asset being valued and is therefore applicable to the Highways Network Asset.

6. To estimate DRC, gross replacement cost (GRC) is first estimated based on the cost of constructing a modern equivalent (new) asset. The difference between the gross and depreciated replacement cost is the value of the asset that has been consumed by the Authority during its useful life. Depreciation is estimated by allocating the GRC over the useful life of the asset.

7. The 2016/17 CIPFA Code of Practice on Local Authority Accounting requires the adoption of the asset valuation requirements of the Code of Practice on Transport Infrastructure Assets (The Transport Code). The Transport Code was first published in 2010 with the objective of using an asset management based approach to produce financial information in relation to HNA. The working group for highways asset management finance information group (HAMFIG) was set up to develop the Transport Code with CIPFA.

8. The valuation techniques for measuring GRC and DRC included in the Transport Code are based on inventory data such as length and width of carriageways. The age and condition of assets are also incorporated into valuations. For certain assets, central replacement costs and toolkits developed by CIPFA and HAMFIG are provided to local authorities to calculate valuations.

9. Since 2011, the Council has been required to submit HNA valuations on a DRC basis for the annual Whole of Government Accounts (WGA). This exercise has been completed on an unaudited basis at the request of HM Treasury to monitor the preparedness of local authorities.

Accounting Implications

10. The change in valuation methodology will have a significant impact on the financial statements of the Council. It will see the value of non-current assets increase substantially.

11. Currently infrastructure assets are held on the balance sheet under Property, Plant and Equipment at depreciated historic cost. A comparison with the new HNA valuation, as estimated in the 2015/16 WGA return, is shown in the table below. The infrastructure asset figure has been independently audited as part of the 2015/16 Statement of Accounts but the HNA figure is unaudited.

Treatment	Asset Class	Valuation basis	Valuation at 31.03.2016 £m
Current	Infrastructure Assets	Depreciated Historic Cost	364
Proposed	Highways Network Asset	Depreciated Replacement Cost	29,369

12. The Highways Network Asset valuation is broken down into seven component types

Component	Valuation as at 31.03.2016 £m
Carriageways	7,106
Footways & cycletracks	807
Structures	351
Streetlighting	229
Street Furniture	9
Traffic Management System	48
Land	20,819
Total	**29,369**

13. The tables above show that the change to DRC represents a significant increase to the total net assets on the Council's Balance Sheet for 2016/17. However, it should be noted that a corresponding entry in the Revaluation Reserve will mean the overall change to the net worth of the Council is zero.

14. Land makes up a significant component of the HNA valuation. The recognition requirements in the CIPFA Code of Practice on Local Authority Accounting means that all highway land where the Council controls the economic benefit and service potential of using the land, should be recognised on its balance sheet regardless of whether it is actually owned by the Council. This means that whilst the Council may not own the land under or at the side of the road, under the Code the value of that land needs to be included on the balance sheet.

15. The land valuation method uses the length of roads and the size of verges to estimate the relevant area of land used for the local highway. This is then multiplied by a centrally provided land value rate applicable to the Council. The combination of a large road network and high land values in Surrey combine to produce a high land valuation.

16. The increase in the net book value of assets will lead to increased depreciation charges and therefore increased costs of service in the Council's Comprehensive Income and Expenditure Account. However, as regulations prevent depreciation from being charged to the General Fund, there is no associated funding requirement and therefore no impact on the Council's budget.

17. There are additional disclosure requirements for HNA in the Statement of Accounts including a reconciliation of the carrying amount at the beginning and end of the financial year. This will be done at the HNA level and will not need to be broken down into each component type.

18. CIPFA have removed from the Local Authority Accounting Code of Practice the standard requirement to produce previous year comparator figures on a consistent basis. This will reduce the burden on local authorities as it means there is no requirement to restate preceding year information to provide the comparator figures.

19. The Finance team have continued to keep the Council's external auditors, Grant Thornton, up to date with progress on the implementation of the HNA. The project plan (annex 1) was shared with the auditors in December 2015 and regular communications are had regarding progress to date. As a result of this Grant Thornton have asked the Council to be a pilot authority for audit testing of HNA data and processes. They feel the Council is well prepared for the change compared to other authorities and therefore they intend to start auditing HNA information during October.

Progress to date

20. The project is being jointly managed by teams in Finance and Highways. As per CIPFA guidance, a project plan (annex 1) has been developed that provides a breakdown of the key tasks.

21. The key factor to successful implementation is the collection of robust asset data. For assets such as roads and structures robust inventory and condition data already existed as Surrey carries out accredited surveys in line with the Codes of Practice for Highway and Structures Management. The condition of these assets are assessed using nationally accredited survey equipment by qualified surveyors and for roads, the survey results are further audited by the Transport Research Laboratory annually.

22. For other assets a gap analysis was undertaken in 2010 to identify the completeness and accuracy of inventory and condition data for highway network assets. Over the past five years a programme of data collection has taken place where gaps were identified, some examples of this are;

    - A five year data collection exercise took place to collect both inventory and condition data for all footways in Surrey;

- a complete inventory and rolling programme of condition data collection for all safety barriers has been collected; and
- inventory and condition data for various elements of street furniture were collected via a video survey.

23. In terms of calculating the required data, for the most significant assets (Carriageways, Footways and Structures) the market leading Asset Management Systems used by SCC to manage inventory and condition data have been adapted to provide calculations for DRC. The system used to calculate the data for Carriageways and Footways, the largest value assets other than land, is one of the systems recommended by HAMFIG; a nationally accredited United Kingdom Pavement Management System (UKPMS) which undergoes an "annual health check" which includes ensuring compliance with the Transport Code. The condition data used by UKPMS is data provided annually to Department for Transport and the rates which determine its modern equivalent value are provided centrally by CIPFA. Calculation of the data for other material assets is generated using toolkits provided by HAMFIG.

24. A large proportion of the inventory data and IT systems and processes are in place to hold and calculate the required data and officers have engaged fully with CIPFA and other authorities to ensure correct usage of toolkits and to benchmark data. Therefore we are on target to produce materially accurate data for the 2016/17 Statement of Accounts.

Conclusions:

25. The introduction of the HNA and the changes required in the valuation method will have significant implications for the Council's balance sheet at 31 March 2017 and onwards.

26. The preparations made so far mean we are well placed for a transition to the new valuation of Highway Network Assets. There will be continual review of the asset data to ensure we achieve the objectives of the project.

Financial and value for money implications

27. There are no direct financial implications of this report, all financial implications in the 2016/17 accounts will be made in line with the Code of Practice.

Equalities and Diversity Implications

28. There are no direct equalities implications of this report.

Risk Management Implications

29. There are no direct risk management implications of this report.

Next steps:

30. Finance and Highways Teams to continue progress on compiling accurate asset data and ensure the information is held within the highways asset management systems.

31. Detailed accounting guidance is due to be issued by CIPFA in September. The Finance team will use this as the basis for the

accounting entries that need to be made into the council's accounting system, SAP, in relation to the HNA.

32. The Finance team will continue to keep the council's external auditors, Grant Thornton, up to date with progress on the implementation of the HNA and maintain a close relationship with Grant Thornton as the accounting deadlines approach.

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Sources/background papers:
The CIPFA Code of Practice on Transport Infrastructure

The Code of Practice on Local Authority Accounting in the United Kingdom 2016/17 CIPFA