

Highways Network Asset Briefing Number 3

Briefing from the Standards and Financial Reporting Team

September 2016

This is the third briefing covering issues relating to the change in measurement requirements for the local authority Highways Network Asset. This briefing will cover the consultation and publication of the *Code of Practice on the Highways Network Asset*, what the chief financial officer will need to consider in relation to the measurement requirements for the Highways Network Asset, commentaries on project implementation, and other guidance issued by CIPFA.

Code of Practice on the Highways Network Asset

As reported in the second of these Briefings in March 2016 the *Code of Practice on the Highways Network Asset* (the Highways Code) was subject to consultation at the end of March/early April 2016. Following consideration of the consultation responses by the Project Implementation Steering Group¹ the final Highways Code was published in August 2016. The changes to this Code were not intended to change the principles or measurement processes within the Highways Code. However, some clarifications and refinements have been made. The changes to the Highways Code are intended to:

- reflect the CIPFA/LASAAC² decisions on the measurement of the Highways Network Asset
- clarify any ambiguities raised in the implementation process, and
- provide clearer links to the *Code of Practice on Local Authority Accounting in the United Kingdom* (the Accounting Code), clarifying which of the provisions relate to the financial reporting requirements.

As outlined in Briefing No. 2 the paragraphs in bold purple font in the Highways Code provide the principles to be applied in order to meet the financial reporting requirements of the Accounting Code. The Highways Code also includes grey shaded paragraphs which represent key asset management principles following commentaries included in the consultation. The paragraphs in bold purple font and the grey shaded paragraphs together form the Highways Code. The explanatory statements in standard type are considered to be a part of the Highways Code insofar as they assist with its interpretation.

¹ The Project Implementation Steering Group is the Group responsible for the development of the Highways Code.

² The CIPFA/LASAAC Local Authority Accounting Code Board is responsible for the development of the Accounting Code.

Other Clarifications to the Highways Code Following the Consultation

Depreciated Replacement Cost and the Modern Equivalent Asset

Both the Accounting Code and the Highways Code include the same definition of depreciated replacement cost extracted below.

“Depreciated replacement cost (DRC) is a method of valuation which provides the current cost of replacing an asset with its modern equivalent asset less deductions for all physical deterioration and all relevant forms of obsolescence and optimisation...”

However, the methodologies in the Highways Code reflect the information available to measure the Highways Network Asset. Given the practical issues of identifying and quantifying technical obsolescence the methodology in the Highways Code uses the information normally available to local authorities and therefore only physical obsolescence is taken into account. The Highways Code therefore confirms that the measurement of the Highways Network Asset only features physical obsolescence.

Use of Local Rates for Gross Replacement Cost Measurements

The Highways Code specifies that where central rates are available they must be used. The consultation process raised the concern as to whether the centrally provided rates adequately reflected a local authority's individual circumstances, for carriageways, structures and footways. The Highways Code has therefore been amended such that if an authority has clear evidence that the central rates are not able to reflect its local circumstances or characteristics, it may amend the central rates in order to provide a reasonable estimate of the gross replacement cost (GRC) value. It is important to note that the information used to adjust the central rates would need to satisfy audit scrutiny such that it adequately represents local circumstances.

Use of Street Furniture Methodology in Absence of Inventory

The Highways Code permits authorities that do not have adequate inventory data for street furniture to use one of three example authorities in order to estimate the street furniture they would have in a modern equivalent asset. This approach was queried by respondents to the consultation who considered that an extrapolated sampling approach of an authority's own inventory would be more appropriate. The Highways Code therefore now permits such sampling for street furniture inventories provided the costs of undertaking the sampling represent value for money and are commensurate with the benefits to users of the financial statements.

Traffic Management Systems

As a result of the consultation responses the Highways Code now permits the use of brownfield replacement rates in the calculation of GRC for traffic management systems.

What Will the Chief Financial Officer Need to Consider?

As with all information in the financial statements the chief financial officer will need to have assurance that the measurement of the Highways Network Asset is materially accurate as part of the confirmation that the financial statements provide a 'true and fair' view of the financial performance, financial position and cash flows of the authority. What are the key issues that will need to be considered?

- **Inventory** – probably the most significant variables in the measurement of the Highways Network Asset are the inventories of its components. Alongside inventories most of the measurements of the Highways Network Asset will require relevant and up to date information on **condition** of its components. This information will be stored on the relevant asset management systems and/or in the toolkits. Inventory information for the Highways Network Asset will be found in the various asset management systems used by the authority to manage the asset. These include:
 - **carriageways** – lengths and widths
 - **footways and cycletracks** – lengths and widths
 - **structures** – inventory requirements include: lengths, widths, headrooms, number of spans, obstacles crossed, and material types
 - **street lighting, traffic management systems and street furniture** – number of units
 - **land** – verge widths (in addition to the highway area calculated from the carriageway, footway and cycletrack lengths and widths).

The CFO will need to gain assurances that both the inventory and condition information is materially accurate and measured in accordance with the methodologies in the Highways Code. Consideration will therefore need to be given as to how these assurances will be achieved, the timeliness of the information and what level of testing and sensitivity analysis will be required to gain them. It is likely that internal audit will need to play a key role in supporting the CFO in attaining the relevant level of assurance.

- **Central assurance** – CIPFA has been leading discussions with the National Audit Office and the various audit firms to try to provide central assurance around the use of the Highways Asset Management Finance Information Group (HAMFIG) toolkits and the application of centrally provided GRC rates (ie the cost of replacing the various highways asset components with their modern equivalent asset). It is anticipated that the outputs from this process will provide commentary on the centrally provided toolkits, relevant UKPMS processes, centrally provided rates and regional factors and whether they have been developed in accordance with the specifications of the Highways and the Accounting Codes. Subject to this process it is hoped that CFOs will be able to use this information to gain reasonable assurance that this information complies with both Codes. Further checks will be required to ensure that the input process of the authority will remain in accordance with both Codes and is free from error.
- **Local information** – other elements of the measurement of the Highways Network Asset require the use of local information. The most substantial of these are the renewal rates which are needed for the measurement of accumulated depreciation for all of the components of the Highways Network Asset (note that the renewal rates for structures are centrally provided by HAMFIG). Some of this information is readily available, some will need to be estimated and some will require judgements to be made. The CFO will need to be assured that the correct rates have been used, that the appropriate technical judgements have been made by engineers (or relevant experts) and again that this information is input correctly into the relevant toolkit or asset management system. Local information is also required for numerous other parts of the measurement process including

estimations of deterioration³, regional adjustments to central rates, ages of the various components and their useful lives (this list is not exhaustive). Substantial local information will also be required for the structures (bridges etc) within a local authority's Highways Network Asset. Again the CFO will need to be assured that the correct rates and information have been identified for the authority and its individual circumstances, that these are applied appropriately and input correctly into the relevant systems.

- **Systems** – the Local Authority Accounting Panel (LAAP) Bulletin 100 *Project Plan for Implementation of the Measurement Requirements for Transport Infrastructure Assets by 2016/17* identified the need for a complete systems audit as a part of the project plan impact assessment. In each authority there are likely to be a number of systems and toolkits needed to bring together all the information requirements to support the measurement of the Highways Network Asset systems. The CFO will need to be assured that these systems are working correctly, that information is able to be input with accuracy and any relevant interfaces with the financial systems are operating appropriately.

Project Implementation – Are You on Target?

Since the first publication of LAAP Bulletin 100 in March 2014 CIPFA/LASAAC has removed the requirement to restate the preceding year information or for an opening balance as at 1 April 2015.

The decision made by CIPFA/LASAAC not to require preceding year information for the move to measuring the Highways Network Asset at depreciated replacement cost should have eased some of the resource issues for implementation in the 2016/17 financial statements. However, if a local authority has followed the implementation project plan in LAAP Bulletin 100 it should by now have undertaken a dry run of the measurement and reporting requirements.

Following the CIPFA/LASAAC decision not to require preceding year information the 2016/17 Accounting Code requires that local authorities make the relevant implementation adjustment to opening balances for the 2016/17 financial year. The CIPFA publication *Accounting for the Highways Network Asset* (CIPFA, September 2016) includes example notes and accounting entries to illustrate these requirements.

The project plan also recommends that the accounting policies and notes are drafted for the 2016/17 financial statements from July to December 2016. Again *Accounting for the Highways Network Asset* includes illustrative accounting policies and notes. Local authorities will need to tailor these notes to meet their individual circumstances.

It is recommended that local highways authorities take some time out to review their project plans in the near future to consider (if they have not already done so):

- whether there is any slippage from their original plans (and what actions are needed to remedy this)
- whether the inventories are complete and, if not, what actions might be needed to rectify this (note that this might include use of the relevant toolkits that support the Highways Code)
- what internal assurance processes and documentation (including evidence) will be required to satisfy external auditors about the information needed to meet the

³ The Society of Chief Officers of Transportation in Scotland (SCOTS) provides rates for deterioration for Scottish local authorities.

financial reporting requirements (this information will in part emanate from the complete systems audit included in the impact analysis recommended in LAAP Bulletin 100), and

- whether the CFO and chief engineer understand their respective responsibilities for the provision and verification of information needed to establish materially accurate estimates for the measurement of the Highways Network Asset.

The LAAP Bulletin 100 project plan refers to discussions between an authority and its auditors to inform auditors about the project plan and approaches being taken and to raise any issues/difficulties etc. The evidencing and auditability of inventory data and the effectiveness of processes which help establish that the measurements of the component parts of the Highways Network Asset are materially accurate are critical. The use of professional judgement in defining key working assumptions or estimates must be documented and reviewed for reasonableness. Key assumptions or estimates may also be a significant factor in the measurement of inventory categories where the availability of actual data is limited. Maintaining a regular dialogue with the external auditor will be essential.

Available Resources

Highways Asset Management Finance Information Group (HAMFIG) Supporting Materials

There is a range of supporting materials developed by HAMFIG to help authorities comply with the requirements of the Highways Code. The 2015/16 Toolkits are available on the CIPFA [website](#). A key element for implementation will be the central rates to be provided under a contract to the Department for Transport. CIPFA has been working with all parties to make these available.

Code of Practice on the Highways Network Asset: Guidance Notes

The *Code of Practice on the Highways Network Asset: Guidance Notes* were published in August 2016, giving both engineers and accountants the practical details they need to value their Highways Network Asset. These guidance notes have been updated to reflect the CIPFA/LASAAC decisions in the Accounting Code and the specifications in the new Highways Code.

Accounting for the Highways Network Asset

A separate publication, *Accounting for the Highways Network Asset*, providing early guidance on the accounting requirements (including detailed accounting entries), illustrations including the transitional reporting requirements and other guidance necessary to implement and support the new measurement requirements was published in August 2016.

Further Briefings

Future briefings to support the implementation of the new measurement requirements for the Highways Network Asset will complement other forms of communication, such as LAAP Bulletins and Technical Enquiry Service FAQs. Future briefings are likely to include the following topics:

- asset management
- audit issues

- an update on the central assurance process
- any other areas where we feel a briefing would be beneficial.

If you have any suggestions for future topics, please contact Mandy Bretherton (mandy.bretherton@cipfa.org).

Briefings will be published on the CIPFA Highways Network Asset section of the website. Alerts to new briefings will be sent out through social media and the usual communication channels, such as the CIPFA Networks and via Treasurers' Societies.



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