

National Competition Council

**URBAN WATER SERVICE PROVIDERS IN
TASMANIA: ASSET VALUATION
METHODS AND FULL COST RECOVERY**

**National Competition Policy Supplementary
Water Reform Assessment**

NOVEMBER 2002

© Commonwealth of Australia 2002

ISBN 0-9581457-2-5

This work is subject to copyright. Apart from any use as permitted under the Copyright Act 1968, the work may be reproduced in whole or in part for study or training purposes, subject to the inclusion of an acknowledgement of the source. Reproduction for commercial use or sale requires prior written permission from AusInfo. Requests and inquiries concerning reproduction and rights should be addressed to the Manager, Legislative Services, AusInfo, GPO Box 1920, Canberra, ACT, 2601.

Inquiries or comments on this report should be directed to:

Communications Officer
National Competition Council
12 / 2 Lonsdale Street
MELBOURNE VIC 3000

Ph: (03) 9285 7474
Fax: (03) 9285 7477
Email: info@ncc.gov.au

An appropriate citation for this paper is:

National Competition Council 2002, *Urban Water Service Providers in Tasmania – Asset Valuation Methods and Full Cost Recovery: NCP Supplementary Water Reform Assessment, October 2002*, AusInfo, Canberra.

The National Competition Council

The National Competition Council was established on 6 November 1995 by the *Competition Policy Reform Act 1995* following agreement by the Commonwealth, State and Territory governments.

It is a federal statutory authority which functions as an independent advisory body for all governments on the implementation of the National Competition Policy reforms. The Council's aim is to 'improve the well being of all Australians through growth, innovation and rising productivity, and by promoting competition that is in the public interest'.

Information on the National Competition Council, its publications and its current work program can be found on the internet at www.ncc.gov.au or by contacting NCC Communications on (03) 9285 7474.

Table of contents

Abbreviations

1 Introduction	5
2 Outstanding issue, 2002 assessment	6
3 Developments since the 2002 assessment	8
4 Discussion and assessment	12
References	14
Attachment 1: Local government asset valuation methods	15
Attachment 2: Strategies for achieving full cost recovery	19

Abbreviations

AAS	Australian Accounting Standards
AASB	Australian Accounting Standards Board
ARMCANZ	Agriculture and Resource Management Council of Australia and New Zealand
CoAG	Council of Australian Governments
Council	National Competition Council
DORC	Depreciated optimised replacement cost
DRC	Depreciated replacement cost
GPOC	Government Prices Oversight Commission
NCP	National Competition Policy

Introduction

Under Australia's National Competition Policy (NCP), the National Competition Council (the Council) assesses the progress of governments with implementing the reform obligations they have agreed to in the NCP agreements.¹ Originally, the Council of Australian Governments (CoAG) scheduled three tranches of assessments: in 1997, 1999 and 2001. In November 2000, CoAG extended the NCP assessment process, resolving that there be ongoing annual assessments after the 2001 assessment, with a review of NCP before September 2005 (CoAG 2000).

Reform of Australia's water industry, aimed at creating an economically viable and ecologically sustainable water industry, is a significant element of the NCP and related reform program. Proper pricing of water, to discourage wasteful use and to encourage appropriate investment of water infrastructure, is an essential element. Proper pricing requires adoption of full cost recovery and pricing practices by water businesses. Accurate information on the replacement cost (real cost) of providing water infrastructure, rather than measures such as historic cost (original purchase price), enables service providers to make appropriate pricing decisions.² Factoring the cost of infrastructure into the price of water and wastewater services provides consumers with price signals that reflect the true cost of water consumption.

The CoAG water reform agreements required governments to have implemented cost recovery reforms by 1999. In the 2002 assessment, the Council found that although Tasmania had generally achieved sound progress, it had provided insufficient information for the Council to conclude on the extent to which the State had addressed full cost recovery obligations. The Council was unable to determine whether Tasmanian urban water and wastewater businesses were applying appropriate asset valuation methods to price water and wastewater services at full cost. The Council also had no information on Tasmania's strategies for improving the adoption of cost recovery principles by urban water businesses that the Government Prices Oversight Commission (GPOC) had found were operating outside the full cost recovery parameters in 2000-01.³

¹ The three NCP agreements are reproduced in NCC (1998). The agreements were amended by CoAG in 2000 (CoAG 2000).

² A seven point pricing/cost recovery guideline (CoAG pricing guidelines) for the application of section 3 of the CoAG water reform agreements was developed in 1998. Point 2 states that asset values should be based on the deprival methodology unless an alternative approach can be justified.

³ Governments have agreed to set prices so that water and wastewater businesses earn sufficient revenue to ensure their ongoing commercial viability but to avoid

In the 2002 assessment, the Council considered that the best approach was to allow an additional period of time for Tasmania to provide information on urban full cost recovery water reforms. The Council therefore recommended that Tasmania's progress be considered in a supplementary assessment in October 2002. The Council advised Tasmania that it would expect the supplementary assessment to show significant progress given cost recovery reforms for urban water and wastewater services were three years overdue.

The Council's earlier assessments,⁴ including a standalone water reform volume on governments' progress in 2002, are available on the Council's website at www.ncc.gov.au.

Outstanding issue, 2002 assessment

Outstanding issue: Tasmania is to demonstrate progress across all retail and distribution service providers, in implementing cost recovery and meeting the lower pricing bound as defined by the CoAG guidelines, with particular attention to asset valuations.

Next full assessment: The Council will assess urban pricing reforms in 2003.

Reference: Water reform agreement, clause 3.

In the 2001 NCP assessment, Tasmania provided the Council with the first audit of local government water and wastewater businesses' compliance with water reform obligations.⁵ The audit showed that a significant proportion of Tasmania's largest service providers (including the largest four)⁶ were not

monopoly returns. Prices should be set to recover: at most the operational, maintenance and administrative costs, externalities, taxes or tax equivalent regimes, provision for the cost of asset consumption and cost of capital; and at least, the operational, maintenance and administrative costs, externalities, taxes or tax equivalents (not including income tax), the interest cost on debt, dividends (if any) and make provision for future asset refurbishment/replacement (NCC 1998, pp. 112-113).

⁴ The Council considered water reform progress in the 2001 assessment (NCC 2001) and the second tranche assessment (NCC 1999). The Council also conducted supplementary assessments on water reform in December 1999, June 2000, September 2000, and February 2001.

⁵ The GPOC is an independent body with responsibility for conducting investigations into the pricing policies and practices of government business enterprises, government agencies and local government bodies that are monopoly, or near monopoly, suppliers of goods and services in Tasmania. The GPOC provides for accountability and transparency in setting and reporting local government water and wastewater business prices and service standards through an annual audit of compliance against the Urban Water Pricing Guidelines.

⁶ The four largest local government water and wastewater providers are Hobart, Glenorchy, Clarence and Launceston.

commercially viable in 1999-2000 as defined by the CoAG guidelines. Tasmania argued at the time that the arrangements it had in place should see a significant improvement in the performance of its largest service providers in future years. Given actions taken by the Tasmanian Government to progress the NCP program generally, the Council indicated it would revisit urban full cost recovery in the 2002 assessment, rather than recommend any reduction in Tasmania's NCP payments in 2001-02.

In the 2002 NCP assessment, the Council found that, while there were improvements overall, Tasmania's largest local government water and wastewater businesses were still not commercially viable as shown in the GPOC 2000-01 data. The outcomes of the GPOC audit for 2000-01 are summarised below.

- 19 of 28 water businesses were commercially viable — an improvement from 14 in 1999-2000.
- 20 of 27 wastewater businesses were commercially viable — an improvement from 9 in 1999-2000.
- None of the four largest local government water service providers identified in the 2001 NCP assessment operated within the bounds of full cost recovery in 2000-01. Table 1 compares the real rates of return achieved by the four largest providers. Real rates of return on water and wastewater assets employed by each local government business are used to indicate whether full cost recovery is achieved.⁷

Table 1: Real rates of return achieved by the four largest service providers

<i>Local government</i>	<i>Service</i>	<i>Connections (approx. no.)</i>	<i>Real rate of return (%)</i>	
			<i>1999-2000</i>	<i>2000-01</i>
Launceston	Water	25 600	-1.0	-0.6
Hobart	Water	20 500	-0.6	-0.9
	Wastewater	n/a	-1.7	-1.4
Glenorchy	Wastewater	16 600	-0.6	11.4
Clarence	Water	17 500	-18.0	-2.1

Source: Treasury/DPAC 2001 (unpublished), GPOC 2002

- Of the two local governments that were identified in the 2001 NCP assessment as earning real rates of return above the 7 per cent upper bound of cost recovery, Latrobe was still operating well in excess of the upper bound. Latrobe water services increased earnings in 2000-01 to

⁷ For compliance with CoAG cost recovery obligations, real rates of return must fall within the band of cost recovery. CoAG has set the lower bound of cost recovery at zero per cent. GPOC has set the upper bound at 7 per cent. Unless a water service provider achieves a rate of return within this band it is either not covering its costs or achieving over recovery.

approximately four times the recommended upper bound, up from two times in 1999-2000, as shown in table 2. The GPOC audit considered that this level of cost recovery results in monopoly pricing.

Table 2: Real rates of return achieved by over-recovering service providers

<i>Local government</i>	<i>Service</i>	<i>Real rate of return (%)</i>	
		<i>1999-2000</i>	<i>2000-01</i>
Latrobe	Water	14.3	25.3
King Island	Wastewater	13.5	8.5

Source: Treasury/DPAC 2001 (unpublished), GPOC 2002

The Council had three key concerns arising from the 2002 NCP assessment.

- Tasmania had provided insufficient information for the Council to be able to make a full assessment of urban pricing reform. While Tasmania had developed asset valuation guidelines for local government, it was unclear whether local governments were adopting these or whether the GPOC audit had made adjustments.
- Based on the information provided, it appeared that a significant number of local governments had levels of cost recovery outside the full cost recovery band. Further, the outcomes in some local governments had deteriorated between June 2000 and June 2001.
- There was insufficient transparency in the GPOC's audit process. The audit was not published. The Council considered this to be a problem because there was no path forward for how full cost recovery will continue to improve.

Tasmania wrote to the Council on 12 July 2002 advising that full GPOC data were not yet available, but committed to provide more information on urban pricing by 31 August 2002. Tasmania undertook to provide:

- a report on local governments' adoption of asset valuation methodologies consistent with CoAG guidelines;
- reasons for alternative valuation approaches being adopted;
- responses to any assessment issues emerging from this information;
- a strategy to improve the rate of progress in cost recovery for those businesses identified in the GPOC audit as either under-recovering or over-recovering costs; and
- the GPOC audit report to be made publicly available.

Given these commitments, the Council decided that it would conduct a supplementary NCP assessment in October 2002 on all issues raised in the 2002 NCP assessment relating to urban full cost recovery.

Developments since the 2002 assessment

Asset valuation methodologies adopted by local governments

Tasmania has compiled more comprehensive information on the asset valuation methodologies used by each local government urban water and wastewater business. Broadly, all 28 local governments providing water and wastewater services value their noncurrent assets using either depreciated replacement cost or depreciated optimised replacement cost. Detailed information is at attachment 1.

Tasmania argues that the CoAG water reform commitment to ‘use the deprival value methodology for asset valuation, unless a specific circumstance justifies another method’ is met by local government water and wastewater businesses applying either of two accounting standards — the Australian Accounting Standards Board (AASB) 1041 *Revaluation of Non-Current Assets*,⁸ or Australian Accounting Standards (AAS) 38 *Revaluation of Non-Current Assets*. These standards involve valuing assets on a ‘fair value’ or a ‘cost basis’.⁹

AASB 1041 defines fair value as:

the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s length transaction (AASB 1041, 2001)

AASB 1041 states that for general assets this usually would be the quoted market price in an active and liquid market. For specialised assets, such as those assets owned by Tasmanian local government water and wastewater service providers, the standard provides specific guidance on estimating fair value. It specifies this should be the ‘replacement cost of the asset’s remaining future economic benefits’, as follows:

⁸ The AASB makes accounting standards for the private, public and not-for-profit sectors.

⁹ AASB staff advised that since 1 July 2000 the AASB has adopted a single series of accounting standards. The reissued AASB 1041 applies to both the public and private sectors (whereas before the reissue, the earlier version of AASB 1041 applied only to entities subject to Corporations Law and AAS 38 applied to public sector entities). The reissued AASB 1041 has led to the withdrawal of AAS 38 for application by public sector entities with respect to annual reporting periods on or after 30 September 2001.

5.1.8 ...In some other circumstances, an asset is so specialised that there is no market evidence of its market selling price.

5.1.9 ...In the circumstance described in paragraph 5.1.8, the asset's fair value is measured at its market buying price. (The best indicator of an asset's market buying price is the replacement cost of the asset's remaining future economic benefits, which is not necessarily the cost of replicating the asset, that is, its reproduction cost.)

AASB 1041 (like the former AAS 38) restricts, subsequent to initial recognition, the measurement of assets to either the cost basis or the fair value basis. Where a local government elects to discontinue revaluing assets it may deem the carrying amount of their water and wastewater assets at the date of the discontinuation of revaluation to be the cost of the asset. All local governments have recently revalued assets using depreciated replacement cost as a minimum: the carrying amounts in their 2000-01 financial statements are therefore relatively current. Tasmania considers that use of AASB 1041 (and previous use of AAS 38) complies with CoAG water reform obligations.

While AASB 1041 (and the former AAS 38) allow for depreciated replacement cost as a surrogate measure of fair value, Tasmania recognises that the cost basis does not have the stricture of periodic revaluations – hence there is no guarantee that assets valued using the cost basis will be maintained at a value that approximates depreciated replacement cost over time. In order to ensure the currency of replacement cost asset valuation, Tasmania proposes to encourage local governments to apply fair value under AASB 1041 for specialised assets, on the basis that depreciated replacement cost, as a surrogate measure of fair value, is more consistent with the optimised deprival valuation.¹⁰

Tasmania reported, on 15 September 2002, that:

- 26 of 28 local governments apply AAS 38 to value water and wastewater assets;
 - 23 use the cost basis, and three use the fair value basis.
- 2 of 28 local governments apply AASB 1041 to value water and wastewater assets.
 - Kingsborough uses the fair value method, and Central Highlands uses the cost basis method. Both methods are allowable under AASB 1041.

¹⁰ The intent of the deprival value method is to establish the written down current cost. Assets will be reviewed periodically to ensure that the assets assessed value remains closely aligned to the value of replacing the service.

Strategies for reaching full cost recovery

Tasmania has established a package of measures which will improve the rate of progress in achieving cost recovery for those local governments identified by the GPOC as not complying with the (Tasmanian) Urban Water Pricing Guidelines.

The GPOC audit report (2000-01) identified seven local governments as not complying with these guidelines. While the report identified several other local governments operating outside the cost recovery band, the audit report considered them to be only marginally noncompliant, and of a lower priority for reform.¹¹

All seven local governments have committed to improve the financial performance of their water and wastewater operations as soon as possible. Each water service provider has proposed strategies for recovering costs within the CoAG cost recovery band. These strategies are summarised at attachment 2.

In relation to the valuation of assets, Tasmania proposes to encourage local governments to adopt the AASB 1041 fair value approach for specialised assets. To address the diversity of asset valuation techniques in use, Tasmania proposes a targeted education campaign. The objective is to raise the level of awareness of the asset valuation techniques that water and wastewater providers are required to adopt. Tasmania suggests that those local governments considered to be leaders in asset management and valuation could play a part in this education program. Tasmania will require local government water service providers to adopt the AASB 1041 approach by the 2002-03 GPOC audit (to be conducted in March 2004), subject to any concerns raised by the Audit Office.

Tasmania will revise its Urban Water Pricing Guidelines in conjunction with the GPOC. The proposed revisions will:

- link the AASB valuation techniques that allow for the application of the deprival value principles, hence encouraging the adoption of fair value for specialised assets under AASB 1041, and the use of depreciated optimised replacement cost as the preferred technique;
- require the collection and reporting of additional information including asset valuations methodologies, community service obligations and externalities; and

¹¹ Local governments considered marginal for water or wastewater cost recovery were Burnie, Glamorgan/Spring Bay, Kentish, Launceston, Waratah-Wynyard and King Island.

- include a reporting template with supporting explanatory notes to assist local governments to prepare and provide appropriate financial information to the GPOC.

The Tasmanian Government intends using the revised pricing guidelines for the next GPOC audit (2001-02), which is to be publicly released by March 2003. Prior to distribution to local governments, Tasmania will provide the Council with an opportunity to comment on the updated guidelines.

The Government has posted the GPOC 2000-01 audit on its website, and has committed to publishing all future GPOC audits.

Stakeholder views

In undertaking this assessment the Council secretariat held discussions with Tasmanian Government officials, the GPOC, and staff of the AASB. These organisations provided valuable information to assist the Council in this supplementary assessment.

The GPOC and the AASB staff consider that the CoAG commitment to value water and wastewater assets by optimised deprival value can be met via the application of the fair value basis for specialised assets under AASB accounting standards.

Staff of the AASB indicated that if a more appropriate surrogate measure of fair value became available (or if the quoted market price in an active and liquid market was to become available) then AASB 1041 would require its use in place of depreciated replacement cost. For the present and foreseeable future, however, it is likely that depreciated replacement cost will continue to be the best surrogate measure of fair value for specialised assets such as those assets owned by Tasmanian local government water service providers.

In addition, the GPOC recommends the use of depreciated optimised replacement cost for valuing local government water and wastewater assets.

Discussion and assessment

Tasmania has provided sufficient information on progress with the outstanding full cost recovery commitments.

The commitment to detail the asset valuation methodologies applied by urban water and wastewater providers has been met. Although most providers do not strictly adhere to the deprival value methodology, the Council agrees nonetheless that application of AASB 1041 (using fair value for specialised assets) achieves a similar outcome to the deprival methodology. The end result will be the application of depreciated replacement cost or the GPOC preferred use of depreciated optimised replacement cost.

The seven local governments that the GPOC identified as not complying with full cost recovery commitments in 2000-01 have each committed to a strategy and timeframe for reaching full cost recovery. While the timeframes for reaching full cost recovery vary among these local governments, in all cases the reforms will be complete by the 2005 NCP assessment.

Tasmania reported that the smaller local governments, with relatively limited access to resources, tended to have less comprehensive and more varied approaches to water reform. Tasmania advised that it will provide additional support to local governments to meet their cost recovery commitments. This support will include revision and issue of guidelines and policy statements, educational material, targeted consultation and correspondence, regional seminars and workshops for practitioners, and a website which draws together government water related information. The Council considers Tasmania's proposals for assisting local governments will be important in reaching cost recovery targets. Tasmania is committed to completing this education program by mid February 2003.

The Council is satisfied that the commitments provided by Tasmania meet the remaining cost recovery obligations for 2002. The Council emphasises, however, that it will be important for Tasmania to implement the commitments it has made, including in relation to additional support for local governments, by the time of the 2003 assessment. The Council is expecting significant outcomes from these measures. In 2003 the Council will assess, as part of a detailed review of urban pricing reform, Tasmania's compliance with commitments on full cost recovery, asset valuations and commitments to education to support the reform process.

References

Australian Accounting Standards 1999, AAS 38 *Revaluation of Non-Current Assets*, Melbourne, December.

Australian Accounting Standards Board 2001, AASB 1041 *Revaluation of Non-Current Assets*, Melbourne, July.

CoAG (Council of Australian Governments) 2000, *Communiqué*, 3 November.

GPOC (Government Prices Oversight Commission) 2002, *Urban Water and Wastewater Audit Report*, Hobart, June.

— 2001, *Urban Water Pricing Guidelines: Consistent with the CoAG water reforms* (revised), Hobart, March.

NCC (National Competition Council) 2001, *Assessment of Governments' Progress in Implementing the National Competition Policy and Related Reforms*, June.

— 1999, *Second Tranche Assessment of Governments' Progress with Implementing National Competition Policy and Related Reforms*, June.

— 1998, *Compendium of National Competition Policy Agreements – Second Edition*, Melbourne, June.

Tasmanian Government 2002, *Supplementary Assessment of Tasmania's Water Reform Obligations – Information Paper*, Hobart, September.

Treasury / Department of Premier and Cabinet 2001, *Urban Water and Wastewater Audit Report*, Hobart, June.

Attachment 1: Local governments asset valuation methods

<i>Local government</i>	<i>Asset valuation methodology</i>
Break O'Day	AAS 38 sewerage and water assets at cost. Break O'Day has deemed the cost of these assets to be equal to the carrying value of these assets as at 30 June 2001. Intend to move to fair value methodology in future.
Brighton	AAS 38 sewerage and water assets at cost. Brighton has deemed the cost of these assets to be equal to the carrying value of these assets as at 1 July 2000. A council engineer revalued the assets during 1999-00.
Burnie	AAS 38 sewerage and water assets at cost. Burnie has deemed the cost of these assets to be equal to the carrying value of these assets as at 30 June 2001. Intend to move to fair value methodology in future. Assets were revalued during 1999-00.
Central Coast	AAS 38 sewerage and water assets are measured using the fair value basis. The assets are revalued to their DRC every five years. The engineering services division of the council determines valuations of sewerage and water assets. These assets were last revalued on 1 July 1999.
Central Highlands	AASB 1041 sewerage and water assets at cost. Water and sewerage assets which were valued at market value as at 1 July 1996 are deemed to be at cost as at 1 July 2001. Additions after 1 July 1996 remain at actual cost. Assets are to be revalued during 2002-03.
Circular Head	AAS 38 sewerage and water assets at cost. Circular Head has deemed the cost of these assets to be equal to the carrying value of these assets as at 30 June 2001. Water assets were valued in 1999 and sewerage assets were valued in 2000.
Clarence	AAS 38 sewerage and water assets at cost. Revalued to DRC to reflect the portion of the economic life that has expired based on information provided by council's engineering officers as at 1 July 1996. Revaluations of a class of assets occurs at such time as there has been significant movement in the current replacement cost of that asset class relative to the value disclosed in the financial statements. Variables influencing such movements in current replacement cost include inflation, changes in available technology and materials and general industry movements and trends.
Derwent Valley	AAS 38 sewerage and water assets at cost. Derwent Valley has deemed the cost of these assets to be equal to the carrying value of these assets as at 30 June 2001. Based on

	<p>engineer's valuation of 2001 replacement cost. Expect to change to fair value basis by 30 June 2003.</p> <p>Infrastructure assets will be revalued every two years to DRC by applying an appropriate cost increase index to the gross carrying value and reassessing the useful life of each class of assets. The resulting carrying values are regularly reviewed to ensure appropriateness after taking into account obsolescence, technological advancement and other relevant factors.</p>
Devonport	<p>AAS 38 and AASB 1041 sewerage and water assets at cost. In general, non-current infrastructure assets are valued, at the end of each financial year, at optimised deprival value less accumulated depreciation to take into account changes in the current costs during the preceding year (DORC). Valuations were determined as at 30 June 2001.</p> <p>Deprival values are council valuations based on specific price indices applied to past carrying values, expert valuations or current market buying prices as appropriate.</p>
Dorset	<p>AAS 38 sewerage and water assets at cost. Dorset has deemed the carrying amount of these assets as at 1 July 2000 to be their cost.</p> <p>Water and wastewater assets were revalued in 1996 to DRC. In conjunction with the council's water and wastewater New South Wales consultants, Hunter Water Australia, the council has continued to identify and improve water and wastewater operations. During 2000-01, pumps and associated wastewater infrastructure were replaced. Investigations into upgrading works to comply with new pump station requirement guidelines were also undertaken with initial improvement works scheduled for 2001-02.</p>
Flinders	<p>AAS 38 water assets at cost. No sewerage assets.</p> <p>Flinders has deemed the carrying amount of these assets as at 30 June 2000 to be their cost. The value of the water assets is based on an engineering assessment supplied by the council's Engineering Consultants, Sinclair Knight Merz, in 1997.</p>
George Town	<p>AAS 38 sewerage and water assets at cost. George Town has deemed the carrying amount of these assets as at 30 June 2000 to be their cost.</p>
Glamorgan	<p>AAS 38 sewerage and water assets at cost. Glamorgan has deemed the carrying amount of these assets as at 30 June 2001 to be their cost. Assets were revalued to DRC as at 1 July 2000.</p>
Glenorchy	<p>AAS 38 sewerage and water assets are measured using the fair value basis. Glenorchy's policy is to revalue the assets at least every 5 years. Water assets were revalued during 2000-01. Many water assets</p>

	<p>were recognised for the first time during 2000-01.</p> <p>Explicitly noted in asset policy that assets are valued in accordance with the deprival value principles which is equivalent to DRC.</p>
Hobart	<p>AAS 38 sewerage and water assets at cost. The council employed the deprival value methodology for the purpose of valuing its assets. This methodology resulted in assets being valued at DRC. Revaluations occur progressively over a 5 year period. Assets are valued by a council engineer.</p>
Huon Valley	<p>AAS 38 sewerage and water assets at cost. Revalued to DRC. Physical identification and valuation of assets as at 30 June 1998 undertaken by council's engineer.</p> <p>Transition to fair value basis is expected to be completed by 30 June 2003.</p>
Kentish	<p>AAS 38 sewerage and water assets at cost. Kentish has deemed the carrying amount of these assets as at 30 June 2001 to be their cost. Assets revalued to written down current replacement cost.</p>
King Island	<p>AAS 38 sewerage and water assets at cost. King Island has deemed the carrying amount of these assets as at 1 July 2000 to be their cost. Assets were revalued in 1998.</p>
Kingsborough	<p>AASB 1041 sewerage and water assets valued using the fair value basis. This means that these assets are revalued on an annual basis to their current replacement cost less accumulated depreciation which is equivalent to DRC.</p> <p>Kingsborough's engineers undertake major revaluations every 5 years with assistance from external consultants. The last full revaluation was in 2000-01. In the interim years, valuations of infrastructure assets are adjusted to take into consideration changes in the cost of construction as reflected in an independently published tender price (building) index.</p>
Latrobe	<p>AAS 38 sewerage and water assets valued using the fair value basis.</p> <p>All noncurrent assets measured on a fair value basis have been revalued during the financial year ending 30 June 2001 utilising rates obtained from Rawlinson's Construction Handbook 2001 and recent similar projects.</p> <p>AAS 38 requires classes of noncurrent assets measured on a fair value basis, to be revalued with sufficient regularity to ensure the carrying amount does not differ materially from its fair value at the reporting date.</p>
Launceston	<p>AAS 38 sewerage and water assets at cost. Launceston has deemed the carrying amount of these assets to be their cost based on 1997 valuations.</p> <p>In accordance with AAS 38, assets previously</p>

	reported as being at valuation are now deemed to be at cost. Infrastructure assets valued at DRC.
Meander Valley	AAS 38 sewerage and water assets at cost. Meander Valley has deemed the cost of these assets to be equal to the carrying value of these assets as at 30 June 2000. The valuation figure is based on a valuation performed by the council's engineer in 1993.
Northern Midlands	AAS 38 sewerage and water assets at cost. Northern Midlands has deemed the carrying amount of these assets as at 30 June 2000 to be their cost. Last revalued during 1996-97.
Sorell	Water and sewerage assets valued at DRC as at 30 June 2001. Water assets valued by engineer as at 1 July 1994 and sewerage assets as at 1 July 1995.
Southern Midlands	AAS 38 sewerage and water assets at cost. Assets valued at DRC as at 1 July 1994 are deemed to be at cost as at 1 July 2000.
Tasman	No water or wastewater schemes.
Waratah-Wynyard	AAS 38 sewerage and water assets at cost. Waratah-Wynyard has deemed the cost of these assets to be equal to the carrying value of these assets as at 1 July 2000. Waratah-Wynyard's valuation was carried out as at 1 July 1998 based on DRC.
West Coast	AAS 38 sewerage and water assets at cost. West Coast has deemed the carrying amount of these assets as at 30 June 2000 to be their cost. Assets were last valued 1995-96.
West Tamar	AAS 38 sewerage and water assets at cost. West Tamar has deemed the cost of these assets to be equal to the carrying value of these assets as at 30 June 2000. Last revalued during 1996-97.

Source: Tasmanian Government (2002)

Attachment 2: Strategies for achieving full cost recovery

The seven local governments that GPOC considered to have not complied with the cost recovery principles for 2000-01 propose to implement the following strategies to improve the application of cost recovery in the future.

Central Highlands

<i>Water:</i>	real rate of return was –8.3 per cent
<i>Wastewater:</i>	real rate of return was –6.2 per cent

Background

The Central Highlands Council has been reluctant to raise rates in the past due to the area being in drought, which has curtailed the general earning capacity and employment opportunities of residents. The Commonwealth Government declared the municipality to be a drought region, and eligible for support measures under the *Exceptional Circumstances Guidelines* in May 2000.

Although the municipality is still suffering from the effects of the five year drought, an improvement in the rainfall has led to increased confidence. The council increased rates for 2002-03 by 2.9 per cent in order to move towards cost recovery. The receipts to expenditure ratio for water was increased by 5 per cent for 2002-03, and for wastewater by 19 percent.

Strategy

The council will reassess its water and wastewater pricing structure in time for the 2003-04 budgetary period with a view to raising both water and wastewater rates. It is envisaged that a similar increase to 2002-03 will be adopted. Other actions that the council will consider include:

- asset revaluation;
- introduction of two-part water pricing; and
- identification of community service obligations with respect to both water and sewerage undertakings.

Provision of facilities which consume water and sewerage resources such as parks, reserves, recreation grounds with pavilions, public toilets and community halls, have not been recognised in the past as contributing to the income earned by these facilities. These community service obligations will be assessed and included in the income calculations for relevant activities. There

will also be a reassessment of the reallocation of indirect overheads to ensure accuracy in the cost attribution.

The council has advised that its aim is to achieve a positive real rate of return for both its water and wastewater businesses by 2004-05.

Clarence

<i>Water:</i>	real rate of return was -2.1 per cent
---------------	---------------------------------------

Background

Clarence City Council has advised that for an average water consumption year the cost recovery breakeven point would be reached. The council has not adopted a two-part tariff regime, and so has no component in its pricing regime that relates to water consumption. In years when rainfall is low, or water consumption is higher than expected, the pricing mechanism does not allow the council to recover enough revenue to cover all costs.

In relation to the proposed future rating effort for water, the council has a policy of fully funding its infrastructure renewal requirements ('depreciation funding'), with the required amount being phased in over time. The estimated target amount is \$6 million per annum for all council assets. In 2002-03, the council expects to raise \$3.3 million.

The amount of infrastructure renewal funding being applied to water assets is currently lower than for certain other asset classes (particularly roads and community facilities) since they typically have longer lives and therefore have the benefit of a longer time frame over which to provide funding. As the council's funding policy draws closer to its target level, the share applied to water will therefore increase, with a consequential effect on the return on its water assets.

Strategy

The Clarence City Council is working towards recovering the lower limit using the annuity approach rather than the 2 per cent of written down replacement cost permitted as an estimate of the annuity amount. The council has advised that in 2001-02 it recovered all its costs such that there will be a positive rate of return on its water assets.

The return on the council's water assets will continue to improve as funding of its infrastructure renewal progresses, both through an increased rating effort and through interest being earned on (and attributed to) funds as they accumulate. The Clarence City Council advised that it is concerned about the impact on ratepayers and is therefore managing the cost recovery issue carefully so that increases in the water rate are phased in.

Derwent Valley

<i>Water:</i>	real rate of return was -3.3 per cent
<i>Wastewater:</i>	real rate of return was 10.1 per cent

Background

The Derwent Valley Council did not operate within the cost recovery bounds for water and wastewater based on the historic cost method of rating the Royal Derwent/Willow Court site, a former State Government psychiatric hospital complex, now owned privately by the Lachlan River Community Group. For water, this has meant a loss of some \$90 000 annually. Once all properties on this site are revalued, the council expects to recover most of the \$90 000. The revaluation will also rectify the over-recovery for wastewater.

Strategy

The council will review the administration and overhead costs allocated to water and wastewater services during the preparation of its 2002-03 financial statements. In addition, the council advises that water and wastewater infrastructure assets are to be revalued for 2003-04. Prior to setting rating estimates for 2003-04, the council will consider the full cost recovery guidelines. The council has advised that it will comply with the cost recovery guidelines for water and wastewater by 2004-05. The council will also consider means of funding community service obligations, given that the Derwent Valley municipality has a high number of welfare recipients.

Glenorchy

<i>Wastewater:</i>	real rate of return was 11.3 per cent
--------------------	---------------------------------------

Background

The GPOC audit reported that Glenorchy had a real rate of return of 11.3 per cent. At the time of the GPOC audit, however, Glenorchy was implementing a new asset management policy. GPOC has advised that, for 2000-01, the council complied with the cost recovery guidelines for wastewater, based on the new asset valuations, achieving a real rate of return of 5.2 per cent. There is no need for Glenorchy to develop a strategy.

Hobart

<i>Water:</i>	real rate of return was -0.9 per cent
<i>Wastewater:</i>	real rate of return was -1.4 per cent

Strategy

The Hobart City Council's water and wastewater undertakings will operate on a full cost recovery basis from 2002-03. This is being achieved by increasing the level of rate revenue raised for these undertakings, together with a review of the level of overheads being attributed to these activities.

Latrobe

<i>Water:</i>	real rate of return was 25.3 per cent
---------------	---------------------------------------

Background

The Latrobe Council advised that it was surprised by the extent of its over recovery from its water business. The council has budgeted for a reduction in the real rate of return on water assets for the 2002-03 financial year to 17.1 per cent. It achieved this by decreasing water rates and re-evaluating overhead allocations.

Strategy

Revaluation of water assets will be completed within the next 12 months. Latrobe is currently in the process of converting to an asset management system. Details of the water assets will be collated over the next 12 months for entry into the system, and valuation issues will be addressed during this process. Latrobe predicts an increase of at least 10 per cent in the value of water assets. The resulting increased cost of capital and depreciation expense, combined with further reductions in water charges, is forecast to reduce the rate of return to approximately 11 per cent in 2003-04.

It is not possible for Latrobe to make the total reduction in the rate of return to the required 7 per cent by 2003-04. This is because a revaluation of water assets will be completed within the next 12 months which implies that Latrobe will need to reassess its cash flow to replace assets in the future. This process is not expected to be completed before the 2003-04 budget is prepared. Latrobe advised that it expects to achieve the desired rate of 7 per cent by 2004-05.

West Coast

<i>Wastewater:</i>	real rate of return was -1.9 per cent
--------------------	---------------------------------------

Strategy

Since the GPOC audit, West Coast has taken action to increase the revenue received by its water and wastewater schemes, while continuing to control the level of expenditure.

In adopting its operational plan in 2001-02, West Coast increased rates for water and wastewater services by 15 per cent, while the 2002-03 operating plan will deliver a further increase of 6 per cent for water and 9 per cent for wastewater. Additionally, in 2001-02, West Coast introduced a separate construction rate for the Strahan wastewater scheme. This is being maintained in 2002-03.

West Coast was only marginally outside the cost recovery parameters for 2000-01. It is confident that the rate increases over the past two years will enable it to achieve cost recovery objectives for the GPOC audit for 2002-03.