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AN EPISTEMIC COMMUNITY AS INFLUENCER AND IMPLEMENTER IN LOCAL GOVERNMENT ACCOUNTING IN AUSTRALIA

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> … epistemic communities can be influential in translating the ideas, perceptions and beliefs of those with legislative or non-legislative regulatory power to operationalize accounting change. Such communities can also exert significant influence on both the development and diffusion of specific accounting policies (Potter, 2005, p. 278, citing Ryan, 1998 and Young 1995).

INTRODUCTION

This paper adopts an epistemic community framework to explicate the dual role of epistemic communities as influencers of accounting policy within regulatory space and as implementers who effect change within the domain of accounting. The context is the adoption and implementation of fair value accounting within local government in New South Wales (NSW).

The roles and functions of Australian local government are extensive, and include the development and maintenance of infrastructure, provision of recreational facilities, certain health and community services, buildings, cultural facilities, and in some cases, water and sewerage (Australian Local Government Association, 2009).[1] The NSW state Department of Local Government (DLG) is responsible for legislation and policy development to ensure that local councils are able to deliver 'quality services to their communities in a sustainable manner' (DLG, 2008c). These local councils receive revenue from various sources including property rates, government grants and user-pays service provision.[2]

In July 2006 the DLG issued Circular 06-45[3] to councils (DLG, 2006c), mandating the staged adoption of fair value measurement of infrastructure assets. This directive followed the policy of NSW State Treasury (NSW Treasury, 2007),[4] and an independent inquiry into the financial sustainability of local councils (LGSA, 2006). It was an attempt to resolve the inconsistency in public sector asset valuation in NSW Local Governments, and to provide greater use- fulness and comparability of financial statements.[5] The focus of this study is the mobilization of accounting change by the DLG within this wider political context. When a regulatory problem arises, those with political power seek advice from professionals with relevant skill and expertise (Potter, 2005). This paper explores the way in which professionals diffuse accounting 'problems' and the associated accounting solutions 'across time and space' (Potter, 2005, p. 277). The DLG's fair value accounting policy emanated from a 'regulatory space' (Hancher and Moran, 1989)[6] as a result of negotiations between many parties, including accounting and finance professionals. Operating within the local government sector, these professionals were identified by the DLG as being capable of providing helpful input. They were also responsible for the implementation of the new policy within local councils. Accordingly they have been identified as an epistemic community with the ability to translate regulatory power by changing the domain of accounting (Potter, 2005, p. 278).[7]

The paper is organised as follows. The background to the DLG's decision to require the introduction of fair value accounting for infrastructure assets is explored. Following this, the method of the study is described, and the epistemic community framework outlined. In the next sections, evidence of the influencing and implementing roles of epistemic groups is provided. Finally, conclusions are drawn about the significance of these groups both within regulatory space in developing accounting regulation, and in embedding change within the domain of accounting.

BACKGROUND

Governed by the *Local Government Act 1993*, local councils in NSW report to the DLG, which is responsible for 'the overall legal, management and financial framework of the local government sector' (DLG, 2005, p. 1).[8] Financial report- ing requirements are outlined in the *Local Government Code of Accounting Practice and Financial Reporting* (DLG, 2008a), which prescribes the form and content of councils' financial statements. Prior to the DLG's fair value announcement, all infrastructure property, plant and equipment assets were stated in councils' balance sheets at cost or deemed cost, and depreciated (DLG, 2006b, p. A-26). Two major external factors can be identified as contributing to the move to fair value accounting for local councils' infrastructure assets. First, the issue of financial sustainability of local councils; and, secondly, Australia's accounting standard-setting arrangements. This study is set within this wider context.

Financial Sustainability

The importance of asset management to the financial sustainability of local councils was given visibility when all NSW local councils were required to report on the condition of their infrastructure.[9] Walker et al. (1999), reviewing the first of these reports, for the financial year 1995–96, recommended an identification of the gap between infrastructure budgets and the cost of repair or upgrade to provide useful information to stakeholders. However, subsequent research revealed that these reports were neither useful nor widely disseminated (Walker et al., 2006) and did not address the issue of local councils' financial sustain- ability. This became a major concern, especially in light of the DLG's (2006a) *Asset Management Planning for NSW Local Government* document that identified NSW local government as being responsible for assets worth 'approximately $50 billion'. The importance of managing these assets well to 'ensure their future sustainability', while at the same time recognising the challenges faced in achieving this goal, particularly by rural and remote councils, was highlighted (DLG, 2006a, p. 4). However, another organisation, with whom the DLG has an 'operating relationship' (DLG, 2005, p. 1), had already expressed this concern. In October 2005, the Local Government and Shires Associations announced an independent inquiry into the financial sustainability of local councils. In its final report, issued in May 2006, that inquiry identified ‘a huge backlog in infrastructure renewals’ of over $6 billion, which was ‘expected to grow to almost $21 billion within fifteen years’ (LGSA, 2006, p. 7). This ‘renewals gap’ or backlog, was defined as the difference between ‘the rate at which councils’ physical assets are depreciating and the rate at which they are being replaced’ (LGSA, 2006, p. 7). Therefore, if the deterioration of assets and consequent reduction in future service potential is represented by depreciation, it must be related to the current values of assets (Howard, 2007, p. 1). The activities of local councils are ‘highly capital intensive’, therefore, the effect on depreciation of the use of fair value accounting for infrastructure assets will have a ‘most significant impact on financial performance’ (Howard, 2007, p. 1).

Historically, the practice at local government level resulted in inconsistent valuation and depreciation methods rendering key performance indicators inappropriate for determining whether councils were viable (Pilcher, 2005).[10] This led to an Australia-wide funding shortfall in the management of local government community infrastructure (McShane, 2006), and to the reality of local government ‘distress’, represented by ‘estimated cost expected to be incurred by local councils to get infrastructure assets into a ‘satisfactory condition’’ (Jones and Walker, 2007).[11]

The decision to require the adoption of fair value for NSW councils was taken at a high level to solve the problems facing local councils, namely asset management and financial sustainability. The NSW Treasury (2007, para. 1.2) stated that ‘fair value is the most relevant measurement attribute for physical non-current assets’, and that it was possible to implement it, since ‘sufficiently reliable estimates of the fair value of assets can be determined’. Subsequent to the DLG fair value announcement, in April 2007 the NSW Treasury (2007, para. 1.1) introduced an accounting policy ‘to provide practical guidance for valuing physical non-current assets’ that would ensure a ‘consistent approach to asset valuation’ across the NSW Public Sector.

Australian Accounting Standard Setting

Prior to the restructure of accounting standard setting arrangements in 2000, Australia had a public sector-specific accounting standard setting body, the Public Sector Accounting Standards Board.[12] Under the new structure, this board was disbanded and the re-constituted Australian Accounting Standards Board (AASB) was made responsible for setting accounting standards across all sectors, public, private and not-for-profit.

In addition to the reorganisation of its accounting standard-setting bodies, Australia adopted International Financial Reporting Standards for financial reporting periods beginning on or after 1 January, 2005. The AASB re-issues the standards of the International Accounting Standards Board as Australian equivalents for reporting entities across all sectors. As a result of these changes, AAS 27, an accounting standard promulgated specifically for local government, has been dismantled. The relevant accounting standard for Australian public sector infrastructure assets is now IAS 16 *Property, Plant and Equipment,* re-issued as AASB 116 *Property, Plant and Equipment*. Paragraph 29 offers entities the choice of adopting a cost or revaluation model subsequent to the initial recognition of an asset. Despite this choice, the NSW government saw the challenge of local councils' financial sustainability as an issue on which it needed to act. The requirement that local councils adopt fair value accounting for infrastructure assets was part of the solution.

According to AASB 116, if entities choose to adopt the revaluation model for a class of assets, and those assets' fair values[13] can be measured reliably, then the assets should be stated at their 'revalued amount', which is defined as being 'fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses' (AASB 116, 2006, paragraph 31). This relies on an entity's ability to access 'market-based evidence' of fair value (AASB 116, paragraphs 32, 33), which is often absent in the case of local government.

Thus, the enforced implementation of the revaluation model presented obvious challenges for local councils. Consequently, the DLG formulated an accounting Code acknowledging and accommodating these challenges in a staged approach to the recognition of assets at fair value over a three year period. It began with water and sewerage assets in 2007, extending this to property, plant and equipment in 2008, and then to roads and drainage in 2009 (DLG 2006c).[14] This study is based on data collected during the first phase of that implementation.

METHOD

The study was conducted over a twelve month period. Initial contact and research was followed by data gathering and analysis, with a preliminary report submitted to the DLG. Following the completion of the study, an interpretive theoretical framework was developed, based on data from documentary sources, interviews and the survey.

Initial Contact and Research

In December 2006, after a period of initial research into the issues surrounding fair value accounting in local councils, the researchers attended a meeting with three of the DLG's finance staff. Several issues relating to the implementation of fair value at local council level were raised as potentially problematic and worthy of research. These included the interpretation of fair value accounting guidelines, the cost of implementation, and the difficulty of obtaining reliable information about council assets. The DLG made available a list of NSW local councils, and identified those that would be implementing fair value accounting in the first phase i.e., those councils responsible for water and sewerage assets.

Data Collection and Analysis

The next stage consisted of the collection of data through telephone interviews, the distribution of a survey, and the analysis of that data. In September 2007, telephone interviews were conducted with nine people. These included seven finance staff from a variety of local councils, an auditor[15] employed by several local councils and an external consultant. Of the council finance officers, some had multiple professional affiliations.

There were five who were members of the Local Government Finance Professionals (LGFP),[16] and, overlapping this categorisation, five who were members of professional accounting bodies. Notes were taken at all interviews and a report on each interview was prepared and checked by all three researchers, in order to ensure the veracity of the record. Interviews were coded and analysed using a qualitative software programme. Table 1 indicates the role, council and professional affiliations of these interviewees.

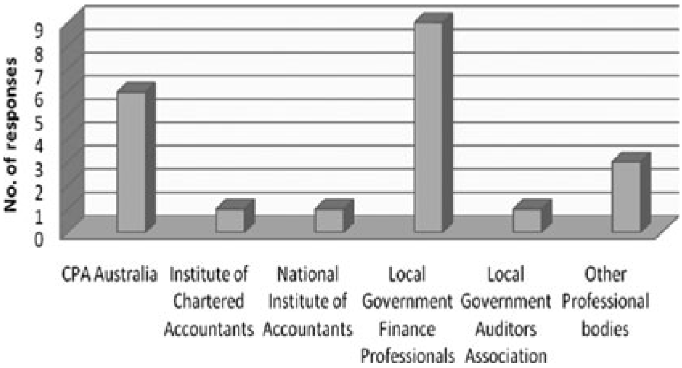
Based on initial research, and issues raised by the interviewees, a survey instrument was constructed. It consisted of 58 content-based questions, primarily around the issue of fair value, but also focusing on the characteristics of local councils, perceptions on the use of council financial reports, details of council auditors, and the qualifications, training and experience of survey respondents. Perceptions of the DLG's role and assistance in accounting matters generally were sought. More specifically, questions were asked in relation to the implementation of fair value, council commitment of resources and training for finance staff when implementing fair value accounting, and the issue of the financial sustainability of local councils.

The survey instrument was pre-tested, and then mailed out to a small sample of 14 people, all of whom worked in accounting or finance roles in 13 local councils in NSW. Thirteen of the surveys were returned, a response rate of almost 93%. Responses to all questions were collated and analysed.

Table 1. Schedule of Interviewees

Interviewee	Role	Type of Council	Council Population Base	Professional Membership
A	Finance Manager	Urban regional	Very large (>120,000)	LGFP
B	Finance and Information Officer	Urban metropolitan, developing	Very large (>120,000)	OGFP; Local Government Accounting Advisory Group
C	Consultant	N/A		Qualified Accountant
D	Auditor	N/A		Qualified Accountant; Local Government Auditors' Association
E	Financial Accountant	Urban fringe	Very large (>120,000)	LGFP; CPA
F	Finance Manager	Rural agricultural	Very large (>120,000)	LGFP; CPA in training
G	Financial Accountant	Urban metropolitan, developing	Medium (30,001-70,000)	CPA
H	Accounting/Finance Manager	Urban regional	Medium (30,001-70,000)	LGFP; Qualified Accountant
I	Senior Financial Accountant	Urban metropolitan, developing	Medium (30,001-70,000)	Qualified Accountant

Figure 1. Professional Affiliations of Council Finance Officers



Unsurprisingly, all 13 respondents had at least one professional affiliation, as shown in Figure 1. Six respondents had more than one professional affiliation. Nine respondents identified themselves as affiliated with LGFP, with four of these indicating they were on the executive of that body. Eight respondents were members of professional accounting bodies,[17] and one was a member of the Local Government Auditors' Association.

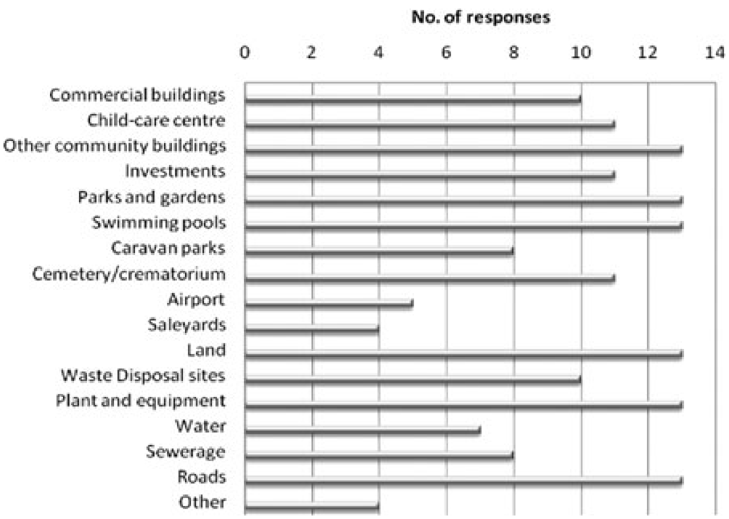
Ten urban and three rural councils were represented in the returned surveys. While there was a spread across the revenue categories of these councils, most came within the $50m–$75m revenue bracket. The single rural agricultural council had the lowest revenue, at less than $20m. Respondents indicated that their councils were responsible for a wide range of assets, as shown in Figure 2. Seven of the respondents identified water assets and eight identified sewerage assets, indicating that the other respondents had not yet been required to implement fair value accounting for infrastructure assets.

Report on Fair Value Accounting in NSW Local Councils

A report on the data collected from the survey was prepared

and distributed to the DLG and all interviewees and survey respondents, in order to provide as much feedback as possible to participants and interested parties. Information was presented in graph or table form. A key finding was the extent and importance of professional groups and affiliations in the formulation of the DLG's fair value accounting policies and their implementation. The DLG's role was seen as that of regulator, rather than a provider of advice or support in the process of implementation,[18] with local council finance professionals providing much needed training and advice.

Figure 2. Types of Assets for which Local Councils are Responsible



EPISTEMIC COMMUNITY

Framing an Epistemic Community

Defined as 'a network of professionals with recognized expertise and competence in a particular domain and an authoritative claim to policy-relevant knowledge within that domain or issue area', members of an epistemic community share a 'set of normative and principled beliefs', 'causal beliefs', 'notions of validity' and 'a common policy enterprise' (Haas, 1992, p. 3). An epistemic community, sharing a set of beliefs or world view, is therefore more than a group of experts or a ‘mere interest group’ (Burritt, 1995, p. 237). In some cases, an epistemic community may be discerned to be emerging, as in the case of the transnational regulation of professional services offered by large accounting firms (Suddaby et al., 2007), or in the field of futures studies (Cinquegrani, 2002).

An epistemic community operates ‘across and beyond the official and authorised assignments and employment relations of formal organisation’, manifesting ‘higher specialised and mostly intangible interpersonal exchange relations among experts’ (Hansen, 2008, p. 1158). Such a community operates instrumentally, defining a problem and being relied upon to provide a solution (Laughlin and Pallot, 1998) that alters the accounting domain. The boundaries of this domain are said to be ‘constantly being drawn and redrawn’ (Potter, 2005, p. 273) with change occurring incrementally at the margins of practice (Young, 1994).

This theoretical framework is consistent with the data and the research techniques suggested by Haas (1992) to demonstrate the existence of an epistemic community. The identification of community membership and a determination of their shared ‘principled and causal beliefs’ (Haas, 1992, p. 34) is explored in the following section. Once established, the activities undertaken by that community in influencing policy development (Haas, 1992) and implementing this policy is explored in the context of fair value accounting in NSW local government.

Establishing the Epistemic Community

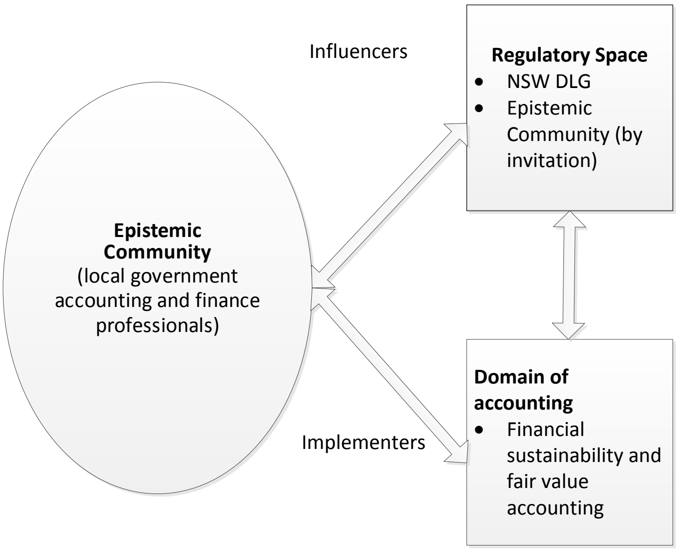
The initial focus of this project was the actual implementation of fair value accounting for infrastructure assets by local councils. However, the most compelling finding was the dual role played by accounting and finance personnel, who, with their multiple professional associations, influenced and implemented local government fair value accounting.

In addition to membership of the professional accounting bodies and LGFP, other groups included the Local Government Auditors’ Association, and the Local Government Accounting Advisory Group. The advisory group is comprised of representatives from the DLG, the NSW Local Government Auditors’ Association, the LGFP, Local Government Shires Associations, and representatives from other NSW state government departments such as Treasury and the Department of Water and Energy (LGAAG, 2008). Within this broadly configured group, accounting and finance professionals played a significant role because of their expertise and their local council connections. The epistemic community consisted of accounting and finance professionals actually working at local council level, either as employees of local councils or as auditors. They provided input to the DLG in the formulation and dissemination of accounting policy, and subsequently implemented that policy at a local council level.

In the case of the introduction of fair value accounting into NSW local councils, the professional groups identified were mobilised as an epistemic community because of a shared understanding of the nature of the ultimate problem, which was the crisis in financial sustainability of local councils. They also shared a commitment to the notion that accounting could contribute to the solution. Their expertise was valued and sought by the DLG, which invited them into the regulatory space to assist in the formulation of new accounting guidelines. The epistemic community comprised accounting and finance professionals from a specific sector and therefore transcended the traditional boundaries of professional groups.

The DLG instituted the policies that were developed in co-operation with the epistemic community, acknowledging their role and importance in the process. Thus, the epistemic community of accounting and finance professionals played a significant and mutually beneficial role as influencers and implementers, as portrayed in Figure 3.

Figure 3. The Epistemic Community as Influencers and Implementers



A reflexive relationship between the epistemic community and the DLG is consistent with that hypothesised by Adler and Haas as a feature of epistemic communities (1992, pp. 371-72):

> … the greater the extent to which epistemic communities are mobilized and are able to gain influence in their respective nation-states, the greater is the likelihood that these nation-states will in turn exert power on behalf of the values and practices promoted by the epistemic community…

In this case, at a local rather than national level, the influence of the epistemic community led to their having a role in determining the accounting policies of the DLG. In addition, they acted as implementers of the policies which they had been instrumental in developing, thus changing the domain of accounting. The dimensions of this framework will now be applied to the implementation of fair value accounting in NSW local councils.

THE EPISTEMIC COMMUNITY AS INFLUENCER IN REGULATORY SPACE

An epistemic community operates within a regulatory space, an arena deter- mined by 'a range of issues' (Hancher and Moran, 1989, p. 277). Because that space can be shared by a number of different actors, it is a 'broad social process' involving both the State and private bodies (MacDonald and Richardson, 2004, p. 492). The dynamics within that space can be 'an often ferocious struggle for advantage' (Hancher and Moran, 1989, p. 277), 'highly contested' (Young, 1994, p. 85), or, in some cases, a co-operative attempt to achieve desired regulation, particularly where a hierarchical organisation dominates that space (Hancher and Moran, 1989).

The Boundaries of the Regulatory Space

In this study, the dynamics within the space were co-operative as the DLG, faced with the need to formulate and implement a new set of accounting guidelines invited accounting and finance professionals into the regulatory space (Potter, 2005).[19] Recognised as a community of like-minded, qualified people, they participated as an epistemic community in 'relations of interdependence' in an attempt (Hancher and Moran, 1989, p. 291) to apply a 'new normative model' (MacDonald and Richardson, 2004, p. 492) to local government accounting. Negotiations between the parties occupying that space established the influence and boundaries of the regulatory process (MacDonald and Richardson, 2004).

The boundaries of influence of the epistemic community within the regulatory space were determined primarily by the decision to require fair value accounting. As already established, and confirmed by Interviewee D, the ‘edict’ came from NSW Treasury. In addition, the DLG’s lack of resources enabled the epistemic community to exert significant influence. Interviewee B observed that the DLG suffered from ‘greater resource problems than many councils’, with its finance branch ‘decimated’ and without resources. In addition, Interviewee C expressed the opinion that DLG representatives displayed a very casual attitude to the technicalities of fair value accounting, and that most department staff did not understand it sufficiently well.

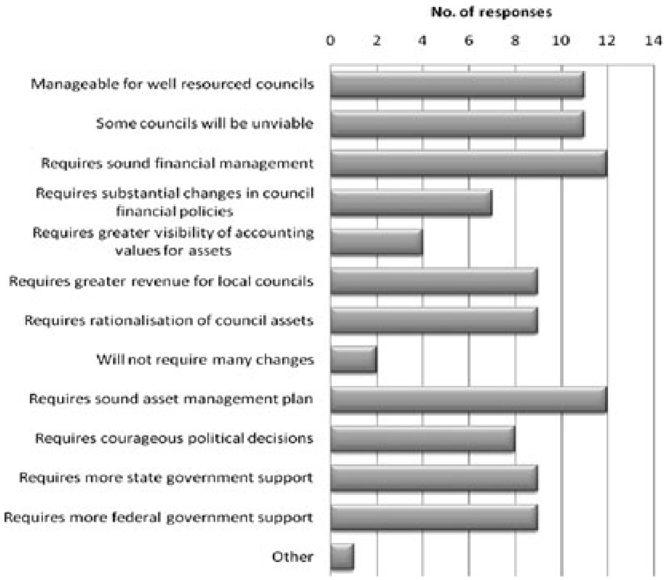
Acceptance of the Boundaries of the Regulatory Space

The DLG’s intention to implement fair value accounting was supported with ‘little or no debate’ from the epistemic community, according to Interviewee D. He reported that even the LGFP, which had a history of influence over the DLG accounting policy,[20] ‘didn’t put up any sort of a fight’. Three reasons could be put forward for this. First, as identified in Figure 4, accounting and finance professionals working in local government were generally in agreement with the government’s identification of the problem of financial sustainability of local councils and the need to develop a sound asset management plan.

Twelve of the survey respondents acknowledged that the financial sustainability of local councils required both sound financial management and a sound asset management plan, while eleven identified financial sustainability as manageable for well resourced councils. In addition, 11 survey respondents expressed the opinion that the issue could result in some councils becoming unviable, an opinion that could be inferred from comments made by interviewees A, D and H. There was widespread agreement that local councils needed greater revenue, needed to rationalise their assets, and needed more support from both state and federal governments (Interviewees B, C, E, F, H). Interviewee C stated that:

> if they [local councils] are going to exercise good governance, they need to understand what assets they've got, what outcome is delivered by those assets and how best to deliver an appropriate level of service to the community in a cost effective way.

Figure 4. Opinions on Financial Sustainability of Local Councils



Secondly, the adoption and implementation of fair value accounting was overwhelmingly seen as a positive move which enhanced the status of accounting and finance professionals. When asked in the survey to identify what they saw as the impact of fair value accounting on local government finance staff, only one respondent identified it directly as 'unreasonable and stressful', as shown in Figure 5.

This survey respondent, a member of the UK's Chartered Association of Certified Accountants, worked in a very large urban/regional council, and had only been working in local government finance for two years. In the 'other' response category, one survey respondent from a very large urban regional council, stated that the fair value requirement provided ‘greater credibility to finance professionals’. Another, from a rural council experiencing significant growth, stated that it provided ‘a new skill and experience which is always a good thing even if stressful’. Only one of the respondents, from a rural council, identified it as having a negative effect in the form of ‘increased stress related to increased workloads’, while at the same time identifying it as creating more demand for finance professionals.

Figure 5. Impact of FV Implementation on Accounting/Finance Professionals in Local Government

Thirdly, and most compellingly, the epistemic community was already involved in the regulatory space through their participation in the Local Government Accounting Advisory Group. Through this group, they had a history of providing input, so that the DLG's decisions about accounting policy were decisions in which they had participated. The DLG's reliance on the advisory group was apparent from the beginning of this study, at the initial meeting. It was therefore not surprising that the DLG asked the LGFPs to undertake fair value training.

Co-operation Within Regulatory Space

This co-operative relationship led the DLG to request the LGFP to provide implementation advice and training. This guidance role was not performed by the DLG, and, as Interviewee H stated, ‘if LGFPs didn't do it, nobody would’.

Survey respondents overwhelmingly perceived the LGFP as being the greatest source of advice and formal training in FV accounting, with twelve of the thirteen respondents identifying it as the source of formal training they had either used or expected to use. Advice was also received from other members of the epistemic community, including council auditing firms, with ten respondents identifying it as the source of advice they had either used or expected to use. Formal training from other sources, such as the DLG, professional bodies and councils, was rated much lower. This dependence on the LGFP for fair value training and advice was further supported by survey respondents' opinions about documentary resource support for fair value implementation, with ten identifying LGFPs as a provider they had either used or would use. Almost as many (nine respondents) identified a consultancy firm as providing documentary support.

LGFPs thus played a significant role in regulatory space by assisting with accounting policy formation, and by taking responsibility for certain activities, such as accounting training, often borne by the regulator itself. It was an expansionary role in driving the training and advice needed for fair value adoption to continue, and illustrates the mutually beneficial nature of the co- operative relationship within regulatory space.

Influence in Regulatory Space

Given that the decision to adopt fair value accounting had already been made, the influence of the epistemic community was limited to advising on the process of adoption. A significant example of its influence on this process can be seen in the community's participation in the decision relating to the timing and sequence of adoption for various classes of infrastructure assets. Auditors were identified as being particularly influential. The Local Government Auditors' Association, according to Interviewee A, 'drive(s) the end product' by influencing the DLG about what they 'will or will not accept in the audit process'.

The minutes of the meeting of the DLG's advisory group prior to the fair value announcement reflect the discussion about the manner and timing of the implementation. A member of the auditors' association suggested that fair value be implemented over three years, as follows:

- 2007 Water & Sewerage

- 2008 Property
- 2008 Plant & Equipment
- 2009 Roads & Drainage (LGAAG, 2006, p. 5).

The implementation of fair value for water and sewerage assets first was endorsed by ten of the thirteen survey respondents. One respondent, a qualified CPA from a medium sized urban/metropolitan council, with fourteen years experience in local government accounting and finance, observed that it placed a great strain on 'bush' [i.e., rural] councils, and that resourcing of local councils should be taken into account in the phased introduction. A finance officer at a rural council responsible for both water and sewerage assets, stated that she 'laughed' when she saw water and sewerage was first, and wondered what would happen when the 'city councils' started applying fair value, since 'they are likely to be more vocal with their opinions' (Interviewee F).

The DLG, as the regulator of local councils, occupied the regulatory space in relation to accounting and finance matters. In this case, it used the space to take political action to address a perceived financial sustainability problem in local councils. The DLG and the epistemic community both contributed to and benefited from their participation. The DLG, being under-resourced, needed the expertise and services of accounting and finance professionals to enforce its regulations. Through this process, the epistemic community benefited from its role in the formulation of policy, thereby ensuring that implementation guidelines were clear and achievable. In the process, they enhanced their reputation.

THE EPISTEMIC COMMUNITY AS IMPLEMENTER IN THE ACCOUNTING DOMAIN

Any consideration of the public management of infrastructure assets must acknowledge its political context (Pallot, 1997), and the wider societal envi- ronment. At the time, as expressed by Interviewee F, councils faced an increase in community expectations of services by consumers and ratepayers. These rising expectations had increased costs, while at the same time, councils were 'stuck with narrow permissible incomes', due to the pegging of rate charges that the state government permitted local councils to levy on ratepayers.[21] This situation made it difficult to provide adequately for infrastructure asset renewal, leading to the financial sustainability challenge.

Therefore, a solution to a proposed deficiency in current practice may involve new and better forms of accounting that not only solve the problem at hand but offer something better (Potter, 2005). This will inevitably change the accounting domain, often causing ambiguity as a new policy is implemented (Arnaboldi and Lapsley, 2009). This epistemic community was instrumental in changing accounting practice as a result of the implementation of fair value.

Accounting for Fair Value

The measurement model of accounting changed when fair value accounting was adopted. In regard to its implementation, interviewees had a variety of opinions about what constituted fair value. It was described by participants in the study as:

- 'current value … but without a market to compare it is difficult to estimate' (Interviewee E);
- 'depreciated replacement cost for infrastructure assets' (if no market) (Interviewee D);
- 'the value that you set upon by a value between a willing buyer and seller' (Interviewee G);
- 'fabulous for investments or assets held to sell but fair value shouldn't apply to water and sewerage etc' (Interviewee F);
- 'more realistic and useful … greater correspondence with realities' (In- terviewee A);
- 'NOT deprival value' (Interviewee C);
- 'up to date value' (Interviewee H); and
- depreciation expense and balance sheet should look 'more realistic' (Interviewee H).

In the survey, eight possible measures of fair value were offered for con- sideration. These were current market prices, modified historic cost, a state government engineering-based measurement, deemed cost, deprival value, depreciated replacement cost, estimated selling price, and, for land, unimproved capital value. Measures chosen by most respondents as an acceptable reflection of fair value were current market prices (12 respondents), depreciated replacement cost (11 respondents) and estimated selling price (7 respondents). All of the suggested measures were considered appropriate by at least one respondent. While the majority limited fair value to three acceptable measures, one respondent, a LGFP member with 15 years experience in council finance, who worked in a rural council experiencing significant growth, found all to be acceptable.

This variety of opinion was not entirely inconsistent with the AASB 116 (2006, paras 32, 33) and its multiple approaches to the determination of fair value. It indicated that the decisions made in the regulatory space did not eliminate ambiguity in the implementation phase. Fair value was adopted and implemented, but the accuracy of its implementation, according to Interviewee C, was questionable, due in part to the attitude of local councils:

> … if they were committed to fair value they would be making sure they get their valuations done properly and that figures are meaningful and reflect the pattern of consumption. But what they do in practice is to take the cheapest price, even if they know it doesn’t apply, as long as it gets the green tick from the auditor. For them it is a pure compliance exercise.

Accounting and Engineering

The domain of accounting expanded into the realm previously dominated by engineers. Engineers play an integral role in asset management in local councils by assessing the nature, location and condition of infrastructure assets. Traditionally, engineers and finance staff did not agree on the importance of an integrated system, as documented by Walker et al. (2006), who observed that the two groups seemed to be disconnected. However, the adoption of fair value has resulted in the recognition that there should be a correspondence between engineering and finance estimates to show the condition of assets and the revenue required to maintain assets (Interviewees A, B, C, D, G, I). The value assigned to the asset is not the most important aspect of fair value accounting, according to Interviewee C. Rather, he saw the benefit of fair value accounting in the local government context as being its potential to provide councils with information about what it would cost them to maintain the assets and thereby to ensure that they can continue to maintain their level of service provision in the future. This would enable council finance officers to quantify asset deterioration through depreciation costs more accurately.

In responding to a question about the benefits of fair value in financial statements, eleven survey respondents stated that it would give managers a better idea of council assets and what they were worth, with ten identifying its usefulness in assisting councils to develop an asset management plan. This was an area traditionally dominated by engineers. All thirteen survey respondents identified the possibility of integrating the fair value of council assets with engineering estimates. Only nine respondents were convinced that fair value accounting could be integrated with a total asset management plan, with two negative about the possibility, and two unsure.

Accounting Expertise in Local Councils

Finance professionals in local councils perceived some benefits from both the adoption of IFRS and the introduction of fair value accounting. One survey respondent identified 'greater transferability between sectors' as a positive benefit for finance professionals in local councils. With the increase in the sophistication of financial reporting now required by the DLG, local councils would need 'people with more qualifications' for the 'more professional processes' (Interviewee A) resulting in changes to the type of skill set required of an accounting or finance professional in the public sector.[22]

The implementation of fair value accounting also increased the profile of accounting in local councils. The necessity to complete or update asset registers and obtain valuations put pressure on local councils, particularly those that were short of resources. It was acknowledged by Interviewee C that while it was assumed that councils already had data on water and sewerage assets, this data was in fact not ‘great’. With the fair value requirement made as a political decision, local council professionals were charged with the responsibility of producing financial statements that portrayed this information.

More than half of the survey respondents indicated that their local council was ‘committed’ to providing finances and staff training for fair value implementation, while respondents from four councils described their council as ‘highly committed’. Significantly, these four were all from urban councils. All survey respondents indicated that councils would outlay funds for staff training, with the majority identifying valuation fees, followed by consultants’ fees and computer solutions. Estimates of the actual outlays councils would make varied considerably, with the most common size of the outlay, according to almost half of the respondents, expected to be between $26,000 and $50,000. One respondent, from an urban council, identified council spending on fair value implementation in the $51,000–$75,000 bracket. The same respondent, however, observed that the council would be ‘doing this anyway for asset management and outlaying more than $200,000’.

Accounting and Financial Sustainability

The adoption of fair value changed financial reporting practice, and reinforced the role of accounting in the wider domain of the financial sustainability of local councils. In particular, it had a role to play in highlighting the sustainability crisis faced by some local councils. In situations where assets had been recorded at historic cost, or not recorded in the accounts at all, depreciation expense would provide a much less accurate proxy for the amount of expenditure required in order to restore infrastructure assets to an acceptable condition, i.e., the ‘renewals gap’ (LGSA, 2006, p. 7).

Interviewee C observed that not just in NSW but nationally, there was not enough funding, and that every state government was 'fully aware' that 'the state of infrastructure within their own states is going backwards'. Or, as Interviewee B observed, it was recognised that there was a widespread failure of local councils to manage assets effectively: 'nearly every council in Australia is not making adequate provisions'. Interviewee A stated that the 'sins of the past' in terms of a minimalist approach to valuations were 'catching up with local councils'. Consequently, the ability of local councils to continue to provide necessary services, while maintaining or replacing infrastructure assets, was recognised as being under severe threat. NSW councils were identified by Interviewee E as being behind other states in their ability to increase revenue through resident rate payments, due to rate pegging, and, not coincidentally, were also behind in introducing fair value accounting for infrastructure assets.

Thus the adoption of fair value accounting provided local councils with the opportunity to alert stakeholders, including elected council representatives and the community, that they were underfunded by the State Government. Interviewee G stated that 'taking assets to fair value is a catalyst for taking a good look at it'. The need to present a true picture of the state of these assets gave a prominence to the amount of revenue needed from State Government or to required increases in user-pays revenue to rebuild or maintain infrastructure consistent with community expectations. Currently, as highlighted by Inter- viewee F, councils faced an increase in community expectations of services by consumers and ratepayers which had increased costs, but were limited in their ability to increase rates due to State government regulations. This situation made it difficult to provide adequately for infrastructure asset renewal. In fact, the role of community expectations was a prominent consideration when considering ways to rationalise assets since 'it's hard to get rid of assets… the public are attached to them' (Interviewee B).

Some contentious issues identified by survey respondents have the potential to expand the domain of accounting in the future as fair value is gradually introduced to more infrastructure assets. Some of these include the lack of qualified accounting and finance staff at local councils, the difficulty of satisfying audit requirements of what constitutes fair value, the valuation of land under roads, and control issues relating to assets.

CONCLUSIONS

The adoption of fair value accounting for infrastructure assets was part of a solution proposed to address the issue of financial sustainability in NSW local councils. The shift to fair value accounting in NSW local government has occurred as a result of a decision taken at NSW State Treasury level, developed by the DLG into an accounting code, with the assistance of its accounting advisory group, and implemented in local councils. This epistemic community acted as influencers in the determination of the DLG's accounting code and as implementers as fair value accounting was embedded in local councils and changed the domain of accounting.

Applying the concept of epistemic communities, this study identifies a coalition of professionals working co-operatively rather than competitively in a regulatory space at the invitation of the primary regulator. This represents a departure from the situation experienced by many epistemic communities that operate politically in order to gain influence and establish their position in a regulatory environment. Faced with limited resources, the DLG relied upon the expertise of accounting and finance professionals in order to activate the fair value policy mandated by the NSW government. By working as an epistemic community towards a new normative system, the professionals experienced benefits both in their professional reputation, and in their ability to influence the accounting code they were required to implement.

While the relationship between the DLG and the epistemic community has been a co-operative one, the implementation of fair value in local councils and subsequent change in the accounting domain has been challenging for local councils and finance professionals. These changes included the embedding of the fair value concept and expanding accounting into a realm previously dominated by engineers. The reputation of local government accounting and finance professionals was enhanced, and the profile of accounting in local councils was raised. Most significantly, however, accounting played a role in highlighting the financial (un)sustainability of local councils.

Documentary sources, interviews and a survey have provided the data on which this paper is based. The adoption of an epistemic community framework emanated from an analysis of the data collected from interviews and a survey. This data indicated the importance of finance and accounting professionals in fair value implementation, and their ability to perform a dual role, working both within and outside the regulatory space.

Developments are continuing in the area of fair value accounting in NSW local councils, as the implementation phase has been extended. The financial sustainability of local councils is acknowledged as vital for the continued delivery of services to all NSW residents. In spite of its ambiguity (Arnaboldi and Lapsley, 2009), fair value accounting can make a contribution to useful financial reporting and, as identified by respondents, to the development of integrated asset management plans that enhance financial sustainability. An interpretive framework offers just one explanation of events and response and this paper could stimulate further research either in the area of the financial sustainability of local councils and its relationship to fair value accounting or on epistemic communities invited into regulatory spaces.

NOTES

1 In Australia three levels of government, federal, state and local, exist with distinct powers and authority for governing. Local government does not have constitutional authority, therefore, councils operate under the direction of their State governments.

2 These councils are categorised as urban rural, urban metropolitan, urban city, rural agricultural and rural with significant growth.

3 This was updated to Circular 06-75 in December 2006.

4 The NSW State Treasury originally mandated the valuation of physical non-current assets at fair value for all NSW public sector entities from 1 January, 2005.

5 As the 'second government in the world and the first government in Australia to adopt accrual based financial reporting' (Christensen, 2002, p. 95), the NSW government's desire was to bring the public sector closer in its management and reporting style to the private sector. Since its initial adoption of new public management practices, however, other states have moved towards fair value accounting more rapidly. The Victorian and Queensland state governments announced the adoption of fair value accounting in their public sectors, in December 2004 and July 2005 respectively.

6 'Regulatory space', an 'analytical construct', is determined by organisations, people and events leading to change (Hancher and Moran, 1989, p. 277).

7 Management consulting firms, in their role in advising governments on New Public Management changes, have been identified as an epistemic community, in an extension of Haas' (1992) view (Christensen and Yoshimi, 2001). The NSW government, in its adoption of performance reporting, has relied on the advice of such an epistemic community of 'international management consulting firms' (Christensen and Yoshimi, 2001, p. 285).

8 NSW local government was identified in 2005 as a $6 billion industry (DLG, 2005, p. 1).

9 *NSW Local Government Act* (1993), subsection 428 (2) (d).

10 Pilcher's longitudinal study of all 172 NSW local councils from 1996/97 to 2002/03 was conducted against the backdrop of the financial health check criteria which were used to assess the viability of these councils. She found inaccuracies in both the valuation of infrastructure assets and consequent depreciation charges, which were then politically 'misused' by government Ministers (Pilcher, 2005, p. 188).

11 A study of NSW local councils found that lower carrying amounts for infrastructure assets were associated with 'greater distress' (Jones and Walker, 2007, p. 410).

12 The Public Sector Accounting Standards Board was established to offer guidance on the issue of accounting for public sector infrastructure assets, and in recognition of the fact that private sector indicators of efficiency were not relevant for the public sector (Public Accounts Committee, 1992, p. 52). The accounting standards promulgated by the Public Sector Accounting Standards Board included AAS 27 *Financial Reporting by Local Governments* (1996), issued in 1990.

13 Fair value is defined as 'the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction' (AASB 116, 2006, paragraph 6).

14 In February 2008, the DLG, together with its Local Government Accounting Advisory Group, issued further guidance for the valuation of property, plant and equipment at fair value, extending the adoption date. For operational land, the new date was 2008, for

community land, 2010 and for other assets, 2009 (DLG 2008b).

15 NSW Local Governments accounts are audited, usually by auditing firms specialising in the public sector.

16 NSW LGFP is a Special Interest Group of Local Government Managers Australia, NSW. The Group's aim is 'to support, promote and develop Local Government Finance Professionals and promote the professional image and recognition of finance professionals in the industry' (LGFP, 2008).

17 Australia's three professional accounting bodies are CPA Australia, The Institute of Chartered Accountants in Australia, and the National Institute of Accountants.

18 DLG's Circular 06-75 ended with the following: 'it is recommended that relevant council staff attend training on revaluing assets at fair value. Councils may wish to contact their Finance Professionals Group representative to obtain details about appropriate training' (DLG, 2006c).

19 The cooperative relationship within this group between the DLG, LGFPs, NSW Local Government Auditors' Association and representatives of other government bodies, is illustrated in the minutes of the meeting held on 12 April, 2006. On State Treasury advice that fair value would be required, the time frame for fair value of property, plant and equipment assets of local councils was discussed and a four year staged implementation suggested (Local Government Accounting Advisory Group, 2006, pp. 5-6).

20 The LGFP were formed at the time of the introduction of AAS27 to form a 'combined voice on exposure drafts'. This profile has led them to be 'invited to the table', as Interviewee E stated, in order to be represented for 'negotiations on public sector accounting issues'. Their influence has led to accounting and finance professionals having a higher industry profile.

21 In NSW, the government 'pegs' rates, by limiting the total amount of income a council can raise from its rates and charges. This limit is determined annually by the NSW Minister for Local Government. This rate pegging' means that 'council's overall rates revenue cannot increase by more than the percentage increase approved by the Minister' (DLG 2009).

22 Laing (2007) noted that the requirements of AAS 27, when initially implemented, caused many local government staff, who were not sufficiently qualified, to leave. The adoption of fair value could have a similar effect.

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