



December 2024

LOCAL WATER DONE WELL

Guidance: Ensuring compliance with financial principles for water service providers

This guidance provides suggested approaches and considerations to ensuring compliance with the financial principles for water service providers, as set out in the key aspects of the Local Government (Water Services) Bill.

It is based on the provisions of the Bill as introduced in December 2024.

The Bill sets out the enduring settings for the new water services system. It is the third piece of legislation in the Government's three-stage process for implementing Local Water Done Well.

This guidance provides suggested approaches to how water service providers¹ can ensure their financial and operating policies and procedures enable adherence to the financial principles for water service providers as set out in the Bill.

This guidance should be read alongside other Local Water Done Well factsheets, especially *Planning and accountability for local government water services*.

Financial principles for water service providers

What are the ringfencing requirements and financial principles?

Ringfencing is a critical requirement for revenue sufficiency and financial sustainability. Water Services Delivery Plans are required to demonstrate how water services will be ringfenced from other council activities.

Stand-alone projected financial statements will need to be developed for each water service in Water Services Delivery Plans. This requires ringfencing of water services from other council activities.

In the longer-term, water service providers will be required to include financial statements on each water service they provide, in the water services strategy and water services annual report provided for under the Bill. These documents will contain:

- a statement of comprehensive revenue and expenses;
- a statement of cash flow; and

¹ Water service providers is a term used in the Bill that includes council providers and water organisations (including existing water services council-controlled organisations that become water organisations).

- a statement of financial position.

The Bill includes financial principles, which support the ringfencing objective of Local Water Done Well. The Bill also includes a set of objectives that apply to all water service providers, including the objective to ensure water services are provided in a cost-effective and financially sustainable manner.

The Bill requires each water service provider to act in accordance with the following financial principles:

- the provider must spend the revenue it receives from providing water services on providing water services (including on maintenance, improvements, and providing for growth);
- the provider must ensure that the revenue it applies to the provision of water services is sufficient to sustain the provider's long-term investment in the provision of water services;
- the provider's revenue (including from charges) and expenses must be transparent to the public; and
- the provider must be accountable for its revenue and expenses to communities and shareholders (as relevant).

Water service providers will also be subject to an economic regulation regime implemented by the Commerce Commission. As part of this role, the Commission will enforce a new "ring-fencing" rule, under which regulated providers will be required to spend the revenue they receive from providing water services on providing those services (see clause 3 of new Schedule 7). Pecuniary penalties will be available if the rule is breached.

What does financially sustainable water services mean?

Financial sustainability means water services revenue is sufficient to meet the costs of delivering water services. The costs of delivering water services include meeting all regulatory standards, and long-term investment in water services.

How councils approach achieving financial sustainability can be different depending on local circumstances and requires councils to consider the balance between three key factors.

These factors are:

- Revenue sufficiency – is there sufficient revenue to cover the costs (including servicing debt) of water services delivery?
- Investment sufficiency – is the projected level of investment sufficient to meet levels of service, regulatory requirements and provide for growth?
- Financing sufficiency – are funding and finance arrangements sufficient to meet investment requirements?

Each council is required to develop a Water Services Delivery Plan that demonstrates financially sustainable water services provision will be achieved by 30 June 2028 at the latest.

Why are the financial principles needed?

Local Water Done Well intends to promote efficiency, improve the governance and management of financially sustainable water services, and ensure accountability within the sector. Local Water Done Well requires water service provision to be financially sustainable and for the ringfencing of water services revenues from other council activities.

The financial principles included in the Bill are intended to provide direction on how water service providers can ensure that water services will be financially sustainable and meet the ringfencing objective of Local Water Done Well.

A significant shift in financial operations, management and governance arrangements may be required for councils and/or other water service providers to comply with these principles.

What do I need to consider to be able to comply with these financial principles?

Water Services Delivery Plans are a critical early step to compliance with these financial principles. Water Services Delivery Plans require councils to consider, decide on and communicate how water services will be delivered in a financially sustainable manner and ringfenced from other council activities.

Developing Water Services Delivery Plans, and assessing preferred delivery models, should set councils up well to understand what financial and operating policies will be required to comply with the financial principles set out in the Bill.

Councils should consider the financial principles, financial sustainability and ringfencing in the development of Water Services Delivery Plans, with the following considerations material to ensuring future compliance with financial principles:

- Whether water services have access to sufficient revenues and debt financing required to deliver required levels of operating and capital expenditure.
- Whether water services have sufficient cash balances and working capital for operations.
- Whether revenues for water services are separately identifiable from other revenues and transparent to ratepayers and consumers.
- Whether sufficient internal controls are in place to ensure that revenues generated for water services are spent on water services, not other council business.
- Whether cashflows relating to water services can be tracked and reconciled, with cash surpluses for water services are retained for future expenditure on water services².

² Establishing separate bank accounts for water services could assist compliance with and auditing of ringfencing, tracking water services related transactions, and demonstrating that cash revenues and surpluses are attributed transparently to water services expenditure.

- Whether accounting systems and general ledgers can identify entries and transactions relating to water services separately from entries and transactions that do not relate to water services.
- Whether a water services trial balance and financial statements could be produced, separate from other council activities from accounting systems.
- Whether financial policies for attributing overheads, finance costs and other internal charges are cost-reflective and transparent, and comply with ringfencing objectives, which could be done by:
 - Maintaining clear financial policies regarding overhead and finance cost attribution to water services³;
 - Implementing appropriate cost allocation methodologies that follow conventional cost recovery principles⁴; and
 - Including appropriate disclosures and assumptions in financial strategies and accountability documents (such as annual reports).
- Whether internal borrowings and other financial transactions between water services and other council activities are on an arms-length commercial basis and governed by transparent financial policies⁵.
- Whether debt balances attributed to water are verifiable, appropriate and transparently demonstrated to have been incurred in the delivery of water services⁶.

Next steps

There will be an opportunity to provide submissions on the Local Government (Water Services) Bill at select committee.

The Department of Internal Affairs will prepare further guidance material to support the implementation of Local Water Done Well, following the enactment of the Bill. This is expected to be in mid-2025.

³ Consideration should be given to attributing finance costs to water services based on an effective interest rate calculation on the verified debt balances attributed to water services, as opposed to some other indirect allocation methodology with no clear link to cost incurrence for water services provision.

⁴ Implementing costed resource and activity-based calculation methodologies will assist with transparency and accountability for charges, ensuring that the 'full cost' of water services provision is appropriately measured and understood.

⁵ Ensuring internal borrowing arrangements are repayable, commercial arrangements will ensure that costs are appropriately allocated and enable water services revenues to be set to an appropriate level that reflects the 'full cost' of service.

⁶ Transparency of debt attribution to water services could be achieved through demonstrating that balances align to confirmed movements in borrowings set out in water services funding impact statements included in historical audited annual reports.

Further information

The Local Government (Water Services) Bill is available at www.legislation.govt.nz.

Information about the parliamentary process and timeline for the Bill, including how to make a submission to the select committee, is available at www.parliament.govt.nz.

For further information about Local Water Done Well, including guidance and information for councils, visit www.dia.govt.nz/Water-Services-Policy-and-Legislation

Questions? Contact waterservices@dia.govt.nz