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LOCAL WATER DONE WELL

Guidance: Ensuring compliance with financial principles for water service providers

This guidance provides suggested approaches and considerations to ensure compliance with the financial principles for water service providers, and related matters.

It is part of a package of factsheets and guidance material relating to the Local Government (Water Services) Act 2025 and the associated Local Government (Water Services) (Repeals and Amendments) Act 2025.

It updates the guidance document: *Ensuring compliance with financial principles for water service providers*, shared in December 2024, to reflect changes made through the Parliamentary process.

Together, the Local Government (Water Services) Act 2025 and the Local Government (Water Services) (Repeals and Amendments) Act 2025 set out the enduring settings for the new water services system. They are the third tranche of legislation in the Government's three-stage process for implementing Local Water Done Well.

This guidance provides suggested approaches for 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 Local Government (Water Services) Act 2025 (the Act). It also outlines the new legislative requirements relating to water services financial statements that apply under that Act – and on a transitional basis under the Local Government Act 2002 (LGA02).

Councils automatically became water service providers when the Act came into force on 27 August 2025 (if they were responsible for providing services prior to that date). A council only ceases to be a water service provider if it transfers its responsibilities for providing water services to a water organisation, in a transfer agreement.

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

¹ Water service providers is a term used in the Act that includes council providers and water organisations (including water services council-controlled organisations that became water organisations when the new legislation was enacted).

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 – which includes developing stand-alone projected financial statements for each water service.

Water service providers will also include **financial statements** on each water service they provide, in the new water services strategy and water services annual report required under Part 4 of the Act. These documents will contain, for each group of water services activities:

- a statement of comprehensive revenue and expenses;
- a statement of cash flow; and
- a statement of financial position.²

In addition, there are transitional provisions – in the LGA02 – that require these financial statements to be included in council annual reports for the 2026/27 financial year.³ Further information on when these requirements do and do not apply is provided later in this guidance.

The Act includes **financial principles**, which support the ringfencing objective of Local Water Done Well.⁴ Under section 18 of the Act, each water service provider is required to act in accordance with the following principles:

- the provider must spend the revenue it receives from, and funding it receives for, providing water services on the water services it provides (including on maintenance, improvements, infrastructure renewal, servicing debt relating to the services it provides, and providing for growth);
- the provider must ensure that the revenue and funding it applies to providing water services is sufficient to sustain the provider's long-term investment in its water services while meeting all regulatory requirements;
- the provider's revenue and funding (including from charges), expenses, and dividends (if applicable) must be transparent to the public;
- the provider must be accountable for its revenue, funding, and expenses:
 - if it is a territorial authority, to its communities; or
 - if it is a water organisation, to its shareholders.

² See clause 5 of Schedule 3 of the Act for the requirements relating to the forecast financial statements to be included in water services strategies, and clause 2 of Schedule 4 for the statements to be included in water services annual reports.

³ See clause 60 of Schedule 1AA of the Local Government Act 2002 (inserted by section 55(a) of the Local Government (Water Services) (Repeals and Amendments) Act 2025).

⁴ See section 18 of the Act for the full provisions.

In addition, each water service provider must demonstrate its compliance with these financial principles in the following documents:

- its financial operations and financial policies;
- its planning and reporting documents prepared under Part 4 of the Act;
- if the provider is a council, in its financial strategy prepared and adopted under section 101A of the LGA02;
- if the provider is a council that is transferring responsibilities to a water organisation, in any transfer agreement it enters into, and in documents relating to a proposal to establish a water organisation.

Certain water service providers (regulated suppliers) will also be subject to an economic regulation regime implemented by the Commerce Commission. As part of this role, the Commission can make and enforce determinations that relate to requirements to “ring-fence” revenue from regulated water services (currently water supply services and wastewater services) – linked with some of the financial principles.⁵

This could include, for example, requiring a regulated supplier to ensure that a portion of the revenue it receives from providing one or more regulated water services is invested in that/those services (including in a particular asset, expense category, project, programme, or type of regulated water service, or held in reserve for any of those matters).

The Commission can also set information disclosure determinations that require regulated suppliers to publicly disclose financial (and other) information. This form of economic regulation will provide further transparency about how regulated suppliers are ring-fencing regulated water services from other services they provide.

In the longer term it is likely there will be some differences between the regulatory accounts that regulated suppliers will need to maintain to comply with economic regulation, and the existing accounts they compile. While the Commission’s preference is to rely on generally accepted accounting practice (GAAP), it may determine the use of specific approaches when there is a choice under GAAP, or where it considers that deviating from GAAP is required to support regulatory objectives.

⁵ See clauses 3 to 5 of new Schedule 7 of the Commerce Act 1986 – inserted by the Local Government (Water Services) (Repeals and Amendments) Act 2025. The purpose is to ensure regulated providers act in accordance with the financial principle in section 18(1)(a) of the Local Government (Water Services) Act 2025, and/or section 18(3) of that Act.

What are financially sustainable water services?

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's water services delivery plan must demonstrate financially sustainable water service provision will be achieved by 30 June 2028 at the latest.

Under the statutory objectives that now apply to water service providers under the new Act, each provider must ensure it provides water services in a cost-effective and financially sustainable manner, including by:

- planning effectively to manage water services infrastructure used to provide water services in the future;
- sharing the benefits of efficiency gains with consumers, including when setting charges for water services; and
- using water resources efficiently when providing water supply services.⁶

Water service providers must explain in their water services strategies how they intend to achieve or meet these objectives.

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 the ringfencing of water services revenues from other council activities.

The financial principles included in the Act are intended to provide direction on how water service providers can ensure water services are 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 to comply with these principles.

⁶ See section 17 of the Act for the full list of objectives.

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 the financial principles in the new Act. They 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.

The processes for developing water services delivery plans, and assessing preferred delivery models, should have set up councils to understand what financial and operating policies will be required to comply with the financial principles set out in the new legislation.

The following considerations are material to ensuring future compliance with financial principles, particularly where councils will be continuing to be a water service provider (with an in-house arrangement):

- 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 services.⁷
- 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 services;⁸

⁷ Establishing separate bank accounts for water services could assist compliance with ringfencing, tracking water services related transactions, and demonstrating that cash revenues and surpluses are attributed transparently to water services expenditure.

⁸ 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.

- implementing appropriate cost allocation methodologies that follow conventional cost recovery principles;⁹ 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 policies.¹⁰
- Whether debt balances attributed to water are verifiable, appropriate and transparently demonstrated to have been incurred in the delivery of water services.¹¹

Transitional provisions relating to financial statements – information to be included in council annual reports for 2026/27

As noted earlier, certain requirements for “ringfenced” financial statements apply to council annual reports adopted under section 98 of the LGA02 for the financial year ending on 30 June 2027.

These new requirements are contained in clause 60 of Schedule 1AA of the LGA02. They mean that, in addition to the information required by Part 3 of Schedule 10 of the LGA02, the annual report must include:

- a statement of comprehensive revenue and expense;
- a statement of cash flows; and
- a statement of financial position.

These statements must be included separately for each group of water services activities provided by the council, and aggregated for all water services provided by the council.

These transitional requirements apply to all council water service providers for the 2026/27 annual report, except where:

- a council is preparing a water services annual report for the period ending on 30 June 2027 under clause 6(2) of Schedule 1 of the Local Government (Water Services) Act – because it decided to move to the new planning and reporting framework for water services in that Act ahead of the statutory deadline;¹² or

⁹ 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.

¹⁰ 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.

¹¹ 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.

¹² Clauses 5 and 6 of Schedule 1 of the Act provide for the timing of the first water services strategy and first water services annual report. The first strategy must be adopted by 30 June 2027 – to come into force on 1 July 2027. However, it may come into force earlier. If it does, the water services annual report (or reports) must cover the earlier periods.

- they are not relevant because a council is not the water service provider for any water services for any part of the 2026/27 financial year. This could occur where a council has established a water organisation and transferred responsibilities for providing water services to that organisation – and the water organisation has a water services strategy and water services annual report for the 2026/27 financial year under Part 4 of the Local Government (Water Services) Act.

Further information

The Local Government (Water Services) Act 2025 and Local Government (Water Services) (Repeals and Amendments) Act 2025 are available at www.legislation.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 wmdp@dia.govt.nz