Strategic Asset Management

Issue 25, December 17 1999

Extracts from Richard Prebble "It's Time to Act" **193**
Extracts from Leslie Chapman's "Your Disobedient Servant" **196**
Extracts from Audit Reports **198**
Read the small print **200**

SCHADENFREUDE

The german word Schadenfreude means "to take joy in the misfortunes of others!" OK, I know this is not very charitable, but most of us do it. And we can also take joy in avoiding the same mistakes ourselves.

So, and since this is the season for joy, here, for your special schaden-freude pleasure, is a small collection of asset management 'gone wrong'.

All are from published or named sources. Deliberately I have chosen some that took place some time ago. It couldn't happen now – or could it?

Enjoy! And Happy Christmas.

Penny Burns (Editor)

NEXT ISSUE (and last for 1999):
"The Way We Were" - the story of the development of asset management to the present.

Researched and written by Dr Penny Burns, AMQ International.
Published fortnightly. Subscription, Comment, or Inquiries to

AMQ Intenational
PO Box 75 Salisbury South Australia
Tel 618 8258 4342 Fax 618 8281 5795
Email: sam@amqi.com

To start things off, some excerpts from Richard Prebble "Now it's time to act" (Seaview Press, Auckland, 1996) (An earlier edition was titled "I've been thinking")

In 1987, at the height of its radical reforms, New Zealand restructured its government portfolios and put all 27 of its state-owned enterprises in one portfolio under Richard Prebble. Over the next few years, New Zealand was to make substantial improvements in SOE productivity, in no small measure contributing to overall economic growth.

▶ . Serving who?

Prebble writes:

'One day I received some parcels that had been smashed out of recognition, so I asked the officials: "Why is it that when I get parcels they look as though they have been dropped out of a third storey window?"

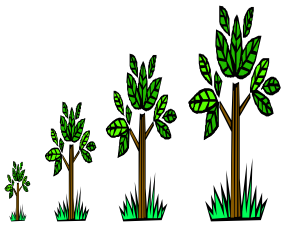
"That is because they have, Minister", the officials replied. "All parcels in Auckland are sorted on the third floor of the central post office and after being sorted they are dropped down chutes to the ground floor for delivery."

The real solution to this problem was to stop dropping parcels 15 metres. But what the Post Office did instead was to try and persuade customers to buy bubble plastic to wrap their parcels in. The television ads of the time used a comedian with a false Chinese accent to make the point to the public. (the ads were considered offensive enough by the Race Relations Commission to be cancelled – parcels continued to be dropped and broken).

It was no surprise that fewer and fewer New Zealanders were using New Zealand postal services'

▶2. Asking the right questions

I liked this one because we so often use the same excuse for not evaluating the benefits of asset management!



'New Zealand taxpayers have been investing in the planting of trees for most of this century. Under normal circumstances this is a useful and profitable activity. The private sector makes good money from their plantation forests. When I became Minister, the State forestry sector had never made a profit.

In my first year as Associate Finance Minister I was asked to approve a multi-million dollar budget for new plantings. I asked a question: "What will be the return to the taxpayer from planting these very large forests?"
The officials looked at me as if I were simple. They said: "Minister, these trees will take 30 years to grow. We can't possibly tell what the return will be."

This was hard to swallow. "I refuse to believe that the Chairman of Fletcher Challenge tells the shareholders every year that he's planted millions of dollars worth of trees and if they come back in 30 years he'll tell them whether they've made a profit. I suggest you go and ask Fletcher's how they work out the economic return from tree planting."

Under the crazy way the New Zealand government used to authorise a budget (namely, after the financial year had started) I was obliged to provisionally authorise the planting to go ahead. Three months later the officials returned with their answer.

"Minister, half of the trees we are planting this year will never be economical to harvest. We've gone back over the planting of the last ten years and found this ratio to be consistent: half of all trees planted over the period will never produce an economic return."

The reason was that the trees were planted so far from any road that the access costs exceeded the value of the trees. Apparently no-one had asked this question before. No-one had asked, "What is he effect of what we are doing here? Why are we doing it, what are we trying to achieve and is this the best way of doing it?"

▶ 3. No-one told us to retreat!

'Some of the best stories come from New Zealand Railways…

[a consultant study] found a warehouse at the end of a line that had been abandoned for twenty years. In the warehouse was a storeman keeping a full inventory of supplies needed for the line. When a product reached its use-by date he arranged for its disposal according to Railways regulations and ordered a new one. No-one had requisitioned a supply from this warehouse for twenty years.'

'In a similar vein there was a consultant sent to make an inventory of the Helensville line, a lightly-used railway line just north of Auckland. As he was working his way up the line he came acoss a group of workmen having their morning cup of tea. He explained he was doing a survey for head office and said "So who are you fellows anyway?"

"Oh, we're the Helensville Signals Maintenance Gang".

"My notes here say that the Helensville line was de-signalled 10 years ago." The men agreed that this was so. "So what are you guys doing here?" the consultant persisted.

"No-one told us to retreat," was the reply.'

4. Production or Productivity?

'There was a close relationship between the Railways and the coal industry – particularly in their working practices.

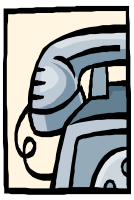
The board of Coal Corp discovered that the coalmines were mining coal way ahead of demand. There were enormous mountains of coal in the stockpiles. When they told me I did a calculation and there was enough coal to coat a four lane highway three centimetres deep from Auckland to Wellington.

Coal is dangerous when piled; it spontaneously ignites. As a result, there were men in Coal Corp whose sole job it was to hose down the stockpile (this is not a rewarding career).

The cost was enormous. Coal degrades when left to stand: the oxygen in the air attacks it and it deteriorates. Coal Corp was mining some of the best coal n the world, putting it on a stack for six months and selling it as third grade coal. The idea of mining what the market wanted had never occurred to anyone. They were simply continuing the second world war practice of getting as much out of the ground as possible.'.

The story over the page is the last NZ story here (but there are plenty more in Prebble's book!)

▶ 5. The Swedish Tracking System



The Post Office were having trouble tracking and recording all available phone lines. The problem was it was still being done manually and they needed a computer system.

"They found an excellent program in Sweden which the Swedish were prepared to sell for $2 million. There was just one problem: the programme was written in Swedish, a language that few New Zealand linesmen were confident in.

So managers decided to budget for translating it into English (estimated cost $1 million and another $1 million for contingencies because it is not as easy as it sounds to translate a computer programme from one language to another).

But as the general manager explained, it had turned out to be more expensive than the contingency budget allowed for and they needed another $7 million to get the programme to speak English.

"How much," I asked, "have you spent on it so far?"

"Thirty seven million dollars," was the reply.

"Why don't you cancel the programme?" I asked.

"How can we cancel a programme that has cost $37 million?" they asked.

"Do you believe the programme will ever work?" I asked.

"No, not properly".

"Well then, why not write me a letter recommending its cancellation and I will sign it".

The relief was visible. So I signed the letter but I knew I needed new managers.

The Source of the "Yes Minister" series?

I found Leslie Chapman's "Your Disobedient Servant" (Chatto and Windus, London,1978) by accident whilst I was advisor to the Minister of Construction in Tasmania. You will appreciate why it appealed to me.

For more than 30 years, Leslie Chapman served in the Ministry of Works. In 1967 he was appointed Regional Director for the South of England and set about a thorough investigation of his new department. In every office he visited he had one question.

> "I want to know" he said "what everybody - every single person -is doing at this minute"
> -

He was appalled at what he found - practically no-one was where the records said they were, doing what the records said they were doing, or doing something that needed to be done.

As a result of what he found - and WITH the support of both staff and unions, within 5 years, Chapman had reduced his department costs by *one third* and labour *by a half*!

> **The savings were made by removing waste and *without any increase in capital or major organisational changes*.**

Chapman reckons there were far more savings yet to be made!

If you read it, you will probably conclude, as I have, that this book is the source of the "Yes Minister" series.

▶6. Performance Audits – It's the assumptions we don't question, that lead us into error

'Early in 1967 I appointed two of the senior professional officers in the region to carry out a survey of maintenance expenditure and to advice whether we needed to change our rate of spending (up or down) to produce the results that would give the best value for money. …

They spent six weeks, not quite full time, in fact-finding visits or interviews and in producing their report.

Both men were well-qualified professionals and had had long experience within the department and outside it. They were competent and conscientious and were aware of the importance we attached to the results of this inspection. In the light of this, and having regard to the results of later surveys, the summary of their findings contain a lesson which has implications elsewhere in the public sector.

In no case did they find 'a single penny' spent that was not essential to the preservation of the fabric of the buildings, complying with the minimum requirements for safety, the observance of bye-laws and similar obligations. In view of what followed *(Ed: ie the 30% cost and 50% labour savings referred to above*), I remember that one phrase very clearly.

Indeed the report went on to say that *a good deal more money needed to be spent than our current budget provided in order to give a really satisfactory service*.'

It emerged that this inspection had taken for granted that if a building or a piece of land was being maintained, then it was right that it should be.

Secondly, much of the basic evidence of expenditure had to be taken on trust. By this I mean that where the work of a directly employed bricklayer was described as "Maintenance at Army Camp ABC' it had been assumed that this meant exactly what it said: that the bricklayer was laying bricks **and that these bricks needed to be laid.'**

On checking, hardly anybody was where the records said they were, or doing something that actually needed to be done!

▶7. We see what we see

Some many years ago I remember Bob Pike, Maintenance Manager, South Australian Housing Trust, telling me that plumbers tended to find plumbing problems and painters found painting problems. He explained that it was not so much that they were 'drumming up work for themselves' but rather that this was an area they understood and so could evaluate.

Chapman found the same. 'The inspecting officer found considerable savings in the field in which he himself was expert, that is, on work involved in maintaining mechanical and electrical engineering plant, but found very little wrong on the bricks and mortar side of the depot's activities. The essence of his recommendations was that we could save about 15-20% of the directly employed labour force."

Chapman subsequently sent a building specialist out and that specialist found similar levels of savings in the building area. After that they were sent out in teams and savings averaged about 30% overall.

▶8. Planned Maintenance

'Changes in the use of what is known as 'planned maintenance' produced very useful economies. Planned maintenance means doing repairs and services so as to stop things from going wrong, instead of waiting for a break down before putting them right. The difficult part is balancing the risk of break down (if you make the intervals too long) against spending a lot of money unnecessarily (if you make the intervals too short).

On the one hand, a warning light at the end of an aircraft runway may need to be looked at every day, yet it may still be necessary to go out in the middle of the night to do emergency repairs.

At the other extreme we found big store sheds with roofs forty to fifty feet high with light provided by banks of fluorescent tubes. Whenever a tube failed a couple of electricians trundled a large mobile tower along to the spot and one of them climbed up and changed the tube.

It took between thirty and forty minutes to change a tube and there were so many tubes that more than one pair of electricians was kept busy.

As the amount of light was not critical and it was possible to operate with up to a third of the tubes out of action, the survey team concerned was able to establish an agreement for the batch replacement of all the tubes, the probable life of which could be estimated with astonishing accuracy. The saving was 80% of the original cost in this case and there were scores if not hundreds of similar cases.'

Remember this was 1978! We are still learning some of these lessons.

▶9. Central Stores?

"A second project which was successfully carried through at about the same time related to the region's stores organisation. Each of the region's thirty-two depots kept a store of materials and equipment for the maintenance works programme.

Nearly all these stores required a full time storekeeper. Some stores, at the Portland naval base, for example, had two or three storekeepers.

It was as a result of the survey at Portland, in fact, that the prohibitively high cost of maintaining these stores compared to the value of goods being issued, had attracted our attention.

At Portland it was calculated that it cost over 8 pounds [*Ed: 1978 prices!]* to store and issue even the simplest piece of equipment such as a tap washer. It was true that some of the items were much bigger and more expensive, but the great majority of the items issued by the stores were for the minor odds and ends used by the maintenance work force.'

With the closure of the depots and the use of alternative supplies costs were reduced by 80-90%!

"I am from Audit and I am here to help you"

Audit Reports are a good source of stories about 'things gone wrong'. They will also alert you to issues that you may find yourself needing to account for, such as the ones on the following pages:

▶10. Resourcing Information Validation

(From: Victoria's prison system: Community protection and prisoner welfare. Special Report 60 Tabled 27 May 1999 Victorian Audit Office)

'With regard to the private prisons, as each of the new prisons were commissioned, the Commissioner's Office experienced many problems with the quality of data initially supplied by all 3 prison operators.

These problems related to omission of matters which should have been reported, or the defining of an incident differently to definitions provided by the Commissioner's Office, resulting in the inclusion of the incident in a different category.

For example, an incident where a prisoner headbutted a wall to obtain medication was defined by the prison operator as "Accidental injury" but according to the Commissioner's Office should have been shown as a self-mutilation. ...

The Commissioner's monitoring program allowed for a 3 month intensive validation program to be in place from the date of commissioning of a new prison.

In planning this program, the Commissioner's Office anticipated that the quantum of initial errors in the recording of data should by the end of 3 months have fallen to a level which would not require intensive monitoring.

However, it became obvious to the Commissioner's Office that it would have to devote more resources to the validation process for the private prisons than originally envisaged.'

▶11. The dangers of fast-tracking

(*From :Automating fare collection: A major initiative in public transport. Special Report 59 Tabled 11 November 1998.* ***Victorian Audit Office)***

'Against a background of some fundamental weaknesses in system planning, the history of the automated fare collection project has been predominantly one of a failure to meet a succession of revised commissioning targets.

The delays arose in the initial stages from the fast-tracking of system development and the setting of milestones by the parties under the 1994 contract that, in hindsight, were unrealistic.

However, as the project progressed, it became more and more evident that OneLink was experiencing ongoing problems in satisfying the PTC on system operational requirements. This environment led to a range of differences between the 2 parties on whether problems with the system had been satisfactorily resolved. ...

Based on the experiences with this project, the Government should strongly re-assess the risks involved in entering into outsourcing arrangements under which total responsibility for all aspects of major and sophisticated technological projects, from design specification through to ultimate completion, rests with a single contractor. These risks are particularly accentuated when a fast-tracking management strategy is adopted. '

▶12. Intellectual Property Rights

This example illustrates some other problems of fast-tracking. (From: Management of Intellectual Property in Computer Software: A Specific Focus on Intellectual Property Rights in Computer Software:Case Studies:

Audit Issues. Auditor General's Office, SA)

'This case study involves uncertainty over contractual provisions. It has now been resolved by way of a deed. Despite that resolution, Audit believes that the case provides useful lessons about the risks associated with failure to formalise contractual relationships.

Fleet SA, operating within the DAIS, maintains a computerised fleet management system for acquisition, leasing and contract management. Fleet SA contracted out the development of its Fleet Management System (FMS) application software to the contractor.

The process began on 23 June 1993 when the contractor agreed to prepare a detailed specification of the requirements of the new computer system.

No written contract was executed between the parties. In the absence of a written agreement, the issue of ownership of the intellectual property in the software was left to be gleaned from various documents – letters, files notes and so forth that might provide evidence of terms of the agreement between the parties. ..

Without a written contract, Fleet SA was left with an incomplete collection of documents, compiled by personnel no longer with the Department, and so had an incomplete picture of an agreement that might have been challenged by the contractor. Letters from the contractor claimed intellectual property rights in the software that would have prevented Fleet SA from engaging others to modify the software without a licence from the contractor. Fleet SA subsequently sought expressions of interest from third parties to tender for internet work on the project. Fleet SA had to approach the contractor to determine the precise terms of the agreement.'

And to round out our baker's dozen of things gone wrong, here is a story contributed by David Hope, Skilmar Systems, Queensland.

13.Read the small print!

'The City of Marion flirted with the idea of leasing vehicles for some time, but every time a leasing deal was compared with the alternatives, the leasing deal missed out.

Around the time when a major replacement of waste collection vehicles was contemplated a number of prospective finance companies were aggressively promoting their products. This time, a comparison of the deals available showed it was close – only a few thousand dollars separated the best leasing deal from a loan from the South Australian Local Government Financing Authority (LGFA), over a five year term, in a $1.25 million investment.

The life of the vehicles was estimated to be seven years and there were strong assertions that the vehicles would be kept at least that long. Leasing the vehicles would transfer the cost of funding from the corporate area to the waste collection area, enabling a better identification of the full cost of providing the service. So the decision was made to lease.

Embarrassment number one occurred shortly after the lease was signed. The finance company advised that there was a stamp duty fee of 1.8% applicable to each lease payment. (At the time, the LGFA was exempted from stamp duty on their loan products.) This added about $28,000 to the lease cost and made the deal uncompetitive.

Worse was to come. About 15 months into the leasing contract, the council took a decision to completely change its waste collection methodology and tendered the whole business out, requiring the disposal of the vehicles under lease and the paying out of the lease, with a significant adverse market adjustment payment.

Although the exercise was an expensive one, lessons were learnt about getting all facts and information before making a decision and the need to build flexibility into financing arrangements.'