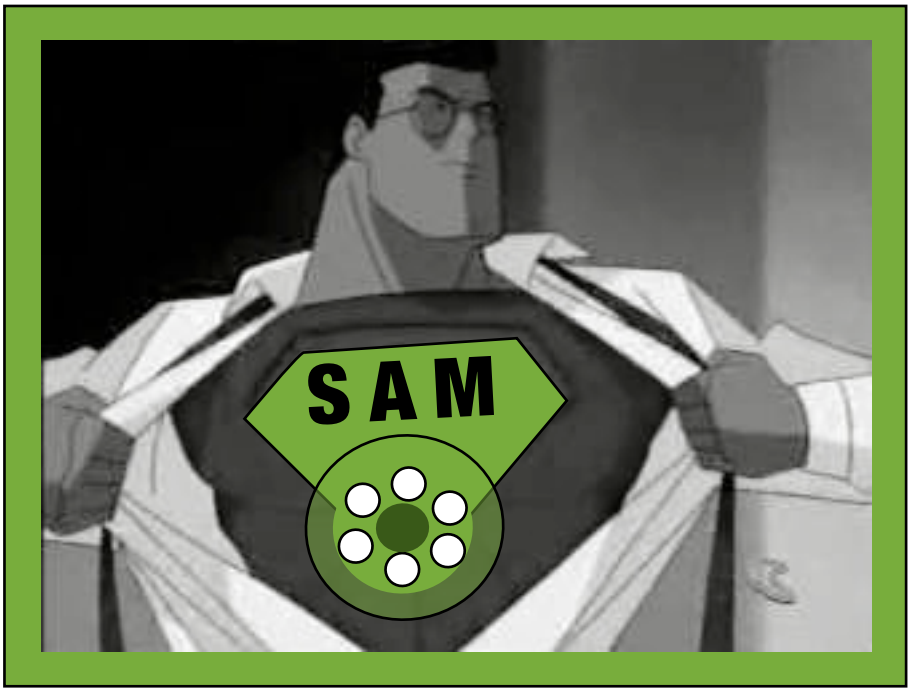
AMQ INTERNATIONAL
STRATEGIC ASSET MANAGEMENT

Issue 268 15th June 2009



What's this?

Last week I was urging a dose of more realism, and here I am with Super SAM! There is a reason - when the easy 'more money' route is eliminated (SAM 267) the only thing left is wiser use of what we have - i.e. Asset Management Strategy, or as it more familiar to you - Strategic Asset Management (SAM).

As most asset managers have had more experience, more practice at the *action* tasks of asset management - acquiring, operating, inspecting, maintaining, and disposal - rather than the *decision* tasks of asset management strategy, this issue sets out a framework within which your strategic information and techniques can be marshalled, practised and refined.

Do consider - and let me know the results of your consideration!

Enjoy!

Penny

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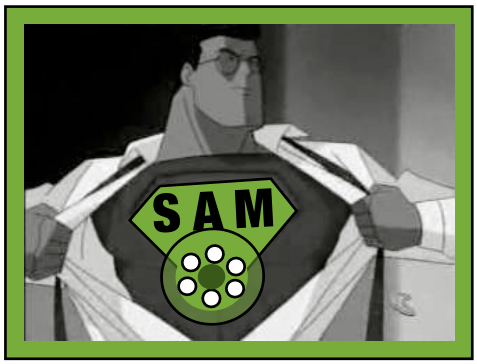


Editorial: Asset Management Strategy

There are two important things to note about Asset Management Strategy:

- **AM Strategy is continuously evolving**.
- **AM Strategy does not, and can not, grow by academic research,** but rather through the implementation and testing of ideas - and by the exchange of these ideas by those who did the implementation and testing: practitioners.

We, at *"Strategic Asset Management"* do our best to be an intermediary in the circulation of these ideas; but it is you - the practitioner - who generate them. Or generate the questions that lead to better ideas. It cannot be otherwise. So we much appreciate "Letters to the Editor" such as the following from Leo Gohier in Canada, and Questions such as that from .....on the following page.

Dear Penny, in Issue 266 you talk about communications and the need to simplify it. As usual, this is great information. I also appreciate the reference to Hamilton, since I sketched that idea on a piece of paper and someone else did a magnificent rendering of it that is still being used today. I would like to share a few other thoughts, that you may want to share with your readers:

1. ***80:20 Rule*** *I try to use the 80:20 rule, but in reverse. I try to capture the 20% of the information that is important into 80% of the space (whether that is a map, a chart, a PowerPoint slide, verbally, or whatever the communication medium happens to be). This helps me bring clarity to complex issues without getting bogged down into details which as knowledgeable professionals we tend to do (I attribute that to professional deformation).*
2. ***25 words or less*** *The other practice that I learned from a training session many years ago is to describe something or express a thought in "25 words or less". We were all public works executives at this training session, and the instructor had us describe on camera what our job was strictly in 25 words or less; he also insisted that our description had to be informative and meaningful, and not full of the bureaucratic gobbledygook that managers are know for. This was quite the challenge, but we all managed to do it after a few tries. Of course, the number 25 is a guideline, but with practice you can increase your communication skills dramatically since this really forces you to focus on the important things because 25 words is really not much. This is particularly useful when speaking with the media or to City Councils, in order to generate the necessary sound bites. I challenge your readers to try this and then to practice, and practice, and practice some more.*
3. ***Off the Cuff*** *Finally, I would refer your readers to an extraordinary book by Ann Cooper Ready titled Off The Cuff. This is absolutely the best communication book that I have ever read simply because it is short and it communicates the message well. The author really practices what she preaches, and it should be on every manager's desk.*

Land Acquisition Costs
Which should be capitalised?

Rakesh Sing of the Brisbane City Council asked what costs of land acquisition should be capitalised in the following two examples:

Case1:

Council acquires a parcel of property to increase its Bushland Program. In this example, lets say Council takes the property and its costs are :

- Cost of the land itself say $1m
- Council also is prepared to pay to mover the present owner-compensation (Owner might claim disturbance/loss of proximity etc..) $200k.
- Cost of house and improvements-Compensation (which we would demolish) $300k.

Disturbance costs here are all types of costs that we would have to settle with owner that is not a land acquisition costs, it can include valuation, interest, legals, business interruptions etc. *These are project costs but should these all be capital?*

Case 2:

Council could be building a major asset and in doing so it has to acquire land and the land had improvements on it (eg House). Council knows that once land is acquired it will demolish the house as the road will go over it. *The same question here is how should the house be treated?*

In such cases, you can't go wrong by asking the experts. David Edgerton, Australian Pacific Valuers provided the most complete answer. I have given his response to Case 1 below. You can find the full response, including answer to Case 2 in 'SAM 268 Supplementary' now available in the subscribers section on the website, www.amqi.com (where you download SAM online) David has also included two very useful Decision Trees.

DAVID EDGERTON, FCPA, Director, APV www.apv.net

Both scenarios need to be considered in light of the Australian Accounting Framework and Australian Accounting Standards. In particular AASB 116 "Property Plant and Equipment". Relevant sections of the Standard are detailed following the analysis of both cases.

The definition of an asset is covered by the Australian Accounting Framework. The Framework defines an asset as –

> An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.

As result, an asset must –

- be controlled by the entity
- be a result of past events
- produce future economic benefits.

IN CASE 1 there are four distinct costs incurred -

- Land value ($1 million)
- Legal and other costs incurred by council ($100k)
- Compensation to current owner ($500k)
- Cost to demolish house and clean up site for public use ($200k)

As a result the total cost council will incur = $1.8 million.

The overall “future economic benefit” provided by the acquisition relates to the provision of green space that can be used for social and physical recreation as well as satisfying numerous environmental objectives. The cost can be reliably measured (actual costs incurred) and is a result of past events. Therefore the expenditure satisfies the definition of an asset.

The question is what should be capitalised and what should be expensed.
Costs are defined in AASB116 as –

6. “Cost" is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction

In this case, all four costs were necessarily incurred in order to acquire the asset so that the entity could obtain the future economic benefit associated with the asset. Therefore all four costs should be capitalised.

The land and associated legal costs are obvious costs to be capitalised.

The compensation paid was “necessarily incurred”. The property could not have been obtained without payment of the compensation and therefore represents a “cost” of the asset.

The cost to demolish the house once settlement occurs is a bit more complex. The future economic benefit delivered by the overall asset is not that it has a house that can be used for accommodation. The demolition of the house enhances the service potential of the overall site and produces future economic benefit. If the house is not demolished the full benefit of the site cannot be obtained. *Therefore its demolition enhances the future economic benefit of the site and must be capitalised.*

In all cases, the future economic benefit of the four costs are tied directly to the future economic benefit of the land. While the land remains as “bushland” with its purpose being for the community’s social and physical recreation and environmental aims, there will be no loss of future economic benefit and therefore no depreciation.

When revalued to “Fair Value” the appropriate valuation basis is Depreciated Current Replacement Cost. This is different to Market Value. Therefore the Fair Value will also include allowance for the costs necessarily incurred ($1.8m) in acquiring the asset.
In summary – at cost the land should be capitalised at $1.8m. If immediately re-valued to Fair Value it would remain at $1.8m.

If at some later point the land was no longer considered necessary and its status was changed to an “Asset Held for Sale” its valuation basis would change to Market Value and the asset would require a write-down to the value of the land component. This is because there is no longer any “future economic benefit” provided by the other costs that were initially incurred.

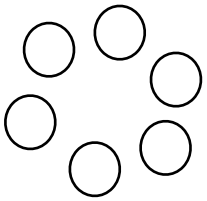
Asset Management Strategy - what is it?

Let us first introduce the notion of asset management strategy and the three different levels of its application within any organisation. In subsequent issues we will look more closely at each of the levels and how you can apply them.

'Asset Management' is concerned with Activity

Twenty or so years ago when asset management was developing as a discipline related to, but separate from, maintenance and its management, it was common to indicate the wider breadth of asset management by listing the activities involved, of which maintenance was but one, thus, for example, "Asset management covers the acquisition, maintenance, operation, rehabilitation and disposal of assets" (c. 1988) and it was popular to show these activities in the form of a 'life cycle' from birth to death. (Fig 1) This is now the field known as engineering asset management.

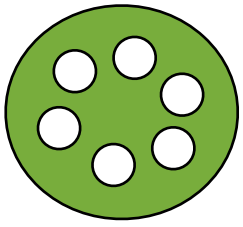
Fig 1. AM Activities in the 'Life Cycle'



e.g.
Acquisition
Operation
Inspection
Maintenance
Renewal
Disposal

Gradually the definition broadened to include the *purpose* of asset management (to meet a required level of service in the most cost effective way), the notion of the *longer term* (for present and future customers), and recognised the role of other disciplines (finance, planning, customer service). In this way the activities were seen as embedded within a context (Fig 2), *but the focus was still on the activities.*

Fig 2 Activities linked to purpose.



Tools and techniques were developed to assist the efficient conduct of these activities. But it was not enough.

Tools such as activity based costing, life cycle costing, reliability engineering and community consultation enabled financial, engineering, and customer service silos, amongst others, to improve the way each activity area got 'its' job done but each acting in isolation did not yield an effective outcome for the organisation as a whole.

What they did do however was to increase the awareness, understanding and even accountability of organisations. They led to a recognition of the importance of risk management and resource allocation and collectively have caused us to understand the greater benefits to be had if we would but integrate these activities within a coherent strategy that brought each silo into line with each other and with the organisation's goals and outside pressures.

And so Asset Management Strategy was born.

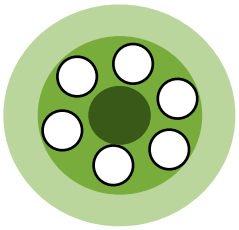
'Asset Management Strategy' is concerned with Decision Making

The asset management life cycle activities in figures 1 and 2 are concerned with efficient 'doing'. Asset Management Strategy, however, is not about 'doing' at all - it's role is effective 'decision-making'. In the diagrammatic representation in Figure 2, the white circles are the various asset management ACTIONS. Decision-Making actually takes place in the 'spaces between' these activities.

Levels of Asset Management Strategy

Decision makers may find it useful to think of three distinct, but related 'spaces', or levels of decision making, namely vision/values in the outer circle, organisational structure in the inner circle, and with performance at the core.

Fig 3. Levels of Asset Management Strategy



Outer circle - vision/ values
Inner circle - organisational structure
core - performance tracking

Note that there are no boundaries between the three levels, they are all connected and shade into each other, just as the outer circle merges with the world outside the organisation.

The Outer Circle - Vision/Values

This is the highest level of decision making. It takes place in that 'space' where the organisation connects with the rest of the world.

Decisions made here answer questions such as: What is it that we wish to achieve in the longer term? What won't we do in order to achieve these things? (i.e. what are our values?) What drives us? How do we balance our short term needs with our long

term desires? How do we balance profitability with community awareness on the one hand and environmental sustainability on the other? Are we sustainable?

Its critical dimension is breadth.

The most strategic of organisations will have a broad outer circle; their vision setting will take a long term perspective, be vivid, energizing and capture the imagination of all stake-holders. Considerable effort will be put into setting goals and aspirations, testing them against a range of future scenarios and examining the consequences of each for the most effective asset portfolio and asset management structure that will best serve the organisation.

Non-strategic organisations will have a narrow outer circle and most of their energies will be devoted to management of the current situation. (more in Part Two)

The Inner Circle - Organisational Structure

The inner circle is concerned with the 'spaces' between each organisational activity.

Decisions made here answer questions such as: What does a good asset management organisation look like? What is the best organisational structure for us to adopt? Where do we start? How do we incentivise our staff yet control change? How do we balance innovation and risk?

Its critical dimension is 'balance'.

Strategic organisations ensure a balance between the power of different activity sectors, with no critical one dominating others to the detriment of the corporate whole. Corporate guidance is strong. Values of co-operation for the overall good will predominate. Staff share the corporate vision and values. Good quality and timely information exchange between activities is easily facilitated

In non-strategic organisations divisions think the aim of the game is to struggle for dominance, each defends its borders and is not required to cooperate. Activities drive decision making rather than corporate decision making driving activities. Mindless compliance with minimum standards prevails rather than intelligent questioning and improvement. (More in Part Three)

The Central Core - Performance

The central core is concerned with ensuring that your performance is delivering on your vision, goals and aspirations.

Decisions made here answer questions such as: How do we stage our aspirations? Is asset management evolutionary or revolutionary? Are we are on track to meet our vision, goals and aspirations? How do we know? And if we are off-track, how do we regain direction? How do we incentivise our people to go beyond mere compliance? How do we get key personnel to think beyond their own area and beyond their own tenure?

Its critical dimension is focus.

The core is what anchors the organisation and keeps it on track. The core is where we reinforce the vision/values through internal communications of all kinds - what gets rewarded and punished, what gets praised, what gains promotion, etc. It is here that we see the practical application of the organisation's values. If there is inconsistency between performance at the core and the stated vision, the core wins! This is where the 'rubber hits the road' as far as values, goals, and aspirations are concerned.

Strategic organisations recognise that you don't need detailed information on every asset to set overall direction. Rather they need to be able to step back and 'see the forest' but ensure that 'the trees' are visible to those who need them - at the action level.

Every organisation uses KPIs (key performance indicators) to keep their *activities* on track. KPIs track outputs. But to keep *decision-making* on track it is necessary to track *outcomes*. (More about this in Part 4)

Summary:

It follows that the best asset management organisations are ones that have

- **a tightly focussed core** that mirrors the vision and values of the outer circle,
- **a balanced inner circle** with no one section dominating the whole, linkages between all, and their activities guided by corporate decision making.
- **an extensive outer circle** that reaches out to the community and the future.

These terms are, of course, purely symbolic. But they serve to represent key ideas.

There are, and can be, no objective tests by which you can determine how you fare on each of these scores. Your needs are your needs. Your circumstances are your circumstances. Benchmarking can be, at best, indicative of areas to re-examine, not a tool for setting targets or objectives.

Asset management Strategy is as much an art as a science.

In future issues, we shall expand on the questions raised above, indicate briefly some of the fields of knowledge that are relevant to the strategy task, provide some illustrations of the problems that can arise when strategic thinking is not applied or mis-applied, and introduce some useful, but currently not extensively used, techniques.

I am grateful for comments on the above text by Thought Leaders, Ian Greenwood and Dean Taylor of Opus International Consultants in New Zealand

YOUR questions, comments, ideas and contributions will help move the frontiers of Asset Management Strategy forward!