

# Review of Asset Management

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## INTRODUCTION

The Roads to Recovery grants have been well received by councils but there is no certainty that they will be renewed at the end of the current four-year period. In fact, with recent increased demands on the Federal Government for defence, border security and refugee relief, it is clear that any extra funding for local government is going to have to be very well argued indeed.

That argument will need to

- Put a credible estimate on the size of the problem
- Show clearly why this is a national, and therefore, federal issue
- Demonstrate that councils are capable of spending extra road funding wisely

Roads are the dominant asset for councils and are highly visible. But while it is the largest group of assets, roads still only account for about half of local government assets when taken across the nation – and the other half (buildings, parks, drainage, footpaths, bridges water and sewerage) also need maintenance and upgrading. All of these assets are important to councils.

This is why the Mildura Committee has adopted a broader asset management focus rather than a purely roads funding focus as the means to a solution for the rural roads problem identified by the Moree Local roads Congress in 2000. The report that resulted from the Moree Congress (the ‘Butcher Report’) was instrumental in identifying the problem. It argued that local roads and bridges throughout Australia were in poor condition, with deficiencies particularly serious in rural and remote areas. Moreover, bad roads were increasing transport costs faced by country industries, hindering export trade, impeding the delivery of education and health services and were having a negative effect on the general social amenity of regional areas.

It is now time to work towards a solution.

To this end, the ALGA initiated the current study of asset management practices in local government, which has been supported by the Federal Government through its local government initiative program (LGIP). Its purpose was to

- Review the current state of infrastructure management in local government across Australia
- Identify the most appropriate practice for local government to address the challenges in funding the maintenance and renewal of their infrastructure assets, and
- Identify gaps in current data and processes

From workshops held in every state, the study sought to understand

- What influences had affected the development of asset management practices
- What data was available
- What issues were considered important and still to be addressed

It also sought suggestions of councils that could be considered sites of good practice for one aspect or another of asset management.

## **RESEARCH RESULTS**

### **1. Major Influences on Asset Management Practices**

States varied in many ways; in some, councils had undergone serious restructuring through amalgamations, in others, they had not; some had semi commercial assets in the form of water and sewerage whilst others did not; some had a high proportion of small, rural, councils; others did not. Yet, despite this range of differences, councils had, nevertheless been exposed to very similar influences

- High interest rates in the late '80s and early '90s
- AAS27, accrual accounting, valuation and depreciation of infrastructure assets
- Review of council acts to include a greater emphasis on asset management and financial reporting of assets
- Competition Policy
- Roads to Recovery Grants
- Non-Feasance

Each of these has impacted on councils in two major ways:

- Increased awareness of infrastructure management issues
- Requirement for data collection and reporting

#### **Interest Rates and Debt Policy**

The high level of interest rates in the late 1980s and early 1990s caught many councils unaware and in some places has left a legacy of 'debt shyness'. Many councils see being 'debt-free' as a desirable, indeed a prudent, position. This has been encouraged by many State organisations. Those councils, however, that fought to repay debt and are now net lenders are finding that the present downturn in interest rates has reduced their revenues, whilst others that could use the current low interest rates to advantage to fund renewal of essential infrastructure are reluctant to do so, being deterred by attitudes within their own councils or by State pressures. Managing cash flows through appropriate use of debt is a means of funding asset management and debt needs to be seen as a tool to be used, rather than a liability to be avoided at all costs.

#### **AAS27, accrual accounting, valuation and depreciation of infrastructure assets**

The move to accrual accounting in the early '90s and the requirement to report asset values and depreciation under AAS27 was the stimulus to asset management for all councils. However, today, it's accounting/reporting focus is holding asset management back. In particular the convention of valuing infrastructure in terms of its replacement cost has taken away the need to determine whether these assets are really 'valuable' to the community at all, and whether their 'value' exceeds their 'cost'.

In all workshops, participants were eager to discuss some of the newer methods being developed for appropriate valuation and depreciation of infrastructure assets. Guidelines have been prepared by a number of the Audit Offices, particularly Queensland and Tasmania. In Queensland, councils are required to fund their depreciation, but are permitted to ‘unfund’ elements that will not be renewed. This has led to great interest in the work being carried out in South Australia where the Local Government Finance Group are conducting a project looking at ‘required depreciation’ and the use of asset management plans to costlessly ‘spin-off’ management-relevant infrastructure depreciation is moving into the pilot stage. (Incidentally, the concept behind this work is the same as that recently adopted by the United States in its alternative to straight line depreciation of infrastructure, known as GASB 34 or the ‘modified approach’.)

The South Australian research drew a great deal of interest because of the costs currently incurred in producing figures that serve no other purpose than to complete balance sheet requirements. A number of participants pointed out that, with the accounting approach, interest in ‘asset management’ was spasmodic, limited to the five yearly valuation reviews. All recognised that what was needed was a management accounting rather than a financial accounting approach.

#### **Review of council acts**

During the 1990s all councils reviewed their acts and all put a greater emphasis on asset management and the financial reporting of assets. New South Wales has adopted ‘Schedule 7’ which requires all councils to report the current state of their infrastructure and how much it would cost to bring sub-standard assets up to an acceptable level.

**National Competition Policy.** Implementation of the national competition policy has helped councils to consider which of their services are, in fact, market services, and to encourage an attitude of full costing of council services, at least for those services that compete in the market place, eg caravan parks, swimming pools and, of course, water and sewerage services.

#### **Roads to Recovery Grants.**

At the moment, reporting requirements are focussing on the benefits of the road projects funded under the grants. All workshops, however, recognised that more needed to be done by way of generating federal support for continuation of the grants.

#### **High Court Decision on Non-Feasance.**

Perhaps the most significant of the recent influences has been the 2001 High Court Decision removing immunity for non-feasance from councils in respect of roads, bridges and footpaths. Although some are fighting to have the decision reversed, this is a decision of great importance for improved management of council assets. The High Court Decision does not mean, as a recent Sydney Morning Herald article concluded, that litigation will skyrocket and “council money is going to be soaked up maintaining existing facilities”. However, councils will need to demonstrate that they are correctly allocating resources and that they are doing the best they can within their limited funds. In other words, the onus will be on good asset management.

## 2. Data Sources

### Grants Commission

The major data source in all States is the Grants Commission. The data is used for the distribution of Commonwealth Road Financial Assistance Grants (general purpose and roads component) to local government and it may also be used for the distribution of some State programs. Their information on roads is generally limited to road length and road type (ie standard). Rural (non-urban) roads are generally also separated from those in urban areas.

Queensland has introduced a comparative data template that they send to Councils with the Grants Commission returns. It not only includes expenditure but also data for calculating servicing and renewal levels. Western Australia has a strong emphasis on estimating the depreciated replacement value of the road assets based on the amount of work undertaken over the year.

Several years ago, ALGA sought the assistance of the State Grants Commissions to collect a standard set of road expenditure data. The purpose was to profile the total expenditure on local roads and bridges across Australia. Two states (NSW and QLD) added the ALGA template to their own, while three other States (VIC, SA and WA) integrated the ALGA items into their own templates. All States (with the exception of TAS) have provided data for ALGA for the last three years. The data was used to estimate the total annual expenditure by local government on roads and bridges and to determine the unit road expenditure for different classes of Councils.

ALGA has recently revised its template to better reflect type of expenditure. In particular, it wanted to identify the amount allocated to recurrent expenditure as opposed to renewal and upgrading. Not all Grants Commissions were able to accommodate the more detailed request at the time but three States (NSW, VIC and QLD) agreed to trial the template in 2001/02.

The more detailed breakdown of expenditure will provide an insight into the Council's asset management strategy. This will supplement the current expenditure profiles and unit rates with information on asset management.

### ABS and Local Government Information

Where the ABS reports asset information, the data is derived from that supplied to the Grants Commission. Most states also produce comparative statistics. However, with a few exceptions, these are mostly limited to comparisons of inputs. Measures of outputs and measures of assets were not generally available. To add to the variation, not only data use but data definitions and their interpretation also varies widely between States and also from council to council within States.

## 3. State by State

### Victoria

The level of interest and awareness was high in all States but especially so in Victoria, which undertook a systematic review of asset conditions and asset management practices in 1997-1998, "Facing the Renewal Challenge". For the first time, it was

possible to project infrastructure renewal requirements for all councils within the State on a relatively consistent basis and over an extended period of time. That study showed that councils in Victoria

- were facing increasing renewal requirements over the next 15 years
- were spending less than the amount projected to be needed within the current five year period
- were spending more on growth than they were on renewal

The “Facing the Renewal Challenge” study created great interest and support from Victorian councils. The Office of Local Government is considering updating the data because consistent data across all councils in the State that can be aggregated for purposes of submissions to the Commonwealth or to State Governments is extremely valuable.

Recently, the Municipal Association has followed up with a benchmarking study looking at the quality with which Councils are managing their asset management inputs. The report identifies the current status of asset management in Victoria with respect to:

- Process and Practices
- Data and Knowledge
- Information Systems
- Asset Management Plans

Other innovations in Victoria include adoption of ‘best value’ which, if correctly applied, will enable Victorian councils to gain a much better appreciation of what their communities really want – and are prepared to pay for – by way of service provision.

### **South Australia**

South Australia has recently completed the first completely voluntary infrastructure asset management study involving all councils in the state. This has recently been released in brochures and CDs entitled “A Wealth of Opportunities”. The report focuses on what can be done, and why, to overcome current and future asset management problems. Copies are available for interested ALGA members. The study covered much of the ground that the Victorian study covered but it was not a ‘one shot in time’ study like the Victorian study – instead databases for each council, and for the state in aggregate, have been established on an accessible website and councils are encouraged to use the software to continuously update their information and to carry out simple scenario analysis. Councils can also swap passwords for benchmarking purposes.

The South Australian Local Government Finance Group has been developing a method of valuing and depreciating infrastructure assets that takes into account the fact that these assets are not consistently run down and replaced but rather are renewed in a piecemeal fashion. Because of this, assigning a ‘life’ to an infrastructure asset and following the normal straight line depreciation is artificial and often results in council books generally showing very low depreciated values for assets which are still operating well. At the same time, the valuation and depreciation provide no guidance for managers.

This is being corrected in the SA work that measures the costs required to keep the assets in a suitable condition for service delivery. The concept behind this form of infrastructure accounting was developed in Australia, adopted in New Zealand, and has now influenced the development of an acceptable alternative to traditional

commercial depreciation for use with infrastructure assets in the United States. There is an indication that the Accounting Standards Board may be prepared to consider the infrastructure approach as an alternative. SA has developed the concept and draft guidelines for use by councils and these will be piloted in the New Year.

### **Tasmania**

Innovative work in Tasmania has been led by the Audit Office which has produced guidelines for the valuation and depreciation of road assets that require councils to depreciate on a residual value/residual life basis. At each revaluation, councils need to estimate depreciation by dividing the remaining value by the remaining life instead of the traditional approach of dividing replacement value by the total economic life. This method allows councils to more accurately value their assets since it is being done on an asset by asset basis.

The Auditor General is also requiring that councils treat the re-metalling of gravel roads as capital renewal rather than maintenance. This has the great benefit of enabling councils to be able to demonstrate improvement (or the reverse) in their gravel road network.

This residual value/residual life approach is only used for roads at the moment but has the potential to be extended. It requires each council to examine the replaceable elements of the road (the surface, the pavement, the sub-form) and to take account of the different geographical conditions and usage patterns of their roads rather than ascribing all of them the same accounting life.

In general, councils are reacting well to this new approach for it enables them to get a much better understanding of their road assets and they can measure changes in overall performance as well as target their maintenance and renewal spending more efficiently. The information lends itself to being incorporated in an asset management plan and could easily be adopted to the infrastructure depreciation approach being developed in South Australia. It has great potential for demonstrating wise management of Roads to Recovery funding.

### **Queensland**

Queensland have been very active in asset management and much excellent work has taken place in the area of water and sewerage in particular.

The Queensland LGA recently conducted a survey of road asset management practices. It identified that Queensland local governments recognise that road condition information is important in the capital works and maintenance prioritisation processes. However the types of data and the use of this data varies significantly within Queensland local governments. Moreover, despite this recognition there is currently a weak connection between the collection of data and the integration of this data into pavement management or road asset management systems, in order to better identify and prioritise works requirements. Better management of this process, particularly on a regional level, will require a greater commitment to supporting road investment decisions with consistent road condition information, as well as planning, programming and reviewing works requirements over common time frames.

This information is important for the development of a road asset management strategy which is a key component of the proposed Alliance between the Main Roads Department and Local Governments in Queensland.

### **Western Australia**

WA has the most advanced general reporting system on road assets and condition of any state.

Councils in WA are responsible for a road network with a replacement value of almost \$10 billion (1998-1999 values). Until recently they lacked information on the age of their roads, their condition, their rate of deterioration, and how much should be spent on them each year.

As the WAMA Transport and Roads Unit argued ‘if Local Government lacks crucial information on its own roads, how can it convince others that it is managing its roads efficiently?’

The latest Report on Local Government road Assets and Expenditure tries to overcome these deficiencies. It is based on

- **Replacement Value** – the current cost of replacing road assets. It provides a datum from which the consumption of roads can be assessed.
- **Written Down Value** – the current value after allowing for depreciation. The difference between replacement cost and written down value represents the amount consumed.
- **Status Quo Cost** – the estimated cost of maintaining the roads at their current condition. It provides a datum against which actual expenditure performance can be compared.

The major deficiency is that assessed condition is based on the ‘written down value’ which is itself derived from depreciation percentages which are neither described nor accounted for.

A combination of the Tasmanian Audit Office approach to depreciation plus the reporting mechanism of the Western Australians would be an excellent basis for a national approach.

### **New South Wales**

NSW had an early start to collecting condition data and expenditures through the requirements of the Local Government Act, 1993-1994, Section 428. They are required to prepare estimates of desirable annual expenditures and estimates of the amount required to bring assets up to an acceptable level. This information was required to be presented in council’s annual reports. This could have provided a very useful time series to analyse asset management performance had guidance been available at the start to ensure consistent responses by councils. It is now realised that this was not provided and the level of variance in the information provided has considerably reduced its value. As a result new guidelines have been prepared within the Asset Accounting Manual. There is considerable value in annual reporting on the costs to bring infrastructure assets up to a satisfactory standard and this idea could well be adopted by other jurisdictions.

#### 4. Issues of Concern

The major issues of concern were surprisingly similar across states:

- Asset management is not necessarily well defined nor understood
- Many practitioners see asset management in terms of what they do rather than in terms of what it provides; or in terms of tools, rather than outputs. Workshop participants suggested that often asset management was seen as ‘an asset register’ or ‘a renewal forecast’ but these were only the tools used to improve service delivery and reduce risk through a better understanding of the asset portfolio
- All workshops considered that there was a major need for better valuation and depreciation methods, and
- Greater consistency in measurement and recording practices.
- It was also important for costs and benefits over the life of the asset to be taken into account, and not just the acquisition costs.
- The lack of asset management plans and strategies was considered an urgent issue to be addressed.
- This was related to an ongoing need for asset management training, both in general and in the construction of plans.
- It was also agreed by all workshops that there was a need for better dissemination (any dissemination!) of good practice and guidelines for standardised practices.

#### CONCLUSIONS

- Consistency needed

A common message from the workshops that have been conducted is the need for some basic consistency of data and approach. No-one is seeking complete standardisation but rather a common core of data that would enable a better understanding. An industry standard detailing minimum information requirements and procedures would be of great assistance not only to councils but to those bodies such as Audit and the Grants Commissions who deal with them

- Common data for internal management AND external reporting

Preferably, the common core would be acceptable for external reporting as well as for internal management: all councils report the difficulties they have experienced in recent years dealing with uncertainty and constant change. It would also make possible the aggregation necessary for dealing with national funding and enable nation-wide improvement and benchmarking. But data by itself is not the answer; councils are also seeking help in using and applying the data. In every state there was a plea for simple, sensible, cost effective and useful measurements for valuation and depreciation.

- There is more to asset management than renewal forecasts

It is also clear that far too many still see asset management and asset renewal forecasts as synonymous. Many pavement management and other asset management systems are capable of projecting required funding and action – if funds were unlimited! But few are capable of sound prioritisation, even within the asset class being recorded, and none are able to handle the difficult prioritisation tasks that daily face councils across their entire range of assets and non-asset responsibilities. This is

where the need for a framework within which data can be analysed and changes made to give best results for a limited budget is urgently needed.

- Prioritisation

This is reinforced by the message from the recent High Court decision removing the immunity for non-feasance with respect to roads in that the only reasonable defence in the case of accident involving any council asset will be that the council is doing the best it can with the resources available, *which requires demonstration of this sound across-the-board prioritisation.*

- Commonwealth Road Funding

All of the above, namely consistent data which can be aggregated to form a national picture, managed in a cost effective manner, and used within a general framework that will enable demonstration of sound prioritisation is, of course, exactly what is needed to argue the case for higher Commonwealth funding for the local road network. For a strong and winnable case to be put, there is a need to

- Show that the problem is a national one, extending across the country
- Measure the size of the problem with some degree of credibility
- Demonstrate the capacity of Local Government to address the issue with increased funding

## **Recommendations**

That Local Government utilise the three year ‘window’ it now has before the ending of the Roads to Recovery grants to gather the necessary data within a suitable practice framework so as to be in a position to present a solid case to the Commonwealth for increased local road funding.

The first stage of preparation should be a feasibility study examining

1. What data should be included within a ‘common core’ of data available from each jurisdiction. This would need to be developed in conjunction with local government bodies, auditors, state road bodies and Grants Commissions, and
2. Options for developing and maintaining the data in an accessible manner

As data is only as good as the use made of it, the first stage of preparation should also include

3. an assessment of good practice frameworks within which the data would sit. This should include analysis not only of the frameworks available in Australia but also those available in the UK, the USA and N.Z.
4. integration with on-going training

The overall aim of this investigation would be to present to this body at its next annual general meeting, a proposal for a common data set and a best practice framework that would win the in-principle support of all members with the intention that the chosen option be put in place over the following two years.

Such a common data set and best practice framework would not only support the case for increased road funding but it could

- Provide large savings for councils in the costs of its current data collection for external reporting and internal management
- Enable councils to compare and benchmark with each other.