

A Guide For Preparing The Financial Information Component Of An Asset Management Plan

Licensing, Monitoring and Customer Protection Division

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1 Important Notice

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2 Scope and purpose of this financial planning guideline

It is a condition of every licence other than trading or retail licences that licensees of electricity, gas and water services are to provide for an asset management system and notify the Authority of details of the system and any changes to it. Licensees are also required to provide the Authority with a report by an independent expert as to the effectiveness of their asset management system.

An asset management system should set out the measures to be taken by the licensee for the proper maintenance of assets used in the supply or provision of electricity, gas and water services and where relevant, the construction, operation and disposal of these assets.

An essential element of an asset management system (or asset management framework) is an asset management plan. An asset management plan is *“a plan developed for the management of one or more infrastructure assets that combines multi-disciplinary management techniques (including technical and financial) over the lifecycle of the asset in the most cost-effective manner to provide a specified level of service. A significant component of the plan is a long-term cash flow projection for the activities”*¹.

The Authority has noted that licensees of smaller electricity, gas and water services have not included financial information in their asset management plans. For this reason, the Authority has developed this guide to help smaller licensees of electricity, gas and water services prepare and update financial information in their asset management plan.

Small service providers (licensees) are those providers who are providing, or who intend to provide, services to customers utilising relatively simple, low capacity systems. For example, licensees who provide electricity, gas or water services to a single town or locality of less than 1000 customer connections. However, it is left to the reader to

¹ International Infrastructure Management Manual – Version 3.0, 2006, pp xii

determine whether the methods set out in this guideline can be usefully applied to their organisation's infrastructure assets.

It is anticipated small licensees will operate relatively simple asset management financial planning systems based on generic spreadsheet or database applications rather than more complex asset management software. It is possible the ongoing financial planning in relation to the asset management plan will be the responsibility of the person or persons who manage the operation of the assets rather than asset management or financial specialists.

Section 3 of this guide is intended to outline the minimum financial information to be included in an asset management plan. However, it is not intended to constrain the applicant from providing additional information that is considered relevant to the licensee's financial management of infrastructure assets.

This guide is also intended to act as an interim guide until such time as the Authority develops a more comprehensive guideline covering all aspects of asset management systems, which will include the financial information components detailed in sections 4 to 9 inclusive.

3 What the licence requires

3.1 Financial information in the licence application

When applying for an electricity, gas or water licence, applicants are asked to demonstrate that they have and will be capable of retaining, or will acquire within a reasonable time after the grant of a licence, and are then capable of retaining the financial resources to undertake the services authorised, or to be authorised, by the licence.²

The licence application should include the following financial information:

- **Current financial position** including a description of the organisation's current financial position, including where possible, the most recent audited financial reports, including the previous year comparatives. In the case of new organisations the application should include financial information to demonstrate an acceptable credit rating or financial standing commensurate with potential exposure.
- **Financial projections** including a description of the organisation's financial projections for the term of the licence or the life of the services to be supplied (usually for at least the next three years), including the financial objectives and assumptions that form the basis of the projections.
- **Financial policies** including a description of the organisation's financial policies, including accounting policies, internal control procedures, internal and external auditing policies and details of any financial arrangements with third parties and/or related parties.

After approval of the licence application, the financial information should be regularly updated and included as part of the organisation's asset management plan.

¹ See the Authority's guidelines - 'Applying for a Water Services Operating Licence and Guidelines for Electricity Licence Applications'.

3.2 Financial information in the asset management plan

The financial information (financial plan) in the asset management plan should include the organisation's current financial position including:

- The organisations most recent audited financial report, including the previous year comparatives and financial statements that comply with the 'Australian Equivalents to International Financial Reporting Standards' (AIFRS). A complete financial report normally includes a balance sheet, an income statement, a statement of cash flows and a statement of changes in equity, and those notes and other statements and explanatory material that are integral to understanding the financial report.
- Comparative figures for the previous year (usually part of the above financial report) so that at least two year's financial information is provided.
- In the case of new organisations, financial information to demonstrate an acceptable credit rating or financial standing commensurate with potential exposure.

3.3 Asset management system audits

After the licence has been granted, the financial plan should be included as part of the licensee's asset management plan and regularly updated. The licensee is also expected to develop an asset management system to manage the assets.

Licensees are required at least once in every period of 24 months (or any longer period that the Authority allows) provide the Authority with a report by an independent expert acceptable to the Authority as to the effectiveness of their asset management system. The independent expert will review the licensee's asset management plan and system in accordance with the audit guidelines. These audit guidelines are available on the Authority's website at www.era.wa.gov.au.

The independent expert's review addresses the adequacy and effectiveness of the licensee's asset management system. This involves auditing the asset management plan, including the financial plan contained in the asset management plan. If this financial plan is not part of the asset management plan, then the licensee should provide a financial plan as a separate document for the auditor to review.

4 Financial planning for infrastructure management - overview

The following sections of this document will outline the essential factors that need to be considered by electricity, gas or water small licensees when preparing a financial plan that forms part of the asset management plan. Each section will address a component of the asset management planning process and provide the reader with guidance on how this might be applied to the management of infrastructure assets operated by the smaller electricity, gas and water licensees.

In smaller licensee organisations, the financial plan contained in the asset management plan may be managed by the same people who manage the infrastructure assets, i.e. works managers or engineering managers, or managed by the finance department. In either case, it is essential that there is alignment between the asset planning process and the financial planning process to ensure that the financial aspects of the asset management process are captured in the asset management plan.

The licensee should identify the financial objectives and strategies of the organisation and show how these generate sufficient cash flows to fund the projected costs of operating the infrastructure assets included in the asset management plan.

The financial plan contained in the asset management plan has a cost component and an income component. The cost component of the plan identifies the current and projected costs of the assets and should ideally include an annual cost profile for the assets covering a number of financial years. The income component identifies the income streams associated with the assets. It is important that the income streams are evaluated to determine if there will be sufficient funds available to cover the forecast expenditures. If there is a projected shortfall then the licensee will have to develop strategies to match the incomes to the costs such as reducing operating costs or increasing tariffs to provide additional income.

For smaller electricity, gas and water licensees the financial plan does not need to be particularly complex, and could even be made up from a number of spreadsheets or a small database application. The financial planner is responsible for populating the financial plan with financial data and ensuring the plan is updated to reflect changes in the assets or new financial information on an at least annual basis.

5 The International Infrastructure Management Manual

The approach to infrastructure asset management set out in the International Infrastructure Management Manual – Version 3.0, 2006³ (IIMM) provides a “best practice” framework for the management of the infrastructure assets operated by small electricity, gas and water licensees. The IIMM contains a number of examples and case studies to provide the reader with an understanding of how the principles of asset management are applied in practice.

Section 3.7 of the IIMM discusses the financial planning and reporting component of infrastructure asset management. This section provides the reader with an overview of lifecycle costing, asset valuation, asset depreciation, financial forecasting and financial reporting. The section also provides the reader with a number of examples and case studies to illustrate how these processes can be applied in the field.

The IIMM is recommended to the reader as a valuable resource to assist with all aspects of the asset management planning process, including financial planning processes.

6 Expenditure and funding categories

The reader is referred to section 3.7.1 (page 3.114) of the IIMM. In this section the reader will find information describing how expenditures associated with asset infrastructure are categorised for financial planning purposes and how capital expenditure on assets gives rise to recurrent expenditures to operate the assets. The reader’s attention is drawn to the need to set service tariffs that will fund projected expenditures on assets and meet the capital use charge objective of the licensee.

³ International Infrastructure Management Manual – Version 3.0, 2006. ISBN No: 0-473-10685-X

6.1 Expenditure categories

It is important to correctly allocate expenditure on infrastructure to the category that best describes the reason for the expenditure. The IIMM describes 5 asset expenditure categories:

- 1) Operations – operational activities that have no effect on asset condition but are necessary to keep the asset utilised (energy costs, materials etc).
- 2) Maintenance – ongoing day-to-day work to keep the assets operating at required service levels; includes repairs and minor replacements.
- 3) Renewal – significant work that restores or replaces an original asset towards its original condition or capacity.
- 4) New Work – create a new asset or upgrade or improve an existing asset beyond its original capacity or performance.
- 5) Disposal – costs associated with disposing of a decommissioned asset.

In most circumstances, organisations account for items 1 and 2 as recurrent (current account) expenditures. Items 3, 4 and 5 are normally accounted for as capital expenditures. However, each licensee differs in how each of these cost categories is captured in its external financial statements. It is a useful exercise for the reader to review their organisation's financial plan and see how each of the cost categories is described in the plan.

6.2 Income and cash flows

6.2.1 Income

The primary source of income for small electricity, gas and water licensees is the tariffs paid by customers for the service. For some licensees there may be an element of income derived from grants and other disbursements from State or Federal governments in addition to tariffs.

For the licensee to be viable, the income collected from customers has to be sufficient to cover all of the expenditures on assets and produce an appropriate return on capital. It is essential the licensee fully identifies its costs in order to ensure that the tariffs charged to customers meet the objective of:

- Recovering expenditures on assets.
- Provide a contribution to future costs such as decommissioning costs and projected renewal costs.
- Produce an appropriate return on capital.

6.2.2 Cash flow

It is not only the level of income that is important to an organisation. The timing of income in relation to expenditure is important as this determines the cash flows that the organisation has to generate to fund expenditures.

Over time cash flows have to be sufficient to cover the forecasted operating expenditures and provide sufficient cash flow to fund the contributions to the accrual or reserve funds to provide for forecasted future expenditures. To meet this objective the licensee needs to

generate and update a long-term financial forecast. The long-term financial forecast will identify the cash flows that will be needed to fund current operations, provide a sufficient contribution to the accrual or reserve funds and return the targeted return on capital. Refer to section 8 for more information on long-term financial forecasting.

6.3 The relationship between capital and recurrent expenditures

The IIMM identifies the relationship between capital expenditure and recurrent expenditure in the context of financial forecasting. Each item of capital expenditure has associated operating (recurrent) expenditure. The most obvious forms of operating expenditure are those on fuel and maintenance that are necessary for the efficient operation of the assets.

The planning process for capital expenditure on new assets, or renewing or refurbishing existing assets, requires the financial planner to undertake a thorough assessment of the operational expenditures that will be required in future years to enable the asset to continue to provide service using the lifecycle costing approach described in section 6.

Capital also gives rise to costs such as depreciation, which may be used to contribute to the future replacement of an asset, and interest on the funds that financed the acquisition of the asset.

7 Lifecycle costs

In order to develop an appropriate financial plan for infrastructure assets, it is important to capture all of the costs that have been incurred, or that are forecast to occur, throughout the working life of the asset. All too often the focus is on the capital cost of acquiring assets and the annual running costs of the assets. This approach can lead to situations where there are insufficient funds for expenditures needed for refurbishment, renewal or replacement of assets to continue to provide services. A sound financial plan for an asset includes provision for projected future expenditures on the asset, i.e. to refurbish or improve the asset, and contingency funds for unforeseen events such as breakdowns.

The remainder of this section identifies the range of costs that may arise during the lifetime of an asset. The reader is encouraged to review the financial plan component of their organisation's asset management plan and identify whether all of the lifecycle costs associated with each asset or category of asset has been captured in the plan.

7.1 Overview of lifecycle costs

Section 3.7.2 (pages 3.115 to 3.188) of the IIMM provides a more detailed treatment of lifecycle costs. This section identifies the lifecycle cost elements that give rise to expenditures throughout the life of an asset. It is important to note that the application of these lifecycle cost elements to each asset or asset category will differ between licensees, and in some cases a cost element might not apply at all.

Costs occur in all phases of an asset's life. It is important that a licensee is able to attribute costs to each phase in an asset's life to arrive at a total cost of ownership over the life of an asset. Fully assessing the lifecycle costs of an asset is essential to sound financial planning and good decision making.

Lifecycle costs include:

- Acquisition and financing costs

- Asset operations
- Asset maintenance
- Risk exposure costs
- Rehabilitation costs
- Asset administration
- Rate of return requirement
- Asset depreciation (replacement costs)
- Taxes

Each of these cost elements is discussed in more detail in Appendix 1.

7.2 Lifecycle costing

Developing a financial plan for small licensees that captures all of the lifecycle costs of the assets need not be overly complex. It is possible to develop simple tools, based on spreadsheets, to capture the lifecycle cost components of the assets and produce financial projections of the expenditures needed to operate the assets in the medium to long-term.

A more difficult task is researching the costs identified in the financial plan to ensure that the plan is accurate and up to date. It may be necessary, in the absence of reliable information, to estimate the values that should be allocated to each asset or asset category in the financial plan based on the best judgement of the planner. The need to estimate costs often arises when new assets or new categories of assets are created. In these cases historical or comparative data is often not available for some of the costs. It is left to the judgement of the financial planner to identify other methods of allocating costs in the financial plan until the asset operating costs can be more accurately estimated.

7.3 Annual service cost method

A method of expressing the lifecycle cost of an infrastructure asset is the Annual Service Cost (ASC), which is described in detail on page 3.118 of the IIMM.

The ASC expresses the lifecycle costs of an asset as an annualised amount. The ASC is the approximate price that would be tendered if tenders were called for the service to be provided under a Build Own Operate contract for the life of the service. The ASC includes depreciation costs and disposal costs as annual costs by taking the total projected depreciation and disposal costs of the asset and equally apportioning them over the lifetime of the contract or the useful life of the asset, whichever is the lesser.

The value of the ASC approach is that it provides a tool for evaluating capital works projects. With this approach the licensee should be satisfied they will receive an income in excess of the ASC when they are considering investing capital in the asset, otherwise alternative means of providing the service should be considered.

7.4 Lifecycle costing as a decision making tool

Lifecycle costing is a valuable tool when significant changes to assets are being contemplated to maintain the current level of service or provide an enhanced service. This might involve:

- Major refurbishment of existing assets.
- Increasing the capacity or performance of existing assets.
- Introducing new services or changing the current level of service by deploying new assets.

It is possible that there is more than one option available to achieve the desired outcome. By applying a lifecycle costing approach to each option it is possible to evaluate the projected lifetime cost of each option. This will assist the licensee with selecting the solution that best meets the cost and service objectives.

8 Asset valuation and depreciation

The reader is referred to sections 3.7.3 and 3.7.4 (pages 3.120 to 3.132) of the IIMM for a more detailed discussion of asset valuation and depreciation.

Licensees who operate infrastructure assets have financial policies describing how the assets are valued and depreciated and the reader is encouraged to refer to the financial policy of their organisation for more information on how to value and depreciate assets.

For small electricity, gas and water licensees the asset valuation database can be an extension of the asset register. Once assets have been captured in the asset register it is then a matter of identifying a suitable basis on which to value the assets in order to develop the valuation database. The asset register is often a simple spreadsheet or database application and it is a relatively simple exercise to assign a value to each of the assets or category of asset in order to create the valuation register.

The following sections provide an overview of the methods that are used to value, depreciate and determine the replacement cost of assets.

8.1 Asset valuation

Licensees in the electricity, gas and water markets invest heavily in infrastructure assets. The value of the infrastructure assets often make up a large proportion of the book value of the licensee. It is important that the licensee has a high level of visibility of the value, and changes in the value, of their infrastructure assets in order that appropriate provisions can be made for depreciation and replacement of assets.

Section 3.7.3(a) of the IIMM defines a number of reasons for valuing assets including:

- Financial reporting.
- Determining appropriate pricing and funding levels for services.
- Determining shareholder equity.
- Risk management (insurance).

The International Financial Reporting Standards requires that assets should be valued at:

- Fair value (FV) - the amount for which the asset can be exchanged between knowledgeable, willing parties. This is known as a market-type valuation as it is assumed that the market can be surveyed to identify the value of similar assets.
- Discounted cash flow analysis (DCA) - a valuation based on future earnings from the assets is used to value the assets. This approach values the assets on the difference between the incomes from operating the assets less the future upkeep costs.

- Depreciated replacement cost (DRC)⁴ – is the optimised cost of replacing the asset after allowing for wear or consumption. The DRC is based on adjusting the value of a reference asset (that most closely replicates the asset being valued) to take account of the age and condition of the asset being valued.

The DRC approach is used to value specialised assets that are rarely, if ever, sold on the open market and for which the potential profitability is not a relevant valuation method. The DRC valuation method is the best fit for valuing the assets of most electricity, gas and water small licensees.

Following the transition to accrual accounting in 2001 by local government authorities, a number of small water licensees have re-valued their assets based on DRC as of 2001 and then used these values as the cost of the assets for depreciating the assets in future financial years. The reader is referred to section 3.7.4 (pages 3.121 to 3.132) for a more detailed treatment of DRC methodology.

8.2 Depreciation

A useful discussion of depreciation methods and depreciation principles, with worked examples, can be found in section 3.7.4 (pages 3.126 to 3.128) of the IIMM. As noted previously, electricity, gas and water small licensees have large amounts of capital invested in infrastructure assets. This implies depreciation of the assets is significant. It is important that the licensee accurately account for depreciation in its financial reports, otherwise the financial statements might be understating the true cost of providing the service to the customers.

Depreciation assigns a value to the consumption of the asset in providing the service to the customers. There are a number of different methods used to calculate the depreciation of assets. The two most commonly used methods are:

- Straight line – the depreciation charge is distributed in equal amounts over the life of the asset,
- Declining balance – the amount of depreciation reduces each year based on a percentage of the book value or carrying value of the asset, which decreases each year.

The assets operated by electricity, gas and water small licensees have long useful lives (15 to 60 years) and it is usual to depreciate these assets using the straight line method. If the asset is re-valued or its useful life is amended at a later time then the depreciation charge in the relevant financial year is adjusted to absorb any change in the current value or useful life of the asset. The future depreciation is then re-calculated to take account of the change in value or useful life.

There are also depreciation methods that take account of the current age and condition of the asset and assign an asset value and depreciation value based on these factors.

It is important to be familiar with the depreciation policy and how this policy has been applied to depreciate the infrastructure assets. Useful sources of information are the accounting policy statement or the notes that accompany the statutory financial statements. The reader is referred to section 3.7.4 (pages 3.126 to 3.128) for a more detailed treatment of the depreciation methods.

⁴ Depreciated Replacement Cost (DRC) is also known as Depreciated Optimised Replacement Cost (DOCR) in some texts.

9 Long-term financial forecasts

The reader is referred to section 3.7.5 (pages 3.133 to 3.137) of the IIMM for a more detailed discussion of preparing long-term financial forecasts.

The objective in preparing long-term financial forecasts is to forecast the organisation's future cash flow requirements for its infrastructure assets ensuring there is sufficient income to fund the cash flows.

The long-term forecast should have a number of properties, including:

- The forecast should be updated regularly: at least annually.
- Capture all operational, maintenance, renewal, replacement and development costs.
- Forecast for a significant period. The IIMM refers to a period of 10 years but it is recognised that a shorter period of, say, 5 to 7 years might be more appropriate for a small licensee.
- Forecast future depreciation and loss of service potential.
- Based on provable unit costs. Figure 3.7.10 of the IIMM sets out a 4-point grading scale for the reliability of the data used when preparing a financial forecast. When preparing financial forecasts the integrity of the data should be recorded when stating the assumptions used to prepare the forecast.

In preparing the financial forecast, the funds required to acquire, operate, maintain and renew the assets and the timing of the fund drawdown should be identified.

It is crucial that the key assumptions made in the preparation of forecasts are recorded. This provides an audit trail for internal and external auditors and also provides a record when the forecast is being updated.

Developing a long-term forecast does not have to be a complicated process for the small licensee. The following steps outline a basic process:

- 1) A useful first step is to work on the assumption that the level of service to be provided remains unchanged during the term of the forecast, unless there is information to indicate an increase in capacity or service level is required.
- 2) Historical operating expenditures on the assets in previous years should be gathered and recorded in a spreadsheet or database. These costs can then be extrapolated with an appropriate allowance for cost increases based on inflation or another suitable indexation factor.
- 3) The asset register and/or the financial plan and, for each asset or category of asset, the available information on activities related to capital expenditures such as scheduled refurbishment, renewal or expansion may be examined.
- 4) For each item identified using the process in 3 above, a projected cost and a projected cost can be calculated and entered in a spreadsheet or database along with information on the timing of the expenditure. Note for larger projects the costs may be spread across more than one financial year.
- 5) The forecast in 2 above may need to be amended to take account of any capital expenditures in 3 above. An example might be replacing a pump unit results in a lower maintenance cost for the succeeding years so the maintenance cost for the pump is reduced for future years.

- 6) Any assumptions that were made in arriving at the forecast should be recorded. Steps 1 to 6 should be repeated on an annual basis.

The forecasting approach in steps 1 to 6 above can be developed in a simple spreadsheet or database application based on the asset register. It is appropriate to align this process with the budgeting process of the organisation with the long-term forecast providing the input into the financial plan for the assets.

The challenge for the financial planner is optimising the accuracy of the forecast. It is reasonable to expect the forecast to be accurate for the first 2-3 years with a reduced level of accuracy in the succeeding years. Implementing an annual review of the financial forecast ensures the organisation is working with the most accurate information when making short to medium-term financial decisions related to its assets.

For new organisations, it is important to ensure that all of the assets, and their projected capital and operating expenditures, are captured in the initial long-term financial forecast. The annual review process will then provide an opportunity to compare actual expenditures with projected expenditures and make the necessary adjustments to projected expenditures in future years.

10 Summary

Electricity, gas and water service providers are required to develop and maintain an asset management plan and an asset management system for the proper maintenance of the assets used in the provision of the service.

The asset management plan and the asset management system are subject to audit by an independent auditor. The Authority has developed audit guidelines for smaller organisations⁵, which includes a review of the financial planning component of the asset management plan.

The financial information (financial plan) contained in the asset management plan is a key component of the licensee's asset management system. The financial plan describes the licensee's financial requirements for the construction, operation, maintenance and disposal of its infrastructure asset portfolio, not just those assets involved in the delivery of services to customers.

This guideline provides the reader with an overview of the financial planning component of an asset management plan with reference to the International Infrastructure Management Manual – Version 3.0, 2006. The manual provides a detailed treatment of the key aspects of asset management and contains a number of case studies to demonstrate the practical application of the methods by a variety of service providers.

The information in this guideline is intended to provide small licensees, or small service providers, who intend to apply for a licence from the Authority with practical guidance on how to develop and maintain the financial plan component of the asset management plan. This guide seeks to demonstrate that an adequate level of financial planning can be achieved without the need for expensive asset management software.

⁵ Draft Audit Guidelines – Electricity, Gas and Water Licensees February 2006

Appendix 1 – lifecycle cost elements

The reader is referred to section 3.7.2 (pages 3.115 to 3.118) of the International Infrastructure Management Manual – Version 3.0, 2006 for a more detailed treatment of lifecycle costing. The following sections provide an overview of the cost elements that should be considered when evaluating the lifecycle cost of an asset. For certain assets, or categories of assets, some lifecycle cost elements may not be relevant; it is left for the reader to identify those elements that apply to the assets under consideration.

Acquisition and financing costs

Examples of the acquisition and financing costs involved in acquiring an asset include:

- Research and feasibility studies
- Planning fees
- Consulting fees,
- Land acquisition and improvement
- Plant installation and commissioning costs
- Cost of raising funds
- Duties and taxes
- Purchase of major spare parts to support maintenance activities

All of these costs are summed together to determine the initial capital value of the asset for valuation purposes.

Asset Operating Costs

Operating costs include items such as operational personnel, materials, fuel, chemicals and energy consumption. Operating costs can be greatly affected by factors such as the age and condition of the asset, which affect the efficiency of the asset. It is often the case that the cost of operating an asset increases with age and this needs to be factored into operating cost forecasts for the asset.

Operating costs can also include external costs imposed on the licensee by external agencies. This can include items such as environmental levies, asset management system effectiveness reviews and resource management charges.

Maintenance Costs

Examples of asset maintenance costs include:

- Scheduled (predictive) maintenance
- Reactive repairs
- Major refurbishment or rehabilitation
- Alteration or reconfiguration of assets
- Holding of spares required for emergency breakdown (sometimes known as critical spares)

Increasing the level of routine maintenance, and hence the cost of maintenance, can reduce the overall cost of maintenance by averting breakdowns. The standard of service required of an asset has a direct influence on maintenance costs. An increase in the standard of service can result in a significant increase in maintenance costs.

Risk Exposure Costs

Risk exposure costs include the cost of insurance to mitigate known risks and the potential costs of risk exposure, i.e. remedial work. The risk analysis process should involve an assessment of the financial costs associated with each risk and the costs involved in mitigating the risk. Often risk exposure can be managed through the creation of a financial reserve to fund remedial work should an event occur.

Rehabilitation Costs

Throughout the life of infrastructure assets there will be points in time where rehabilitation is required to reduce rising maintenance costs, address poor operating performance, accommodate new technology or meet changing customer expectations on standards of service. Rehabilitation can involve significant additional capital expenditure to renew or refurbish parts of the asset.

Renewal/Replacement Costs

Asset renewal/replacement costs arise when a decision has been made to renew or replace an asset. The asset renewal costs should include all costs associated with the renewal or replacement such as consents, disposal of existing assets, design fees and supervision/labour costs.

Asset Administration Costs

These costs are often referred to as indirect costs or overheads. These costs are an allocation of the central support costs incurred by the licensee in delivering services to the community. Examples of these costs include central administration staff costs, building or land operating costs, insurances and management expenses. Licensees differ in how these costs are allocated to assets and often an arbitrary method such as labour hours, number of full-time staff or square meters of occupied space are used to apportion indirect costs. Some licensees use activity based costing to determine cost allocation.

Capital Use Charges

The capital use charge, or return on capital invested in the assets, is a measure of the effective use of the assets. It is usually measured in terms of a percentage of the asset value. In order to apply the capital use charge it is necessary to attribute a value to the assets and keep this valuation current during the life of the asset.

Depreciation costs

The calculation of depreciation assigns a value to the consumption of an asset over its useful lifetime. Section 3.7.4(f) (page 3.126) of the IIMM sets out the accounting concept of depreciation as a cost allocation process; where the cost (or value) of the asset is charged to the organisation over the periods in which the benefits of operating the asset are received. If depreciation is not charged then the real costs of owning assets will be understated. The International Financial Reporting Standards require depreciation to be

reported as an operating expense in financial statements. A more detailed discussion of depreciation can be found in section 8.2 of this guide.