

THE ENVIRONMENTAL CONSEQUENCES OF DISPOSAL OF FIXED CAPITAL

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Session overview

- Background / the problem
- Position of the SEEA-2003 on terminal costs (incl. decommissioning costs)
 - position of the 2008 SNA
 - other possible options
- Further clarifying the revised SEEA
 - remedial costs
 - terminal costs

Background / the problem

- Terminal costs and ownership transfer costs on disposal of fixed capital
 - simply intermediate consumption of the enterprise; or
 - an integral part of the value of fixed capital asset?
- If capital, how to account for decline in asset value?
 - consumption of fixed capital; or
 - other changes in volume?

Definitions...

- Terminal costs – those costs incurred to prevent environmental problems when production ceases
- Remedial costs – costs incurred when production has already ceased, and no cost provision made during the production phase

Terminal and remedial costs

- Key distinctions between these:
- 1. Timing of cost payment
 - Remedial costs incurred *after* site has closed
- 2. Who makes the payment
 - terminal costs incurred by the owner of the associated asset
 - remedial costs incurred by another party

Position of the SEEA-2003

- Expected terminal costs are part of the value of the associated asset (e.g. oil rig)
 - recorded as gross fixed capital formation when actually incurred
 - but recorded as consumption of fixed capital throughout the life of the associated asset
 - i.e. the asset is being written off *before* it even comes into existence

Position of the SEEA-2003, *continued...*

➤ Remedial costs...

➤ For managed landfill:

- 1. Costs to inhibit damage in an ongoing way are considered EPE (intermediate expense)
- 2. Where costs are for land reclamation, the spending will lead to formation of a capital asset ('land improvement')
 - (and SEEA EPE accounts need to be consistent)

What does the 2008 SNA say?

- 2008 SNA and SEEA-2003 are consistent
- But the 2008 SNA clarifies:
 - ownership transfer costs on disposal of fixed assets – asset life is the expected period of ownership
 - terminal costs on fixed assets – asset life is the expected life of the asset

The 2008 SNA, continued...

- Terminal costs can be difficult to accurately predict
- Where cumulated consumption of fixed capital does not cover all terminal costs
 - terminal costs treated entirely as gross fixed capital formation at time incurred
 - Shortfall is recorded as consumption of fixed capital at same time terminal costs are incurred

Other treatment options for terminal and ownership transfer costs (OTC)

- 1. as an expense
- 2. as gross fixed capital formation as occurs – write off immediately as other volume change (OVC)
- 3. as gross fixed capital formation as occurs – write off immediately as consumption of fixed capital

1. Terminal and OTC as an expense

- These costs look like expenses i.e. they do not create a store of value; they are not tradeable
- In SNA - OTC for financial assets are treated as expenses
- Expense treatment avoids potentially significant impact on capital stock simply from selling assets

On the other hand...

- Contrary to SNA
- Capital services provided by asset should cover purchase price and terminal costs/OTC

2. Terminal and OTC: gross fixed capital formation as occur – write off immediately as OVC

- Terminal costs and OTC don't fit SNA definition of Other Volume Change (OVC)
- these costs will impact on balance sheet and accumulation accounts but by-pass production and income accounts
- i.e. capital formation not matched by consumption of fixed capital. Value added overstated

3. Terminal and OTC: gross fixed capital formation as occur - write off immediately as CFC

- treating as capital formation (= SNA)
- consistent with SNA principle purchasers' prices
- consistent with capitalisation of these costs in business accounting,

But...

- by writing off immediately, we're effectively saying it's an expense
- 'fence sitting'

Recommended treatment of terminal costs:

- The SEEA Rev should treat terminal costs as capital formation, CFC written off over expected life of the asset
 - consistent with 2008 SNA (avoid user confusion)
 - workable and defensible solution
 - not perfect, but none of the other options are perfect either...

Q1. Does LG agree that terminal costs should be treated as capital formation, CFC written off over the expected life of the asset?

Further clarifying the SEEA Rev

- Clarifying treatment of remedial costs
- Two distinct classes of remedial costs:
 - 1. to restore land for some alternative use (GFCF)
 - 2. to 'lock up' harmful contaminants within a site
- Require a treatment for the second class
 - Suggest these costs be treated as intermediate consumption (no store of value, no use in production, cannot be on-sold, no property income derived etc.)

Q2. Does LG agree with this suggested treatment?

Further clarifying the SEEA Rev *continued...*

- Clarifying treatment of terminal costs
 - SEEA-2003 recommends that where no estimate of terminal costs has been made during the life of the asset, terminal costs incurred are treated as:
 - 1. Capital formation, and instantly written off (para 6.73);
 - OR 2. Intermediate consumption (para 6.74)
 - SEEA Rev must adopt singular recommendation:
 - Option 1. (capital) – consistent with 2008 SNA
- Q3 Does LG agree with this suggested treatment?*

Further scenario re terminal costs...

- Terminal costs are anticipated and provisions put in place *but* enterprise ultimately avoids responsibility for these costs
 - Scenario not considered in SEEA or SNA
 - Recommendation: when it is clear that costs will not be incurred by the enterprise, full amount of cumulated consumption of fixed capital (CFC) be reversed with a negative CFC entry

Q4 Does LG agree with this recommendation?

Terminal costs are anticipated and provided for *but* enterprise ultimately avoids responsibility for these costs (*continued...*)

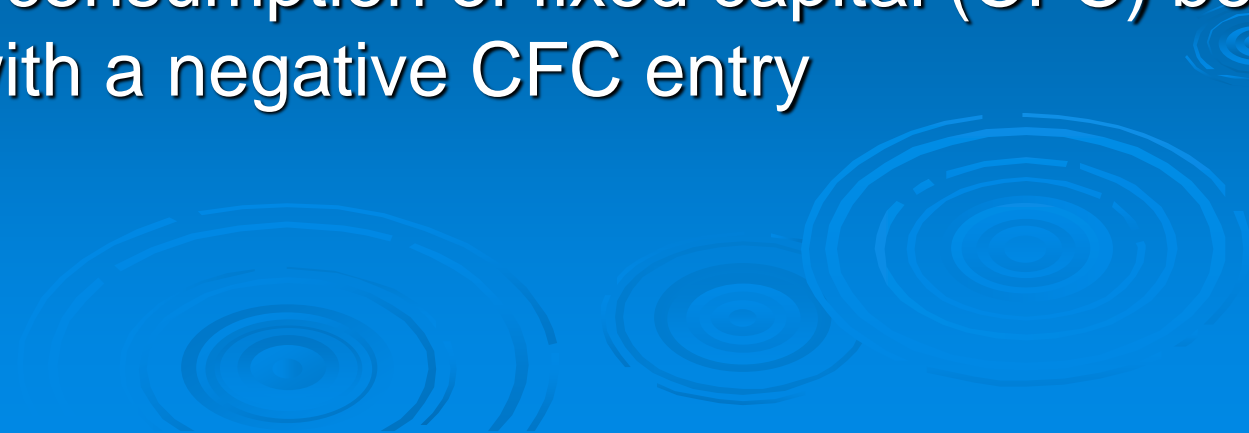
- if government assumes responsibility for terminal costs
- there is no longer an asset 'associated' with the decommissioning / terminal costs
- so these expenses are treated as remedial costs (described earlier) undertaken by government

Summary of questions

Does London Group agree:

- that terminal costs should be treated as capital formation, CFC written off over the expected life of the asset?
- agree that terminal costs to 'lock up' harmful contaminants within a disused site be treated as intermediate consumption?

Summary of questions, *continued*...

- Does London Group agree that:
 - Q3 where no estimate of terminal costs has been made during the life of the asset, such costs are always treated as capital formation?
 - Q4 when it is clear that terminal costs will not be incurred by the enterprise, full amount of cumulated consumption of fixed capital (CFC) be reversed with a negative CFC entry
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- Three sets of concentric circles, resembling ripples in water, are positioned at the bottom of the slide. They are light blue and fade out towards the bottom edge.