

Local Government Finance Circular 8/2014

Directors of Finance of Scottish Local Authorities
Audit Scotland

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Our ref: A9164061
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Dear Director of Finance,

ASSET DECOMMISSIONING OBLIGATIONS – STATUTORY FRAMEWORK

Introduction

The Local Authority (Scotland) Accounts Advisory Committee (LASAAC) has just issued guidance on proper accounting practice for the recognition of asset decommissioning obligations. Scottish local authorities are required to follow this guidance, this being recognised accounting guidance under section 12 of the Local Government in Scotland Act 2003.

The LASAAC guidance, in accordance with the Code of Practice on Local Authority Accounting in the UK (the Accounting Code) requires a Scottish local authority to make a provision to recognise a decommissioning liability if certain criteria are met. The provision requires to be capitalised in accordance with proper accounting practice. These decommissioning liabilities and the related capitalised costs are measured at the best estimate of the costs required to settle the decommissioning obligation. Where the time value of money is significant, the amount of the provision should be the present value of the expected expenditure necessary to discharge the obligation.

The decommissioning asset is depleted (depreciated) in the same way as other assets. This means that the cost of decommissioning is charged to the Comprehensive Income and Expenditure Statement (CIES) over the life of the asset, rather than in a lump sum at the end of the asset life.

If the decommissioning provision has been discounted the provision is increased over time as the discount is unwound. This is also charged to the CIES.

The result of these transactions is that at the end of the asset life the provision reflects the full decommissioning cost, and, these costs will have been charged to CIES.

Under statutory arrangements the depreciation charge to Surplus or Deficit on the Provision of Services is not a proper charge to the General Fund. Such amounts are

transferred to the Capital Adjustment Account and reported in the Movement in Reserves Statement.

The result of this statutory adjustment means the cost of decommissioning obligations will not have been charged to the General Fund over the life of the asset. Whilst any unwinding of the discount will have been charged to the General Fund over the life of the asset the initial estimate and associated provision will remain unfunded.

Statutory arrangements require funding to be identified for all capital expenditure on recognition. This therefore extends to the capitalised costs recognised for the decommissioning obligation. This means that when decommissioning obligations are recognised and a provision is made in the accounts funding requires to be identified for the capital expenditure (the decommissioning cost recognised in the cost of the asset) in full.

As this is capital expenditure the normal capital funding sources may be applied, including an advance from the loans fund (borrowing). Any advance from the loans fund is repaid by a charge to the General Fund, being the statutory repayment of debt, over the life of the asset. The unwinding of the discount to increase the provision may not be capitalised but is a revenue cost to the General Fund as the cost arises. The funding of the capital expenditure relating to the decommissioning obligation, together with the charge to the General Fund for any increase in the provision, will result in a fully funded provision available to meet the actual costs of decommissioning when they are incurred. When the actual costs are incurred the expenditure is not capital expenditure and statutory funding is therefore not required, or only to the extent that the provision is insufficient to meet the actual costs of decommissioning.

This statutory treatment for decommissioning obligations for local authorities will place them in the same position as private companies – the costs of decommissioning will have been fully funded during the life of the asset.

LASAAC recognised that retrospective restatement arising from the application of proper accounting practices will have an immediate funding impact for local authorities as they are required to fully fund the new capital expenditure and any unwinding of the discount. LASAAC therefore asked the Scottish Government for statutory mitigation. Scottish Ministers have agreed to this request and the statutory guidance and transitional arrangements are set out below.

STATUTORY GUIDANCE

Assets with decommissioning obligations

1. Statutory funding must be identified for all capital expenditure on recognition. For decommissioning obligations the recognition point is when the decommissioning cost is recognised in the cost of the asset and this cost is required to be capitalised in accordance with proper accounting practices.
2. Statutory funding of the capitalised decommissioning obligation can be met from all normal capital funding sources such as capital grant, capital receipts, revenue contribution, loan fund advance (borrowing) etc.

3. Where the statutory funding is to be met from borrowing prudential principles apply. The capital expenditure will increase a local authority's Capital Financing Requirement (CFR). This increase in CFR will be funded by an advance from the loans fund. The CFR represents an underlying need to borrow externally, not a requirement to borrow externally. External borrowing should be in accordance with treasury management principles.

4. Paragraph 31 of Schedule 3 of The Local Government (Scotland) Act 1975 sets the fixed period for the repayment of a loans fund advance as not exceeding 30 years from the date of the advance or any other period that Scottish Ministers may determine. Finance Circular 29/1975 replaces the 30 years and sets out various maximum periods to apply for different types of asset. For loan fund advances made for capital expenditure related to decommissioning obligations the maximum fixed period for the repayment of the advance is now formally set by Scottish Ministers as the remaining useful life of the asset (i.e. the future period of service provided by the asset).

Transitional arrangements

5. Statutory funding (capital resource) must be identified for all capital expenditure arising from restatements to recognise existing decommissioning obligations. Where the statutory funding identified is a Loans Fund advance statutory mitigation is available for the repayment period (fixed period).

Statutory funding by Loans Fund advance – fixed period

6. Proper accounting practice, as set out in the Accounting Code / LASAAC Guidance, may require a local authority to restate their accounts for existing assets with a decommissioning obligation. This restatement may give rise to an immediate financial impact where the asset is partway through its useful life. For restatements made in response to the LASAAC guidance / the Accounting Code the fixed period for the restated asset may extend beyond the remaining useful life of the asset.

7. The fixed period for these restated assets is still over the useful life of the asset but that period now commences from the date of restatement. For example if the useful life has been identified as 10 years and the asset value is restated in 2013-14 in year 5 of the asset life, the maximum fixed period is 10 years from 2013-14.

8. In response to the LASAAC guidance a local authority may identify a future decommissioning obligation which has not yet been triggered. If the future decommissioning obligation will require recognition in the next 5 years (commencing 1 April 2013) the fixed period for a loans fund advance made during this 5 year period may extend beyond the remaining useful life of the asset. Paragraph 7 applies to determine the fixed period.

9. Any loan fund advance made to fund an increase in the decommissioning obligation during the same 5 year period (this increase must be capable of capitalisation in accordance with proper accounting practices) may be repaid in the same fixed period as determined for that asset when paragraph 7 was applied.

10. From 1 April 2018, i.e. after the 5 year period (1 April 2013 to 31 March 2018) all decommissioning costs which are capitalised in accordance with proper accounting practice, whether these are new or increased costs, which are funded from borrowing (a loans fund advance) have a maximum fixed period for repayment equal to the remaining useful life of the asset. Paragraph 7 ceases to apply from 1 April 2018.

11. The fixed period set out above only applies to new capital expenditure recognised for assets with decommissioning obligations. Any loan fund advance made to fund capital expenditure on these assets prior to 1 April 2013 is unaffected i.e. the repayment profile of the original advance will not change.

Unwinding of the discount

12. On retrospective restatement, a revenue charge to the General Fund may need to be made to recognise that part of a provision that relates to the unwinding of any discount that has been applied. As this is not capital expenditure it cannot be funded from borrowing or other capital sources and will therefore have an immediate financial impact for a local authority. Scottish Ministers have therefore agreed, as a transition arrangement, that a local authority may treat this cost as capital expenditure.

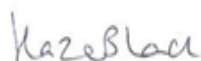
13. Scottish Ministers issue this part of the guidance using powers contained in section 12 of the Local Government in Scotland Act 2003 (proper accounting practices). On the restatement of an asset a local authority may, if it chooses, capitalise that part of the provision which relates to the unwinding of any discount applied. If a local authority chooses to borrow to fund this cost the fixed period for the repayment of the associated loan fund advance is to be determined in accordance with paragraph 6 above.

14. Only this initial cost on restatement may be capitalised. After restatement all future costs arising from the unwinding of the discount must be treated as revenue expenditure and charged to the General Fund.

15. The issue of this statutory guidance under section 12 of the Local Government in Scotland Act 2003 to vary proper accounting practices to allow the revenue cost arising from the restatement for decommissioning obligations to be capital expenditure applies only for the period 1 April 2013 to 31 March 2015.

If you have any questions please do not hesitate to contact me.

Yours faithfully



Hazel Black
Head of Local Authority Accounting