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UPDATE OF SNA93: PROGRESS BY THE CANBERRA II GROUP ON THE MEASUREMENT OF NON-FINANCIAL ASSETS[1]

Paper submitted by OECD[2]

INTRODUCTION

1. Changes in the economic environment necessitate a continuous updating of the 1993 SNA to ensure and maintain its relevance. Therefore, initially an incremental updating mechanism was adopted. However, it was increasingly felt that prospective changes to the 1993 SNA should be more adequately and comprehensively dealt with to ensure the integrity and consistency of the System as a whole. As a consequence, the Intersecretariat Working Group on National Accounts (ISWGNA) was given a mandate to oversee the update of the 1993 SNA with the objective of publishing revision 1 in 2008. In this endeavour, the Advisory Expert Group on National Accounts (AEG) to the ISWGNA, the electronic discussion groups (EDGs), the (Canberra II) Group on the Measurement of Non-financial Assets and task forces are all playing key roles.

2. It was recently agreed to consider over 50 issues (including relevant balance of payments and government finance statistics issues) for updating the 1993 SNA, and just under

[1] The Statistical Division has submitted the present documentation after the official deadline due to resource constraints.
[2] Paper prepared by Charles Aspden.

half of these are to be addressed by Canberra II. This paper very briefly outlines the updating process, gives some basic information about the Canberra II Group and then focuses on the Canberra II issues. It lists each issue, indicating when it is likely that it will be considered by the AEG, and then gives a short description, including a summary of progress, of each of them.

3. For a complete description of the updating process, criteria for accepting issues, governance and decision-making process, please refer to the UNSD website http://unstats.un.org/unsd/nationalaccount/snarw1.htm

THE UPDATING PROCESS

4. For the efficient execution of the governance and decision-making process, the AEG takes decisions on the scope of the updating and on technical and conceptual issues in conjunction with the ISWGNA. The list of issues to be considered for updating was approved at the first meeting of the AEG in February 2004.

5. Issues are first deliberated by various existing expert groups, such as the Canberra II group on non-financial assets, city groups, regional commission meetings, EDGs, and possible new expert groups. The terms of reference for every expert group have been formulated with a deadline and a moderator to monitor the discussions and to write the conclusions to be submitted to the ISWGNA. The recommendations of these groups of experts are then forwarded to the AEG for discussion and final decision. The moderator or chairman of the expert group is responsible for the preparation of an issues paper for each topic that includes the recommendations of the group, with, if possible, indications of the paragraphs of the current 1993 SNA that are impacted. The AEG will deliberate on the recommendations in the issues papers and propose for each one a final recommendation of clarification or change of the SNA.

6. Throughout the updating process of the 1993 SNA, the ISWGNA will assess and evaluate the consistency with revision of the Balance of Payments Manual (BPM) and, to the extent possible, with the Manual on Government Finance Statistics (GFS). To this end, the ISWGNA will liaise with the IMF's Balance of Payments Committee and the International Task Force on Harmonization of Public Sector Accounting. A deliberate coordination mechanism has been put in place consisting of (a) coordination within the international organizations and countries, (b) bringing BPM and GFS issues to national accounts meetings and (c) inclusion of these consistency coordination issues in the agenda of the meetings of the AEG. Coordination with the IMF's Balance of Payments Committee should also ensure parallel progress of the review of the 1993 SNA and the revision of the BPM.

DELIBERATIONS ON ISSUES

7. Deliberations on issues in the updating process include the following steps:

a) Deliberations on specific issues are carried out through expert groups that include the EDGs, city groups and regional commission meetings during 2003-2005. Recommendations of the expert groups are forwarded to the ISWGNA and are then to be made publicly available, with comments invited from other regional and international expert group meetings on national accounts prior to being presented for discussion and approval at the meetings of the AEG.

b) The AEG met in February 2004 and will meet again in November 2004 and 2005 to deliberate the recommendations of the expert groups. An additional meeting of the AEG is planned in May 2006 for a review of the mutual consistency of the recommendations on the updated issues and the overall integrity of the system. A final meeting will be held in 2007 to adopt the proposed changes, taking account of countries' comments. Thus, tentatively, five meetings of the AEG are planned.

c) The recommendations of the AEG will be sent to countries for comments after each meeting in the years 2004-2005.

d) Consolidated recommendations for changes will be circulated to countries for comments in 2006 and submitted to the ISWGNA in tandem with the AEG for approval by March 2007.

ABOUT CANBERRA II

8. The Canberra II Group on the Measurement of Non-financial Assets is the successor to the Canberra Group of the same name whose major accomplishment was its contribution to the OECD manual 'Measuring Capital' which was published in 2001. Canberra II is focussed on the update of the 1993 SNA in respect of non-financial assets.

9. It is a self-selected group open to all interested persons who wish to contribute to its objectives. Members include officials from national and international statistical offices and central banks, as well as academics and unattached persons. Its chairman is Peter Harper from the Australian Bureau of Statistics (peter.harper@abs.gov.au) and the OECD provides the secretariat support. It has its own EDG on the OECD's website, with access restricted to members.

10. Four more meetings have been planned. The next two are in Washington D.C. from 17-19 March 2004 and in London in early September 2004. The other two meetings are scheduled for 2005, probably in March and early September. If you wish to participate, please contact me (charles.aspden@oecd.org).

Current list of Canberra II issues accepted by the AEG for review and when they might be considered by the AEG

<u>February 2004</u>

1. Costs of ownership transfer (part)
2. Military expenditures
3. Cultivated assets

<u>November 2004</u>

4. Costs of ownership transfer (part)
5. Originals and copies
6. Databases
7. Mineral exploration
8. Government owned assets – cost of capital services
9. Capital input into production account
10. Treatment of land

<u>November 2005</u>

11. Leases and licences
12. Borderline between rent/rental and sale
13. Classification of assets and terminology
14. BOOT schemes
15. Purchased goodwill and other non-produced assets (i.e. trademarks, brand names and franchises)
16. Asset boundary for non-produced intangible assets
17. Amortization of intangible non-produced assets
18. R&D (plus impact on patented entities)
19. Obsolescence/depreciation
20. Water
21. Transactions of the right to use/exploit non-produced resources between residents and non-residents and between residents

BRIEF DESCRIPTION OF ISSUES

<u>Costs of ownership transfer (COT)</u>

11. This issue has been the subject of an EDG (moderator: Peter van der Ven) and discussion at two Canberra II meetings. Debate has revolved around the consistency of treatment of COT for different types of asset, whether COT on fixed assets should be completely expensed, and if not it how it should be recorded in respect of second hand sales and what its service life should be. Two recommendations were made and accepted by the AEG at the February 2004 meeting:

a) Costs of ownership transfer of non-financial assets should continue to be recorded as fixed capital formation;

b) Costs of ownership transfer incurred on the acquisition of an asset should be written off over the period the owner expects to hold the asset. (The SNA currently says over the entire life of the asset.)

12. Three other recommendations in the issues paper were referred back to Canberra II for further consideration. They concern the treatment of COT on disposal, the inclusion in COT

of installation and transport costs when separately invoiced, and the treatment of terminal costs.

Military expenditures

13. The current recommendation of the SNA is that expenditures on weapons and weapon platforms should be expensed, irrespective of their expected service lives. This has been reviewed by Canberra II and it was recommended and subsequently accepted by the AEG that all military assets which are expected to provide an on-going capability to achieve their military objective (including deterrence) for more than a year be capitalized. As a corollary, it was also accepted by the AEG that expendable military items such as bullets or bombs should be treated as materials and supplies inventories. The most notable implications are that GDP will be raised by the value of consumption of fixed capital on existing military assets and that net saving will be raised by the value of net fixed capital formation.

Cultivated assets

14. During the System of Economic and Environmental Accounts discussions, it was agreed that the present definition of cultivated assets is ambiguous. There was agreement that a satisfactorily tighter definition for cultivated assets was “cultivated assets cover livestock for breeding, dairy, draught, etc. and vineyards, orchards and other trees yielding repeat products **whose natural growth and regeneration is** under the direct control, responsibility and management of institutional units”. The words in bold replace the words “that are” in the SNA. This change has been accepted by the AEG.

Originals and copies

15. The focus is on two questions, “How should expenditures on originals and copies be recorded, should both be recorded as expenditure (on new goods) on the basis that originals are distinct from copies, or should originals be considered as being analogous to a ‘stock’ of copies, and so expenditure on a copy partly (or mostly) reflects a sale of an existing good?” and “How should the transactions in copies be recorded?” Three different options have emerged, and a description of the three and a detailed comparative analysis of how they could be recorded in the accounts has been prepared and posted on the Canberra II EDG. They will form the basis for discussion, and hopefully decision, at the forthcoming meeting in March 2004.

Databases

16. The SNA currently recommends that expenditure on large databases that are expected to produce a flow of services for a year or more should be capitalized. Should this be all databases? And if not, which should be capitalized? Canberra II has come to the view that all databases that meet the criterion of an asset should be capitalized. A draft issues paper is to be considered at the March 2004 meeting.

Mineral exploration

17. Canberra II has come to the view that there should be no change to the intent of the SNA, but thinks there is a need to clarify the division between mineral exploration knowledge assets and sub-soil assets. A draft issues paper is to be considered at the March 2004 meeting.

Government owned assets – cost of capital services

18. The SNA currently recommends that the cost of services provided by government owned assets is equal to their depreciation (i.e. consumption of fixed capital) over a period of time. Should this be changed to include a return to capital as well, and, if so, should this apply to all government owned assets or just some of them, such as office equipment? At its meeting in October 2003, a majority of Canberra II members agreed that all public non-financial assets other than valuables produce capital services. The issue is to be pursued further at the meeting in March 2004.

Capital input into production account

19. Canberra II has come to a broad agreement that there should be an (optional) alternative presentation of the production account showing the contributions of capital services to gross operating surplus and gross mixed income (GMI). The issue will be taken further at the March 2004 meeting with the papers on natural resources, GMI, inventories and volume measures of capital services.

Treatment of land

20. The SNA currently records improvements to land as gross fixed capital formation and consumption of fixed capital is recorded for them, but in the balance sheet, land improvements are included with land itself – a non-produced asset. A number of Canberra II members have expressed dissatisfaction with the current SNA recommendation on both conceptual and practical grounds. A survey of members was conducted to seek their views on whether the SNA should be changed and, if so, how. They were presented with a proposal, emanating from the October 2003 meeting, to treat land improvements in the same as way as buildings and other structures, i.e. as separate fixed assets. The results of the survey have been placed on the EDG and will be discussed at the March 2004 meeting.

Leases and licences

21. This issue has been discussed at two meetings of Canberra II, and concerns the treatment of contracts, leases and licences relating to different types of asset. The questions are should they be treated as assets and, if so, how and under what conditions? Members were invited to post their opinions on the EDG in response to a questionnaire. A summary of the responses is to be presented at the March 2004 meeting where the matter is to be discussed further.

Borderline between rent/rental and sale

22. Following the discussion on mobile phones, the ISWGNA established a set of criteria to determine whether a transaction relating to mobile phone licences should be considered as sale of an asset or as rent on a non-produced asset. The ISWGNA explicitly requested that Canberra II fully investigate the consequence of the introduction of this set of criteria in the case of other assets. In addition, work should be conducted to elaborate a broader set of criteria to aid decision making between the treatment of payments for leases or licences as rent or as the sale of an asset. The same issues arise in the case of leases of fixed assets. This issue has not yet been separately addressed.

Classification and terminology

23. Some members of Canberra II feel that the current classification of assets and terminology needs revising. Progress has already been made, but because this issue will be affected by the outcome of considerations of other issues, such as leases and licences, it will be one of the last ones to be dealt with by the AEG.

BOOT schemes

24. Buy-own-operate-transfer schemes typically take the form of a private sector enterprise and government reaching an agreement whereby the enterprise undertakes the building of a piece of infrastructure, such as a road, bridge, tunnel, airport, etc., then operates it, taking at least part of the revenue, and after a pre-determined period hands over ownership to the government. How should such arrangements be recorded in the national accounts? The discussion will be taken further at the March 2004 meeting when a report by a Eurostat task force on this subject will be presented.

Purchased goodwill and other non-produced assets

25. The SNA currently only recognizes purchased goodwill. Should there be a wider view of goodwill (internally generated goodwill)? Should it be derived residually using the values of assets and liabilities, including stock market valuation of businesses? At present, there is also an inconsistent treatment of purchased goodwill for incorporated and unincorporated business that needs to be addressed. Should the balance sheet recognize assets such as brand names, trademarks, franchises, etc.? This issue was discussed at the October 2003 meeting and is scheduled to be discussed again at the September 2004 meeting.

Asset boundary for non-produced intangible assets

26. Should instruments involving the securitisation of future receipts be regarded as intangible non-produced assets? This issue is yet to be addressed. It is also of interest to the Task Force on the Harmonisation of Public sector Accounts.

Amortization of intangible non-produced assets

27. Paragraphs 14 to 16 of the final report of the ISWGNA on mobile phone licences includes a brief discussion on the issue of the amortization of such intangible non-produced assets. Canberra II was asked if it would care to look at this matter further. This issue is yet to

be addressed.

Research and development

28. The SNA currently does not recognize the output of R&D as capital formation. Canberra II already has made an in-principle decision that all R&D covered by the Frascati Manual should be included in the asset boundary. It is now addressing the practical difficulties of deriving satisfactory estimates, such as using expenditure data collected as per the Frascati Manual, and obtaining appropriate deflators and service lives. If these difficulties can be satisfactorily overcome, then a proposal is likely to be made to the effect that the SNA should be amended to treat R&D expenditure in a similar way to mineral exploration.

Obsolescence/depreciation

29. This is one of the issues left over from Canberra I. It concerns the appropriate way of defining and measuring depreciation. Consumption of fixed capital (i.e. depreciation) is defined in the 1993 SNA in general terms as the decline during the course of the accounting period in the current value of the stock of fixed assets owned and used by a producer as a result of physical deterioration, normal obsolescence or normal accidental damage. It is referred to as time series depreciation because it is defined in terms of the change in value of an asset over time. An alternative definition, called cross section depreciation, is defined to be the difference in value of two assets that are identical, except one is older than the other by the same length of time as the accounting period, and is used in the derivation of estimates of multifactor productivity. Depending on how time series depreciation is interpreted, it can be equivalent to cross section depreciation. But is this the correct interpretation? Precisely, how should depreciation be defined in the SNA? This issue was discussed at the October 2003 meeting and will be further discussed at the March 2004 meeting.

Water

30. The issue is that water has in the past usually been regarded as a free resource, but the matter of charging for it is much discussed now. Should it therefore be treated in a similar way to land or mineral resources as giving rise to (resource) rent? It is complicated by the fact that there is a large distribution element in many cases and there is a decision to be made about whether the production is only getting water from A to B or whether one is only paying for this and the water itself. This issue will be discussed for the first time at the March 2004 meeting.

Transactions of the right to use/exploit non-produced resources between residents and non-residents and between residents

31. This is a new issue for clarification that arose at the 2004 meeting of the AEG.