

Sustainability – Excerpt from TRAC Vol.II c7

Capital infrastructure costs

Under present accounting standards, institutions are required to account for their infrastructure either on a historical cost or valuation basis, but this rarely covers the full economic costs of their premises or equipment.

It is important that costs reported under the Transparency Review reflect the full long-term costs of maintaining the institution's infrastructure in a safe and productive state, and to a standard that reflects the norm required to be competitive in the sector.

Cost of capital employed

All businesses need to cover the cost of financing and to generate a minimum level of retained surplus to permit rationalisation, updating and development.

In economic theory, these surpluses are part of the costs of financing the business. The term 'cost of capital' is generally used to describe the total of these costs (covering both loan and equity capital: and represented through interest, dividends and retained surpluses).

These are legitimate costs of running a business, and are accepted under the Government Accounting Conventions (GAC) for this reason. The aim of the GAC profit formula when applied to private contractors is to give them a fair and reasonable profit based on a return on capital employed comparable with British industry.

Under the Transparency Review the term 'cost of capital employed' (COCE) is used to cover:

- the surpluses required for rationalisation, updating and development
- the costs of raising and servicing capital, including short-term borrowings.

However, 'cost of capital employed' does not cover the costs of maintaining or depreciating assets - this is part of the adjustment for infrastructure.