KENORA DISTRICT SERVICES BOARD

FINANCE SERVICES DIRECTIVE

DATE:	**December 3, 2009**	**CATEGORY:**	**Materials Management**
SUBJECT:	**Tangible Capital Asset – Accounting Treatment**	**NUMBER:**	**FNS-II-03**
		REVISION DATE:	

Service Objective:

The Board's objective is to ensure investment in tangible capital assets is recorded appropriately and accurately.

Service Description:

<u>Tangible Capital Assets</u>

1. Tangible capital assets are non-financial assets having physical substance that:

    (1) Are held for use in the supply of goods and services, for rental to others, for administrative purposes or for the development, construction, maintenance or repair of other tangible capital assets;

    (2) Have useful economic lives extending beyond one year;

    (3) Are to be used on a continuing basis; and

    (4) Are not for sale in the ordinary course of operations.

    Examples of tangible capital assets include buildings, vehicles, equipment, land, computer hardware and software.

2. Tangible capital assets should be assigned to an asset type as outlined in KDSB-FNS-II-03 Materials Management - Tangible Capital Assets – Accounting Treatment Policy based on their nature characteristics and useful life.

3. Where departments are uncertain as to which category a tangible capital asset belongs, or where no appropriate category exists, they should contact the finance department.

4. The following assets should **not** be capitalized and amortized:

   (1) Land (or other assets) acquired by right, such as Crown, forests, water and mineral resources;

   (2) Works of art and historical treasures; and

   (3) Intangible assets such as patents, copyrights and trademarks.

5. Assets held for sale which otherwise would have been reported as capital assets may be required to be reported as financial assets as opposed to tangible capital assets.

<u>When to Account for Tangible Capital Assets</u>

6. A tangible capital asset should be accounted for and recognized in the financial statements when:

   (1) It is probable that future benefits associated with the tangible capital asset will be obtained;

   (2) There is an appropriate basis of measurement and a reasonable estimate of the value of the asset can be made; and

   (3) The asset is in use.

<u>Amortization</u>

7. Amortization is the accounting process of allocating the cost of a tangible capital asset to operating periods as an expense over the useful life in a systematic manner.

8. All corporation assets will be amortized using the straight line method which allocates the cost of the asset evenly over its' useful life.

9. A full year's amortization will be recorded in the year of acquisition, construction, development or put into use, regardless of when this event occurs in the fiscal year.

10. Land has an unlimited estimated useful life and should not be amortized.

11. Amortization will be calculated based on the full cost of the tangible capital asset. Where an asset's residual value is expected to be significant in comparison to the asset's costs (20% or more), the amount would be deducted from the cost when calculating amortization.

12. No amortization will be recorded in the year an asset is disposed of. This does not apply to deemed disposals.

13. No amortization will be recorded on work in progress or tangible capital assets which have been removed from service but not yet disposed of.

Useful Life of a Tangible Capital Asset

14. The useful life of an asset or part of an asset is the period over which an asset is expected to be used.

15. An asset's useful life can be estimated based on its expected future use, effects or technological obsolescence, expected wear and tear from use or the passage of time, the level of maintenance and experience with similar assets.

16. All tangible capital assets have predetermined estimated useful lives as outlined in the following chart. The estimated useful lives shown here are intended to apply to assets in new condition.

ASSET TYPE	**USEFUL LIFE**
Land	Indefinite
Land improvements	
Parking lot	15 years
Landscaping	25 years
Fences	20 years
Retaining walls	20 years
All other land improvements	15 years
Buildings	
Buildings – residential	60 years
Buildings – commercial	60 years
Buildings – portable/short term	20 years
Building improvements – residential	20 years
Building improvements – commercial	20 years
Leasehold and occupancy improvements	20 years
Machinery and equipment	
Operating equipment	10 years
Computer software	5 years
Computer hardware	5 years
System development	5 years
Office furniture and equipment	10 years
Vehicles	
Ambulance	6 years
Utility	10 years

17. When used assets are acquired the estimated useful lives should be reduced based on the age and condition of the asset.

Tangible Capital Asset Cost

18. The cost of a tangible capital asset includes the purchase price of the asset and other acquisition costs, such as installation costs, design and engineering fees, legal fees, survey costs, site preparation costs, freight charges, transportation costs, insurance costs and duties.

19. The cost of a constructed asset includes direct construction or development costs such as materials, including inventories held for consumption and use, and labour and overhead costs directly attributable to the construction or development activity. Capitalization of administrative costs should be limited to salaries, benefits and travel for staff directly involved in the project delivery (e.g. project management or construction).

20. Studies and other initiatives that relate “directly” to the acquisition of a tangible capital asset shall be capitalized. If the study/initiative does not relate “directly” to the acquisition of a tangible capital asset, then the expense shall be recorded in the year(s) in which they occur.

21. Where several tangible capital assets are purchased together, the cost of each asset is determined by allocating the total price paid in proportion to each asset’s relative fair value at the time of acquisition.

22. Interest expense related to financing costs incurred during the time a capital asset is under construction or development can be included in the cost of the capital asset until the asset is put into service.

23. If the construction or development of a capital asset is not completed to a usable state, the costs that would be otherwise capitalized should be expensed.

24. If a tangible capital asset is donated to the organization, the cost is its fair value at the date of contribution. Fair value of a donated capital asset may be estimated using market and appraised value.

25. When the organization receives funds from a third party, such as a provincial or federal government, to assist with the construction or purchase of a capital asset, the full cost of the asset should be recorded. The funds received should be recognized as revenue.

Tangible Capital Asset Types

26. The following table lists the tangible capital asset types and examples of assets and costs included in each type.

Tangible Capital Asset Type	Examples of Tangible Capital Assets	Examples of TCA Costs
Land	▪ land acquired for building sites, etc	▪ purchase price ▪ professional fees for title searches, architect, legal, engineering, appraisals, environmental surveys ▪ improvement and development costs such as land excavation, filling, grading, drainage, demolition of existing buildings (less salvage)
Land improvements	▪ parking lot, landscaping, fences, retaining walls, etc	▪ original purchase price or completed project costs including costs of material and labour or costs of a contractor
Building – residential Building – commercial Building – portable /short term	▪ public housing rental buildings ▪ office buildings, land ambulance bases ▪ operational storage facilities, sheds, small buildings, and pump houses	▪ original purchase price or completed project costs including basic cost of material and labour or cost of a contractor ▪ costs to remodel, recondition or alter a purchased building to make it ready to use for the acquired purpose ▪ preparation of plans, blueprints, and specifications ▪ costs of building permits, studies, test (pre-acquisition costs) ▪ professional fees for title searches, architect, legal, engineering, appraisals, environmental surveys ▪ operating costs such as temporary buildings used during construction
Building improvements	▪ major repairs that increase the value or useful life of the building such as structural changes, installation or upgrade of heating and cooling systems, plumbing, electrical, telephone systems	▪ complete project costs including basic costs of material and labour or costs of a contractor ▪ preparation of plans, blueprints, and specifications ▪ cost of building permits, studies, test ▪ professional fees for architect, legal, engineering, appraisals, environmental surveys ▪ operating costs such as temporary buildings used during construction
Leasehold and occupancy improvements	▪ improvements that increase the functionality of leased or similar accommodations (refer to the assets listed under the “building improvements” category)	▪ costs similar to those listed under the “building improvements” category
Operating equipment	▪ equipment specific to service delivery ▪ examples include refrigerators, stoves, washers, dryers, lawn tractors, defibrillators, etc	▪ original contract price or invoice price ▪ freight charges ▪ sales taxes on acquisition ▪ installation charges ▪ charges for testing and preparation ▪ costs of reconditioning used items when purchased ▪ parts and labour associated with the construction of equipment

Tangible Capital Asset Type	Examples of Tangible Capital Assets	Examples of TCA Costs
Computer software	▪ off the shelf software and related upgrades, software licenses after removing any maintenance or similar charges	▪ purchase price of off the shelf software and related upgrades ▪ sales taxes on acquisition ▪ installation charges
Computer hardware	▪ servers, voice logging equipment, scanners, hard drives, modes, tape drives, etc	▪ purchase price ▪ installation charges ▪ freight and transit charges ▪ sales taxes on acquisition
System development	▪ consultant fees, web site development and custom developed software	▪ external direct costs of materials and services such as consultant fees ▪ web site development costs ▪ costs to acquire software and any custom development ▪ salary and related benefits of employees directly associated with the application development stage ▪ costs of upgrades that improve the functionality of the system
Office furniture and equipment	▪ desks, tables, chairs, filing cabinets, fax machines, photocopiers, video-conferencing stations, projectors, digital cameras, etc	▪ original contract price or invoice price ▪ freight and installation charges ▪ sales taxes on acquisition ▪ costs of reconditioning used items when purchased ▪ parts and labour associated with the construction of furniture
Vehicles	▪ used primarily for transportation purposes such as automobiles, trucks under one tonne, vans, boats, all terrain vehicles, snowmobiles and ambulances	▪ original contract price or invoice price ▪ freight charges ▪ sales taxes on acquisition ▪ costs of reconditioning used items when purchased

Tangible Capital Asset Thresholds

27. The thresholds for each category represents the minimum cost an individual asset must have before it is to be recorded as a tangible capital asset on the statement of financial position of the organization.

28. Tangible capital assets not meeting the threshold are expensed in the year in which they are purchased. Costs for these assets are referred to as capital-type expenses.

29. Thresholds should be applied on an individual asset or per item basis.

30. The following schedule outlines the thresholds for each tangible capital asset as established in KDSB-FNS-II-03 Materials Mangement Tangible Capital Assets – Accounting Treatment Policy.

ASSET TYPE	THRESHOLD
Land	$0 (capitalize all)
Land improvements	$5,000
Buildings – residential	$10,000/unit
Buildings – commercial	$25,000
Buildings – portable/short term	$5,000
Building improvements – residential	$5,000/unit
Building improvements – commercial	$10,000
Leasehold and occupancy improvements	$10,000
Machinery and equipment	$5,000
Vehicles	$5,000

<u>Betterments</u>

31. Betterment is a cost incurred to enhance the service potential of a tangible capital asset. Betterments increase service potential and may or may not increase the remaining useful life of the tangible capital asset. Service potential is enhanced if one of the following occurs:

(1) There is an increase in the previously assessed physical output or service capacity;

(2) Associated operating costs are lowered;

(3) The original useful life is extended; or

(4) The quality of the output is improved.

32. Betterments which meet the threshold of the applicable tangible capital asset type are capitalized. Otherwise, they are expensed.

33. Repairs and maintenance which are necessary to obtain the expected service potential of a tangible capital asset for its estimated useful life are not betterments. These costs should be expensed when incurred. They include:

(1) Repairs to restore assets damaged by fire, flood, accidents or similar events, to the condition just prior to the event; and

(2) Routine maintenance and expenditures, such as repainting, cleaning and replacing minor parts.

34. Where betterment enhances the service potential of a tangible capital asset without increasing its estimated useful life, the amortization period will remain the same.

35. Where betterment increases the estimated useful life of a tangible capital asset, its useful life should be changed.

36. Where betterment involves the replacement of an identifiable component of a tangible capital asset, the original cost of that component and the related accumulated amortization will be removed from the accounting records.

Write-Down/Write-Off

37. A write-down is used to reflect a partial impairment in the value of a tangible capital asset. The carrying value of a tangible capital asset should be written down if it can no longer contribute to the organization's ability to provide service at the previously anticipated level and the impairment is permanent in nature.

38. Conditions that may indicate that a write-down is required include an expectation of providing services at a lower level than originally planned, a change in use for the asset, technological advances which render the asset obsolete or other factors such as physical damage which reduce the asset's service potential. Documentation for write-downs will be retained.

39. A write-off is a 100% reduction in the net book value of a tangible capital asset to reflect the decline in the asset's value due to a permanent impairment.

40. Write-downs and write-offs of tangible capital assets should be accounted for as an expense in the current period.

41. Annual amortization of an asset that has been written down will be calculated using the net book value after the write-down and the remaining estimated useful life.

42. Regardless of any change in circumstances, a write-down or write-off will not be reversed.

Tangible Capital Asset Disposal

43. Disposals occur when the ownership of a tangible capital asset is relinquished and may occur by sale, loss, destruction or abandonment.

44. When a tangible capital asset is disposed of, the cost and the accumulated amortization should be removed from the accounting records and any gain or loss recorded.

45. Costs of disposal paid by the organization should be expensed.

46. A gain or loss on disposal is the difference between the net proceeds received and the net book value of the asset and will be accounted for as a revenue or expense, respectively, in the period the disposal occurs.

<u>Capital Leases</u>

47. Capital leases are a means of financing the acquisition of a tangible capital asset where the lessee carries substantially all of the risks and benefits of ownership. Capital leases are recorded as if the lessee had acquired the asset and assumed the liability.

48. If one or more of the following criteria exists, the lease should be accounted for as a capital lease:

(1) There is reasonable assurance that the organization will obtain ownership at the end of the lease. (i.e., transfer of ownership occurs at the end of the lease or the lease has a bargain purchase option)

(2) The organization will receive substantially all the economic benefits of the assets (i.e., the lease is 75% or more of the economic life of the asset)

(3) The lessor is assured of recovering the investment in the asset and earning a return. (i.e., the present value of the minimum lease payment is 90% or more of the fair value of the asset)

49. Where at least one of the conditions in the preceding section is not present, other factors may indicate that a capital lease exists.

50. For example, a capital lease may exist if:

(1) the organization owns or retains control of the land on which a leased asset is located and the asset cannot be easily moved;

(2) the organization contributes significant assistance to finance the cost of acquiring or constructing the asset that it will lease; or

(3) the organization bears other potential risks, such as obsolescence, environmental liability, uninsured damage or condemnation of the asset and any of these are significant.

51. Operating leases are leases in which the lessor does not transfer substantially all the benefits and risks of ownership. If the arrangement is an operating lease, the lease payment should be expensed and no liability is recorded.

52. If the arrangement is a capital lease, the organization will apply the thresholds of the appropriate tangible capital asset type.

53. If the thresholds are not met, an expense and a liability should each be recorded for the present value of the minimum lease payments.

54. If the thresholds are met, a tangible capital asset and a liability will each be recorded for the present value of the minimum lease payments. The leased asset should be amortized over the lesser of the lease term or estimated useful life for similar tangible capital assets.

55. Executory and maintenance costs will be excluded when calculating minimum lease payments. The discount rate should be the lesser of the organization's incremental borrowing rate or the interest rate implicit in the lease, if determinable.

<u>Work In Progress</u>

56. Where the construction or development of a tangible capital asset occurs over several years, capital costs will be accumulated until the asset is ready for use.

57. Costs relating to work in progress will be identified in any interim and year-end reporting.

58. The organization will not record amortization on work in progress.

59. A work in progress account will be established to allow work in progress capital costs to be tracked separately from the tangible capital assets subject to amortization.

60. Examples of work in progress are the construction of a new building or the development of an asset which occurs over several years. Work in progress would also include down payments and deposits which are to be applied to the cost of a tangible capital asset.

Definitions

The words and phrases listed below when used in this directive shall have the following meanings ascribed to them.

"*Amortization*" is the accounting process of allocating the cost less the residual value of a tangible capital asset to operating periods as an expense over its useful life in a rational and systematic manner appropriate to its nature and use.

"*Betterment*" is a cost incurred to enhance the service potential of a tangible capital asset. Betterments increase service potential (and may or may not increase the remaining useful life of the tangible capital asset). Such expenditures would be included in the tangible capital asset's cost.

"*Capital-type expenses*" are costs for assets that meet the definition of a capital asset but are less than the thresholds. These assets are expensed in the year in which they are purchased.

"*Component*" is part of an asset with a cost that is significant in relation to the total cost of that asset. Component accounting recognizes that each part might have a different useful life and requires separate accounting for each component that has a different useful life than the whole asset does.

"*Cost*" is the gross amount of consideration given up to acquire, construct, develop or better a tangible capital asset, and includes all costs directly attributable to acquisitions, construction, development or betterment of the tangible capital asset, including installing the asset at the location and in the condition necessary for its intended use. The cost of a contributed tangible capital asset, including a tangible capital asset in lieu of a developer charge, is considered to be equal to its fair value at the date of contribution. Capital grants would not be netted against the cost of the related tangible capital asset.

"*Disposal*" refers to the removal of a capital asset from service as a result of sale, destruction, loss or abandonment.

"*Fair value*" is the amount of the consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act.

"*Gain on disposal*" is the amount by which the net proceeds realized upon as asset's disposal exceeds the asset's net book value.

"*Loss on disposal*" is the amount by which the net book value of a capital asset exceeds the net proceeds realized upon the asset's disposal.

"*Market value*" is defined as the estimated amount for which a property would be exchanged on the date of valuation between a willing buyer and a willing seller in an arm's length transaction wherein the parties had each acted knowledgeably, prudently and without compulsion.

"*Maintenance and repairs*" maintain the predetermined service potential of a tangible capital asset for a given useful life. Such expenditures are charged in the accounting period in which they are made.

"*Net book value*" of a tangible capital asset is its cost, less both accumulated amortization and the amount of any write-down.

"*Residual value*" is the estimated net realizable value of a tangible capital asset at the end of its useful life to a government.

"*Tangible Capital Asset*" means a non-financial asset having physical substance that:

a. are held for use in the production or supply of goods or services, for rental to others, for administration purposes or for the development, construction, maintenance of other tangible capital assets;
b. have useful economic life extending beyond an accounting period;
c. are to be used on a continuing basis; and
d. are not for sale in the ordinary course of operations.

"Threshold" is the value above which assets are capitalized and reported in the financial statements.

"*Service Potential*" is the output or service capacity of a tangible capital asset, and is normally determined by reference to attributes such as physical output capacity, quality of output, associated operating costs, and useful life.

"*Straight-line amortization*" allocates the cost less estimated residual value of a capital asset equally over each year of its estimated useful life.

"*Useful life*" is the estimate of either the period over which a tangible capital asset is expected to be used by a government, or the number of production or similar units that can be obtained from the tangible capital asset by a government. The life of a tangible capital asset may extend beyond the useful life of a tangible capital asset to a government. The life of a tangible capital asset, other than land, is finite, and is normally the shortest of the physical, technological, commercial and legal life.

"*Work in progress*" is an accumulation of capital costs for partially constructed or developed projects.

"*Works of art and historical treasures*" are property that has cultural, aesthetic, or historical value that is worth preserving perpetually. These assets are not capitalized as their service potential and expected future benefits are difficult to quantify.

"*Write-down*" is a reduction in the cost of a tangible capital asset to reflect the decline in the asset's value due to a permanent impairment.

"*Write-off*" is a removal in the cost of a tangible capital asset to reflect the decline in the asset's value due to a permanent impairment.

Reference: KDSB Policy No. FNS-II-03

Program Director	November 24, 2009 Date
Chief Administrative Officer	November 24, 2009 Date