



PROCEDURE

PROCEDURE NO: 351•1

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TITLE: Managing Tangible Capital Assets

APPROVAL DATE: May 28, 2012

POLICY: Tangible Capital Assets
Policy 351

REVISION DATE:

SECTION: Finance

RESPONSIBLE

DEPARTMENT: Finance

Valuation of Capital Assets

Tangible capital assets should be recorded at cost plus all ancillary charges necessary to place the asset in its intended location and condition for use. The cost is the gross amount paid to acquire, construct, develop or better a tangible capital asset and includes direct construction or development costs (such as materials and labour) and overhead costs directly attributable to the acquisition, construction or development of the asset. These costs may include but are not limited to:

- Amounts paid to vendors;
- Duties/delivery/freight charges to the point of initial use;
- Handling and storage charges;
- Extended maintenance/warranty contracts if the contract is purchased at the same time as the capital asset. Expense if not purchased at the same time;
- Direct design/production costs such as labour, equipment rentals, materials and supplies;
- Engineering, architectural and other outside services for designs, plans, specifications and surveys;
- Acquisition and preparation costs of buildings and other facilities;
- Fixed equipment and related installation costs required for activities in a building or facility;
- Direct costs of inspection, supervision and administration of construction contracts and work;
- Legal and recording fees and damage claims;
- Fair values of land, facilities and equipment donated;
- Appraisal costs, advertising costs, application fees and supervisory fees;
- Utility costs and site preparation costs.

Procedure 351•2 provides further guidance on asset classification and types of costs to capitalize.

Acquired, Constructed or Developed Assets

Cost includes all costs directly attributable (e.g. construction, architectural and other professional fees) to the acquisition, construction or development of the asset. Carrying costs such as internal design, inspection, administrative and technical work and other similar costs prior to the commencement of and during construction may be capitalized. Capitalization of general administrative overheads is not allowed. Costs of a general nature such as expenditures for feasibility studies, post implementation reviews, training, training materials, etc. are never capitalized.

When two or more assets are acquired for a single purchase price, it is necessary to allocate the purchase price to the various assets acquired. Allocation should be based on the fair value of each asset at the time of acquisition or some other reasonable basis if fair value is not readily determinable.

Capitalization of carrying costs ceases when no construction or development is taking place or when the tangible capital asset is ready for use. If the construction or development of a capital asset is not completed to a useable state, the costs that would otherwise be capitalized should be expensed.

The City of Grande Prairie will not capitalize interest costs on tangible capital assets.

Donated or Contributed Assets

A tangible capital asset may be gifted or contributed by an external third party with no cash outlay. For example, land may be contributed by another level of government at zero or nominal consideration to facilitate the construction of a roadway or structure. Another example is a developer may install services such as storm systems mains or roads within a subdivision at its own cost and then turn them over to the municipality to operate, maintain and replace. Where an asset is acquired through a third party contribution, the amount to record the asset is at the cost provided by the contributor. If the cost cannot be provided, a fair value may be estimated using either market or appraised values or cost may be determined by an estimate of replacement cost. When an estimate of fair value cannot be reasonably estimated, the asset will be recognized at a nominal value. Donated or contributed assets are capitalized over their useful lives.

When funds are received from a third party, such as the provincial government, to assist with the construction or purchase of a capital asset, the full cost of the asset should be recorded. Capital grants are not netted against the cost of the related tangible capital asset. The funds received are to be recognized as revenue and recorded under separate cover.

Work/Construction in Progress

Work in progress is the construction or development of a capital asset that extends over several years. Work in progress is not capitalized or amortized until the asset is in use. The capital costs for such an asset should be accumulated until the asset is ready for use. A work in progress account should be established to allow capital costs to be tracked separately for easy identification in reporting. Amortization is calculated and begins the first fiscal year that the asset is in use.

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

Amortization

Unless otherwise stated, the acquisition cost (historical cost) will be amortized over its estimated useful life, on a straight-line basis. Amortization normally begins when an asset is purchased or completed, and accepted. A full year's amortization is recorded in the year the asset is acquired, constructed or developed and put into use, regardless of when this event occurs in the fiscal year. No amortization is recorded in the year an asset is disposed of.

The estimated useful life is the period over which a capital asset is expected to provide services. All capital asset classifications have predetermined estimated useful lives as outlined in **Procedure 351•3**. The economic or physical life of an asset may be extended beyond the useful life of an asset.

The estimate of the remaining unamortized portion of a tangible capital asset should be reviewed on a regular basis and revised when a change is clearly appropriate. Factors such as obsolescence, excessive wear and tear or other events may require a need to revise the amortization estimate of the remaining useful life of a tangible capital asset.

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

Componentization

Tangible capital assets may be accounted for using either the single asset or component approach. Whether the component approach is to be used will be determined by the usefulness of the information versus the cost of collecting and maintaining information at the component level.

Factors to consider when determining whether to use a component approach include:

- Major components have significantly different useful lives and consumption patterns than the related tangible capital asset;
- Value of components in relation to the related tangible capital asset.

Civil infrastructure systems should use the component approach. Major components should be grouped when the assets have similar characteristics and estimated useful lives or consumption rates.

Betterments

Betterment is a material cost incurred to enhance the service potential (useful life or capacity) of a tangible capital asset. A betterment typically includes:

- Increase the previously assessed physical output or service capacity;
- Significantly lower associated operating costs (efficiency);
- Extend the useful life of the asset; or
- Improve the quality of the output.

Betterments which meet the threshold of the applicable capital asset classification are capitalized. Otherwise, they are expensed. Where a cost cannot easily be differentiated between a repair and a betterment, the cost should be expensed in respecting the accounting principle of conservatism. Betterments, which extend the useful life or improve the efficiency of the asset, must be added to the historical cost and amortized.

Where a betterment enhances the service potential of a capital asset without increasing its estimated useful life, the amortization period should remain the same. If however, the betterment increases the estimated useful life of a capital asset, its useful life should be changed. The revised amortization period should not exceed the estimated useful life of the applicable capital asset classification as outlined in **Procedure 351•2**.

Maintenance and expenditures for repairs that do not prolong an asset's economic life or improve its efficiency are not betterments. These expenditures are usually incurred on a more or less continuous basis to keep the condition of an asset at its expected operating standard. These costs are charged to the accounting period in which they are incurred. They would include such things as:

- Repairs to restore assets damaged by fire, flood or similar events, to the condition just prior to the event;
- Routine maintenance and expenditures necessary to realize the benefits originally projected.

Write-downs

When conditions indicate that a tangible capital asset no longer contributes to a government's ability to provide goods and services, or that the value of future economic benefits associated with the tangible capital asset is less than its net book value, the cost of the tangible capital asset should be reduced to reflect the decline in the asset's value. The net write-downs of tangible capital assets should be accounted for as expenses in the statement of operations.

A write-down should not be reversed. Write-downs of capital assets should be accounted for as an expense of the current period. A government would write down the cost of a tangible capital asset when it can demonstrate that the reduction in future economic benefits is expected to be permanent. Conditions that may indicate that the future economic benefits associated with a tangible capital asset have been reduced and a write-down is appropriate include:

- A change to the extent or manner in which the tangible capital asset is used;
- Removal of the tangible capital asset from service for an extended period of time;
- Physical damage;
- Significant technological developments;

- Removal of the tangible capital asset from service;
- A decline in, or cessation of, the need for the services provided by the tangible capital asset;
- A decision to halt construction of the tangible capital asset before it is complete or in usable or saleable condition; and
- A change in the law or environment affecting the extent to which the tangible capital asset can be used.

Disposals

When tangible capital assets are taken out of service as a result of being sold, destroyed or replaced due to obsolescence, scrapping or dismantling, the department head or designate must notify the Finance department of the asset description and effective date. The Finance department is responsible for adjusting the asset registers and accounting records recording a loss/gain on disposal. No amortization should be recorded in the year the capital asset is removed from service.

On disposal of a tangible capital asset, the historical cost and accumulated amortization must be removed from the books. The difference between the net proceeds on disposal and the net book value must be recorded as a gain or a loss for the accounting period.

A **Trade-in** occurs when an asset is disposed of and replaced with a new asset through the same supplier in the same transaction. This transaction should be accounted for as two separate entries. The trade-in value should be treated as proceeds of disposal and is used in calculating the gain or loss on the disposal of the assets being traded in. The new asset acquired is recorded at its full cost; it is not reduced by the trade-in value of the old asset.

Capital Leases

A capital lease is accounted for as though the asset had actually been purchased. From the view-point of the lessee, a lease would normally transfer substantially all the benefits and risks of ownership from the lessor to the lessee when, at the inception of the lease, one or more of the following conditions are present:

- There is reasonable assurance that the lessee will obtain ownership of the leased property by the end of the lease term or when the lease provides for bargain purchase option. A bargain purchase option is a provision allowing the lessee an option to purchase the leased property for a price that is sufficiently lower than the expected fair value of the property at the date the option becomes exercisable that, at the inception of the lease, exercise of the option appears to be reasonably assured;
- The lease term is of such duration that the lease will receive substantially all the economic benefits expected to be derived from the use of the leased property over its life span. This condition is considered to be met if the lease is for a term equal to or greater than 75% of the economic life of the leased property;

- The lessor would be assured of recovering the investment in the leased property and of earning a return on the investment as a result of the lease agreement. This condition would exist if the present value at the beginning of the lease term, of the minimum lease payments, excluding any portion relating to executory costs, is equal to 90% or more of the fair value of the leased property. In calculating the present value of the stream of lease payments, at the inception of the lease, the discount rate used by the lessee would be the lower of the lessee's rate for incremental borrowing for a term equal to the initial lease term and the interest rate implicit in the lease, if known.

Even if the lease does not meet any of the three (3) tests, if it transfers substantially all of the benefits and risks of ownership to the lessee, the transaction should be accounted for as an acquisition of an asset and an incurrence of an obligation by the lessee.

At the inception of a capital lease, an asset and a liability must be recorded at the lesser of:

- The present value of the minimum lease payment; and
- The property's fair value at the beginning of the lease.

The capitalized value of an asset under a capital lease must be amortized consistent with the following:

- If the lease has a bargain buy out option or allows ownership to pass to the lessee, the asset must be amortized on a straight-line basis over the useful life of the associated asset class;
- In all other circumstances the asset should be amortized on a straight-line basis over the lesser of the lease term and the useful life of the associated asset class.

Assets leased under a capital lease must be disclosed separately to distinguish between assets the government owns and those that it only has the right to use.

All other leases are to be accounted for as operating leases, where rental payments are expensed as incurred.