M.D. of Opportunity No 17
FINANCE POLICY

TITLE: **Tangible Capital Assets Policy**

EFFECTIVE DATE: **MAY 11, 2011**

POLICY NUMBER: **F.3**

Purpose of Policy:

This policy is intended to set out the action to be taken by the municipality in dealing with tangible capital assets.

I.1 General

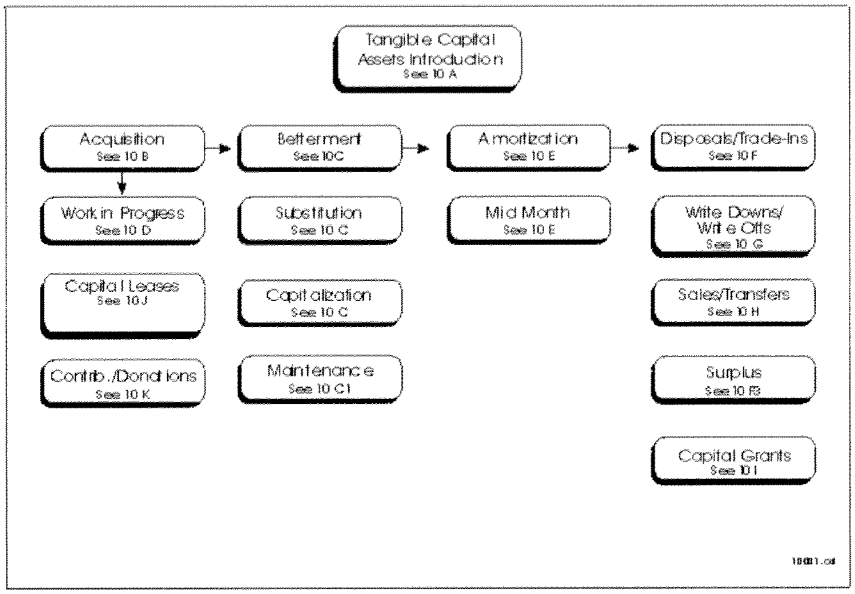
The objectives of capitalizing tangible capital assets are:

- to maintain appropriate accountability for MD's tangible capital assets;
- to ensure accounting consistency across the public sector, regardless of the legal form of the entity concerned;
- to measure and report the full cost of MD operations; and
- to ensure efficient and effective use of assets.

See Appendix A for detail on the reported asset classes and the proposed timetable for the addition of future classes.

Tangible capital assets *do not* include such things as:

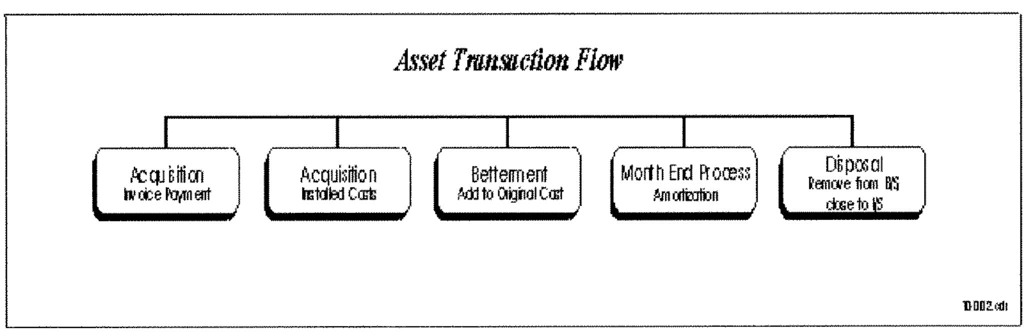
- inventories held for resale (including land);
- assets acquired by Right, such as forests, water and mineral resources;
- heritage assets;
- capital grants
- intangible assets, except for software which is a tangible asset for purposes of capitalization;
- feasibility studies, business cases, management reviews (e.g., post implementation); and
- assets below threshold (except heavy equipment assets below $10,000 threshold;



Policy

Tangible capital assets are reported in the MD's financial statements when:

- a reasonable estimate can be made of the cost involved; and
- future economic benefits associated with the asset are likely to be received.



Tangible capital assets are reported on the Statement of Tangible Capital Assets in the following major categories:

- opening balances;
- additions;
- disposals;
- the amount of any write-downs in the period;
- the annual amortization;
- accumulated amortization;
- net book value; and
- comparatives for the prior year end.

The cost of a tangible capital asset must be capitalized at the time of acquisition or construction and amortized over its useful life.

Tangible capital asset cost and amortization information should be generated and maintained at the major program, responsibility centre and activity levels.

Tangible capital assets must be reported on a historical cost basis.

Land must always be separately identified, recorded and reported.

Work-in-progress and related carrying costs must be capitalized.

Works of art and historical treasures are not recognized as tangible capital assets, as a reasonable estimate of the future benefits cannot be made. Nevertheless, their existence and nature must be disclosed.

I.2 Acquisition of New Assets

The cost of a tangible capital asset includes direct construction or development costs (such as materials and labor) and overhead costs directly attributed to the acquisition, construction or development of the asset. These costs may include, but are not limited to:

- amounts paid to vendors;
- transportation/freight charges to the point of initial use;
- handling and storage charges;
- direct production costs (for assets produced or constructed), such as labor (non-MD employee costs), materials, supplies, etc.;
- engineering, architectural and other outside services for designs, plans, specifications and surveys;
- acquisition and preparation costs of buildings and other facilities;
- an appropriate share of the costs of the equipment and facilities used in construction work and tenant improvement costs;

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- 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 construction work;
- legal and recording fees and damage claims;
- fair values of land, facilities and equipment donated to the municipality;
- appraisal costs;
- advertising costs;
- application fees;
- management fees;
- utility costs;
- site preparation costs;
- transportation insurance costs;
- customs and duty charges;
- interest charges during acquisition, construction or development (up to substantial completion of 97%).

Working papers are to be prepared to verify that the MD's financial statements fairly present the tangible capital assets owned by the municipality. Municipal records must be reconciled to the control accounts balances, errors and omissions corrected and all capital asset working papers must possess auditable backup documentation.

Effective January 1, 2009 the municipality will capitalize employee salary and employee travel for large projects when these are capitalized under Generally Accepted Accounting Principles (GAAP) and the municipality's thresholds.

For roadway construction/rehabilitation projects (asset threshold $50,000+), salaries and benefits during construction may be capitalized.

Calculation Principles:

- For employees who work 100% of their time on such projects, 100% of their salaries and benefits will be charged to the capital project.
- For employees who work a portion of their time on such projects, the calculation for salaries and benefits would be # of project hours x rate per hour x 1.4 (includes impact of statutory holidays and vacation time to reflect the all-in-cost of salaries to be capitalized. Time sheets or a similar tracking method must support these salary costs. The amount charged to a capital project for salaries and benefits cannot exceed 100% of the salary and benefit for an employee.

The costs of risk and controls reviews are not capitalized; however, there is one exception. If the risk and controls review forms an integral part of a contract external to MD for the development of major systems software and this review relates to the implementation phase, it may be included in the capitalization of the system.

Costs of a general nature such as expenditures for feasibility studies, post implementation reviews, training, training materials, etc. are never capitalized. If in doubt whether a cost should be capitalized, please contact the municipality corporate services manager.

In the purchase of a combination of assets, the cost of each is determined by allocating the total price on the basis of its relative fair value at the time of acquisition to each one.

Where assets consist of a number of components, each component should be accounted for as a separate asset, where the cost/benefit supports detailed breakdown reporting of information.

Where the purchase of land is one part of a packaged deal or a series of transactions, the substance of all elements of the agreements must be analyzed to determine whether or not they impact the capitalized value of the land. Such packaged deals/serial transactions should clearly identify which costs relate to land acquisition and which costs relate to other MD objectives such as regional development or industrial incentive.

When an acquired tangible capital asset includes a portion that will not be used, the asset cost shall include all components and disposal costs. For example, the cost of acquired land that includes a building that is to be demolished includes the cost of the land and building, and the cost of demolishing the building.

If the historical cost and accumulated amortization of fully amortized assets are not available, the assets are to be recorded at their residual value, when it is material and estimable, or at nominal value.

The acquisition date is the earliest of:

- the date the asset is received by the municipality; or
- the date legal ownership of the asset passes from the seller to the purchaser.

Items not meeting the capitalization threshold shall be expensed in the appropriate function.

Recording Assets Purchased in a Prior Year

Assets that should have been booked but were overlooked in a prior year should be recorded as a current year acquisition. It is not anticipated that any adjustment to equity will be permitted.

I.3 Betterments

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

- increase the previously assessed physical output or service capacity;
- significantly lower associated operating costs (efficiency);
- extend the life of the property; or
- improve the quality of the output.

Maintenance and expenditures for repairs that do not prolong an asset's economic life or improve its efficiency are not betterments. 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;

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- expenditures necessary to realize the benefits originally projected.

Betterments, which extend the useful life or improve the efficiency of the asset, must be added to the historical cost and amortized.

The amortization rate applied to the betterment should reflect the increase in the useful life of the asset. However, the amortization period of the betterment cannot exceed that of the asset class to which it relates.

I.4 Work-In-Progress

Work-In-Progress (or "Construction in Progress") represents the costs incurred to date on a project, which is not substantially complete (<97% complete) or for systems, the earlier of 97% complete or when the system is not in production at the end of the fiscal year. Examples include engineering structures or custom developed computer/software systems that are not ready for use.

Work-In-Progress for assets under development or construction (as described above) must be recorded on the Balance Sheet for the accounting period. All costs including carrying charges associated with holding assets (land) that are currently in the construction phase are to be capitalized.

If an incomplete project is terminated or put on hold indefinitely, any costs currently recorded as Work-In-Progress must be written off.

Where a project has distinct, multiple, completely self-contained phases that will be brought into production or use at different points of time, the municipality should use professional judgment and consult with the senior administration to determine the appropriate timing for transfers from Work-In-Progress to Assets.

Work-In-Progress is not amortized. Work-In-Progress balances must be reconciled and the appropriate transfers made to completed assets or written off to insure that only active, but incomplete Work-In-Progress is carried forward to the next period. This reconciliation should be done quarterly.

I.5 Amortization

Unless otherwise stated, the acquisition cost (historical cost) less the residual value of capital assets must be amortized over estimated useful life, on a straight-line basis. The amortization period for a tangible capital asset shall be limited to 75 years unless it can be clearly demonstrated that the useful life of the asset is expected to exceed 75 years.

Land normally has an unlimited life and is not amortized.

Useful Life and Thresholds

See Appendix A

Recording Amortization

Annual Rule

For all tangible capital assets (including large server systems, heavy equipment, buildings, roadways, bridges, etc.) that are acquired or constructed with a completion date of the last day of the year, amortization will not be taken for the current year. If assets are acquired or construction completed on December 31 of the year, amortization will not start until the following year.

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Amortization Review and Revision

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.

Significant events, which may indicate a need to revise the amortization estimate of the remaining useful life of a tangible capital asset, include:

- a material change to the extent to which the tangible capital asset is used;
- a material change in the 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;
- a material change in the demand for the services provided through use of the tangible capital asset; or
- a material change in the law or environment affecting the period of time over which the tangible capital asset can be used.

I.6 Disposals

In the case of legacy pooled assets acquired prior to January 1, 2008, (such as personal computers, office furniture and equipment and operating equipment), when a pool of assets acquired in a given fiscal year has been fully amortized that pool must be written out of the books. This is referred to as "deemed disposition" and applies only to legacy pooled assets. The deemed disposition takes place the year following the final year in which amortization is posted for the asset pool.

No tangible capital asset may be disposed of without the authorization of the designated officer or Manager..

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 in the Statement of Operations as a gain or a loss for the accounting period.

Gains and losses on the disposal of capital assets are included as part of the funding and are recorded in the appropriate gain or loss expenditure of the function. Proceeds from the sale of the asset should be debited to cash and credited to the expenditure "gain or loss proceeds of disposal of capital asset".

If the disposal and sale transaction occur in the same fiscal year, the difference between the net book value and the proceeds will be recognized as a gain/loss on disposal of capital assets. If the two events occur in different fiscal years, the municipality will experience a loss on disposal in one year and a gain on disposal in a subsequent year.

Disposal Costs

Loss anticipated on disposal:

If there is an estimated loss on disposal of a MD asset, the loss would be recognized as an expense, at the date on which management adopts a formal plan of disposal. Disposition costs are all expensed.

Gain anticipated on disposal:

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If there is an estimated gain on disposal of a MD asset, the disposition costs may be treated in several ways.

For the disposition of a MD asset which will occur within a fiscal period, whether or not a formal plan of disposition has been adopted, disposition costs are all expensed.

Deferral of disposal costs when gain anticipated:

For the disposition of a MD business segment or asset that will occur over several fiscal periods and before the date of adoption of a formal plan of disposition, disposition costs are all expensed until a formal plan of disposition is adopted.

- The disposal takes place over a long period of time (minimum one year): e.g., it is anticipated that it will take at least a year from the formal adoption of a plan of disposition to the actual disposal of the asset or business segment; and

- The disposal costs are material; and

- The disposal is expected to generate a net revenue after taking into consideration the costs of disposal; and

- A formal plan of disposition has been adopted.

Costs incurred after the adoption of a formal plan of disposition and prior to receipt of the proceeds of disposition would be eligible for deferral. Any deferred costs would be deducted from gross proceeds in calculating the net gain on disposal. Once a decision has been made to defer project costs, the decision applies to all costs associated with the project. It is not permissible to defer the costs in one fiscal year and expense them in another fiscal year unless there has been an abandonment of the disposal plan or there has been a revision of the expected gain on disposal such that the anticipated gain is insufficient to cover the full costs of disposal.

Any gain arising from net proceeds on disposition should be recognized only when realized.

Incremental salaries and benefits directly related to the disposition of an asset may be deferred until the sale proceeds are received where they meet CICA Handbook Guidelines 3060.56 or 3475.09, and the municipality's materiality thresholds. The historical cost or market value of the asset is in excess of $1 million and the salary costs associated with the disposal are equal to or greater than $25,000. These salary costs must be supported by an audit trail (e.g., time sheets or a similar tracking method) for those employees not dedicated 100% to the project.

Calculation Principles:

The calculation for salaries and benefits for staff that allocate a portion of their time to a project would be # of project hours x rate per hour x 1.4 (includes impact of statutory holidays and vacation time to reflect the all-in-cost of salaries to be capitalized). The total amount of salary and benefits deferred cannot exceed 100% of the salary and benefit for an employee.

Trade-ins occur when an asset is disposed of and replaced with a new asset through the same supplier in the same. 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.

Insurance Proceeds □ Asset Loss

Proceeds from insurance claims are to be recorded as proceeds of disposal and form part of the gain/loss on disposal of the original asset. The proceeds cannot be used to purchase a new asset.

I.7 Asset Write-downs & Write-offs

A **write-down** is used to reflect a *partial* impairment in the value of an asset. A **write-off** is used to reflect 100 percent impairment in the value of an asset.

Capital assets are written-off in instances where they are destroyed, stolen, lost or obsolete. The write-off of a tangible capital asset requires approval by the Manager

Any abandoned or indefinitely postponed projects must be written-down to their net realizable value and charged to the period in which the abandonment or indefinite postponement occurs.

When the reduction in the value of the asset can be objectively estimated and it is expected to be permanent, the tangible capital asset must be written down.

An asset write-down can not be reversed.

An asset is never written up except on initial capitalization or as the result of a betterment.

Conditions, which may indicate a write-down is necessary, include:

- a change in the manner or extent to which the tangible capital asset is used;
- removal of the tangible capital asset from service;
- physical damage;
- significant technological developments;
- a decline in, or cessation of, the need for the service provided by the asset;
- a decision to halt construction of the asset before it is complete or in usable or saleable condition; or
- a change in the law or environment affecting the extent to which the asset can be used.

I.8 Sales and Transfers of Tangible Capital Assets

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Land transfers related to aboriginal land claims are recorded at net book value.

Sales or transfers between the Crown or external bodies should be recorded at the exchange price (usually market value).

Exchanges of assets between the Crown and external entities: If the market value of the assets exchanged is materially the same, only a memo notation is required. If the consideration given up is greater than the value acquired, the difference is recorded as an expense. If the value received is greater than the value given up, the difference is recorded as revenue, gain on disposition of assets.

Sales/Transfers Between the MD and the Crown

In order to record these transfers at fair market there must be:

- an independent appraisal of the value of the assets to be transferred;
- a genuine business reason for the transfer; and

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- an intended, productive use for the asset (i.e., not just holding for resale).

If any of these conditions are not met, the transfer will be recorded at net book value.

If the asset is transferred at fair market value, the historical cost and accumulated amortization (and other asset details) is to be removed from the tangible capital asset records of the entity along with the recording of a loss or gain on disposal.

When the net book value of the asset is higher than the fair market value of the asset, the asset should be written down. If the fair market value exceeds the book value of the asset, a gain on disposal results.

If the gain on disposal of land or an asset is immaterial the amount is recorded as a gain or loss on disposal provided that the land or asset has been capitalized and if the land or asset was not capitalized or is material.

Sales/Transfers to External Third Parties

Where assets are transferred from an organization to an external party, the assets are removed from the tangible capital asset records of that organization. In addition, the gain or loss on disposal is recorded immediately. Gains and losses on disposal are recorded as expenditures. Proceeds of disposal are to be credited to the function for recoveries to gain or loss on disposal.

These transfers are to be made at market value. The difference between the market value and the book value of a transferred asset will be recorded as an expense of the transferring municipality.

Transfers resulting from aboriginal land claims are excluded from this accounting policy.

Exchange of Similar Assets with External Parties

Where similar assets with similar fair market values are exchanged, the details of the old asset must be removed from the tangible asset records and the details of the new asset added. There would be no change in net book value of reported assets (i.e., there is no write-up to fair market value for the old asset or the new asset).

If the fair market value of the asset given up exceeds the fair market value of the similar asset acquired, the difference is recorded as an expense. There would be no change in net book value of reported assets unless the fair market value of the asset received is less than the book value of the asset given up.

If the fair market value of the asset given up is less than the fair market value of the similar asset acquired, the difference is treated as revenue. The net book value of the reported assets would also have to be written up by that same difference.

If the assets are not similar, the transaction is recorded separately as a sale and purchase.

I.9 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 lessee 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 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 payments, 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 (municipality), 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 that the MD 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.

Procedures

To record the capital lease expenditure and its related liability, the present value of the minimum lease payments must be calculated at the beginning of the lease term. The discount rate to use for the present value calculation would be the lower of the MD's borrowing rate and the interest rate implicit in the lease (if known).

For subsequent lease payments (principal and interest), the principal portion is to be charged against the liability. The interest portion of these payments will be expensed to interest expense in the function or department. *The interest is calculated on the outstanding balance of the lease liability for the period since the last payment at the same interest rate as used in the original present value calculation.*

The capitalized value of an amortizable asset under a capital lease is amortized on a basis that is consistent with the amortization policy for similar capital assets.

I.10 Contributions and Donations

Contributions received from outside the municipal budget for the acquisition of an asset fall into two categories:

- External coming from an entity outside the municipality

- Assets that are donated or contributed to the municipality, which meet the requirements for capitalization and the asset class thresholds are treated in the same manner as cash contributions and donations.

External Contributions Under $10,000

External contributions less than $10,000 are to be netted against the acquisition cost of the asset. The net amount of the asset is the amount set up as the historical cost for the asset and the municipality will be responsible for accommodating the related amortization expense.

As long as the gross acquisition cost of the asset exceeds the required threshold for the asset, the difference between the purchase price and the contribution towards the asset will be set up and amortized. However, contributions for land should be recognized as revenue in the year it is received (not deferred revenue as there is no amortization related to land).

External Contributions $10,000 and Greater

If the asset or contribution singly or in combination exceeds $10,000, then the asset is to be capitalized at gross acquisition cost and the contribution is to be deferred and amortized on the same basis as the amortization of the related capital asset. The amortization of the deferred revenue and the amortization expense offset each other. Contributions should not be split up into smaller amounts for the sole purpose of avoiding the requirement to defer and amortize.

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