The Town of Fort Frances	**SECTION** ADMINISTRATION AND FINANCE
ACCOUNTING FOR TANGIBLE CAPITAL ASSETS **POLICY**	**NEW:** May 2009 **REVISED:**
Resolution Number: 05/09 Consent 156	Supercedes Resolution No.
Policy Number: 1.18	**PAGE 1 of 11**

1. PURPOSE:

The objective of this policy is to prescribe the accounting treatment for tangible capital assets so that users of the financial report can discern information about the investment in property, plant and equipment and the changes in such investment. The principal issues in accounting for tangible capital assets are the recognition of the assets, the determination of their carrying amounts and amortization charges and the recognition of any related impairment losses.

In addition the policy covers policy and procedures to:

a) Protect and control the use of all tangible capital assets.
b) Provide accountability over tangible capital assets
c) Gather and maintain information needed to prepare financial statements.

2. SCOPE:

This policy applies to all Town departments, boards and commissions, agencies and other organizations falling within the reporting entity of the Town.

3. DEFINITIONS:

Tangible Capital Assets:

Assets having physical substance that;

a) Are used on a continuing basis in the Town's operations.
b) Have useful lives extending beyond one year.
c) Are not held for re-sale in the ordinary course of operations.

Betterments:

Subsequent expenditures on tangible capital assets that:

- increase previously assessed physical output or service capacity;
- lower associated operating costs;
- extend the useful life of the asset; or
- improve the quality of the output.

Any other expenditure would be considered a repair or maintenance and expensed in the period.

Grouped (Pooled) Assets:

Assets that have a unit value below the capitalization threshold but have a material value as a group. These assets are normally recorded as a single asset with one combined value. Although recorded in the financial systems as a single asset, each unit may be recorded in the asset sub-ledger for monitoring and control of its use and maintenance. Examples could include personal computers, furniture and fixtures, small moveable equipment, etc.

Fair Value:

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

Capital Lease:

A capital lease is a lease with contractual terms that transfer substantially all the benefits and risks inherent in ownership of property to the Town. For substantially all of the benefits and risks of ownership to be transferred to the lessee, one or more of the following conditions must be met;

a) There is a reasonable assurance that the Town will obtain ownership of the leased property by the end of the lease term.
b) The lease term is of such a duration that the Town will receive substantially all of the economic benefits expected to be derived from the use of the leased property over its life span.
c) The lessor would be assured of recovering the amount invested in the leased property and of earning a return on the investment as a result of the lease agreement.

See the above noted definitions and further definitions of commonly used terms in Appendix A.

4. POLICY STATEMENTS:

Capitalization

Tangible capital assets should be capitalized (recorded in the fixed asset sub-ledger) according to the following thresholds:

a) all land;
b) land improvements with a unit cost of greater than $5,000;
c) buildings and building improvements with a unit cost of greater than $5,000;
d) leasehold improvements with a unit cost of greater than $5,000;
e) civil infrastructure systems (built assets such as roads, bridges, sewers, water, transit, etc.) with a unit cost of $5,000 or greater;
f) motor vehicles with a unit cost of greater than $5,000;
g) all others with a unit cost of $5,000 or greater.

Different thresholds may be used for group assets. Capitalize betterments to existing assets when unit costs exceed the threshold.

Please see Appendix B – Capitalization Decision Tree to further illustrate the capitalization thought process.

Categories

A category of assets is a grouping of assets of a similar nature or function in the Town's operations. The following list of categories shall be used:

- land;
- buildings;
- equipment;
- roads;
- water;
- sewer;
- bridges;
- communication networks;
- motor vehicles;
- furniture and fixtures;
- computer systems (hardware and software).

Valuation

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.

1.1 Purchased assets

Cost is the gross amount of consideration paid to acquire the asset. It includes all non-refundable taxes and duties (e.g. ***net of the GST rebate***), freight and delivery charges, installation and site preparation costs, etc. It is net of any trade discounts or rebates.

Cost of land includes purchase price plus legal fees, land registration fees, transfer taxes, etc. Costs would include any costs to make the land suitable for intended use, such as pollution mitigation, demolition and site improvements that become part of the land.

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 (e.g. a land and building purchase). 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.

1.2 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 other similar costs may be capitalized. Capitalization of indirect general administrative overheads is not allowed.

Capitalization of carrying costs ceases when no construction or development is taking place or when the tangible capital asset is ready for use.

1.3 Capitalization of Interest Costs

Borrowing costs incurred by the acquisition, construction and production of an asset that takes a substantial period of time to get ready for its intended use should be capitalized as part of the cost of that asset.

Capitalization of interest costs should commence when expenditures are being incurred, borrowing costs are being incurred and activities that are necessary to prepare the asset for its intended use are in progress. Capitalization should be suspended during the periods in which active development is interrupted. Capitalization should cease when substantially all of the activities necessary to prepare the asset for its intended use are complete. If only minor modifications are outstanding, this indicates that substantially all of the activities are complete.

1.4 Donation or Contributed Assets

The cost of donated, contributed, or assets purchased for a nominal value that meet the criteria for recognition is equal to the fair value at the date of construction or contribution. Fair value may be determined using market or appraisal values. Cost may be determined by an estimate of replacement cost. Ancillary costs should be capitalized.

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:

a) Major components have significantly different useful lives and consumption patterns than the related tangible capital asset.
b) Value of the 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.

Amortization

The cost, less any residual value, of a tangible capital asset with a limited life should be amortized over its useful life in a rational and systematic manner appropriate to its nature and use. The amortization method and estimate of useful life of the remaining unamortized portion should be reviewed on a regular basis and revised when the appropriateness of a change can be clearly demonstrated.

Useful life is normally the shortest of the asset's physical, technological, commercial or legal life. Town departments, boards and commissions, agencies and other organizations are responsible for establishing and utilizing an appropriate estimated useful life for assets acquired.

Amortization will be recorded on an annual basis and calculated using the straight-line amortization method. The straight-line method is calculated by dividing the asset's original cost, less estimated residual value (if any), by its estimated life in years. This generates a constant annual amortization amount each year. For example, where a piece of equipment has estimated useful life of 10 years and the cost of the equipment is $30,000, the annual amortization would be calculated as $30,000/10 years or $3,000. The amortization charges related to the asset should be reviewed for reasonableness at year-end. Town departments, boards and commissions, agencies and other organizations are responsible for establishing and utilizing an appropriate amortization methodology and rate for assets acquired.

The Town of Fort Frances will be applying the half-year rule to calculate amortization. The half-year rule states that an asset is amortized for only half of the year in which the asset is purchased/put into service. Utilizing the above example, amortization in the acquisition year would be $3,000 x ½ year or $1,500.

Disposal

Disposal of tangible capital assets is the responsibility of the division manager. Department heads should notify the manager when assets become surplus to operations.

In disposal of real property, the Town should follow policy number 1.7.

When other constructed tangible capital assets are taken out of service, destroyed or replaced due to obsolescence, scrapping or dismantling, the department head or designate must notify finance of the asset description and effective date of disposition. The finance department is responsible for adjusting the asset registers and accounting records recording a loss/gain on disposal.

Capital Leases

Account for a capital lease as acquiring a capital asset and incurring a liability. Account for a lease as an operating expense when the net present value of the future minimum lease payments or fair value, which ever is less, is less than $5,000.

Appendix A – Definitions of Commonly Used Terms

Amortization – is the accounting process of allocating the costs less the residual value of a tangible capital asset to operating periods as an expense over the useful life in a rational and systematic manner appropriate to its nature and use. Amortization expense is an important part of the cost associated with providing local government service, regardless of how the acquisition of TCA is funded. Depreciation accounting is another commonly used term to describe the amortization of TCA.

Asset Category - a category of assets is a grouping of assets of a similar nature or function in the Town's operations.

Betterment – is a cost incurred to enhance the service potential of an asset and will:

- Increase the previously assessed physical output of service capacity
- Significantly lower associated operating costs
- Extend the life of the property or
- Improve the quality of the output

Expenditures have to meet one of the above criteria in order to be considered betterments. Otherwise the expenditure is accounted for as a current year expense of maintaining an asset (see Repairs and Maintenance).

Capital Budget – is an estimate of expenditures for a capital project.

Capital Financing – is an allocation from the current budget to finance capital programs that consists of debt charge payments and capital levy contributions.

Capital Project – is an activity during which expenditures are incurred that result in the creation of a capital asset.

Capital Reserve – is an allocation of funds established as a result of legislation, council bylaw or contractual obligations for the funding of potential future capital projects.

Carrying Costs – are costs directly attributable to an asset's acquisition, construction or development activity where, due to the nature of the asset, it takes a long period of time to get it ready for its intended use. Typically carrying costs could include:

- Technical and administrative work prior to commencement and during construction;
- Overhead charges directly attributable to construction or development

Component – is a part of an asset with a cost that is significant in relation to the total cost of the 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.

Contributed/Donated Assets – is a tangible capital asset that is gifted or contributed by an external party at a zero or nominal value. Where a tangible capital asset is acquired at no cost, or for a nominal cost, the amount recognized should be equal to its fair value as at the date when the asset is put into service (ready for use).

Cost – is the amount of consideration given up to acquire, construct, develop or better a capital asset and includes all expenditures, including non-refundable taxes and duties, directly attributable to its acquisition, construction, development or betterment, including installing the asset at the location and in the condition necessary for its intended use. The cost of a contributed/donated asset is considered to be equal to its fair market value at the date of contribution.

Depreciation Accounting – is the accounting procedure in which the costs or other recorded value of a fixed asset less any estimated value on disposal is distributed over its useful life in a systematic and rational manner. It is a process of allocations, not valuation.

Disposal – refers to the removal of a capital asset from service as a result of a sale, destruction, loss or abandonment. When a capital asset is disposed of, the cost and the accumulated amortization should be removed from the accounting records and any gain or loss is recorded at that time.

Fair Value – is the amount of the consideration that would be agreed upon in an arm's length transaction between knowledgeable and willing parties (buyer and seller).

Gains – can arise from transactions and events including the disposition of assets purchased for use and not resale.

Grouped (Pooled) Assets – are homogeneous in terms of their physical characteristics, use and expected useful life. Group assets are amortized using a composite amortization rate based on the average useful life of the different assets in a group.

Historical Cost – of an asset is the amount of consideration given up to acquire, construct, develop or better an asset and includes all costs directly attributable to the acquisition, construction, development or betterment of the asset including installing the asset at the location and in the condition necessary for its intended use.

Impairment – occurs when conditions indicate that a tangible capital asset no longer contributed to the ability to provide goods and services, or that the value of future economic benefits associated with the tangible capital assets is less than its net book value.

Infrastructure – is composed of linear assets and their associated specific components generally constructed or arranged in a continuous and connected network and may include transportation components such as roads, bridges, tunnels, storm sewers, traffic signals and signage.

Land – is the surface that is used to support structures and purchased or acquired for value, for building sites, infrastructure (roadways, bridges, water or sewer mains, etc.) and other program use but not land held for resale. Land normally has an unlimited life and is not amortized.

Linear Assets – are assets generally constructed or arranged in a continuous and connected network. They are usually defined in terms of details such as length, unit of measure and geographic reference (ie. start and end points).

Leased Capital Assets – are non-financial assets leased by the municipality for use in the delivery of goods and services. Substantially all of the benefits and risks of ownership are transferred to the municipality without requiring the transfer of legal ownership.

Losses – can arise from transactions and events affecting local government. Such transactions and events include the disposition of assets purchased for use and not for resale.

Market Value – is defined as the estimated consideration for which a property would be exchanged in a sale between a willing buyer and willing seller in an arm's length transaction wherein the parties had each acted knowledgeably.

Net Book Value – of a tangible capital asset is its cost, less accumulated amortization and the amount of any write-downs.

Non-financial Assets – include TCA and other assets such as prepaid expenses and inventories of supplies. Non-financial assets are acquired, constructed or developed assets that are normally employed to deliver local government services, may be consumed in the normal course of operations and are not for sale in the normal course of operations.

Pooling of Assets – refers to assets of value below the materiality threshold when considered on an individual basis but collectively make up a significant group of assets that exceeds the threshold level (ie. computers on network, library collection, traffic lights, etc.).

Repairs and Maintenance – are reoccurring expenditures, periodically or regularly required as part of the anticipated schedule of works required to ensure that the asset achieves its useful life. It is an expenditure that keeps an asset in a condition that helps maintain or ensure realization of the future economic benefits that are expected from the asset over its initially assessed life. These types of expenditures are accounted for as a current year expense of maintaining an asset (ie. expensed in the year incurred).

Residual Value – is the estimated net realizable value of a capital asset at the end of its estimated useful life. A related term, salvage value, refers to the realizable value at the end of an asset's life. If the municipality expects to use a capital asset for its full life, residual and salvage value are the same.

Straight-line Amortization Method – is amortization that allocates the costs less estimated residual value of a capital asset over each year of its estimated useful life.

Tangible Capital Assets (TCA) – are non-financial assets having physical substance that are acquired, constructed or developed and

- Are held for use in the production or supply of goods and services
- Have useful lives extending beyond the fiscal year
- Are intended to be used on a continuing basis; and
- Are not intended for sale in the ordinary course of operations

Threshold – is generally the minimum cost that an individual asset must have before it is to be treated as a tangible capital asset. The threshold amount is to be used as a guide in addition to the Treasurer's judgement.

Trade-in – occurs when an asset is disposed 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; trade in value for the old asset does not affect the cost of the new asset.

Useful Life – is an estimate of the period over which a tangible capital asset is expected to be used. The life of the tangible asset may extend beyond its useful life. The life of a tangible capital asset, other than land (infinite) is limited.

Work in Progress – is the accumulation of capital costs for partially constructed or developed projects (often projects that are constructed/developed over more than one fiscal period).

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 capital asset as a result of a decrease in the quality or quantity of its service potential. A write-down should be recorded and expensed in the period the decrease can be measured and is expected to be permanent.

Appendix B – Capitalization Decision Tree