Capital Policy Development Guideline

Introduction and Approach

Your municipality needs to develop policies to record and report tangible capital assets. These policies must be a proper fit for the municipality and must meet the requirements of Public Sector Handbook Section 3150 - Tangible Capital Assets.

Capital policies will vary for each municipality because there can be different approaches to accounting for tangible capital assets that still comply with PS 3150. This capital policy development guideline outlines the policies that your municipality should have in place and provides information to consider when preparing these policies. This is not a draft capital policy.

Your municipality can choose between having one policy that addresses all of the necessary topics or multiple policies as part of a capital policy section of the policy manual. The main topics identified in this guideline can be subsections of one capital policy or treated as separate policies. The guideline is organized by topic name, questions to consider and suggested options.

There are sample policies available in current literature including:

CICA/PSAB Guide to Accounting for and Reporting Tangible Capital Assets Development of Tangible Capital Asset Accounting Policies (Chapter 4, Section 1.0, page 39)

Sample Tangible Capital Asset Policy (Appendix C, page 94)


(Appendix A-15, page 141)
1. Authority, Purpose and Scope

This policy provides the basis for all capital policies of the municipality, including the premise for recording tangible capital assets. Your policy should address the following broad areas:

a. What is the purpose and scope of a capital policy (or policies)?

Start with a general statement about the importance of having capital policies to:

- achieve the consistent recording of tangible capital assets, and
- to help with the preparation of financial statements that will comply with generally accepted accounting principles. The scope of these policies should be mentioned. To do this, state that the policies should include all departments and organizations that the municipality is responsible to include in its reports. The specific organizations should be identified.

b. What is the authoritative basis and who has the authority?

PS 3150 Tangible Capital Assets is the basis for developing these capital policies, but your municipality will be required to make some internal decisions to specifically meet the requirements of PS 3150. Authority should be defined and may include some of the following issues:

- Who is responsible to ensure that this capital policy (s) is followed?
- Who prepares and reviews the implementation plan and develops implementation budgets?
- How are policy amendments handled?
- Who makes the final decision in the event of disagreement regarding policy application or interpretation?

c. What is the implementation plan?

You can expect that it may take more than one year to fully implement the strategies to meet the requirements of PS 3150. In the absence of organization business plans, some key elements of the implementation plan may need to be included in the policy.

d. What is the effective date?

The compliance date is to be no later than 2009, but municipalities may choose an earlier date. Include a statement here about the date by when all tangible capital assets will be recorded and reported.
e. *Are there specific expenditures which should be recorded?*

Your municipality may find it appropriate to provide a general statement about some assets that are exempt from recording by policy, but which need to be recorded for reasons such as risk management, security, safety and environmental considerations. A separate policy may be required to identify the specific situations and treatment; for example, some assets may be recorded for tracking purposes, but treated as an expense and not amortized for financial statement reporting purposes.

### 2. **Definition and Classification of Assets**

The broad and, in some cases, specific definitions of assets will be addressed in this policy. Your municipality should identify the level of detail in classifying these assets, and include the following areas:

#### a. Definitions:

The following definitions can be stated:

i. The broad definition of a tangible capital asset as stated in PS 3150.02 and .05(a).

ii. The definitions of the major classifications (Clause 4) and the minor classifications of engineered structures (Clause 6) of Recommended Guideline #1 – Asset Classification which should be used by all Alberta municipalities.

#### b. Classifications

In this section, your municipality needs to decide about the level of detail in the tangible capital asset records. It is recommended that your municipality use the major classifications as mentioned under *Definitions*. Recommended Guideline #1 should be used to help make classifications decisions. The key questions to ask are: What data is required to analyze the cost and performance of business units, determine user fees and plan for future financial requirements? Further classification may also be determined by factors such as useful life and variable timing of construction of assets. Your municipality may find it appropriate to have an appendix to this section to identify the specific classification as presented in Appendix A of Recommended Guideline #2.
c. **Capital leases**

Your municipality will need to determine if its capital leases are to be treated as a tangible capital asset. If so, the policy should define or reference when this treatment is required. From your municipality’s point of view, a capital lease is a lease that substantially transfers all the benefits and risks of property ownership to the municipality. (Section 3065.03(a) CICA Handbook) This would normally occur when one or more of the following conditions are present at the inception of the lease:

i. There is reasonable assurance that the municipality will obtain ownership of the leased property by the end of the lease term.

ii. The lease term is of such duration that the municipality will receive substantially all of the economic benefits expected to be derived from the use of the leased property over its lifespan.

iii. 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. (Section 3065.06 CICA Handbook)

d. **Specific situations**

Sometimes, your municipality may develop definitions and related procedures for specific situations. These should be included in the policies to achieve the objective of consistent application. Some examples are road allowances, land improvements and gravel pits.

### 3. **Recording and Valuing Assets**

Developing and maintaining a good recording system is crucial to meeting the requirements of PS 3150 and managing the municipality’s assets. This section will identify what your municipality needs to consider when developing a system.

a. **Recording the asset**

Your municipality needs to carefully consider what assets should be recorded and what information should be recorded for each type of asset. Factors to consider when making these decisions are materiality, record keeping, asset management and rate setting. The asset record system needs to be manageable, but provide sufficient information for good business decisions.
i. What information should be recorded for each asset class to meet the PS 3150 requirements? Is there additional information that should be recorded to improve asset management and financial planning? Refer to the Asset Inventory and Valuation section of this toolkit for detailed information on the asset register data requirements.

ii. What assets should be recorded?

- **Capitalization thresholds**
  Some expenditures that meet the definition of a tangible capital asset should be treated as an operating expense. This is because their value is low and the cost of recording and tracking the asset is greater than the resulting benefit. The capitalization threshold or recognition threshold is the minimum value of a tangible capital asset to be recorded. Your municipality needs to determine what the appropriate threshold would be for each major asset for your organization. Recommended Guideline #3 – Capitalization Thresholds provides additional information and suggested maximum capitalization thresholds. The guideline recommends that all land be capitalized.

- **Is an expenditure betterment or maintenance?**
  There will be subsequent expenditures on existing assets. In these cases, your municipality should have a policy to determine the situations where the expenditure would be added to the value of the existing asset, or if the expenditure should be recorded as an operating expense. For example, a policy may state that betterments would occur when physical output or service capacity is increased, the operating costs are decreased, the useful life is extended, or the quality of output is improved. Any other expenditure would be considered a repair or maintenance and expensed. The decision on betterment or maintenance will also be affected if engineered structures are recorded as networks instead of by component.

iii. When should assets be recorded?

The question of when an asset should be amortized should be addressed in a separate section of your municipality’s policy. It may be appropriate to determine when newly acquired assets or constructed assets will be recorded in the asset record system.
iv. How should an asset be recorded?

Many tangible capital assets will be recorded as single items. However, some will be treated differently and policies should be developed to achieve consistent treatment. Examples of these situations are noted as follows:

- **Network or component**

  Engineered structures such as a road system may be recorded as a single asset; i.e. a network. The major components of the structure will be recorded and valued as one asset. The alternative approach is to record the major components separately. Buildings may also be recorded using the component approach. Recommended Guideline #5 – Networks, Components and Segmentation, summarizes these options. Recording treatments can vary for different asset classes or construction timing; for example, existing structures may be recorded as networks and new structures recorded in components.

- **Segmentation**

  Asset records for linear infrastructure may be separated by geographic location. For example, roads or waterworks can be recorded for each block, mile, subdivision, etc.

- **Pooling**

  Some assets are similar in type and cost and exceed the capitalization threshold. Therefore, these assets should be capitalized, but it is easier to record them as one asset. This is referred to as ‘pooling’ assets. Examples are computers, small culverts, and fire hydrants. Your municipality should decide whether this option is suitable for certain assets. One question to answer is: Should these assets still need to be individually tracked? If so, how it would be done using the pooling method?

- **Groups**

  Some assets are identical with a unit value below the capitalization threshold, but have a material value as a group. Recommended Guideline #3 - Capitalization Thresholds suggests that these expenditures would be expensed. The municipality should address this situation in policy.
v. *What about assets that are developed or constructed?*

Your municipality will be recording assets that are developed or constructed and may be under construction at the end of the fiscal year. The following questions regarding these assets need to be considered:

- When will the asset be capitalized?
- What will be the capitalization process when the asset is not completed and not in service at the end of the fiscal year?
- Will the asset be in a ‘construction in progress’ classification and move to its appropriate classification upon completion?

vi. *What assets should be recorded that are outside of policy?*

There may be some assets which can be expensed, but their nature or use requires capitalization. These types of assets should be stated in policy. It may be appropriate to establish ‘property control’ systems so that these assets are inventoried, but are not capitalized.

b. *Valuing the asset*

i. How will the valuation method be determined?

This question will probably apply only to the implementation of the asset recording system. The actual historical cost, if known, should be used. In the event that the actual historical cost is not available, a decision and valuation process should be established to estimate the historical cost.

ii. How will unique assets be valued?

Contributed or donated assets are to be recorded at fair value. The policy should establish procedures about how the fair value will be determined.

iii. What defines the cost of an asset?

- The cost of purchased assets is the gross amount of consideration paid to acquire the asset. Costs such as non-refundable taxes and duties, freight and delivery charges, installation and site preparation costs should be identified in policy. Discounts and rebates would reduce the total cost.
➢ The costs attributed to purchasing land should be identified.

➢ How will the fair value be determined for each asset when two or more assets are acquired for a single purchase price?

➢ What costs will be included for constructed or developed assets? Will carrying costs be capitalized and, if so, what are the carrying costs? How will these carrying costs be determined and when do they cease being attributable to the asset? How will interest costs be capitalized?

4. Amortization methods and rates

This policy will identify the amortization methods and rates. Questions that should be answered when developing this policy are noted as follows:

a. Will one amortization method be used or various methods?

Recommended Guideline #2 - Useful Life and Amortization Methods identifies various amortization methods which can be used. The guideline states that the straight-line method is the most common and can be used to amortize all assets. It should be noted that land is not amortized. Some assets may require an alternate amortization method (i.e. declining balance, unit of output) to provide better information related to asset management. If that is the case, these asset types should be identified.

b. How will the useful life for each asset be determined?

Recommended Guideline #2 provides information on the maximum useful life for most asset categories, but a shorter life may be more appropriate. Information on some specific assets may provide useful life data. This policy should establish the process to determine the proper useful life and also develop a schedule of the useful life for most asset types.

c. How will the residual value of assets be established?

PS 3150.27 states that the residual value should be factored into the amortization calculation if it is considered to be significant. Including a residual value may assist in financial planning for asset replacement. This policy should establish if residual values will be used and, if so, how they will be determined by asset class.
d. When will assets start and stop being amortized?

Recommended Guideline #2 suggests that 50% of the annual amortization amount be recorded in the year of acquiring an asset, putting an asset into service or disposing of an asset. Other methods are acceptable, but they should be applied consistently. Examples of other options are:

- to start amortization in the year following purchase and record the annual amount in the year of disposal, or
- to amortize based on the month of acquisition and month of disposal.

5. Reviews and Write-Downs

Decisions on the useful life and appropriate amortization method may change during the life of the asset. PS 3150.29 states that the amortization method and useful life should be reviewed on a regular basis with revisions made when necessary. Capital policies should address this process by answering the following questions:

a. Who is responsible for the periodic review?

A specified staff position may be responsible to ensure that these reviews are being done, but other staff, such as departments, may be responsible to carry out the review.

b. How often should the assets review be conducted? Will this vary for different asset classes?

c. What is the process when the useful life or amortization method needs to be amended?

d. How will asset write-downs be handled? Will there be a waiting period to determine if the factors causing the write-down remain and, if so, how will this waiting period be determined and monitored?

PS 3150.31 – 37 provides information on how to determine when a write-down is required.

6. Maintaining Records

A good initial asset recording system is important, but the records must also be properly maintained into the future. This section should address the following:
a. Who is responsible to ensure that the asset records are current, accurate and complete?

b. What is the process for reporting asset improvements, additions, retirements and disposals?

c. How often are asset inventories to be conducted and by whom?
   It is important that the asset records agree with the actual stock; therefore, comparisons need to be conducted periodically.

d. What supporting documentation is required and how will it be filed?

   Adequate documentation will be required for future reference and to meet audit requirements. This documentation will include information on how the useful life and value was determined.

7. Asset Disposal

Disposals of assets may occur by sale, trade-in, destruction, loss or abandonment. Your municipality will need to amend your financial records to recognize these events. Capital policies must address this important part of the asset system. Some questions to consider when developing this policy are:

a. What are the criteria to determine when an asset would be defined as surplus? When should surplus assets be disposed?

b. Who is responsible for disposing of assets?

c. What information is required when assets are disposed?

d. What is the accounting process for the proceeds of disposals?

8. Financial System, Asset Recording System and Asset Management System

Your records for tangible capital assets must be integrated as much as possible with other systems to improve efficiency and accuracy. Your municipality should establish policies to:

a. Identify what tangible capital asset systems will be used and how they are expected to interface.

b. Determine who is responsible to approve tangible capital asset-related system changes.
c. Establish the process so that tangible capital assets that are purchased will be interfaced to the other asset-related systems.

d. Determine the structure of the General Ledger chart of accounts.

e. Determine the unique identifier for each recorded asset.

f. Determine what information should be reported, how often and to whom.

9. Financial Reporting and Budgets

Policies should be developed regarding the format for reporting amortization in the financial reports and for the treatment of amortization expense in the annual budget.