SCHOOL BOARD
&
SCHOOL AUTHORITY
TANGIBLE CAPITAL ASSETS

DRAFT

ACCOUNTING POLICIES FOR THE 2004-05 REPORTING PERIOD

OCTOBER 2005

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General Introduction

.01 This document provides policies and guidelines for the accounting and reporting of school board and school authority acquisitions, construction, renovations, replacements and repairs to school boards and school authorities owned and leased land & building assets for purposes of inclusion in the Province of Ontario's financial statements for the 2005-2006 fiscal year.

.02 This document addresses construction projects in progress, owned tangible capital assets, capital assets under capital leases and leasehold improvements.

.03 School boards and school authorities shall report their tangible capital assets and leases in accordance with existing PSAB handbook Section PS 3150 (for senior governments) and PSG-2. This policy shall serve as an additional guidance.

.04 Land and building assets of entities controlled by district school boards or school authorities are not to be included in this reporting process; such assets will be included when school boards/school authorities are required to report tangible capital assets in their financial statements.

.05 This policy **does not** apply to:

- Goodwill or other intangible assets such as copyrights and patents;
- Works of art and historical treasures that have cultural, aesthetic or historical values;
- Other tangible capital assets such as furniture and equipment.

.06 Unless otherwise stated, this policy **does not** apply to inventories of buildings and land assets, held for resale that are recognized as a financial asset. **Inventories for resale** are recognized as a financial asset if the school board or school authority owned tangible capital asset has been permanently removed from service and all of the following criteria have been met:

- prior to the date of the financial statements, the appropriate level of authority commits the school board or school authority to selling the asset;
- the asset is in a condition to be sold, such that no further development is required – it is a "finished good";
- the asset is publicly seen to be for sale;
- there is a plan in place for selling the asset; and,
- it is reasonably anticipated that the sale to a purchaser external to the government reporting entity will be completed within one year of the reporting date, as would be the case with a signed purchase and sale agreement or evidenced by the school board obtaining a firm purchase commitment.

Bundling of Assets (Whole Asset vs. Component Approach)

.07 For purposes of capitalization and amortization, there exist two methods of defining a tangible capital asset: Whole Asset approach and Component approach

.08 **The whole asset approach** considers an asset to be an assembly of connected parts. Costs of all parts would be capitalized and amortized as one asset. For example, a building would be considered as one asset.

.09 Under **the component approach**, different components are individually capitalized and amortized. Under this approach, boilers, roofs, electrical systems that are parts of the building would all be individual assets.

.10 The whole asset method and the component approach are equally acceptable under PSAB. However, for the purposes of this document, school boards and school authorities are asked to follow the whole asset approach.

Definitions & Guidelines

Pre-Construction Costs and Construction in Progress

.11 Constructed tangible capital assets such as schools may extend over one or more accounting periods, and certain pre-construction costs may be incurred prior to commencing construction of the tangible capital asset.

.12 Examples of pre-construction costs include the costs for feasibility studies, engineering specifications, environmental assessment, consulting studies, and site survey directly attributable to a tangible capital asset.

.13 Pre-construction costs incurred prior to the actual acquisition or construction of a tangible capital asset should initially be accumulated separately for each tangible capital asset or project as deferred charges. The amount accumulated as deferred charges should be capitalized to the related tangible capital asset once the actual acquisition or construction of the tangible capital asset begins.

.14 The school boards / school authorities must ensure that there is sufficient appropriate evidence to demonstrate that the costs accumulated as deferred charges are attributable to the acquisition, development or construction of <u>specific</u> tangible capital assets.

.15 The rationale for including certain costs as pre-construction costs must be supported by documentation. For example, there should be documented evidence to demonstrate that costs incurred for an environmental assessment or developing engineering specifications that are accounted for as pre-construction costs are directly attributable to the proposed construction of a specific tangible capital asset.

.16 Costs that cannot be **directly** attributed to the acquisition, development or construction of a specific tangible capital asset must be expensed in the period they are incurred. Examples include general administrative costs.

.17 If in a subsequent period it is determined that the acquisition, development or construction of the tangible capital asset will not proceed, the costs accumulated as deferred charges should be expensed immediately.

.18 **Construction in progress** assets refers to a tangible capital asset under construction that is not completed and not ready to be put into service.

.19 Construction-in-progress projects are not amortized until construction is completed and the asset is ready to be put into service.

.20 Interest expense related to financing costs incurred during the time as asset is under construction will be capitalized as part of the construction costs.

.21 Assets under construction are to be transferred out to an appropriate tangible asset class (e.g. building) when the construction is **substantially complete** and the asset is **ready for use**.

.22 Determining when a tangible capital asset is **completed** and **ready for use** requires consideration

of the circumstances. Such determination would normally be made with reference to whether the tangible capital asset is in a condition ready to be put into service. Normally, it would be pre-determined with reference to factors such as productive capacity or occupancy level (e.g. whether a school building is ready to be occupied).

.23 For a new tangible capital asset, certification that the asset has met engineering and safety standards and is ready for public use will provide evidence that the tangible capital asset is completed and ready for use. Certification by an architect, issuance of an occupancy permit or engineering certification may provide evidence that a new building or land is ready for use.

.24 If construction of the tangible capital asset is terminated or deferred indefinitely before completion, the costs capitalized to-date must be expensed, unless there is an alternative use for the tangible capital asset.

Tangible Capital Assets (Leased and Owned)

.25 **Tangible capital assets** are non-financial assets having physical substance that meet all of the following criteria:

- are held for use in the production or 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;
- have been acquired, constructed or developed to be used on a continuing basis:
- have useful economic lives extending beyond an accounting period; and,
- are not intended for sale in the ordinary course of operations.

.26 Tangible capital assets include such items as land, buildings, equipment, furniture, vehicles, etc.

.27 For purposes of this document, the term "tangible capital assets" applies to land and building assets only.

.28 **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 acquisition, construction, development, or betterment of the tangible capital asset.

.29 **Building costs** typically include (but are not limited to):

- materials, labour and overhead costs incurred during construction;
- fees, such as legal fees and architect fees;
- building permits;
- all other costs starting with excavation to completion of the building;

- actual interest costs incurred during construction until the building is substantially completed and ready for its intended use;

- fair values of buildings donated to the school board or school authority;

.30 **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.

.31 **Land costs** typically include (but are not limited to):

- purchase price;

- costs incurred in "closing", such as title to the land and legal fees;

- appraisal costs;

- costs incurred in getting the land in condition for its intended use, such as grading, filling, draining and clearing. When land has been purchased for the purpose of constructing a building, all costs incurred up to the excavation for the new buildings are considered land costs. Example: removal of old buildings, clearing, grading and filling are considered costs of the land because these costs are necessary to get the land in condition for its intended use;

- any proceeds obtained in the process of getting the land ready for its intended use, such as salvage receipts on the demolition of an old building or the sale of timber that has been cleared, are treated as reductions in the price of the land;

- assumption of any liens or mortgages or encumbrances (example, back taxes) of the property;

- actual interest costs related to the financing of the acquisition or construction of the land asset;

- fair values of land, donated to the school board or school authority; any additional land improvements that have an indefinite life – for example, special assessments for local improvements, such as pavements, street lights, sewers, and drainage systems should be charged to the land account as they are relatively permanent in nature.

.32 **Land improvements** are improvements to land assets. Land improvements with limited lives such as driveways, walkways, fences, light posts, landscaping and parking lots should be reported in the land improvements asset class. Land improvements with <u>infinite life</u> (such as ponds) should be reported in the land asset class.

.33 **Additions** to tangible capital asset classes are reported at the earliest of:

a. The date on which the tangible capital asset being constructed is complete and ready for use; or,
b. The date legal ownership of the tangible capital asset is transferred to the school board or school authority

.34 A **leased tangible capital asset (capital lease)** is a non-financial asset that has physical

substance and a useful life extending beyond an accounting period, and is held under lease by a school board or a school authority for use, on a continuing basis, in the production or supply of goods and services. Under the terms and conditions of the lease, substantially all of the benefits and risks incident to ownership are, in substance, transferred to the school board or school authority without necessarily transferring legal ownership

.35 From the point of view of a school board or school authority, the **benefits and risks of ownership** would be transferred to the school board/school authority when, at inception of the lease, one or more of the following conditions are present:

- there is reasonable assurance that the school board/school authority will obtain ownership of the leased property by the end of the lease term (when the terms of the lease would result in ownership being transferred to the board/school authority by the end of the lease term or when the lease provides for a bargain purchase option).

- the lease term is of such duration that the school board/school authority will receive substantially all of the economic benefits expected to be derived from the use of the leased property over its life span. The school board/school authority would normally be expected to receive substantially all of the economic benefits related to the leased property if the lease term is equal to a major portion (usually 75% or more) 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 is equal to substantially all (usually 90% or more) of the fair value of the leased property, at the inception of the lease.

  In assessing the factors above, it is necessary to look at their overall effect; it is not appropriate to focus on one factor in isolation.

.36 Assets under **operating leases** are <u>not</u> reported in a school board / school authority's statement of financial positions. The lease payments are expensed when incurred (e.g. school board enters into an operating lease to provide continuing education or ESL classes).

.37 **Leasehold improvements** (land or building) is a betterment made to a leased property. To be considered a leasehold improvement, the modification must have at least four characteristics:

a) the modifications must be made to assets that have been leased;
b) the lessee school board/school authority must pay for the improvements. If the expenses are the responsibility of the lessor then it will account for the expenses in their own records
c) the leasehold improvements should be durable, and should bring benefits to the school board/school authority for a prolonged period of time (e.g. at least one year)
d) the betterment reverts to the lessor at the end of the lease (i.e. cannot be detached from the leased property)

.38 **Lessee** is the person leasing the asset from the owner.

.39 **Lessor** is the person leasing the asset to the school board / school authority, also known as the owner.

.40 Examples of leasehold improvements that should be capitalized include significant upgrades to the electrical system to meet the needs of computer systems and the installation of walls and doors to create permanent offices. Examples of modifications that would not be capitalized would include remodeling costs such as painting and carpeting.

.41 Betterments made to an asset subject to an operating lease or a capital lease where ownership does not transfer to the lessee (ie. Lease does not contain a bargain purchase option or provide for transfer of ownership of the asset) should be classified as a leasehold improvement.

.42 Betterments made to an asset subject to a capital lease where ownership is expected to transfer to the lessee, should be classified as betterments. The cost of betterments must be capitalized as part of the cost of the capital asset and amortized over the lease term.

Tangible Capital Assets Acquired at Nominal Value

.43 A tangible capital asset may be gifted or contributed by an external party. For example, land may be contributed by another school board or from a municipality at zero or nominal consideration to facilitate the construction of a building, in the case of vacant land, or if it is a surplus building.

.44 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 acquisition date.

.45 Fair value may be estimated using market or appraised values. When an estimate of the fair value cannot be reasonably estimated, the tangible capital asset would be recognized at its nominal value.

Acquisition of a Bundle of Tangible Capital Asset as Part of a Single Purchase

.46 The school boards and school authorities may acquire property consisting of both land and buildings in a single purchase for a lump sum amount. The purchase price should be allocated to each tangible capital asset based on its fair value relative to the fair value of all the tangible capital assets acquired in the same transaction at the time of the acquisition.

.47 If at the time of acquisition, a portion of the acquired tangible capital asset is not intended for use, its cost and any costs of disposal, net of any estimated proceeds, should be allocated to the remaining tangible capital asset that is intended for use. For example, a school board purchases a property consisting of both land and a building. The school board then demolishes the existing building to facilitate the construction of a new building. The purchase price that had been allocated to the building and the related demolition cost would be capitalized and allocated to the cost of the land.

Financial Contributions from Outside Parties

.48 Accounting for the financial contributions made by outside parties towards the costs for the acquisition, development and construction of specific tangible capital assets should be

determined based on the individual circumstances, terms and conditions of the arrangement between the board and the contributing outside party.

.49 Where the board receives outside financial contributions that are intended to cover part or all of the costs for the acquisition, development and construction of specific tangible capital assets owned by the board, the cost of the tangible capital asset would be recorded on a gross basis and should not be offset against the cost of the asset.

Asset Classes

.50 There are 7 tangible asset classes and 4 leased asset classes pertaining to the 2004-05 reporting period as follows:

Tangible Capital Asset Classes

.51 **Buildings – 40 years**: include permanent structures ranging from elementary schools to secondary schools to administrative offices. They are structures with permanent foundations.

.52 **Buildings – 20 years**: include non-permanent structures such as portables, portapaks, and non-permanent relocatable classroom modules (RCM's) and other buildings with an expected useful life of less than 40 years.

.53 **Land:** includes vacant parcel(s) of land as well as land situated under building structures.

.54 **Land improvements** (see definition provided above in paragraph .32).

.55 **Construction-in-Progress** (see definition provided above in paragraph .18)

.56 **Assets permanently removed from service (APRFS)**: include tangible capital assets that are permanently removed from service and no longer contribute to the board's ability to provide services. There is no intent to use this asset in the future. They consist of two sub asset classes:

APRFS - Land
APRFS – Buildings

.57 If the capital asset is subsequently returned to service, school boards/school authorities must not "write up" its book value. Only betterments that have been made to bring the asset back into service should be added to the book value.

Leased Tangible Capital Assets Classes

.58 **Capital Leases – Buildings** include all buildings under capital leases.

.59 **Capital Leases – Land** include all land assets under capital leases (Note: this asset class is rare. An example is a lease to perpetuity).

.60 **Leasehold Improvements – Buildings** include all betterments made to building operating leases that have enduring nature (more than one year).

.61 **Leasehold Improvements – Land** include all betterments made to land operating leases that have enduring nature (more than one year).

Measurement Subsequent to Initial Recognition

.62 Subsequent to an acquisition or construction of an asset, the board incurs asset related costs over its useful life. These costs include expenditures on maintenance, repairs, replacements, additions, and improvements. Depending on the nature and materiality of the expenditures, they are classified as either betterments or expenses.

Betterments

.63 The cost of betterments should be added to the recorded cost of the tangible capital asset.

.64 Betterments are costs incurred to enhance the service potential of a tangible capital asset and may or may not extend the useful life of a tangible capital asset. In general, the service potential of a tangible capital asset may be enhanced when there is:

- an increase in the previously assessed service potential;
- a significant reduction in the operating costs of the tangible capital assets due to efficiency gains;
- the useful life of the tangible capital asset is extended; or
- the quality of the output is improved.

.65 An expenditure has to meet one of the above criteria to be considered a betterment. Otherwise the expenditure is accounted for as a current year expense of maintaining the asset.

Maintenance

.66 Maintenance expenses are incurred to repair or maintain the pre-determined service potential of a tangible capital asset to the end of its original useful life. These expenses do not enhance the functionality, capacity, usability, and efficiency of the tangible capital asset. Such costs should be accounted for as an expense in the fiscal year in which they are incurred.

.67 Maintenance expenditures are costs spent to keep the condition of an asset at its expected operating standard. These expenditures are usually incurred on a more or less continuous basis.

.68 Costs that do not increase the previously assessed useful life, service capacity or quality of output would be expensed as incurred.

Repairs

.69 Repairs are costs to restore a tangible capital asset to its originally designed productive capacity or service potential after damage, accident, or prolonged use.

.70 Restoration of an asset to its originally intended design does not constitute an increase in its service potential. Accordingly, repair costs are expensed as incurred.

Replacements

.71 Replacements involve removal of component parts and substitution of a new part or component of essentially the same type and performance capabilities.

.72 If the replacement of the component results in an enhancement of the service potential of the property as a whole, the replacement is considered a betterment and the costs are capitalized. Enhancements to service potential only result from replacements which:

- extend the useful life of the property as a whole;
- increase the capacity or usage of the property;
- improve the quality of the property to a higher building class; or,
- improve the overall operating efficiency of the property

.73 ***Appendix A*** provides guidance to assist in the classification of costs on the school board/school authorities' tangible capital assets.

Useful Life of Assets & Changes Therein

.74 **Remaining service life** identifies the estimated period over which the tangible capital asset is expected to be used by the school board or school authority. Stated differently, it is the asset's estimated useful life less the years that have been amortized to date.

.75 **Change in useful life** results from the fact that estimating useful lives of tangible capital assets is a matter of judgement based on experience and should be applied on a consistent basis. As a general practice, the expected useful lives of tangible capital assets should be reviewed regularly (every 5 years) and revised when appropriate. Factors to be considered in estimating the useful life of a tangible capital asset include:

- expected future usage;
- technical obsolescence;
- expected wear and tear through the passage of time;
- the maintenance programme; and
- the condition of existing comparable items

The service potential of a tangible capital asset is normally consumed through usage. However, factors such as obsolescence, excessive wear and tear or other events could significantly diminish the service potential that was originally anticipated from the tangible capital asset.

.76 Significant events, which may indicate a need to revise the estimated useful life of a tangible capital asset, include:

- completion of a major betterment;
- a change in the extent which the tangible capital asset is used;
- a change in the manner which the tangible capital asset is used;
- removal of the tangible capital asset from service for an extended period of time
- physical damage or destruction;
- significant technological developments;
- a change in the law, environment or public preferences, which affects the usage and time periods over which the tangible capital asset is used

.77 The rationale supporting the decision to revise useful life estimates of a tangible capital asset shall be documented by the school board or school authority.

.78 **Asset write-down** is the impairment in value which means that the asset can no longer contribute to the school board/school authority's ability to provide service at the previously anticipated level and that the impairment is permanent in nature.

Conditions that indicate that a write-down may be required include:

- An adverse change in the extent and manner in which the tangible capital asset is used;
- The permanent removal of a tangible capital asset from service;
- The service potential of a tangible capital asset is permanently impaired due to neglect, theft or abandonment;
- The service potential of a tangible capital asset is permanently impaired as a result of damage or destruction; and

- The service potential of a tangible capital asset is permanently impaired due to technical obsolescence

The persistence of such conditions over successive years increases the probability that a write-down is required, unless there is persuasive evidence to the contrary.

.79 An asset write-down cannot be reversed, thus should only be recorded, in consultation with the school board / school authority's external auditors, when the status has been finalized

.80 School boards and school authorities will be asked to report if an asset has suffered a partial of full impairment in the value of a tangible capital asset starting in the 2005-06 fiscal year. School boards/school authorities must be able to demonstrate that the impairment of the tangible capital asset's service potential is permanent in nature, and a reasonable estimate of the amount can be made.

.81 For school closures, it is necessary to evaluate whether a school is contributing to school board/school authority's ability to provide services. In cases where closed schools continue to provide services after closures (e.g. as an administrative building), the asset should remain in the appropriate asset class. In cases where schools are "mothballed" and do not intend to re-open, the asset should be transferred into assets permanently removed from service (APRFS) class, as defined in paragraph .56.

.82 If a tangible capital asset is permanently removed from service and then subsequently returned to service, school boards / school authorities must not "write up" its book value. Only betterments that have been made to bring the asset back into service should be added to the book value.

.83 If a tangible capital asset is temporarily removed from service, amortization should continue. The estimated useful life of the tangible capital asset should not be revised due to the temporary nature of the removal of the tangible capital asset from service. Once the school board / school authority has made a decision on how the tangible capital asset will be re-deployed, the estimated useful life of the tangible capital asset would be revised and amortization would be based on the new future usage of the tangible capital asset.

Retirements and Disposals of Tangible Capital Assets

.84 **Retirement** of an asset can occur due to:

- replacement of a building, structure, facility or previously identified component parts;
- disposal or demolition of a building, structure, facility or previously identified component parts;
- sales or transfer of ownership of a building, structure, facility, property or previously identified component parts to a party outside the government reporting entity; or,
- abandonment of a building, structure, facility, property or previously identified component parts

.85 When an asset is **replaced**, the costs of removal of the old asset are considered a cost of installation or construction of the new replacement asset. The remaining net book value of the old asset should be removed from the asset accounts. Net costs or proceeds on sale or disposal should be identified, and any resulting net gain or loss on retirement recognized as revenue or expense in the year of retirement.

.86 When an asset is **disposed of or demolished and not replaced**, the remaining net book value of the asset should be removed from the asset accounts. The costs of removal, disposal, and demolition, net of any proceeds on disposal, should be identified and any resulting loss on retirement recognized as an expense in the year of retirement.

.87 When an asset is **sold or transferred** the remaining net book value of the asset should be removed from the asset accounts. The proceeds on sale (if any), net of any costs of sale, should be identified as net proceeds on disposition, resulting in a gain or loss on sale. The impact of any gain or loss will be eliminated upon consolidation by the Ministry of Education.

.88 School boards or school authorities may dispose of property consisting of both land and buildings in a single sale or transfer for a lump sum amount. Proceeds of disposition (as defined in .87) should be allocated to each tangible capital asset based on their fair market value relative to the fair value of all the tangible capital assets disposed of in the same transaction.

.89 When a tangible capital asset is **abandoned**, the remaining net book value of the asset should be removed from the asset accounts. The costs of abandonment should be identified and any resulting loss on retirement recognized as an expense in the year of retirement.

.90 **Disposal costs** should be expensed as incurred, except in cases where the disposal is expected to result in a gain. In cases where the disposal is expected to result in a gain, the costs incurred prior to the fiscal year the disposal is completed should initially be accumulated as deferred charges, to the extent that the amount deferred does not exceed the gain expected on disposal. In the fiscal year the disposal is completed, the disposal costs accumulated as deferred charges would be netted against the gain from disposal.

.91 Disposal costs that do not meet the criteria as described in paragraph .92 should be expensed as incurred.

.92 Disposal costs are costs incurred that are incremental in nature and are essential to transact the disposal. Disposal costs result directly from the decision to dispose the tangible capital asset. Disposal costs include:

- direct marketing;
- legal;
- engineering;
- title search;
- survey;
- appraisal;
- brokerage fees; and,
- commissions.

.93 In general, disposal costs do not include environmental clean-up costs related to the property being disposed, except in cases where environmental clean up is an essential condition for completing the sale of a tangible capital asset by the board to an external party. For example, the school board or school authority may enter into an agreement of purchase and sale with an external party for a parcel of board owned land. To complete the sale transaction, the board may be required under the terms of the agreement of purchase and sale to perform environmental clean up. In this case, environmental clean-up costs incurred prior to completion of the sale would initially be recorded as a deferred charge to the extent the expected gain from disposal is sufficient to cover the environmental clean-up cost. Upon completion of the sale, the deferred charge would be netted against the gain from the sale.

Capitalization Guidelines

.94 Assets with a dollar value as set out in paragraph .95 of this policy or greater shall be capitalized. Assets with a dollar value **lower** than what is set out in paragraph .95 may be capitalized at school board/school authority's discretion, if there is a benefit in doing so and the asset meets the criteria for capitalization.

.95

Asset Class	Capitalization Threshold	Amortization Method	Estimated Useful Life
Buildings- permanent	$10,000	Straight-line	40 years
Buildings – non-permanent	$10,000	Straight-line	20 years
Land	All	N/A	Infinite
Land Improvements (limited life)	$10,000	Straight-line	TBD
Construction in Progress	All	N/A	N/A
Assets Permanently Removed from Service – Buildings	All transferred from building class	N/A	N/A
Assets Permanently Removed from Service – Land	All transferred from land class	N/A	N/A
Capital Leases – Building	All	Straight-line	Over the lease term. If bargain purchase option exists, over the economic life of the asset.
Capital Leases – Land	All	N/A	Infinite
Leasehold Improvements (Buildings)	All	Straight-line	Over the lease term
Leasehold Improvements (Land)	All	Straight-line	Over the lease term

.96 Estimated useful life depends on the asset class to which the tangible capital asset belongs.

.97 If the tangible capital asset is permanently removed from service and is not being used by the school board/school authority, amortization should cease and its carrying value should be written down to its residual value.

.98 A leased tangible capital asset is amortized over the period of expected use of the asset, on a basis that is consistent with the school board/school authority's amortization policy for other similar tangible capital assets. If the lease contains terms that allow ownership to pass to the board or a bargain purchase option, the period of amortization would be the economic life of the property. Otherwise, the property would be amortized over the lease term.

.99 The capitalization threshold for capitalization of betterment is the same as the threshold for the related asset class.

.100 Individual betterment costs may be less than the threshold for the tangible capital asset class. However, these costs should be capitalized where these costs form part of or are phases in a major betterment project that may extend to more than one fiscal year and the total of these costs exceeds the threshold for capitalization for the tangible capital asset class.

APPENDIX A

Maintenance versus Betterment

Overview

A.01 To ensure a consistent and appropriate application of the school board/school authority's tangible capital asset accounting policy, this Appendix provides guidance on the distinction between betterments and maintenance/repair/replacement expenses.

Betterments

Additions

A.02 Additions are made to an existing tangible capital asset to extend, enlarge or expand the existing tangible capital asset. Examples include adding an extra wing or room to a building.

A.03 As additions increase service capacity or physical output of a property, they are betterments. Accordingly, the costs of additions meet the definition of a betterment and therefore should be capitalized. The key consideration is increase of quantity of service or output.

Improvements

A.04 Improvements include upgrades and rearrangements that improve the service potential of an asset.

Upgrades

A.05 Upgrades involve the removal of a major part or component of a tangible capital asset and the substitution of a different component having significantly improved performance capabilities beyond the property's original design standard.

A.06 Upgrades increase the overall efficiency (e.g. increasing utilization, lowering operating costs, increasing output of service), quality (i.e. transforms the asset into a higher class property) or expected service life of a tangible capital asset. The costs of upgrades are capitalized.

A.07 The following examples would have characteristics of an upgrade:

- Installing air conditioning in a building that was previously not-air conditioned increasing the service quality of the property;
- Replacing existing lighting with energy saving lighting reducing future operating costs;
- Substituting a tile roof for wooden shingles increasing the expected useful life of the building beyond its currently estimated life;
- Replacing an elevator with a new high-speed elevator improving the building class of the overall property; or,
- Replacing a furnace with a high-efficiency furnace decreasing future operating costs.

Rearrangements

A.08 Rearrangements are the reinstallation, rerouting, or rearrangement of asset components to achieve greater service efficiency or effectiveness of the tangible capital asset. It is a change in the internal arrangement or other physical characteristics of an existing tangible capital asset so that it may be effectively used.

A.09 Examples include (but are not limited to):

- increasing the number of partitions in the office area to increase office space (i.e. better utilization of office space)
- re-routing the wires in the building to increase the number of computer workstation connections

A.10 Rearrangements of the building that increase service capacity or physical output meet the definition of a betterment and should be capitalized as part of the building.

Maintenance

A.11 Examples of costs that would be categorized as maintenance expenses would typically include (but are not limited to):

- Replacement of individual units or parts of a tangible capital asset due to age, "wear-and-tear" and damage in order to maintain the tangible capital asset in an operating condition without significantly enhancing the functionality, capacity, usability, and efficiency of the tangible capital asset;

- Costs incurred to service or maintain the tangible capital asset until the end of its estimated useful life, where the estimated useful life is expected not to extend beyond a fiscal year;

- Repairs, including emergency repairs, due to equipment failure;

- Routine cleaning and servicing of equipment;

- Repairs to restore assets damaged by fire, flood or similar events, to a condition just prior to the event; and,

- Costs that must be incurred in order to realize the benefits originally projected from the tangible capital asset.

A.12 For example, regular maintenance activities prescribed by the manufacturer of a new heating, ventilation and air-conditioning system (HVAC) system would normally be required to ensure that the asset is able to provide service at a level and quality as originally intended by the manufacturer (e.g., lubrication of motor and compressors, replacement of air filters). Performance of regular maintenance may also be required as part of the product warranty provided by the manufacturer. Similarly, the costs of regular maintenance would be expensed on an as-incurred basis.

Repairs

A.13 Examples include (but are not limited to):

- repairing shingles on a roof
- repairing a faulty HVAC or boiler with new parts
- repairing a broken window
- fixing the electrical system
- repairing carpet

Replacements

A.14 It can be argued that replacing an old HVAC system with a new HVAC system always increases performance capabilities, since after prolonged use the operating efficiency of existing HVAC system usually deteriorates and a new replacement is always more efficient. However, if the replacement is essentially restoring the system to the original design standard for the building, the service potential of the overall property has not been enhanced. Accordingly the replacement is considered a repair cost and expensed.

A.15 The school board/school authority's tangible capital asset policies follow a whole property approach in capitalizing and amortizing its buildings. Under this approach, all services and equipment permanently attached to the building structure (i.e. electrical lighting, power supply, elevators, HVAC, fire protection systems, telecommunications etc.) are amortized over a composite service life of the property as a whole. Even though the services and equipment may have a shorter life than the building structure itself (e.g. 15 years versus 40 years), it is amortized over the composite service life of the property (e.g. 40 years).