CAPITALIZATION & AMORTIZATION PROCEDURE

This procedure is governed by its parent policy. Questions regarding this procedure are to be directed to the identified Procedure Administrator.

Functional Category:	Finance
Parent Policy:	Tangible Capital Asset Management Policy
Approval Date:	October 4, 2016
Effective Date:	July 1, 2015
Procedure Owner:	Vice President, College Services and Chief Financial Officer
Procedure Administrator:	Director, Integrated Planning and Financial Services (IPFS)

Overview:

Assets are regularly acquired by NorQuest College (college). Accounting practice permits these expenditures to be treated as either:

- an expense in the year that the asset was acquired; or
- to have the expense apportioned over a period of time based on the nature of the asset.

For purposes associated with capitalization and amortization, the college is required to comply with accounting practices that are outlined in the Chartered Professional Accountants of Canada (CPA Canada) Public Sector Accounting (PSA) Handbook Section PS 3150.

This procedure sets out:

- conditions for determining when an expenditure is to be classified as a tangible capital asset,
- information on the amortization period of tangible capital assets,
- actions required by operating divisions to identify tangible capital asset acquisitions, and
- actions required by IPFS division regarding tangible capital asset and amortization activities.

Authority to establish this procedure is derived from the NorQuest College Board of Governors Policy No. 7, which delegates responsibility for the college's financial planning and activities to the President and CEO and Board Policy No. 5, which delegates authority to the President and CEO to establish policies and procedures for the college's management and operation.

Procedures:

College assets will be identified and accounted for as follows:

Determining Capital versus Non Capital Assets

Depending on the characteristics of an asset, an asset is determined to be either "capital" or "non capital".

Non capital assets are fully expensed in the period in which they are received while tangible capital assets are amortized over their useful life. Intangible assets are not recognized as tangible capital assets. When the amounts become material, they are disclosed in the notes to the financial statements.

Tangible capital assets also have the following characteristics:

- beneficial ownership and control clearly rest with the college;
- the asset is used to achieve college objectives; and
- per item cost is greater than or equal to $1,000.

The following table specifies the conditions that apply in determining if an asset is to be recognized as capital or non-capital.

Conditions	Tangible Capital	Non Capital
General		
Individual assets have a useful life ≥ 1 year and cost ≥ $1,000	✓	
Individual assets have a useful life < 1 year or cost < $1,000		✓
Bulk purchase: assets where useful life ≥ 1 year and individual cost < $1,000 but when assessed in aggregate represent a material increase in business capacity (as determined by the Director of IPFS)	✓	
Exceptions		
Intangible assets (e.g. curriculum development and program development costs, marketing, branding, etc.)		✓
Works of art and historical treasures		✓
Land	✓	
Non-recoverable Goods and Services Tax and Harmonized Sales Tax associated with a tangible capital asset	✓	
Interest expense when financing during time asset is under construction	✓	
Betterments to a capital asset; non leasehold improvements	✓	
Leasehold improvements have a useful life ≥ 1 year and cost ≥ $1,000 or as determined by the Director of IPFS	✓	
Leasehold improvements have a useful life < 1 year or cost < $1,000		✓
Repairs and maintenance to a capital asset		✓
Cannot determine if a cost is a betterment or a repair		✓
Capital lease	✓	
Non-capital lease (operating lease)		✓
Future site restoration costs - net of expected recoveries but excluding cost related to environmental liability due to contaminated site.	✓	
Building or infrastructure built on leased land	✓	
Library collection items regardless of cost		✓
Rental books		✓
Computer software where cost ≥ $1,000 (including upfront cost such as setting up a new system, configuration and customization)	✓	
Data migration from old system to new system		✓
Enhancement or upgrade to software where cost ≥ $1,000	✓	
Software licenses		✓

New internally developed software where cost ≥ $1,000 or as determined by the Director of IPFS	✓	
New internally developed software where cost < $1,000		✓
Software maintenance, minor fixes, patches		✓
Warranty		✓

Notes:

- Work in progress: construction or development of an asset is capitalized when the project is complete and the asset is in service. Projects that have not been completed as of the date of the financial statements are recorded as "Work in Progress".
- Where a college builds a building and/or infrastructure on leased land, these costs would be capitalized as a leasehold improvement except where the land is leased from another provincial government department or the lease provides for transfer of ownership. In the latter cases, the building and/or infrastructure will be capitalized as an asset rather than a leasehold improvement.
- The transfer of land from an outside party to the college will be capitalized as an asset when the agreement provides for a transfer of ownership. Where the agreement does not provide for a transfer of ownership, the land may not be capitalized.
- Buildings and infrastructure built on the land transferred from an outside party will be capitalized if they meet the capitalization criteria.
- Composite assets purchased after June 30, 2000 that are composed of several pieces intended to operate as a unit that are collectively valued at $1,000 or more (includes computers with monitors, keyboards, modem and mouse, etc.) are to be capitalized.

Determining Tangible Capital Asset Cost

The cost of a tangible capital asset includes the purchase price of the asset and other acquisition costs such as installation costs, design and engineering fees, legal fees, survey costs, site preparation costs, freight charges, transportation insurance costs and duties.

The cost of a constructed tangible asset would normally include direct construction or development costs (such as materials and labour) and overhead costs directly attributable to the construction or development activity. The activities necessary to prepare a tangible capital asset for its intended use encompass more than the physical construction of the tangible capital asset. They include the technical and administrative work prior to the commencement of and during construction.

Notes:

- The cost of betterments may be capitalized as part of the cost of the tangible capital asset and amortized over the useful life of the asset.
- Transfers of tangible capital assets between the college and other departments of the provincial government shall be at the net book value of the asset. The tangible asset is recorded at its original historical cost and accumulated amortization.
- Tangible capital assets are to be recorded at cost at date of acquisition, completion of construction or development, or fair value at date of gift-in-kind donation excluding art works or historical treasures.
- Labour may be capitalized when all direct costs of labour can be identified and are properly allocable to the construction, modification, or installation of specific items of tangible capital assets.

- The cost associated with acquiring software is capitalized, such as the configuration and customization cost to make the software meet the college's needs; cost of hardware required to use the software, and cost of setup or acquiring access to infrastructure needed to use the software. The cost associated with new system data migration and training is expensed.
- All lease agreements must be reviewed to determine if a leased asset should be accounted for as a leased tangible capital asset using the Leased Tangible Capital Asset Determination form and approved by the Director, IPFS.
- Donated tangible capital assets are to be appraised as specified in the Donation Acceptance Procedure.

Actions: Budgeting and Recording Expenditures

College Divisions

- Divisional and project budgets, projections and forecasts are to be developed using the above conditions to identify and properly report expected capital versus non capital expenditures.
- When uncertain or unexpected circumstance occurs, consult the Director, IPFS for clarification and decision.
- Correct financial expenditure codes are to be used when recording the commitment to purchase and the actual purchase of assets.

IPFS Division

- Review and confirm that the appropriate asset classification has been recorded for expenditures based on the above conditions.
- Support other college divisions in correctly identifying and recording capital versus non capital assets.

Amortization of Tangible Capital Assets

Amortization of capital assets will be recognized as an expense in the financial statements.

The following table specifies the amortization periods associated with various capital assets. Amortization expense is determined on a straight line basis in relation to the amortization period.

Tangible Capital Asset Description	Amortization Period
Land	not amortized
Buildings	40 years
Site improvements	Remaining useful life of building
Machinery and equipment	10 years
Computer hardware	3 years
Computer software	3 years
Furniture and fixture	10 years
Vehicles	10 years
Leasehold improvements	Period based on the useful life of the improvement or the lease term, whichever is shorter. The lease term would include any renewal option periods where extension of the lease is reasonably assured.

Notes:
- A consistent approach is to be used for estimating the useful life of tangible capital assets.
- The amortization method and estimate of the useful life of the remaining unamortized portion of a tangible capital asset should be reviewed every three years and revised when the appropriateness of a change can be clearly demonstrated.
- Work in progress, which includes facilities and improvement projects and development of information systems, is not amortized until after the project is complete and the asset is in service.

Adjustments
- When tangible capital assets are sold or traded-in, the historical cost and accumulated amortization amounts relating to the particular asset are removed from the appropriate general ledger account and a gain or loss on disposal is recognized to the extent that the asset net book value differs from the sale proceeds or from the trade-in value.
- When conditions indicate that a tangible capital asset no longer contributes to the college's ability to provide goods and services, or that the value of future economic benefits associated with the tangible capital asset is less than its net book value, the cost of the tangible capital asset are reduced the decline in the asset's value.
- The net write-downs of tangible capital assets are accounted for as expenses in the statement of operations.
- If the tangible capital asset is subsequently returned to service, there must not be a "write up" of the assets book value. However, betterments that have been made to bring the asset back into service are to be added to the book value of the asset.

<u>Actions</u>

<u>IPFS Division</u>
- Update PeopleSoft Asset Management module when assets are sold, traded-in, impaired, removed from service or become obsolete.

<u>Defining a Tangible Capital Asset - Whole Asset versus Component Approach</u>

For purposes of capitalization and amortization, the two approaches of defining a tangible capital asset are whole asset and component.
- The whole asset approach considers an asset to be an assembly of connected parts. The total cost of all parts would be capitalized and amortized as one asset.
- Under the component approach, different components are individually capitalized and amortized.

The whole asset approach and the component approach are equally acceptable under the Public Sector Accounting Standards.

In certain circumstances, it is appropriate to allocate the total disbursement on an asset to its component parts and account for each component separately. This is the case when the component assets have different useful lives or provide economic benefits or service potential to the entity in a different pattern, thus necessitating use of different amortization rates and methods. Additional factors influencing the choice of an approach include:
- significance of amounts;
- quantity of individual asset components (volume);

- availability of information with respect to specific components of the capital expenditures; and
- specific information needs of management for decision making and asset control purposes.

For information technology systems, the whole asset approach is used for purchased systems since the contract is for the entire implementation of the system, software and hardware, to a third party. In addition to not having separate costs for the various components, these systems are usually larger, are for a specific purpose, have well-defined parameters and a definite start date.

The component approach will be used for internally developed and internally implemented information technology assets. These systems are usually more general in use and purpose with different start dates for different areas of the department. The department also typically purchases the components of the system from different suppliers.

Actions

IPFS Division

- Determine and apply the approach that best serves the college needs.

Definitions:

Amortization: is an expense that is systematically allocated to operations based on the useful life of a tangible capital asset.

Betterment: is a cost incurred to enhance the service potential of a tangible capital asset. In general, for tangible capital assets other than complex network systems, service potential may be enhanced when there is an increase in the previously assessed physical output or service capacity, where associated operating costs are lowered, the useful life of the property is extended or the quality of the output is improved.

Cost[1]: 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, including installing the asset at the location and in the condition necessary for its intended use.

Fair value[2]: 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.

Intangible asset: is an identifiable non-monetary asset without physical substance.

Leased tangible capital asset: is a non-financial asset that has physical substance and a useful life extending beyond a fiscal year, and is held under lease by the entity 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 entity without necessarily transferring legal ownership.

[1] Per CPA Canada PSA Handbook
[2] Per CPA Canada PSA Handbook

Leasehold improvement: Betterment made to leased property. To be considered a leasehold improvement, the modification must have the following four characteristics:

- The modifications must be made to assets that have been leased;
- The lessee must pay for the improvements. If the expenses are the responsibility of the lessor then it will account for the expenses in its own records;
- The leasehold improvements should be durable, they should bring benefits to the department for more than one year; and
- The betterment reverts to the lessor at the end of the lease (i.e. cannot be detached from the leased property).

Net book value: is a tangible capital asset cost less both accumulated amortization and the amount of any write-downs.

Operating Lease: is a lease for which the lessee acquires the property for only a small portion of its useful life. An operating lease is commonly used to acquire equipment on a short-term basis. Any lease that is not a capital lease is an operating lease.

Repairs and Maintenance: are actions that maintain the functionality of an asset.

Tangible capital assets: are non-financial assets having physical substance that is owned by the college, whose value is recognized for more than one fiscal year and whose cost exceeds the prescribed threshold value.

Tangible capital assets specifically:

- are held for use in the supply of goods and services, for administrative purposes or for the development, construction, maintenance or repair of other tangible capital assets;
- have useful economic lives extending beyond a fiscal year;
- are to be used on a continuing basis; and

are not for sale in the ordinary course of operations.

Useful life: is the estimate of the period over which a tangible capital asset is expected to be used by the college. The life of a tangible capital asset may extend beyond the useful life of a tangible capital asset to the college. The life of a tangible capital asset, other than land, is finite, and is normally the shortest of the physical, technological, commercial and legal life.

Related Information:

- Asset Inventory Management Procedure
- Contract Management Procedure
- CPA Canada Public Sector Accounting Handbook
- Donation Acceptance Procedure
- Goods and Services Procurement Procedure
- Tangible Capital Asset Management Policy
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Related Documentation:

- Capital vs. Expense Decision Tree
- Leased Tangible Capital Asset Determination form

Next Review Date: October 2020

Revision History:	June 2012: New June 2013: Revised August 2013: update for document links and branding November 2014: update for document links June 2016: revised October 2016: revised