

Tangible Capital Assets

Guideline 3: Maintenance/Repairs versus Betterments

Overview

To ensure consistent and appropriate application of the Tangible Capital Assets (TCA) Policy, it has been determined that further clarification around the issue of maintenance/repairs versus betterments is required.

The following guideline is intended to supplement the TCA Policy and provide further guidance on this topic. It should be noted that no guideline can be all-inclusive and professional judgement must be exercised in applying this guideline to each circumstance.

Departments will be required to maintain appropriate supporting documentation to support the decision to capitalize certain expenditures which will be subject to testing by the Office of the Auditor General during its annual financial statement audit or during any value for money audits conducted.

Definitions

At the current time, the TCA Policy provides the following definitions:

BETTERMENT

The cost incurred to enhance the service potential of a tangible capital asset is a betterment. Service potential is enhanced if one of the following occurs:

- there is an increase in the previously assessed physical output or service capacity;
- associated operating costs are lowered;
- the original useful life is extended; or
- the quality of output is improved.

Betterments and replacements include additions to a tangible capital asset or a substitution of a component part of a tangible capital asset. The distinguishing feature between a betterment and a replacement is that a betterment is the substitution of a better component for one currently used. A replacement on the other hand, is the substitution of a similar component.

Betterments are treated as tangible capital assets (set up as a sub-number of the related asset) and amortized accordingly. Replacements are treated as ordinary operating expenditures.

REPAIRS AND MAINTENANCE

The cost incurred in the maintenance of the service potential of a tangible capital asset is a repair, not a betterment.

Ordinary repairs are expenditures made to maintain assets in operating condition; they are charged to an expense account in the period in which they are incurred on the basis that it is the only period benefited. Replacement of minor parts, lubricating and adjusting of equipment, repainting and cleaning are examples of the type of maintenance charges that occur regularly and are treated as ordinary operating expenses.

Guideline Directives

A number of factors must be considered when determining if an expenditure meets the criteria to be set up as a tangible capital asset.

BETTERMENTS

An expenditure that meets the definition of a betterment must also meet the threshold of the related class to be set up as a tangible capital asset before it is capitalized. The exception to this is building and school betterments which have a threshold of \$150,000. Therefore, there may be situations where betterments are not capitalized due to the low dollar value of the expenditure.

REPAIRS & MAINTENANCE

In order for tangible capital assets to reach the estimated useful life, periodic maintenance is required over the life of the asset. The “normal” maintenance schedule of an asset may require maintenance every month or year, whereas others may require maintenance every five years or a combination of both. For some assets, this maintenance may be quite extensive and expensive but it would not qualify as a betterment due to the nature of the work performed.

REPLACEMENTS

The TCA Policy defines a replacement (which is an expense) as a substitution of a component of the asset with one of similar quality. This implies that no replacement could be capitalized as a betterment. However, some replacements can be considered betterments and capitalized under certain conditions when they are evaluated against

the criteria established. For example, a major roof replacement near the end of the useful life of a building enables the building to be used for a number of years past its useful life. This replacement may be of similar quality to the old roof but would meet the definition of a betterment based on the criteria. Therefore, it is important to review the expenditure in relation to the criteria to determine if it is capital in nature.

PROJECT DEFINITION

A project may qualify as a betterment under certain circumstances. The key determinants include total cost and purpose of the project. There has been some question as to what constitutes a project in relation to the Tangible Capital Assets Policy, particularly in the area of betterments to buildings. The following criteria have been developed to provide more guidance in this area.

A tangible capital asset project must meet the following criteria:

1. The project must be related to a specific asset.
2. The project must meet the criteria associated with betterments.
3. The project must exceed the relevant threshold level defined in the Tangible Capital Assets Policy.
4. The project objective must be specific and the work required to achieve the objective clearly defined. Some examples of project objectives are:
 - environmental
 - accessibility
 - program enhancements
 - building envelope (often environmental related)
5. The project work must be continuous in nature but take into account factors that may interrupt the work flow, such as:
 - weather
 - asset utilization constraints
 - working conditions
 - business cycle
 - seasonal restrictions

There may be cases where part of the project is completed and in use prior to the completion of the entire project, particularly where the project is broken into phases to accommodate asset utilization constraints (e.g., school—can only work on project during summer months). In these cases, the costs associated with the completed

phase should be transferred to a completed asset category once that phase has been put into use. The remaining project costs would be transferred to the completed asset once the project is complete and available for use.

Decision Tree/Questions

Departments may find it helpful to use the following decision tree/questions when determining if expenditures are capital (betterment) or operating (repairs/maintenance) in nature. It should be noted that the application of professional judgement is critical to the interpretation and use of these questions.

1. Does the expenditure extend the original useful life of the asset significantly?
Yes: Does the expenditure meet the threshold guidelines? If yes, then capitalize. If no, then expense.
No: Proceed to question 2.
2. Does the expenditure materially improve the property beyond its original condition?
Yes: Does the expenditure meet the threshold guidelines? If yes then capitalize. If no, then expense.
No: Proceed to question 3.
3. Does the expenditure increase the original assessed physical output?
Yes: Does the expenditure meet the threshold guidelines? If yes, then capitalize. If no, then expense
No: Proceed to question 4.
4. Does the expenditure improve the quality of the output?
Yes: Does the expenditure meet the threshold guidelines? If yes, then capitalize. If no, then expense.
No: Proceed to question 5.
5. Does the expenditure result in an increase in the service capacity?
Yes: Does the expenditure meet the threshold guidelines? If yes then capitalize. If no, then expense.
No: Expense.