Tangible Capital Assets

Guideline 8: Leasehold Improvements

Overview

Clarification has been requested relating to the classification of leasehold improvements for accounting purposes.

The following guideline is intended to supplement the Tangible Capital Assets (TCA) Policy and provide further guidance on its application. It should be noted that this guideline is not all inclusive and professional judgement must be exercised in applying it to each circumstance.

Definitions

The TCA Policy provides the following definitions:

LEASEHOLD IMPROVEMENTS

Leasehold improvements are additions, improvements or alterations made by the lessee to leased property that cannot be removed upon termination of the lease because they are attached to, or form part of the leased premises.

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 the one currently used. A replacement on the other hand, is the substitution of a similar component.

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 benefitted. 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.

General Discussion

THRESHOLD

In order to be capitalized, expenditures relating to leasehold improvements must meet the threshold of the leasehold improvements asset class as indicated in Appendix 14-C of the TCA Policy.

Leasehold improvements relate to property which is subject to an operating lease. Leasehold improvements should be similar to betterments (which relate to provincially owned property or property under a capital lease) and should enhance the service potential of the leased property.

To be capitalized as a leasehold improvement, the improvement must have the following characteristics:

- the improvement must be made to leased property which is subject to an operating lease;
- the lessee must pay for the improvement (either up front or over the remaining term of the lease);
- the improvement must provide benefits that are long-term in nature (i.e., extend beyond one year); and
- the improvement becomes part of the property and reverts to the lessor upon termination of the lease.

Leasehold improvements are amortized on a straight line basis over the remaining term of the lease.

Expenditures Which Meet the Criteria of Leasehold Improvements

The following are examples of expenditures which meet the criteria of leasehold improvements and should be capitalized, provided the threshold is met:

- alterations required to a new leased property to make it suitable for its intended purpose;
- alterations required due to a change in use of space of the leased property;
- significant improvement to the building envelope or building services of the leased property;
- significant alterations and renovations which would enhance the service potential of the leased property;
- additions to the leased property, including extensions, enlargements or expansions

Expenditures Which Do Not Meet the Criteria of Leasehold Improvements

The following are examples of expenditures which do not meet the criteria of leasehold improvements and should be charged to operating expense:

- repairs and maintenance;
- alterations which are cosmetic in nature, such as painting and carpeting;
- minor alterations which do not enhance the service potential of the leased property;
- moving costs associated with moving into the leased property

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