CORPORATE POLICY

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CICA 1508 – Accounting for Estimates

POLICY STATEMENT:
This policy prescribes the accounting and financial reporting treatment of tangible capital assets for all departments of the City of Waterloo (the City).

PURPOSE:
The objective of this policy is to outline the accounting treatment for tangible capital assets. In particular, this policy is intended to:

- Establish accounting policies for tangible capital assets in accordance with PS 3150 – Tangible Capital Assets, PSG-2 - Public Sector Guideline 2, Leased Tangible Capital Assets and their respective representation on the financial statements of the City of Waterloo.
- Establish a consistent approach to accounting estimates in areas where measurement uncertainty exists in accordance with CICA Section 1508 – Accounting for Estimates.
- To ensure consistent, transparent treatment of all tangible capital assets and the reporting of the financial results.

DEFINITIONS:
Tangible Capital Assets are defined by the Canadian Institute of Chartered Accountants (CICA) as non-financial assets having physical substance that:

i. 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, and

ii. have useful economic lives extending beyond an accounting period based on industry standards and City experience, and
iii. are to be used on a continuing basis, and
iv. are not for sale in the ordinary course of business.

GENERAL DEFINITIONS

Accrual Based Accounting is a system of accounting that measures the economic impact of transactions and economic events rather than cash flows.

Amortization is a rational and systematic manner of allocating the cost of an asset over its estimated useful life. Amortization is reported as an expense on the Statement of Operations.

Betterments are costs incurred for enhancements to the service potential of a capital asset such as:

- an increase in the previously assessed physical output or service capacity;
- a reduction in associated operating costs;
- an extension of the estimated useful life; or
- an improvement in the quality of output of the asset.

Capital Assets are non-financial assets having physical substance that:

- are held for use by the municipality 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 useful lives extending beyond a year and are intended to be used on a continuing basis; and
- are not intended for sale in the ordinary course of operations.

Capital-type expenses are costs for assets that meet the definition of a capital asset but are less than the thresholds set by the City of Waterloo. These assets are expensed in the year in which they are purchased.

Cost is the amount of consideration given up to acquire, construct, develop or better a capital asset and includes all costs directly attributable to its acquisition, construction, development or betterment, including installing the asset at the location and in the condition necessary for its intended use. For contributed assets, the cost is considered to be equal to its fair market value at the date of contribution.

Disposal refers to the removal of a capital asset from service as a result of sale, destruction, loss or abandonment.

Estimated Useful Life is the estimate of the period over which a capital asset is expected to be used or the number of units of production that can be obtained from the asset. It is the period over which an asset will be amortized and is normally the shortest of the physical, technological, commercial or legal life.

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.

Financial Assets are assets that are available to discharge existing liabilities or finance future operations and are not for consumption in the normal course of operations. Examples of financial assets are cash on hand and accounts receivable.

Group/Pooled Assets are similar assets that have a unit value below the capitalization threshold (on their own) but have a material value as a group. Such assets shall be 'pooled' as a single asset with one combined value. Although recorded in the asset as a single asset, each unit of the pool may be recorded in an asset sub-ledger for monitoring and control of their use and maintenance. Examples of group/pooled assets are computer software, street lights, furniture and fixtures and small machinery or equipment.

Gain on Disposal is the amount by which the net proceeds realized upon as asset's disposal exceed the asset's net book value.

Hours of Production Method is an amortization method which allocates the cost of an asset based on its estimated hours of use or production.

Leased Capital Assets are non-financial assets with physical substance and a useful life of greater than one year which are leased by the municipality for use in the delivery of goods and services. Substantially all of the benefits and risks of ownership are transferred to the municipality without necessarily requiring the transfer of legal ownership.

Loss on Disposal is the amount by which the net book value of a capital asset exceeds the net proceeds realized upon the asset's disposal.

Net Book Value is the capital asset cost less accumulated amortization and any write-downs. It represents the asset's unconsumed cost.

Non-Financial Assets are assets that do not normally provide resources to discharge liabilities. They are employed to deliver municipal services, may be consumed or used up in the delivery of those services, and are not generally for sale. Examples of non-financial assets are capital assets and inventories held for consumption or use.

Repairs and Maintenance are ongoing activities to maintain a capital asset in operating condition. They are required to obtain the expected service potential of a capital asset over the estimated useful life. Costs for repairs and maintenance are expensed.

Residual Value is the estimated net realizable value of a capital asset at the end of its estimated useful life to the municipality. A related term, salvage value, refers to the realizable value at the end of an asset's life. If the municipality expects to use a capital asset for its full life, residual value and salvage value are the same.

Service Potential is the output or service capacity of a capital asset.

Straight-Line Method is an amortization method which allocates the cost of a capital asset equally over each year of its estimated useful life.

Threshold is the minimum cost an individual tangible capital asset must have before it is recorded as a capital asset on the statement of financial position.

Useful Life is the estimate of either the period over which the City expects to use a tangible capital asset, or the number of production or similar units that it can obtain from the tangible capital asset. The life of a tangible capital asset may extend beyond its useful life. The life of a tangible capital asset , other than land, is finite, and is normally the shortest of the physical, technological, commercial or legal life.

Work in Progress is the accumulation of capital costs for partially constructed or developed projects.

Works of art and historical treasures are property that has cultural, aesthetic, or historical value that is worth preserving perpetually. These assets are not capitalized as their service potential and expected future benefits are difficult to quantify.

Write-down is a reduction in the cost of a capital asset when conditions indicate that the asset no longer contributes to a government’s ability to provide goods and services or the value of future economic benefits associated with the asset is less than net book value. A write-down should be recorded and expensed in the period the decrease can be measured and is expected to be permanent.

SCOPE:

This policy applies to all tangible capital assets owned, purchased, constructed by the City of Waterloo (the City) or donated to the City by other governments and non-governmental parties. This policy applies to all City departments. Intangible assets are not covered by this policy.

POLICY COMMUNICATION:

The Policy will be posted on the City’s intranet and staff will be advised of the new policy via distribution to the Corporate Management Team and Operational Leadership Team.

INTERPRETATION:

In the event of disagreement on the interpretation or implementation of these policies and procedures, the Chief Financial Officer shall make the final decision, guided by the Municipal Act, Public Sector Accounting Handbook Section 3150, and the Ontario Municipal Benchmarking Initiative's "Municipal Guide for Accounting for Tangible Capital Assets".

POLICY:

ASSET CLASSES

Tangible capital assets shall be classified using two distinct categories. The first is a "primary" category, which describes what an asset objectively is. The second category is the "functional" service area in which the asset is used. These categories will be presented separately in the notes to the financial statements.

Primary Category
The primary asset category will be shown in the notes to the financial statements as "Segmented by Asset Class". The list of primary asset categories to be utilized is as follows:

- Land
- Land Improvements
- Buildings
- Machinery & Equipment
- Vehicles
- Office Furniture
- IT Equipment
- Playgrounds
- Meters
- Linear Assets:
  - Roads
  - Sidewalks
  - Sanitary
  - Storm
  - Water
- Streetlights
- Capital Work in Progress

Functional Category
The functional asset category will be shown in the notes to the financial statements as "Segmented by Division". The list of functional asset categories is as follows:

- General Government (Land, Land Improvements, Buildings, Machinery & Equipment, Vehicles)
- Protective Services (Fire, Property Standards)
- Transportation (Roads, Sidewalks, Parking, Streetlights)
- Environmental Services (Storm, Water, Sanitary)
- Health Services (Cemetery)
- Recreation & Culture (Parks, Recreation, Library, Museum, Golf)
- Planning & Development (Planning, Zoning, Forestry

For further clarification:

i. Tangible capital assets do not include intangible assets such as copyrights, trademarks, patents and human capital.
ii. Natural resources that have not been purchased are not recognized as assets in the consolidated financial statements.
iii. Non-operational heritage assets will not be capitalized. Non-operational heritage assets include: museum and gallery collections, other works of art, monuments and statues.
iv. Spare parts, acquired as part of the same procurement as the original capital asset, will be considered integral to the acquisition of the capital asset and form part of the total cost of the tangible capital asset.

CAPITALIZATION THRESHOLDS

Tangible assets shall be capitalized and recorded in the capital asset module according to the following thresholds:

a) All land;
b) Land improvements (parking lots, retaining walls, sidewalks, sprinkler systems, etc.) with a unit cost of $5,000 or greater;
c) Buildings with a unit cost of $10,000 or greater;
d) Leasehold improvements with a cost of $10,000 or greater;
e) Linear assets (built assets such as roads, bridges, communication networks, etc.) with a unit cost of $10,000 or greater;
f) Pooled assets with a combined total of $25,000 or greater;
g) All other assets with an individual unit cost of $5,000 or greater;
h) Any other asset below these limits that is deemed necessary to capitalize by the Chief Financial Officer of the City of Waterloo.

Studies and other initiatives that relate directly to the approved acquisition of a tangible capital asset shall be capitalized. If the study/initiative does not relate directly to the acquisition of a tangible capital asset, it shall be expensed in the year(s) in which they occur.

For constructed assets, all direct costs associated with the project shall be included in establishing the asset value.

Tangible capital assets that are to be developed or constructed shall be recorded as “Work in Progress”. Amortization shall begin on the earlier of the day that the asset goes into service or that ownership/responsibility/control is transferred to the City. Subsequently, the asset will be transferred from “Work in Progress” to the applicable asset category. The City does not capitalize interest costs associated with the acquisition or construction of a tangible capital asset.

Expenditures that qualify as betterments to existing assets, should be capitalized when unit costs exceed the threshold. Consult the “Definitions” policy to determine what will qualify as a betterment.

AMORTIZATION

1. Tangible capital assets are recorded at cost which includes amounts that are directly attributable to acquisition, construction, development or betterment of the asset.

2. All tangible capital assets shall be amortized on a straight-line basis (based on original life), except in conditions where it would be deemed more appropriate to use a different method. The Chief Financial Officer shall approve any alternative methods considered.

3. Amortization will be calculated annually and listed in the appropriate TCA schedule.

4. Annual amortization is charged in the year of acquisition and in the year of disposal. Assets under construction are not amortized until the asset is available for productive use.

5. Land and land components of tangible capital assets (e.g. land on which a building is situated) shall be recorded at cost and not amortized.

6. Tangible capital assets are not expected to have significant residual value and therefore shall be deemed to have no residual value for purposes of calculating amortization. If, however, the residual value is significant it will be considered in calculating amortization. For items that have been fully amortized, any eventual sale proceeds received, less costs to dispose, shall be recorded as a “gain on sale of asset”. Any costs relating to the disposal of a fully amortized item, net of proceeds, shall be recorded as a “loss on disposal of asset”.

7. Estimates of useful life (for purposes of the amortization calculation) will be determined by the City of Waterloo based on the expected use of the asset. The expected use of the asset will be based on reasonable assumptions.

   The City will consider various other sources when making useful life assumptions, including, but not limited to:

   - Expected future use;
   - Expected wear and tear from use or passage of time:
   - Effects of technological obsolescence;
   - Maintenance program for the asset;
   - Capacity versus actual usage or changes in demand for services;
   - Condition of existing comparable assets;
   - Manufacturer estimates;
   - Previous experience;
   - Ontario Municipal Benchmarking Initiative documentation

The following useful lives have been determined for these common asset categories:

Capital Asset Class and Category	Est'd Useful Life	Amortization
Land and land improvements		
Land	Indefinite	N/A
Land improvements	15-35 years	Straight-Line
Buildings and building improvements		
Buildings	40 years	Straight-Line
Machinery and equipment		
Operating equipment	3-10 years	Straight-Line
Fleet		
General Vehicles	8 years	Straight-Line
Large Fire Vehicles	15 years	Straight-Line
Office and information Technology		
Computer hardware	3-5 years	Straight-Line
IMTS - Fibre Optics	25 years	Straight-Line
Office furniture and equipment	5 years	Straight-Line
Infrastructure		
Roads	15-40 years	Straight-Line
Water, Sanitary, Storm Infrastructure	75 years	Straight-Line
Other		
Meters – Household (15)	25 years	Straight-Line
Meters – Larger (25+)	8-10 years	Straight-Line
Streetlights – Decorative	20 years	Straight-Line
Streetlights – Concrete, Wooden, Steel	40 years	Straight-Line
Playgrounds	15 years	Straight-Line

8. The useful life estimate for leasehold assets will be restricted by the terms of the lease agreement. The useful life will be the lesser of the actual estimate, and the sum of the number of years remaining in the current and ensuing lease terms.

9. The method of asset amortization and the estimated useful life will be reviewed on a regular basis. This review is event driven. Significant events that may indicate the need for a revision include:
   - A change in the extent to which the tangible capital asset is used;
   - A change in the manner in which the tangible capital asset is used;
   - Removal of the tangible capital asset from service for an extended period of time;
   - Physical damage;
   - Significant technological developments;
   - A change in the demand for the services provided through use of the tangible capital asset;
   - A change in the law or environment affecting the period of time over which the tangible capital asset can be used.

POOLED ASSETS

Certain items such as tools, furniture and computers are generally below the capitalization threshold individually but are typically purchased or held in large quantities which may represent significant expenditures overall. In such cases, it would seem reasonable to capitalize all items acquired in a given asset class or pool and amortize the pool over a pre- determined amortization period.

Due to the large financial impact and large numbers purchased, there are certain assets that represent a material pooled asset. The City will create pools of assets when it believes that the pool of assets represent a significant pool of tangible capital assets that has or will have a significant financial impact on the City.

Inventory disposal will be accounted for utilizing the deemed disposal method.

BUNDLING OF ASSETS

For purposes of capitalization and amortization, the two methods of defining tangible capital assets are whole asset and component asset.

i. 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 computer network could be considered one asset.
ii. Under the component approach, different components are individually capitalized and amortized. Under this approach, the servers, routers, lines, software, etc. used in a network would all be individual assets.

Both the whole asset method and the component method are equally acceptable under GAAP.

The City of Waterloo will utilize the whole asset approach for all assets.

TANGIBLE CAPITAL ASSETS UNDER CONSTRUCTION (WORK IN PROGRESS)

Determining when a tangible capital asset, or a portion thereof, is ready for productive use requires consideration of the circumstances in which it is to be operated.

Assets under Construction will be reflected in the work in progress inventory until it is determined that the asset has been placed in service.

Assets under Construction will not be amortized while in progress.

BETTERMENTS

Betterments are costs incurred for enhancements to the service potential of a capital asset such as:

- o an increase in the previously assessed physical output or service capacity;
- o a reduction in associated operating costs;
- o an extension of the estimated useful life; or
- o an improvement in the quality of output of the asset.

Betterments need to meet the capitalization threshold.

A betterment expenditure adds to the useful life of an asset once the original useful life has been attained. A repair & maintenance expenditure allows or assists in attaining the original useful life. A betterment cost is capitalized and a repair & maintenance cost is expensed in the statement of operations.

When recording a betterment, the cost of the betterment should not be added to the original cost of the asset, rather it will be set- up as its own standalone asset with a partial disposal processed against the original existing asset when the improvement occurs.

Examples of betterments that should be capitalized include: replacing entire roof, replacing entire HVAC systems, building new offices within an existing building, installing new sleeves within infrastructure assets and major parking lot asphalt resurfacing, provided they extend the life of the asset. Examples of modifications that would generally not be capitalized are items such as a minor or partial resurfacing of a parking lot, replacing a road asphalt overlay, partial roof replacements.

Where a cost cannot easily be differentiated between a repair and a betterment, the accounting principle of conservatism dictates that the cost should be expensed. Departments must provide the rationale to the Financial Services Department both at the budget stage and following project completion.

DONATED ASSETS

Contributions of tangible capital assets are recorded at their fair value at the date of receipt, and are also recorded as revenue.

The cost of a contributed or donated tangible capital asset, including a tangible capital asset in lieu of a developer charge, is considered to be equal to its fair value at the date of contribution. Contributed or donated assets will be recognized as City owned assets when the Legal Title is transferred.

Asset transfers from other governments will be accounted for in accordance with the CICA Handbook.

In order to determine the fair value, an independent valuation of the tangible capital asset will be undertaken such as an appraisal, professional opinions or quotes from independent sources. These accounting estimates must be documented and provided to the Financial Services Department for the appropriate financial transactions.

In the case where a tangible capital asset is being constructed on behalf of the City or as part of a development, the responsible Director should attempt to acquire the fair value from the developer and include this as a requirement of the contract. If the fair value cannot be determined by any means outlined above, the asset should be recorded at a nominal value and disclosed in the notes to the financial statements.

DISPOSALS

Upon disposal, the Department must inform the Financial Services Department of the result of the disposal and provide information on the proceeds together with the documentation describing the disposal.

Disposals of tangible capital assets in the accounting period may occur by sale, trade-in, destruction, loss or abandonment. Such disposals represent a reduction in the City's investment in tangible capital assets, regardless of how that investment is reported.

Under PS3150, the difference between the net proceeds on disposal of a tangible capital asset and the net book value of the asset should be accounted for as a revenue or expense in the statement of operations.

IMPAIRMENT OF ASSETS/WRITE DOWNS

The net write-downs of the tangible capital asset will be accounted for as an expense in the statement of operations and cannot be reversed. Consequently, the decision to write- down an impaired asset could have a significant impact on the annual surplus or deficit. It is important to note, however, that this is simply a timing difference. Upon disposal, the impairment of the asset will be reflected on the statement of operations.

The City should write down the cost of a tangible capital asset when it can demonstrate that the reduction in future economic benefits is expected to be permanent. A write down of an asset is generally more desirable than a change in amortization method since those decisions are policy decisions affecting prior accounting periods.

Conditions that may indicate that the future economic benefits associated with a tangible capital asset have been reduced and a write-down is appropriate include:

i. a change in the extent to which the tangible capital asset is used;
ii. a change in the manner in which the tangible capital asset is used;
iii. significant technological developments;
iv. physical damage;
v. removal of the tangible capital asset from service;
vi. a decline in, or cessation of, the need for the services provided by the tangible capital asset;
vii. a decision to halt construction of the tangible capital asset before it is complete or in usable or saleable condition; and
viii. a change in the law or environment affecting the extent to which the tangible capital asset can be used.

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

When the tangible capital asset no longer contributes to the municipality's ability to provide goods and services, it should be written down to residual value, if any. This would be appropriate when the City has no intention of continuing to use the asset in its current capacity, and there is no alternative use for the asset.

In other circumstances, it will be necessary to estimate the value of expected remaining future economic benefits. Where a municipality can objectively estimate a reduction in the value of the asset's service potential to the government, and has persuasive evidence that the reduction is expected to be permanent in nature, the tangible capital asset would be written down to the revised estimate of the value of the asset's remaining service potential to the government.

Since all of the above decisions affect the City's statement of operations, the department and the Financial Services Department must work together to determine the best approach. In the event that the impact is material, a report to City Council outlining the impact on the financial statements, budget and operations may be warranted.

CAPITAL LEASES

Leases which transfer substantially all of the benefits and risks incidental to ownership of property are accounted for as leased tangible capital assets. All other leases are accounted for as operating leases and the related payments are charged to expenses as incurred.

As defined by the CICA, a leased tangible capital asset 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 government 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 government without necessarily transferring legal ownership.

A tangible capital asset procured and financed, meeting the definition of a capital lease, must be capitalized in the same manner as all the other tangible capital assets and follow this policy. The Chief Financial Officer, in conjunction with the Department, will make the determination of the type of lease – Capital vs. Operating lease.

All operating lease costs are treated as an expense in the statement of operations.

LEASEHOLD IMPROVEMENTS

A leasehold improvement is a betterment made to leased property. Betterments are expenditures relating to the alteration or modernization of an asset that appreciably prolong the item's period of usefulness or improve functionality for more than one accounting period.

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