

Oxford City Council's Capitalisation Procedures November 2009

These procedures have been based upon the following guidance:

- Practitioner's guide to capital finance in local government – CIPFA
- Statement of Recommended Practice 2008 – CIPFA
- FRS 15 – Accounting Standards Board
- IAS 16 – International Accounting Standards Board

Acquisition or Creation of New Fixed Assets

Oxford City Council (the Council) will only include a fixed asset onto its asset register if it complies with the following definition of a fixed asset as per FRS 15:

“Rights or other access to future economic benefits (controlled by an entity as a result of past transactions or events) that have physical substance and are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes on a continuing basis in the reporting entity's activities.”

The definition of property, plant and equipment and the definition of an asset under IAS 16 are similar to the FRS 15 definition.

A tangible fixed asset is thereby acquired or created when the Council acquires or brings such rights into existence. In practical terms this means:

- The assets must be grounded in some physical property, such as land, a building or a machine.
- It is not necessary for an authority to own the property represented by the assets, provided that it controls the way in which it can be used and benefits generated by such use e.g. a finance lease asset.
- There needs to be a past event that has given the authority the rights to future economic benefits.
- Rights can take many forms, provided that they relate to future economic benefits e.g. occupation of a building, use of a vehicle.
- The rights must extend into the future, at least beyond the end of one financial year.
- The authority must plan to use the asset for the provision of its own services

The Council will comply with FRS 15/IAS 16 in relation to the provisions in respect of costs that can be capitalised. The cost to be recognised for a fixed asset is the purchase price (less trade discounts), plus directly attributable costs.

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Attributable costs are defined as:

- Labour costs of the entity's own employees (for example architects and surveyors) arising in the construction of the asset.
- Incremental costs to the entity that would have been avoided only if the tangible asset had not been constructed or acquired, for example external professional fees used in the acquisition or construction of the asset which aid in bringing into working condition for its intended use. Therefore costs on speculative projects or aborted plans should not be capitalised. Any type of operating costs in relation to setting up a new service cannot be capitalised such as staff training or the cost of alternative arrangements whilst an asset is being constructed.

See Appendix 2 for more detail on directly attributable costs and Appendix 3 for examples of capital and revenue expenditure.

Capitalisation of Finance Costs

The Council is permitted to capitalise finance costs in relation to capital projects, in accordance with the requirements of FRS15/IAS 16. These could comprise interest on bank overdrafts and short- and long term debt, plus amortisation of ancillary costs incurred in connection with the arrangement of debt, arising as a result of fixed assets taking a substantial period of time to bring into service.

Enhancement of Fixed Assets

The Council will only capitalise enhancement expenditure providing the cost can be measured reliably and it meets at least one of the following three criteria:

1. Lengthen substantially the useful life of the asset. Has it been assumed in the previous assessment of the useful life of the property that the works would need to be incurred in order for the asset to last that long?
2. Increase substantially the market value of the asset. This can most straightforwardly assessed by commissioning a valuation (internal or external) before and after the works have been carried out.
3. Increase substantially the extent to which the asset can or will be used for the purposes of or in conjunction with the functions of the Council. This will be a subjective assessment made by the Council, determining whether an asset is more or less likely to contribute to the Council's policy objectives once the works have been carried out.

All expenditure on repairs and maintenance relating to fixed assets should be charged to the appropriate service revenue account. Capitalisation of major repairs, no matter how large e.g. painting cycles, are not permitted.

IAS 16 states that subsequent expenditure can be capitalised when: it is probable that future economic benefits associated with the item will flow to the entity and the cost of the item can be measured reliably. The three criteria listed above are consistent with IAS 16's criteria.

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The Council can capitalise enhancement expenditure on a leased asset providing it controls the rights to the benefits of the capital expenditure. This can be determined by reviewing the useful economic life of the enhancement compared with the lease term. In general enhancement expenditure that is spent on finance-leased assets, where the Council is the lessor, will be treated as revenue expenditure funded from capital under statute. Conversely enhancement expenditure spent on a finance-lease asset, where the Council is the lessee, will generally be capitalised.

Enhancement expenditure will be added to the value of relevant fixed assets and only written off to the extent that there is evidence that an impairment review might be needed and that review results in a devaluation of the asset. If the valuation determines that the value of the asset had not increased by the level of the enhancement expenditure, then it should formally be processed as an impairment loss and passed through the I+E Account (where there is clear consumption of economic benefits or insufficient compensating revaluation gains in the Revaluation Reserve for the enhanced asset) or posted to the STRGL as a revaluation loss.

De –Minimus Capitalisation Limits

The principles of capital accounting are applicable to all fixed assets. However, the Council is able to prepare the financial statements in accordance with the concept of materiality – capitalisation of expenditure on fixed assets is not necessary where the amounts involved are not material to the fair presentation of the financial position and which would not affect the understanding of the users of the accounts. Therefore, the Council will capitalise costs that are greater than the following limits:

- individually have a cost of at least £5,000 (£1,500 for residential properties); or
- collectively have a cost of at least £5,000 (£1,500 for residential properties) and individually have a cost of more than £250, where the assets are functionally interdependent, have broadly simultaneous purchase dates, are anticipated to have simultaneous disposal dates and are under single managerial control.
- Form part of the initial equipping and setting-up cost of a new building, or significant refurbishment, irrespective of their individual or collective cost.

In certain scenarios the Council may want to capitalise below the de-minimus level providing the expenditure meets the criteria for enhancement expenditure, for example the expenditure is funded through capital grants.

Capital expenditure that relates to communal areas within a block of flats, or similar accommodation, is to be apportioned across the number of flats within the block. The proportion of capital expenditure that relates to privately owned flats should be treated as revenue expenditure funded from capital under statute as the work is increasing the value of properties not owned by the Council. The proportion relating to Council owned properties should be capitalised. The use of this method may reduce the capital expenditure per asset below the £5,000 (£1,500 for residential properties) de-minimus limit mentioned in the paragraph above. Therefore, the de-minimus limit for capital expenditure on communal areas is to be £5,000 (£1,500 for residential properties) per component.

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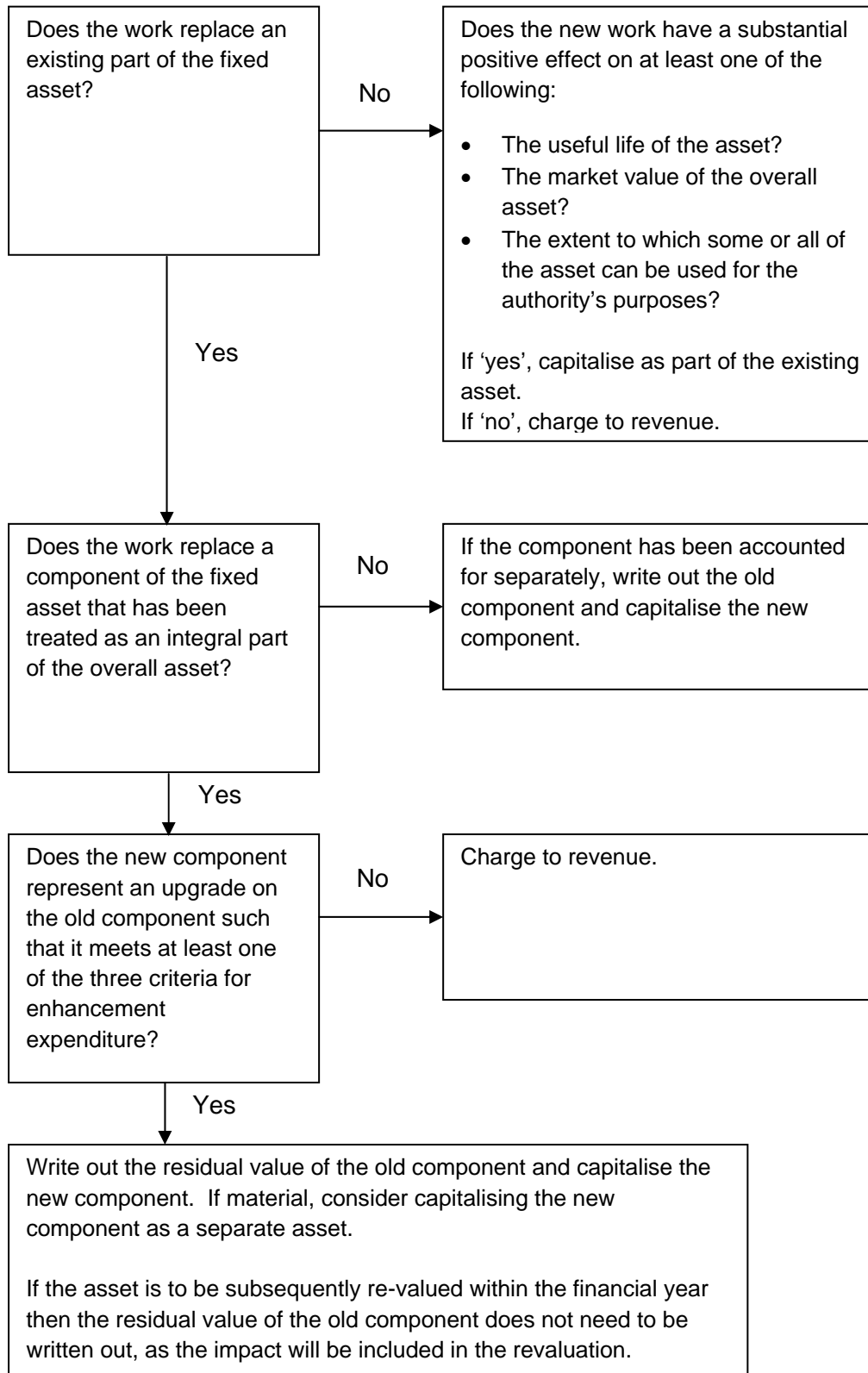
The Council will account for a component separately if the capital cost of the new component is above £50,000 and the useful economic life of the component is significantly different from the useful economic life of the remainder of the asset. The separation of component assets is likely to be necessary when there are large pieces of plant and equipment within a property.

The Council believes that the adoption of these de-minimus limits for the capitalisation of assets will not result in fixed asset-related disclosures in the Statement of Accounts that are materially different from those that would have resulted if capital accounting had been followed to the penny for every fixed asset. The Council believes the limits included in these procedures correctly balance between the need for management information for the authority's stewardship responsibilities, administrative cost and the impact on financial statements.

See appendix 1 for a flow diagram of the decision making process when determining the appropriate accounting treatment for project expenditure.

Appendix 1

The following flow diagram summarises the considerations the authority will make in determining whether expenditure on an existing asset represents enhancement.



Appendix 2

Labour Costs of the Entity's own employees arising in the construction or acquisition of a tangible fixed asset

Only labour costs that relate to the time spent by employees on constructing or acquiring a specific asset should be capitalised. Time spent on potential acquisitions or developments cannot be included. If an employee spends 40% of their time on a particular development project, then only 40% of the employee costs should be capitalised as part of the cost of the asset. Costs would include the full employee costs of the officer, including those relating to retirement benefits (i.e. an attributable amount of the FRS 17 current service cost). Overhead costs can be capitalised (such as the costs of support service that are apportioned across the authority on a per capita basis) providing they are the incremental costs to the authority that were incurred only due to the construction of the tangible fixed asset.

Incremental Costs to the Entity that would have been avoided only if the tangible asset had not been constructed or acquired

External professional fees incurred in finding a suitable asset for the authority's specification, which is then acquired or constructed, may be capitalised, as they are incremental costs to the entity that would have been avoided only if the tangible fixed asset had not been constructed or acquired. This contrasts with the treatment of labour costs of an authority's own employees in searching for suitable site or assets, which cannot be capitalised. The definition of directly attributable costs in FRS 15 and IAS 16 is the requirement that only costs directly attributable in bringing the tangible fixed asset into working condition for its intended use should included in the cost of the asset.

Costs that do not relate to the construction of the physical asset, but rather relate to setting up the new service as a whole, even though they are incurred during the construction phases, do not qualify to be capitalised as part of the cost of the tangible fixed asset.

Appendix 3

The following table provides examples of whether expenditure is Capital or Revenue.

Item of Expenditure	Capital or Revenue?
Feasibility Studies	Revenue. All costs incurred whilst an authority is deliberating on the problems it wishes to resolve by scoping potential solutions and choosing between them and assessing whether resources will be available to finance a project will normally be revenue. This is because, until a specific solution has been decided upon, costs cannot be directly attributable to bringing an asset into working condition.
Demolition of existing building	Capital. Providing that the costs incurred are a necessary step in preparing a site for a new building, it can be argued that they are an integral part of new works.
Costs of buying out sitting tenants of existing building	Capital. Similar to demolition costs, this would be a step towards preparing the site in its existing condition for the new works.
Hiring alternative accommodation to allow continued service provision whilst a new property is being built.	Revenue. This is because it makes no direct contribution to the productive capacity of the building.
Site security during construction	Revenue. This activity protects the investment made in the building during construction but does not enhance it.
Professional fees	Capital – to the extent that the services provided make a contribution to the physical fabric of the new property (e.g. architecture design) or the work required to bring the property into working use (e.g. legal advice in the preparation of building contracts).
Furniture and Fittings	Capital – Items that are needed to bring an asset into working condition for its intended use are often capitalised as part of the overall cost of the property, even if such items would normally be below the authority's de minimis limit. The downside of such a treatment is that it might be harder to justify future replacement of furniture and fittings as being capital, as initial capitalisation will have been integrated into the overall asset and might not be identifiable as a component.
Rectification of design faults	Capital. Rectification work will take an asset closer to being in working condition.
Training and familiarisation of staff in operation of new building.	Revenue. The building will be regarded as being in working condition even if there is no one component at the authority actually to operate it.
Borrowing costs incurred whilst new building was under construction	Capital. Any interest payable on expenditure incurred before the asset is in working condition can be added to the cost of the fixed asset.
Apportionment of costs of capital expenditure team and internal audit	Revenue. These costs are generally incurred make sure the project runs as intended, rather than enhancing it.

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Senior management time including Chief Executive	Normally Revenue: The usual presumption is that senior management at an authority will be working at a strategic level and that their efforts will not be reflected in any particular fixed asset that is created. However, it is possible that senior management is spending some of its time working directly on a single project. It needs to be clear that any efforts have an effect on the completed asset, and that the managers are not just managing the relationship between the authority and the contractors.
Disability discrimination Act Works	Generally Capital – The Council has a legal obligation to make its buildings accessible for disabled persons. Any works performed will usually be increasing the service provision of the asset as an increased number of people can then use the asset.
Internal Decoration	Revenue – This does not increase the value of the asset or its service potential.
Complete re-wiring to meet regulatory standards	Capital – The old wiring has effectively reached the end of its useful economic life, as it is no longer fit for purpose. The new wiring is an enhancement as it complies with new regulatory standards.
Churchyard stone wall repairs	Revenue – This is repairing an existing asset and not enhancing it.