

Tangible Capital Assets

Guideline 7: Building/School Betterments

Overview

Further to Guideline 3 Maintenance/Repairs versus Betterments, the purpose of this guideline is to provide clarification regarding the accounting treatment of building/school betterments.

The following guideline is intended to supplement the Tangible Capital Assets (TCA) Policy and provide further guidance on this topic. Please note that this guideline is not all inclusive and professional judgment 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.

Reference

Public Sector Accounting Standard PS 3150.19 states:

“Costs of betterments are considered to be part of the cost of a tangible capital asset and would be added to the recorded cost of the related asset. A 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.”

Definitions

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 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

Building/school betterments relate to provincially owned buildings/schools or those under a finance lease.

THRESHOLD

An expenditure that meets the definition of a betterment must also meet the threshold of the related asset class to be set up as a tangible capital asset before it is capitalized. Therefore, there may be situations where betterments are not capitalized due to the low dollar value of the expenditure. The thresholds are provided in Appendix 14-C of the TCA Policy.

EXPENDITURES SUBSEQUENT TO ACQUISITION/CONSTRUCTION

Expenditures which may be incurred subsequent to acquisition/construction of a building/school include:

- repairs and maintenance
- replacements
- betterments
- additions
- alterations and renovations

In determining if expenditures subsequent to acquisition/construction are capital or operating in nature, the expenditures have to be evaluated against the criteria of a betterment to determine whether or not the service potential of the asset has been enhanced. As the name implies, the result should be *better* - not just new or more attractive, but *better* in terms of enhanced service potential of the asset. This means the result should be an increase in service capacity, lower associated operating costs, an extended useful life, or an improved quality of output.

The Decision Tree/Questions section is provided in Guideline 3 Maintenance/Repairs versus Betterments to assist in the determination of whether expenditures are capital or operating in nature.

If the expenditure fails to meet the criteria of a betterment, then it should be classified as an operating expense and recorded in the period incurred.

REPAIRS AND MAINTENANCE

Repairs and maintenance maintain the service potential of a tangible capital asset and should be charged to operating expense as incurred. Examples of repairs and maintenance related to buildings/schools include structural repairs; roof repairs; repairs to windows; masonry repairs; repairs to shingles; painting; caulking; weather stripping.

Repairs to restore an asset partially damaged by fire, flood, accident or other similar events, to the condition just prior to the event, should be charged to operating expense. The expenditure is simply restoring the asset to its original condition.

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 of a betterment, and meet the threshold. Therefore, it is important to assess if the expenditure has enhanced the service potential of the asset to determine if it is capital in nature.

The following are examples of expenditures which are operating in nature in one situation, and are capital in nature in a different situation, depending upon the specific circumstances of each situation:

Example - New Roof

Operating

Maintenance - Original useful life is maintained

A new roof may be a normal maintenance cost which is required in order to maintain the original useful life of the existing building. Without this expenditure, the building would not last the original useful life. Since this new roof does not extend the original useful life, but rather simply maintains it, it does not meet the criteria of a betterment. As a result, the expenditure is a replacement and should be charged to operating expense.

Capital

Service potential is enhanced

If the new roof is the substitution of a better quality component such as an old wood shingle roof with a modern fireproof tile roof, this new roof results in enhanced service potential. As a result, it meets the criteria of a betterment and should be capitalized, provided it meets the threshold.

Capital

Original useful life is extended

If a new roof is installed near the end of the useful life of the building, and it is determined that the new roof extended the original useful life, this new roof enhances the service potential. Although the substitution may be of similar quality to the old roof, it meets the criteria of a betterment because it has extended the original useful life. As a result, the expenditure should be capitalized, provided it meets the threshold.

Example - New Windows

Operating

Maintenance - Original useful life is maintained

New windows may be a normal maintenance cost which is required in order to maintain the original useful life of the existing building. Since the new windows do not enhance the service potential, the criteria of a betterment is not met. As a result, the expenditure is a replacement and should be charged to operating expense.

Capital

Associated operating costs are lowered

If the new windows are the substitution of a better quality component such as substituting old windows with new energy saving windows, and it is determined that the new windows would lower associated operating costs, the new windows would meet the criteria of a betterment. As a result, the expenditure should be capitalized, provided the threshold is met.

Example - New Floor Operating

Maintenance

The substitution of a wooden floor with another wooden floor would not meet the criteria of a betterment if the substitution is of a similar quality and service potential is not enhanced. As a result, the expenditure is a replacement and should be charged to operating expense.

Capital

Enhanced service potential

If a wooden floor is removed and a new concrete floor is installed, this would meet the criteria of a betterment as the substitution is of a better quality which would enhance the service potential. As a result, the expenditure should be capitalized, provided the threshold is met.

BETTERMENTS

Betterments related to buildings/schools would include the following:

- Significant improvements beyond the original construction specifications to the building envelope or building services.

The building envelope consists of the external elements, including walls, floors, ceilings, roofs, windows and doors, of a building that enclose conditioned spaces. The following is an example of an improvement to the building envelope:

- structural improvements such as strengthening the foundation of a building

Building services include energy supply - gas, electricity and renewable energy sources; heating and air conditioning; water, drainage and plumbing; natural and artificial lighting, and building facades; escalators and lifts; ventilation and

refrigeration; communication lines, telephones; security and alarm systems; and fire detection and protection. The following are examples of significant improvements to building services that would lower associated operating costs, be more environmentally friendly, or improve the quality of output:

- significant improvement of the electrical system in a building;
 - significant improvement of the plumbing system by using a newly developed plastic tubing system in place of the original cast iron pipes and copper tubing;
 - significant improvement of the plumbing system by installing low-flow toilets throughout an entire building in place of the original toilets;
 - the addition of an air conditioning system to a building which did not previously have an air conditioning system
- Required improvements to become compliant with The National Building Code (NBC), provincial building regulations, and other evolving standards as required by law to ensure public safety or to meet environmental standards, where the standard improves the building's quality of output. These improvements could relate to safety; health; accessibility; or, fire and structural protection of a building.

ADDITIONS

Additions include extensions, enlargements, or expansions of an existing asset. Since additions increase the service capacity of an asset, they are typically capital in nature, provided the expenditure meets the threshold. The following is an example of an addition:

- the expansion of square footage of an existing building by the addition of a new wing, floor, or room increases the physical capacity of the building

ALTERATIONS AND RENOVATIONS

Nature of work

With alterations and renovations, it is important to evaluate the *nature of the work* (versus the scope in terms of dollar value). Alterations and renovations of a significant dollar value are not necessarily capital - the objective of the work being completed must be considered. Alterations and renovations must be evaluated against the criteria of a betterment to determine if the expenditure is capital in nature. The result of the alterations and renovations should be *better* - not just new or more attractive, but *better* in terms of enhanced service potential of the building/school.

Alterations and renovations which are cosmetic in nature do not enhance the service potential of a building/school and should be charged to operating expense. The following are examples of cosmetic alterations and renovations that do not meet the criteria of a betterment:

- replacement of carpet;
- painting of walls;
- replacement of window coverings (e.g., window blinds);
- ceiling tile replacement;
- replacement of doors and related hardware

Minor alterations and renovations which would not enhance the service potential of a building/school should be charged to operating expense. The following are examples of minor alterations and renovations that do not meet the criteria of a betterment:

- renovations to a small area of a building;
- renovations to a washroom such as re-tiling the interior and replacing faucets and toilet fixtures;
- the removal of a wall;
- the construction of an office in currently occupied space;
- minor layout changes or re-arrangement of existing occupants

Alterations and renovations which are required due to a change in use of space and are making the space suitable for its intended purpose would enhance the service potential of the asset. As a result, the related expenditure should be capitalized, provided the expenditure meets the threshold. The following is an example of a change in use of space:

- the converting of office space to a laboratory

Significant alterations and renovations which would result in enhanced service potential of a building/school should be capitalized, provided the threshold is met. The following are examples of significant alterations and renovations that meet the criteria of a betterment:

- the complete “gutting out” and renovation of an entire building near the end of its estimated useful life results in extending the building’s original useful life;
- the conversion of a basement, an attic, meeting rooms or boardrooms into usable office space results in an increase in service capacity of the building

For those alterations and renovations in which the nature of work consists of both an operating and a capital component, the operating costs should be expensed provided they are not trivial, and the capital costs should be capitalized provided they meet the threshold.

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