PSAB/Asset Management

NEWSLETTER NO. 17

CAPITALIZATION THRESHOLDS

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The stapler on your desk is, by definition, a tangible capital asset. You use it for administrative purposes, and occasionally as a hammer. It should serve you long beyond the end of this accounting period, unless you are hard on your work tools. You use it many times a day, so that you certainly wouldn't ever contemplate selling it.

Its location can be documented = your office. Someone is responsible for it = you, even if it does sit out on your desk all the time. You refuel it when it runs out of staples, just as you do maintenance when two or three staples try to escape simultaneously. This isn't really any different from having a car or a high-volume water pump, is it?

But would you really want to go to all the effort and expense of tracking, documenting and reporting assets that have as small a value as a stapler?

NO WAY!!! - did you say?

Then how do you deal with smaller items like this, and make the job of developing and documenting your asset inventory manageable? There are two approaches:

- setting a high enough capitalization threshold, or
- using asset pools, which we will discuss in the next newsletter.

The first is a generally applicable tool, whereas using asset pools is specific to the types of assets in the pools that you create and recognize.

Capitalization Threshold

Capitalization threshold (or recognition threshold) is the value above which assets are capitalized and reported in the financial statements as tangible capital assets, as opposed to being expensed in the year of acquisition. This definition is given in the Public Sector Accounting Group Municipal Guide (p. 99), the OMBI Municipal Guide (p. 21) and the OMBI

Reference Manual (pp 28 and 106). PS 3150 does not provide any specific guidance as to what an appropriate threshold might be.

Do bear in mind that whatever capitalization thresholds you set, they must be applied consistently, ideally on an on-going basis. However, they are not cast in stone, and it may well be appropriate to change a value up or down at some point in time. This will then be documented as an accounting policy change in your financial statements for that year. This consistency is to be maintained not only over time, but over the entire inventory of assets included in the class to which your capitalization threshold applies.

Your capitalization thresholds will be part of your accounting policies for tangible capital asset accounting, to be followed diligently and consistently, so that some careful thought should be given when setting them.

A capitalization threshold of $x will have the following impacts on how you budget, pay and account for your tangible capital assets:

Capitalization Threshold = $x		
< $x or = $x	**Total cost of asset**	**> $x**
Operating or Capital	**Budget**	Operating or Capital Budget
Operating or Capital Financing	**Financing**	Operating or Capital Financing
Expensed	**Accounting**	Capitalized
No	**In asset inventory?**	Yes
No	**Amortized?**	Yes, over estimated life span
Expensed	**Repaired?**	Expensed
Expensed	**Upgraded?**	Expensed or Asset Capitalized *
No action required	**Substantial loss of functionality**	Write down asset valuation in asset inventory
No accounting impact	**Disposed of/written off**	Write down asset inventory and accumulated amortization appropriately

* To be the subject of a future Newsletter on maintenance and betterment

You can readily see that you can budget for the acquisition of a tangible capital asset, and finance that acquisition any way you choose. The method of financing is a management decision. However, once an accounting threshold has been determined, the final accounting treatment of the acquisition is determined by the threshold in your accounting policy. Amounts in excess of the threshold will be capitalized and amortized over its estimated life span. Amounts under the threshold will be expensed in the year of acquisition.

Initial Capitalization Threshold Values

You are going to have to go out and identify and document all of your tangible capital assets. If a stapler is a tangible capital asset, you will need a mechanism to make the exercise manageable and realistic, by concentrating on what is material and significant for your organization and to your business operations. The capitalization threshold is such a mechanism.

By definition, you can safely ignore all those assets whose original cost or value is below your designated threshold. Thinking of the stapler, one can make the business case that these items are likely simply another cost of doing business, no different than buying paper or electricity, except that they provide on-going service over 2 or more fiscal years. If there is no compelling operational reason to manage and track an asset on an on-going basis, there is no compelling accounting reason.

It is almost a certainty that less than 20% of your individual assets will account for at least 80% of the total value of all of your assets. The split may be as high as 10/90. Your efforts should therefore be allocated accordingly.

Setting a high threshold value will reduce the number of items in your tangible capital asset inventory, and substantially reduce the documentation and accounting effort required. However, this may result in a significant number of assets not being included in the asset inventory and not being reported in your financial statements, even though there may well be business and operational concerns with some or most of them that would make tracking advisable. You might wish to collect and maintain information on assets for management purposes even though they might be below your capitalization threshold. Similarly, you might wish to collect and maintain more detailed information on assets for asset management purposes, even though you might not need this information for tangible asset accounting purposes. For example, when it comes to buildings, you might treat these as a single asset for TCA accounting, but might want separate information with regard to HVAC, elevators, etc. for asset management purposes. Just because you collect information on a component basis for asset management, does not mean that you cannot adopt a whole asset approach for TCA accounting.

Depending on the total value involved, your auditor may deem the amount to be significant, and that your valuation is materially understated. The result is that you will then get a qualified audit opinion, which tells a reader of your statements that you are not telling the whole story. **Until you have developed an asset inventory, it will be difficult to tell what thresholds will give a reasonable balance.**

How to resolve this chicken and egg situation? Which comes first?

Set relatively low initial capitalization thresholds to begin with, so that you do not include the really small and relatively insignificant items. At the same time, this will give you data on your smaller value assets, so that you can determine later the impact of raising your thresholds.

So what is a reasonable dollar value? The Public Sector Accounting Group Manual provides some guidance on pages 45 to 47, with the significant suggestion that "a certain percentage (for example, at least 95%) of estimated total assets by value be reported in the financial statements" (p 47). Unfortunately, you will not know if you meet this criterion unless you cover everything, and then determine where the 95% cut-off is.

It is also recognized that this is not a one size fits all situation and that "different thresholds will be appropriate for different local governments" (p 45). A city will likely use a much higher threshold value than a township.

The six OMBI Pilot Sites developed their own set of threshold values, as shown in "Table 4" on the next page: Use these figures as a guide to set your initial capitalization thresholds. They are relatively low, in order to be as inclusive as possible, while excluding the multitude of small assets that may account for less than a percentage point of your total value. The numbers are a reasonable starting point.

The table covers seven types or classes of capital assets. An upcoming newsletter will discuss in more detail how you can classify your tangible capital assets, to facilitate analysis and financial reporting. Note that it is quite reasonable and legitimate to have different threshold values for different classes of assets.

The OMBI Municipal Guide (p 24) reproduces the capitalization and amortization guidelines provided for municipalities by the Government Accounting Standards Board (USA) in GASB Statement #34: These are no longer endorsed by GASB itself, and they may not be particularly relevant to Canadian municipalities. But they do provide another point of view.

Table 4
Materiality Thresholds used by Pilot Projects

	Single Tier Municipalities			Upper Tier Municipalities		
	BRANT Notes 1 & 2	**THUNDER BAY Note 1**	**HAMILTON Note 1**	**MUSKOKA Note 1**	**NIAGARA Notes 1 & 3**	**YORK Note 1**
APPROXIMATE MUNICIPAL REVENUE	**$48M**	**$370M**	**$1,166M**	**$111M**	**$687M**	**$1,008M**
ASSET SUB CLASS : General						
Land	$0 (capitalize all)	$5K	$0 (capitalize all)	$0 (capitalize all)	$0 (capitalize all)	
Land Improvements	$0K	$5K		$25k	$25k	
Buildings & Building Improvements	$5K	$5K	$50K	$50k	$25k	$200K
Leasehold Improvements	$5K	$5K		$50k	$25k	
Vehicles	$5K	$5K	$5K	$15k	$5k	$5K
Equipment	$5K	$5K	$5K	$15k	$5k	$25K
ASSET SUB-CLASS : Infrastructure	Linear assets - $100K	$5K	$50K	$50k	$50k	$500K

Note 1 – Thresholds listed will be reviewed again at a later date. These are not necessarily the final thresholds that will be used for the implementation of tangible capital assets reporting.
Note 2 – Threshold for pooled assets will be $50k
Note 3 – The threshold for pooled assets will be $250k.

(from OMBI, "Municipal Guide to Accounting for Capital Assets", page 26)

On-going Capitalization Thresholds

This will be at the heart of setting capitalization or recognition thresholds for tangible capital assets for your municipality - finding values that minimize the amount of on-going tracking and record-keeping required, while not seriously understating the value of the assets that your municipality controls. These are values that will ensure that you are capturing at least 95% or more of the total value of your tangible capital assets.

Once you have identified and valued your assets, based on the initial thresholds, it will be the time to analyze your data to determine how sensitive the total asset value is to changing the capitalization threshold. For example, does doubling the threshold value reduce your total asset value by just 1%, and the number of assets included by 25%? This would be a situation where it would make sense to raise the capitalization threshold.

PS 3150 recognizes that you may want to change your accounting policies over time to reflect changed circumstances or perspectives. Thus it will be perfectly logical that the capitalization thresholds that you use for developing your initial asset inventories will not be the ones you use for on-going tangible capital asset accounting down the road, and that even those thresholds may change again in time.

It is also recognized that this is from the perspective of asset accounting, which is looking to make this trade-off, in order to keep the tracking and maintenance of the data reasonable. Asset management may want its data bases to be much more inclusive for operational reasons. We will deal with the two perspectives in a future newsletter.

If your Finance Department has a goal of ensuring that its staff can always staple immediately and effectively, then you may indeed want to track the staplers.

And in conclusion

Unfortunately, there isn't one. Your uniqueness means that you may need a unique set of thresholds to meet your internal requirements and to satisfy your auditor. It is hoped that the table provided will give you a good starting point for your initial valuation.

Our next newsletter will look at asset pools, which is a way of addressing large numbers of smaller value assets. For more information and resources regarding tangible capital asset management, go to PSAB Asset Management, or contact:

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