NEWSLETTER NO. 18

ASSET POOLS, OR GROUPS

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In our previous newsletter, we used the common office stapler as an example of how low one can go in identifying assets. Trivial, perhaps, and certainly a *reductio ad absurdum*, but you do have large numbers of smaller value items that collectively may be worth a lot of money. If you want to account for these and report them in your financial statements, we mentioned the use of asset pools as an approach for processing such assets.

You may also want to pool larger assets, such as land parcels or networks, rather than account for individual parcels or components. This newsletter will look at when and how you may want to use asset pools.

Public Sector Accounting Handbook Section PS3150.12

"*Many tangible capital assets, particularly complex network systems such as those for water and sewage treatment, consist of a number of components. Whether a government decides to record and account for each component as a separate asset will be determined by the usefulness of the resulting information to the government and the cost versus the benefit of collecting and maintaining it*."

The Public Sector Accounting Group's "Guide To Accounting For And Reporting Tangible Capital Assets" notes (page 47):

> *Assets that have a lower value, per unit, than the capitalization threshold, may be material when grouped. Such assets are generally recorded as a single group asset, with one combined value. Examples where this may be appropriate include:*
>
> - *computer networks;*
> - *furniture and fittings;*
> - *certain types of moveable equipment; and*
> - *library contents.*

What is an asset pool?

An asset pool is a grouping of identical, similar, or related tangible capital assets. It involves identifying, treating, accounting for and reporting on an entire set of individual assets as a collective group, as though they were a single asset. This is, of course, only for the purposes of accounting for tangible capital assets, and definitely not for the purposes of asset management.

Note that for TCA accounting, the asset pool will be recorded and accounted for as a **single** asset, and will be a single entry in your asset accounting environment. At the same time, you may well have one or more subsidiary ledgers or systems with itemized information that serve the purposes of asset management, and which may be able to provide necessary data for updating the asset pool information, when required.

What types of items may you want to pool?

Besides the four types cited earlier, other typical examples would be:

- Fire hydrants
- Utility poles and street lights
- Culverts
- Firefighters' uniforms
- Benches and other park and street furniture
- Laboratory testing equipment
- Utility meters (water, sewage, traffic counters, etc.)
- Beds and other resident furniture in long-term care facilities
- Kitchen equipment in a cafeteria or facility kitchen
- Play equipment at day-care centres
- Guns, rifles and other weaponry (ammunition is an inventory item)

Note how in each case, the value of each individual item may be well below your asset capitalization threshold, but collectively, the total value may be significant.

The asset pool can be a very cost-effective approach for handling large numbers of smaller value items, rather than trying to maintain individual accounting records for each one. It is also appropriate for larger value items, such as a network, where the network is managed and maintained as a network, and there may be disagreement or uncertainty as to what the most appropriate logical asset components would be.

You may decide to include higher valued capital assets in an asset pool, such as an asset worth more than your capitalization threshold for an individual asset. For example, some kitchen equipment may cost more than the threshold for an individual asset, yet operations may look on everything as comprising one fully-equipped kitchen, and would cost, budget, maintain and

account for it as such. In this example, your asset pool is comprised of all of the individual assets make up the kitchen, including the high value items. This is quite reasonable from an accounting perspective, just as it may be from an operating perspective. Alternatively, this could be viewed as an *aggregated* asset, to be discussed in a future newsletter.

Why use asset groups or pools?

When is this approach helpful? First and foremost, it can simplify the bookkeeping and accounting required, especially if someone else is maintaining detailed asset records for asset management and operational reasons, and there is no compelling reason to maintain individual accounting records for each asset. Most, if not all, of the asset types cited earlier would meet this criterion.

If you have a large number of virtually identical assets, e.g. residents' beds, utility poles, firefighter uniforms, these may or may not be individually tracked by operations, or, at most, only to note the location for each unit. They are typically replaced but not necessarily actively maintained, and have a defined life expectancy. The asset pool may simply recognize that you have *X* items ranging in age from 0 to *Y* years, and be valued appropriately.

This is a particularly useful approach for dealing with your smaller value assets that, collectively, may add up to a significant amount, and which would otherwise require a major effort if they were to be addressed individually.

As mentioned earlier, the other extreme is to pool assets where it is difficult to determine appropriate or useful components. You may choose to pool your entire road or water network, in order to capture all the ancillary features, and so that you don't have to determine what are appropriate or useful components, and have to account for each one separately.

Why should you not use asset pools?

There is a school of thought which regards asset pools as a waste of time in terms of accounting for tangible capital assets. The basic argument is that acquiring the smaller value assets is not really a significant investment by a municipality, and that their value will be minimal, relative to the major capital assets of the municipality – facilities such as buildings and plants, and networks, such as roads, water mains and sewers.

If you look at the types of assets that might typically be included in a pool, the collective value of all of them may not be as much as your materiality threshold. While operations management may closely track such items individually for asset management purposes, there is often no compelling business reason to account for these individually, or even collectively. They are simply a cost of doing business. Every firefighter gets a protective suit, just as every police officer is issued a service revolver, and every LTC resident needs a bed.

In short, they are not long-term investments, as the typical expectation is that a certain percentage of the items will probably be, or have to be, replaced or upgraded each year. If you are already budgeting and financing this on-going replacement of these assets, then a major objective of moving to tangible capital asset accounting – budgeting and financing for sustainability - is already being achieved, and the exercise of treating them as an asset pool, then valuing it and amortizing it adds little further value to your municipality or to the accounts of your municipality, **if the total gross book value of all such assets is not material**.

For the larger assets and networks, the argument would be that components are tracked and managed for asset management and operational reasons, and that these components will have to be valued somehow for asset pooling anyway, as each may have different characteristics. Ergo, why not account for them as discrete components?

What is your capitalization threshold for an asset pool?

If you are using an asset pool for larger value items, such as a network, capitalization threshold is a non-issue, as you will include the asset pool in your asset inventory regardless. The pool value will likely be substantially higher than any appropriate asset capitalization threshold that you may have decided upon, as will be the case for many of the individual components.

We stated earlier that the asset pool is most commonly a way of capturing items of small value, which collectively may amount to a significant consideration. If they don't, you will not want to waste your time setting up a pool. Expense them. At the same time, you may want to have a substantially higher threshold value for an asset pool than for single assets, so as not to set yourself up for having asset pools for everything, your staplers included.

If you are making extensive use of asset pools, you will want to use a relatively lower capitalization threshold so that you are not otherwise leaving out pools of assets and assets generally that collectively may be quite material in value. Materiality and materiality levels will be discussed in a future newsletter.

We will see again and again that for many aspects of accounting for tangible capital assets, there are guidelines, but no yardsticks. Your municipality has discretion to make choices, always subject to the constraints of consistency, reasonableness and, of course, materiality.

How do you account for an asset pool?

When using asset pools, the OMBI Reference Manual noted (p 35) that "*the key is that someone else is maintaining the detailed data for operational purposes, and that pooling the items will not diminish the value and integrity of the accounting and financial information. Should you ever require information on an individual item, it will be readily identifiable and obtainable from the database maintained by the operations unit*." This would be the ideal, where you have

access to complete, up-to-date asset information, and the asset pool is the aggregate of the data for the individual components, maintained in sub-ledgers or separate systems.

This will likely be the case for pools of larger value assets or for networks, as these are typically assets that are closely tracked for on-going maintenance and management.

The original historical cost, or a reasonable surrogate, for the assets (gross book value) in the pool will be determined, and the accumulated amortization as of December 31, 2008 calculated for the components or items in the pool. The difference will be the initial net book value of the pool.

For 2009 and subsequent years, the asset pool will be revalued at year-end, or even at quarter-end or month-end, if you choose to do this and want to allocate out your amortization expense by period. The gross book value at the end of the period will be the starting balance, less disposals and write-offs, plus acquisitions and betterments. Amortization expense for the period will be the starting gross book value times the annual amortization rate for the pool divided by the number of periods in the year. This assumes that all transactions take place on the last day of the period. If you do this accounting only annually, it may be more appropriate to use the Canada Revenue Agency (Federal Income Tax Act) approach and assume a mid-year disposal and acquisition date for everything, and calculate amortization expense at only 50% of the normal annual rate for all disposals and acquisitions occurring during the year.

Note that to be consistent, your asset pool will have a single or average life expectancy, and a single amortization rate, regardless of what may be included within the pool. If you want to use different amortization rates or life expectancies for different types of assets in the pool, then you are effectively creating a pool for each such different type of asset, and for clarity and sanity, establish separate asset pools. By definition, a pool averages out or melds the characteristics of the component parts. If a component has significant different characteristics, then it should not be pooled.

What about the smaller items?

Is an operating unit maintaining up-to-date records for the assets in question? Do they need current information on the assets in order to be able to operate effectively, or provide good service, as in the case of IT equipment? Is there a legislated requirement, such as for firearms?

If so, the data will come from these externally-maintained data bases, just as described above for larger assets that you may want to pool. The potential downside to this is that these data bases may not contain sufficient information for accounting purposes. Should this be the case, it would be advisable to work with operations staff to add this information into the records, so that their data can serve the needs of asset accounting, as well as of asset management. This will be substantially less effort than trying to create the asset accounting data from scratch.

After you have developed your initial valuation, the expectation is that operations staff will maintain the source data for your asset pool for their own asset management purposes. The work of adding acquisitions, removing disposals, recording relocations and upgrades and other changes to the asset pool will ideally be done by operations staff. Accounting's concern and role will be to ensure that this is, in fact, happening, and again, to ensure that the requisite information is included for asset accounting purposes.

EXAMPLE 1

As of January 1, 2009, the Municipality has computer equipment that it bought for $900,000, in equal installments over the previous 3 years. Computer equipment is assumed to have a life expectancy of 3 years. Accumulated amortization will be $450,000, calculated annually:

- $300,000 bought in 2006 (2.5 years amortization) = $250,000
- $300,000 bought in 2007 (1.5 years amortization) = $150,000
- $300,000 bought in 2008 (0.5 years amortization) = $50,000

Net book value as of January 1, 2009 will be $900,000 - $450,000 = $450,000

In 2009, a third of the equipment is replaced for $360,000.

Disposals = $300,000. Acquisitions = $360,000.

Year-end gross book value will be $900,000 - $300,000 + $360,000 = $960,000.

Amortization expense for 2009 will be calculated:

- $300,000 bought in 2006 = 0.5 years amortization = $50,000
- $300,000 bought in 2007 = 1.0 years amortization = $100,000
- $300,000 bought in 2008 = 1.0 years amortization = $100,000
- $360,000 bought in 2009 = 0.5 years amortization = $60,000

for a total expense of $310,000.

Accumulated amortization as of December 31, 2009 will be starting balance, less amortization of disposals, plus 2009 expense = $450,000 – $300,000 + $310,000 = $460,000.

Net book value as of December 31, 2009 will be $960,000 - $460,000 = $500,000

Note that there is no mention or interest in the individual items that make up this pool. It is being accounted for as a single asset. What is disposed of in 2009 may be three years old, or it may not. It really does not matter, because the latter scenario would imply that other equipment is serving longer than the expected three years, and thus providing an offset.

The breakdown by year was provided to show how the numbers are derived. In reality, you would only be concerned with what was carried forward a year, and with disposals and acquisitions during the year. There would be no requirement to identify what is less than one year old, two years old etc.

There will normally be no reconciliation of the asset pool figures with what is on the ground, as the accounting does not concern itself with the individual, only with the totality. That is the reason that you use asset pools. You may need to account at the individual asset level for asset management purposes, but not for financial reporting. If you do, then do not pool the assets for accounting and financial reporting.

For audit or independent verification purposes, you may well want to check that the asset pool totals are reasonable, and that the information on which pool data is based reflects reality, even if this is just confirming a count, such as of assets that are not individually tracked.

What if the assets are not being tracked?

There may be situations where assets are acquired and used, but not really tracked. One example is beds in a long-term care facility. They are bought and used, and typically are repaired or replaced when they break. There is one per resident, plus any special purpose beds, such as at the main nursing station, or for short-term stays.

One can safely assume that the number acquired in a year will equal the number disposed of in that year. The accounting will be similar to the above, only the asset costing may be different. For assets like this, it would be appropriate to use a moving average value for gross cost.

EXAMPLE 2

Maisongrise long-term care facility has 100 beds, whose historic cost is $50,000 (average of $500 each). The life expectancy of a bed is 10 years. Accumulated amortization as of December 31, 2008 is $25,000 and net book value will be $25,000.

In 2009, Maisongrise buys 15 beds for $800 each, or $12,000, and disposes of 15 beds. For simplicity, assume no residual value.

The 15 disposed beds had a gross book value of $7,500, and since we expect a bed to last 10 years, they are assumed to have been amortized fully, for $7,500.

Amortization expense for 2009 will be:

- 85 beds at 10% of $500 = $4,250
- 15 beds at 5% of $500 = $375

- 15 beds at 5% of $800 = $600

for a total charge of $5,225.

Gross book value at December 31, 2009 will be $50,000 - $7,500 + $12,000 = $54,500. Note that the average cost per bed will now be $545.

Accumulated amortization at December 31, 2009 will be $25,000 - $7,500 + 5,225 = $22,725.

In this case, the accumulated amortization has decreased, because we replaced 15 beds, rather than the expected 10. If only 5 are replaced in 2010, this decrease will be reversed. However, were another 15 to be replaced in 2010, then either the life expectancy of a bed should be reduced to reflect the faster turnover of assets, or the existing older beds written down or amortized faster, to reflect the accelerated replacement rate.

Again, note that the age of the individual bed scrapped is immaterial, as the expected or average life is 10 years. Whether one was 8 years old and one was 12 years old does not matter. The moving average cost of each was $500, and there would have been $400 and $600 in accumulated amortization respectively, for an average of $500 each. Always remember that you are accounting for a pool as a pool, and not specifically for the individuals in the pool.

How will you report your asset pools?

An asset pool is a grouping or aggregation of items, treating the group as though it is a single asset. There is no special treatment required as each pool will be classified along with every other asset (to be discussed in our next newsletter), and its valuation and its accumulated amortization will be included in the values for its respective class.

On-going accounting for asset pools

If you choose to establish asset pools, you will need to update your valuation and calculate your amortization expense at least once annually. Remember that an asset pool is a single asset, accounted for and reported as such, regardless of how many items may be included within. Thus at the end of each year, you will need to know what has been disposed of or replaced during the year, so that you can determine the amount of capital cost and accumulated amortization to be written off for the year for such disposals,

If acquisition information is not captured through your corporate accounting system at the time of purchase, you will need to collect this information too.

While asset pools provide a very convenient way of dealing with asset data for purposes of the initial valuation, do give some thought as to how each asset pool that you create will be updated and maintained on an on-going basis, **before you create and use it for your initial valuation.**

Our next newsletter will look at classification of assets, or how to sort your asset inventory into meaningful groupings for data management and reporting purposes.

For more information and resources regarding tangible asset management, go to PSAB/Asset Management, or contact:

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NOTE: This Newsletter is published to assist you with your implementation of tangible capital asset accounting and with related matters. The Public Sector Accounting Handbook is the only authoritative primary source on matters relating to GAAP, and you should consult with your auditor to resolve specific issues that you may have.