PSAB/Asset Management

NEWSLETTER NO. 40

BURNING ISSUES
-other than furnaces and incinerators

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Over the past year, there have been questions about a number of weird and wonderful items as to whether each might be a tangible capital asset. Approaches to dealing with some of these have been addressed during the Fall Workshops last year or in other newsletters. However, they seem unusual and perplexing enough to warrant a brief look at each, as to how you might account for them.

These include:

- Landfills
- Waste disposal areas
- Cemeteries
- Gravel pits and quarries
- Dams
- Large maintenance contracts that include free upgrades

Landfills

A sanitary landfill site usually has a very large hole in the ground (see also the discussion for Gravel Pits and Quarries), and some surrounding property at grade, which acts as a buffer between the operation and its neighbours. To prepare the site for operation, buildings, a weigh station, heavy equipment and access roads will be required. A sewer and/or pumping for leachate will be required, and a supply of clay for a liner may have to be provided. All of these will be tangible capital assets.

The site will have a pre-determined life expectancy or tonnage capacity that was reported in the original feasibility study for the capital project. Amortization of these capital assets can be on the basis of either project life expectancy or annual tonnage processed, or for equipment, the life of the individual item, such as bulldozers and heavy-duty trucks.

At the termination of operations, the reasonable assumption is that the buildings have no residual value, unless they can be moved, and that the entire property normally has no commercial value, as it is

completely impaired for residential, commercial or industrial redevelopment. Because of post-closure issues and requirements, you probably cannot give the site away. You are stuck with an on-going liability for at least 50 years, while there is still active "fermenting" below. Some of these costs may be offset by the sale of methane gas generated from the "fermentation" to commercial interests.

Looking ahead, the site can possibly be redeveloped for recreational purposes, and there are a number of examples of this around Ontario, such as instant ski-hills. Once dormant, it may be possible to sell off the buffer lands for development. There has been speculation that future generations may mine these sites for raw materials, especially metals and plastics.

So what would be the post-closure value of the land? One approach would be to assume total asset impairment, and to write down the entire value of the land over the active life of the landfill. An alternative approach would be to use a residual value for the land if used for green space or recreational purposes, but a value that recognizes it has very limited or no potential for development beyond such surface uses. If anything, these possibilities may offer some compensation for the post-closure costs, especially the unforeseen ones.

Waste Disposal Areas

As understood from the questions, these are more like transfer stations, where waste is collected, to be dealt with at some point in time, but not on site, and not immediately.

The major asset here is the land, which is temporarily impaired because of its obnoxious use, but which, unlike a sanitary landfill, is not permanently impaired, because the site can be cleaned up and made good for other purposes. Thus the land, and any improvements made to it to prepare the area would be capitalized, but not amortized.

Any buildings and equipment would be treated as tangible capital assets and amortized over their anticipated useful lives, as would access roads. Unlike landfills, there would normally be no post-closure costs, unless there had been "accidents," but there would be clean-up or closure costs to prepare the property for other uses. If the property is contaminated, it may be appropriate to consider taking an asset impairment write down as and when the impairment occurs. It may then be appropriate to capitalize the costs incurred to "clean up" the property that restore the service potential of the property, i.e. prepare the property for alternative use or sale. Note that the clean up costs would not be considered a reversal of the impairment write down, but rather as a betterment of the asset.

Cemeteries

A cemetery is like a special-purpose landfill, where the site becomes permanently impaired for all other future uses, unless all the corpses were to be exhumed and relocated elsewhere, and the land deconsecrated. Once there are no further interments, often no-one wants the site, but no-one can do anything with the site, or wants it to be decommissioned. If a cemetery is abandoned, the local municipality is obligated to take responsibility for it under the *Ontario Cemeteries Act*. How do you account for cemeteries as tangible capital assets?

First, there is land occupied by the cemetery, and all site improvements made to prepare the land for use as a cemetery, such as general grading and landscaping, drainage works and grading of access roads.

These are capital expenditures that would be treated as costs of a tangible capital asset, but not amortized. This would also yield a per square metre cost for the improved land.

Access roads will be built around the property, and various buildings will be constructed for business and operational purposes, including possibly a crematorium, if a municipal or private cemetery. Equipment will be required, such as motorized mowers, trucks and a backhoe. These are all tangible capital assets that will be amortized over their anticipated life expectancies.

A cemetery typically has four major components:

- buildings and operational areas such as a works yard,
- landscaped gardens or grounds,
- access roads and paths to get to the plots, and
- the burial plots themselves.

All four components occupy their respective share of the total land area. For the first three, the land area occupied will be a separate tangible capital asset, land, costed using the per square metre cost for acquiring and preparing the entire site.

The land devoted to the plots themselves is not a tangible capital asset, and should not be capitalized as such. This is an inventory of land for sale, and as the plots are sold, the inventory will be reduced accordingly. For accounting, the cost of the plot is the area of the plot times the afore-mentioned cost per square metre. For pricing, it is probably the greater of what the market will bear or the total cost of developing the entire cemetery divided by the number of plots for sale.

It is understood that some municipalities **rent** cemetery plots, though it is not clear what happens when the lease expires and is not renewed. While this is still an inventory of plots, they would be a tangible capital asset per PS 3150.05 (a) (i), "cemetery plots" for rental to others. If the lease is in perpetuity, one might argue that the plot is therefore not available for rental to others, and should be accounted for as though it was sold.

In the case of abandoned cemeteries that you have inherited by design or default, the historical cost of the land may well be minimal, especially if you extract the area occupied by plots. PS 3150.14 requires you to determine and use the fair value of a contributed or transferred asset at the date of contribution, Fair value of a property that you can probably do nothing with, or use for alternative purposes, and which may present a substantial on-going financial liability to care for it, will likely be a negative amount. The book value is definitely inconsequential in terms of the total tangible capital assets that you are trying to inventory and value for your municipality. It is suggested that you assign a nominal value to record such cemeteries, unless there is a potential for reusing the land for other purposes.

Gravel Pits and Quarries

A gravel pit or a quarry is a business operation, not a tangible capital asset per se, because the core attribute of the business is a product for sale. It exists for the extraction and production of aggregates and/or stone pieces. So what are the assets you received when you bought or acquired the venue for this type of operation?

First, there is the land on which the gravel pit or quarry is situated. Then there is the extractable gravel or rock located on or under the property. For this latter, you will likely have a geologist's report on the estimated quantity and quality of materials that you can expect to be able to extract. This will be your **inventory** of raw material or ore that you have, and your annual operations will reduce this inventory by the amount extracted.

One possible approach is that if you acquired the property strictly for this inventory of product, the value of your starting inventory could be the cost of acquiring the property plus the costs of preparing the site for initial production. There would be no TCA called land. Your cost per ton or cubic metre of raw material will be the total of these costs divided by the estimated quantity of raw material sitting in the ground. Each unit extracted will reduce the value of inventory by the cost per unit that you have determined.

When the site has been completely worked out, you will by implication have a hole in the ground covering a large area with a book value of zero, plus buildings and equipment that may be total write offs. Any resale revenues will be gain on sale of an asset that has a residual value of zero, less all post-closure rehabilitation costs incurred, which would be capitalized as a betterment of the land..

A gravel pit has a potential after-life as a sanitary landfill site, and if a Ministry of the Environment permit can be obtained for the location, it may be worth more for that function than it originally was as a potential gravel pit site. However, this is not something that can be counted on up front, and also requires a willing buyer, plus getting all the approvals in place.

The alternative approach would be to consider its future use for park and recreation purposes, and determine a residual value for the land and buildings on that basis. This would be the value of the TCA land on your books, and the valuation of your starting inventory of product would therefore be reduced by this amount.

Dams

These structures are built across waterways, and come in all shapes, sizes and materials. They are typically constructed for flood control, provision of water supply, generation of hydro-electric power, facilitation of water transport, land reclamation or for recreational purposes, and for combinations thereof. They are specifically identified as an example of a tangible capital asset in the last line of PS 3150.02:

> *"Tangible capital assets are a significant economic resource managed by governments and a key component in the delivery of many government programs. Tangible capital assets include such diverse items as roads, buildings, vehicles, equipment, land, water and other utility systems, aircraft, computer hardware and software,* ***dams****, canals, and bridges."*

The cost of the structure itself is known or can be determined, and engineers can estimate the probable life expectancy of the structure. There is no residual value, as the structure will either be rehabilitated or replaced, respectively, in the event of partial or total failure.

There will be other tangible capital assets related to the dam that will also be included in your asset inventory. For example, any land acquired and utilized for storing the water impounded above the dam

would also be identified as a separate asset. The lake would not exist without the dam, but the land area occupied by the lake is the tangible capital asset, not the lake per se. The water in the lake is a natural resource, and may have value if used for power or sold for irrigation or for industrial or residential usage, but would definitely not be a tangible capital asset. PS 3150.03 clearly states that natural resources are **not** tangible capital assets:

> "*This Section (PS 3150) does not apply to intangible assets, natural resources, and Crown lands that have not been purchased by the government."*

You may have other structures associated with the dam, such as a power station, pumping station, distribution pipes or canals, locks, ladderways for fish, booms and spillways for overflow, etc. These are all tangible capital assets with their own life expectancy and should ideally be accounted for separately from the dam itself, though they are integral parts of ensuring the utility of the dam.

Large Maintenance Contracts that include free upgrades

The Hotline received the following email:

"In 1997, the Municipality purchased Microsoft Office 97. Since that time, the Municipality has had a maintenance contract with Microsoft (recently re-negotiated at approx. $500,000/year). While these maintenance contracts obviously provide for maintenance on the applications, they also provide the rights to upgrade the product. Thus, the Municipality now owns the latest version of Microsoft Office (and all previous versions) without the subsequent outlay of cash that occurred related to the initial purchase of Office 97. Therefore, how do we treat these maintenance contracts when they provide the ability to own and upgrade the software?"

Software is identified as an example of a tangible capital asset (see PS 3150.02 above), and this contract provides upgrades, which may or may not be betterments. This suggests that we are dealing with a tangible capital asset and may be paying for betterments that can be capitalized. At the same time, you may or may not want the additional functionality.

When major versions or upgrades of software are issued every year or two, this is indicative of the real value and life expectancy of all shrink-wrapped software, like Microsoft Office, regardless of how much you have to pay initially. The original investment on this should have been completely amortized at least 6 years ago (by 2002 at the latest). Even major accounting software has a life expectancy of only about 7.5 years, based on research by the Gartner Group.

The Municipality has had a large value on-going maintenance contract with Microsoft (NASDAQ – MSFT) for the past 11 years, and presumably will continue to do so. The current cost for it is approximately $500,000 per year. The asset purchased in 1997 had a very limited shelf life, and the municipality is paying an annual fee to keep it going, which may or may not include upgrades, but so that technical support will still be available.

That would seem to be the definition of maintenance, which is an operating expense. At least the annual "maintenance fees" are relatively stable for the term of the contract, and are known in advance. Treat these contracts as they are called – maintenance – and expense them.

Summary

For each of these weird and wonderful types of tangible capital assets, we have tried to show the thought process that one should be going through in order to determine an appropriate approach for accounting for them under PS3150.

The key points here, or with any potential tangible capital asset you may have to deal with, are:

- Is it a tangible capital asset at all? Apply PS3150.02 to .05. Be realistic and reasonable.
- What am I really dealing with? A totality or with components? Consider the cemetery or the gravel pit ….. And
- What is the life expectancy and residual value, if any, of the tangible capital asset? Will these be significant, such as for other purposes?

As always, exercise sound judgment on a consistent basis, documenting what you have done, and the conclusions you have reached and applied.

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Up to now, these newsletters have looked at various aspects of developing your asset inventories, from a more high-level view. It is now late 2008, and you have hopefully made a lot of progress towards completing your asset inventories for January 1, 2009. The next set of ten newsletters will take a look at the theme of the Spring Workshops, PS3150 and budgeting. They will cover how to budget for certain types of tangible capital assets, and a couple of major issues. The next newsletter will start with a look at whether you need to change your budget reporting, because of the accounting change.

For more information and resources regarding tangible capital 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.