Asset Capitalisation Policy

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Classification:	General
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Responsible Officer:	Chief Executive
Applicable Legislation:	*Local Government Act 1999*
Relevant Policies:	

Policy Statement

The purpose of this policy is to provide guidance, clarity and consistency regarding the treatment of capital expenditure, which will provide for greater understanding and accuracy of Council's capital requirements and depreciation expenses. The existence of this policy will assist to ensure there is a distinction made between expenditure on long-lived assets and expenditure on goods and services for immediate consumption. This is critically important in determining the cost of providing services.

The Policy will assist in ensuring that Council complies with its obligations under section 124 of the Local Government Act.

Legislative framework and other references

There is no legislative requirement for Council to have a policy relating to this area.

The following legislation applies to this policy:

Local Government Act 1999

Section 127 of this Act provides that Council must prepare Financial Statements in accordance with the Act and the Local Government Financial Management Regulations 2011. Expenditure is to be correctly classified – i.e. as either operating or capital in Council's Financial Statements.

Section 125 of this Act provides that council must ensure that appropriate policies, practices and procedures of internal control are implemented and maintained in order to assist the council to carry out its activities in an efficient and orderly manner to achieve its objectives, to ensure adherence to management policies, to safeguard the council's assets, and to secure (as far as possible) the accuracy and reliability of council records.

Other references

Australian Accounting Standards Board Standards:

- AASB 116 - Property Plant and Equipment
- AASB 136 - Impairment of Assets
- AASB 1031 – Materiality
- AASB 13 – Fair Value Measurement

Framework for the Preparation and Presentation of Financial Statements, published by the Australian Accounting Standards Board

Definitions
For the purposes of this policy the following definitions apply:

Asset – according to 49a of the "Framework for the Preparation and Presentation of Financial Statements" published by the Australian Accounting Standards Board (AASB), "an asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity".

There are three specific elements that define an asset:

- Future economic benefits – in the case of public sector entities, future economic benefits (or service potential) are the goods and services to be provided by the asset, whether or not the entity receives a net cash inflow for their provision

- Control by the entity - control means the ability of the entity to benefit from the future economic benefits or to restrict the access of others to those benefits
- Occurrence of past event – the asset must be in existence. A contract to purchase an asset does not give rise to an asset, nor does the intent to acquire an asset. The asset must have been purchased, acquired or transferred to the control of the entity prior to the date of the financial report.

Capital Expenditure - Capital expenditure can be broken down into two categories:

- Costs incurred in the creation of a new asset – these can include design costs, planning and development compliance costs, construction costs. When considering the cost of construction of a new asset, attention must be paid to AASB 136 - Impairment of Assets to ensure that the final carrying value of the asset does not exceed its recoverable amount

- Costs incurred for replacement and repair of an existing asset – these costs can be considered capital when the replacement or repair results in an extension of the useful life of the asset over which future economic benefits can be expected and/or the replacement value of the asset is materially increased. Again attention must be paid to AASB 136 - Impairment of Assets.

Carrying amount - is the amount at which an asset is recognised after deducting any accumulated depreciation and accumulated impairment losses.

Cost - is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction or, where applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of AASB 116 – Property Plant and Equipment.

Depreciable amount - is the cost of an asset, or other amount substituted for cost, less its residual value.

Depreciation - is the systematic allocation of the depreciable amount of an asset over its useful life.

Entity-specific value - is the present value of the cash flows an entity expects to arise from the continuing use of an asset and from its disposal at the end of its useful life or expects to incur when settling a liability.

Fair value - is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.

An *impairment loss* - is the amount by which the carrying amount of an asset exceeds its recoverable amount.

Property, plant and equipment - are tangible items that are:

- Held for use in the production or supply of goods or services, for rental to others, or for administrative purposes
- Expected to be used during more than one period.

Recoverable amount - is the higher of an asset's fair value less costs to sell and its value in use.

The *residual value* - of an asset is the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.

Useful life - is the: Period over which an asset is expected to be available for use by an entity; or Number of production or similar units expected to be obtained from the asset by an entity.

Group Asset - an asset that by itself does not meet the capitalisation criteria but as part of a cohesive whole, does meet the capitalisation criteria. Examples of group assets are library books and office furniture.

Maintenance - maintenance of an asset is the periodical expenditure required to ensure that the asset lasts as long as it is expected to last and that it provides and continues to provide future economic benefits for its entire useful life. Maintenance costs are expensed as they are incurred.

Operating Expenditure - operating expenditure refers to the running costs incurred in operating an asset. They represent costs such as security services for a building, electricity costs of a building, registration of motor vehicles, fuel, insurance etc. These costs do not preserve or extend the life of an asset and are expensed as they are incurred.

Work in Progress - work in progress is the accumulation of the construction costs of an asset that is incomplete as at the end of the financial year. The most common example is the design costs of an asset that has yet to commence construction. Every year the work in progress is reviewed and where it is not certain that the construction of the asset will commence within the following financial year the amount of work in progress shall be expensed.

POLICY

Recognition of an Asset

The criteria for recognising an asset is outlined in paragraph 89 of the "Framework for the Preparation and Presentation of Financial Statements":

"An asset is recognised in the Statement of Financial Position when it is probable that the future economic benefits will flow to the entity and the asset has a cost or value that can be measured reliably."

The two essential components of recognition are:

- Probable future economic benefits – probable means that it is more likely than less likely that the benefits will be realised (i.e. >50%)
- Reliably measured – reliability means the faithful representation of the underlying transactions or events, without bias or error. Essentially, a third party would come to a similar value if presented with the information relating to the transactions or events.

Measurement at Recognition

The basis for measurement of the value of an asset, upon recognition, is its cost. AASB 116 – Property Plant and Equipment outlines this in paragraph 15:

"An item of property, plant and equipment that qualifies for recognition as an asset shall be measured at its cost."

Not withstanding paragraph 15, in respect of not-for-profit entities, where an asset is acquired at no cost, or for a nominal cost, the cost is its fair value as at the date of acquisition.

AASB 116 – Property Plant and Equipment provides guidance on recognising parts of assets in paragraph 13:

"Parts of some items of property, plant and equipment may require replacement at regular intervals. For example, a furnace may require relining after a specified number of hours of use, or aircraft interiors such as seats and galleys may require replacement several times during the life of the airframe. Items of property, plant and equipment may also be acquired to make a less frequently recurring replacement, such as replacing the interior walls of a building, or to make a non-recurring replacement. Under the recognition principle in paragraph 7, an entity recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if the recognition criteria are met."

Depreciation of Assets

In the context of asset capitalisation, depreciation is an important determinant of the current fair value of an asset. Paragraphs 43 to 47 of AASB 116 – Property Plant and Equipment provide guidance in applying the concept of depreciation to parts of assets:

"Depreciation

43. *Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately.*
44. *An entity allocates the amount initially recognised in respect of an item of property, plant and equipment to its significant parts and depreciates separately each such part. For example, it may be appropriate to depreciate separately the airframe and engines of an aircraft, whether owned or subject to a finance lease.*
45. *A significant part of an item of property, plant and equipment may have a useful life and a depreciation method that are the same as the useful life and the depreciation method of another significant part of that same item. Such parts may be grouped in determining the depreciation charge.*

46. To the extent that an entity depreciates separately some parts of an item of property, plant and equipment, it also depreciates separately the remainder of the item. The remainder consists of the parts of the item that are individually not significant. If an entity has varying expectations for these parts, approximation techniques may be necessary to depreciate the remainder in a manner that faithfully
represents the consumption pattern and/or useful life of its parts.
47. An entity may choose to depreciate separately the parts of an item that do not have a cost that is significant in relation to the total cost of the item."

Materiality
The relevance of information is affected by its nature and materiality. Information is material if its omission or misstatement could influence the decisions of users or assessments made on the basis of the financial statements. Materiality depends on the nature or size of the item or error judged in the particular circumstances of its omission or misstatement. Materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful.

AASB 1031 – Materiality sets out the requirements for applying the concept of materiality to information in financial statements.

Fundamentally, the concept of materiality leads to the recognition that, in the case of non-current assets, it is not necessary to recognise each and every non-current asset in the balance sheet. Similarly, the minor refurbishment of a non-current asset, which may increase the future economic benefits of the asset, but which is a very small portion of the value of the asset, need not be recorded as an increase in the value of the asset if the change in value is not material.

The purpose of setting a threshold level or levels is to provide the greatest balance between efficiency in administrative effort associated with maintaining records and the need to 'expense' items, through depreciation, against more than one financial year so that revenues and expenses are matched as well as the need to present financial information fairly.

Care needs to be taken to ensure that assets which may be under the threshold, but which form part of a network or asset group, such as desktop computers, office furniture and the like, are treated as a group. These assets need not be identified individually (each group or sub-group can be an individual entry in the asset database), but the group needs to include 'ons' and 'offs' and record total numbers and values. Sub-groups may also be used to capture information and values for homogenous assets – e.g. different types of computers, chairs etc.

Paragraph 15 of AASB 1031 – Materiality provides guidance on the quantitative measure that may be used to determine whether an item is material:

"Quantitative thresholds used as guidance for determining the materiality of the amount of an item or an aggregate of items shall, of necessity, be drawn at arbitrary levels.
Materiality is a matter of professional judgement influenced by the characteristics of the entity and the perceptions as to who are, or are likely to be, the users of the financial report, and their information needs. Materiality judgements can only be properly made by those who have the facts. In this context, the following quantitative thresholds may be used as guidance in considering the materiality of the amount of items included in the comparisons referred to in paragraph 13 of this Standard:

(a) an amount which is equal to or greater than 10 per cent of the appropriate base amount may be presumed to be material unless there is evidence or convincing argument to the contrary

(b) *an amount which is equal to or less than 5 per cent of the appropriate base amount may be presumed not to be material unless there is evidence, or convincing argument, to the contrary."*

Therefore, in summary, amounts over 10% of the appropriate base value can be considered material; amounts below 5% of the appropriate base value can be considered not material and amounts in between 5-10% are a judgment call with respect to the prevailing circumstances.

Capitalisation Thresholds

The following table provides guidance when determining whether expenditure is both capital and material in nature.

Item	Maintenance	Capital
Fleet and Plant Assets	• Expenditure <$1,000 for individual assets or assets that cannot be easily grouped.	• Expenditure >$1,000 for individual assets, or assets that can be easily grouped.
Sealed Roads and Car Parks	• Minor road patching. • Shoulder grading • Line marking • Road cleaning and sweeping • General kerb maintenance	• Expenditure >$1,000 for individual assets, or assets that can be easily grouped • Road patching other than minor works • All new road construction • Resealing • Reconstruction • Repairs to Kerb and • Channel • All new kerb construction.
Unsealed Roads	• Grading • Sweeping • Scrub Clearing.	• Expenditure >$1,000 for individual assets, or assets that can be easily grouped • Other Treatments • Resealing.
Information Technology	• Expenditure <$1,000 for individual assets or assets that cannot be easily grouped. • Minor repairs	• Expenditure >=$1,000 for individual assets, or assets that can be easily grouped.
Stormwater and CWMS	• Expenditure <$1,000 for individual assets or assets that cannot be easily grouped. • Minor repairs	• Expenditure >$1,000 for individual assets, or assets that can be easily grouped • Pipe and structure replacement • New pipes and structures • New Wetlands • Purchase or replacement of Pump and Bore
Office Furniture and Equipment	• Asset purchases <$1,000	• Asset purchases >$1,000.

Item	Maintenance	Capital
Bridges	• Minor bridge repairs.	• Expenditure >$1,000 for individual assets, or assets that can be easily grouped • Bridge structure replacement.
Signs	• Repairs to existing signs and posts.	• Expenditure >$1,000 for individual assets, or assets that can be • easily grouped • All new signs and/or posts • Replacement of existing signs.
Footpaths	• Footpath maintenance (pothole repair, joint grinding, segment paving resetting)	• Expenditure >$1,000 for individual assets, or assets that can be • easily grouped • Footpath replacement. • All new footpath construction
Research ,Design and Project Management Costs	• All research, design and project management costs incurred on projects which have not proceeded.	• Subject to the tests of AASB 136 Impairment of assets.
Traffic Calming Devices	• All line marking • Any maintenance to existing devices.	• Any new or complete replacement of kerb, fence and DDR component of the device • New Traffic islands.
Irrigation	• Maintenance to existing irrigation equipment	• All new irrigation equipment • Major Repairs/ replacement of irrigation equipment.
Land and Reserves	• All maintenance of landscaping structures • Renewal of mulch and garden beds • Plants and trees • All maintenance to existing park furniture	• Pavers and concrete paths • Irrigation • All new park furniture. • Replacement of existing park furniture.

Item	Maintenance	Capital
Sporting Ovals and Playing Courts	• Line Marking • Lawn mowing • Light tower bulb replacements.	• Major Earthworks • Court construction and resurfacing • Light tower construction and
Playground Equipment	• All maintenance to existing playground equipment.	• All new playground equipment • Repairs/replacement
Library Collection	• Magazines, Newspapers and periodicals.	• Library Books, Video's, CD's and other permanent additions to the library collection.
Buildings	• All maintenance of building components.	• Any structural addition to the buildings >$1,000 • Repairs/renewal of building

Review & Evaluation
This policy will be reviewed after each general election of Council. The Chief Executive will ensure that a draft policy with changes highlighted will be circulate amongst staff for comment before being presented to the Audit Committee which will consider the final draft policy and recommend to the Chief Executive the adoption of the draft policy.

This process shall be undertaken whether or not any changes are proposed to the policy.

Availability of Policy
This Policy will be available for inspection at the Council office during ordinary business hours and via the Council's website www.council.robe.sa.gov.au. Copies will also be provided to the public upon request, and upon payment of a fee in accordance with Council's Schedule of Fees and Charges.