CAPITAL ASSETS PROCEDURE

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Procedure Sponsor:	Vice-President, Finance and Operations	Last Revised:	January 25, 2025
Administrative Responsibility:	Finance Department	Review Scheduled:	January 2030
Approver:	President and CEO		

A. PURPOSE

This procedure establishes the processes, accounting policies, and financial reporting practices for the various stages within the life cycle of Tangible Capital Assets and Purchased Intangible Assets at Alberta University of the Arts (AUArts).

Non-compliance with this procedure constitutes misuse of AUArts property and may result in disciplinary action up to and including termination of employment.

B. SCOPE

The Finance Department administers this procedure and it applies to all employees involved in purchasing, disposing of, or managing Tangible Capital Assets (referred to as "Capital Assets") or Purchased Intangible Assets.

This procedure applies to all Capital Assets, Computer Software, and Purchased Intangible Assets, including those leased, received in kind, internally developed, and accessed through Cloud Computing arrangements. This procedure does not apply to:
a) Intangible Capital Assets acquired through a transfer, contribution, or inter-entity transaction
b) Internally developed or inherited intangible assets
c) Natural resources and
d) Collections (generally, works of art, historical treasures, and similar items that have cultural, aesthetic, or historical significance)

C. PRINCIPLES

1. Capital and intangible asset purchases are a significant commitment of resources. The acquisition, identification, safeguarding, valuation, and disposal are necessary internal control processes to ensure the recognition, tracking and protection of University assets.
2. Security of Capital Assets is an integral part of risk management. Each Department is responsible for ensuring that Capital Asset inventories are maintained and safeguarded from loss or theft.
3. Capital Assets are significant economic resources controlled by the University as a result of past transactions or events and from which future economic benefits are

expected to be obtained.

4. Capitals assets are non-financial assets having a physical substance that are acquired, constructed, or developed and are:
    a) held for use in the production or supply of goods and services, for rental to others, for administrative purposes or the development, construction, maintenance or repair of other Capital Assets
    b) have useful lives extending beyond one year
    c) intended to be used on a continuing basis, and are not intended for sale in the ordinary course of operations.

5. To recognize Capital or Purchased Intangible Assets in the financial statements, the following criteria must be met:
    a) Embodies a future economic benefit that involves a capacity, singly or in combination with other assets, to provide goods and services, to provide future cash inflows, or to reduce cash outflows
    b) The University has control of the economic resources and access to future economic benefits
    c) The transaction or event giving rise to the University's control has already occurred

D.   PROCEDURES

1.   RECORDING AND REPORTING

1.1.   The Finance Department is responsible for the completeness and accuracy of the Capital and Purchased Intangible Assets recorded in the general ledger. Capital Asset ownership rests with the University, whether purchased with operating, ancillary, capital, grant or other restricted funds or on a capital lease.

1.2.   The University will capitalize Capital and Purchased Intangible Assets using the following thresholds:

Asset category	Threshold
Building improvements	$5,000
Furniture	$5,000
Equipment	$5,000
Computer hardware	$5,000
Purchased Computer Software	$5,000
Internally Developed Software	$25,000

   a) Items purchased not meeting the threshold are expensed in the year of acquisition.
   b) Capitalization thresholds are applied to individual items with exceptions for Purchased Computer Software, Internally Developed Software, and Bulk Purchases.
   c) Purchased Computer Software will be recorded at the total purchase cost. The purchase price may not be divided by the number of licensees/users before addressing Capitalization Threshold Amounts.

1.3.   Bulk Purchases of similar Capital Assets with a unit value below the Capitalization Threshold but with a minimum value as a group equal to or greater than the Threshold Amount shall be pooled as a single asset with one combined value. Although recorded as a single purchase in the finance asset

module, each unit of the pool shall be recorded separately by the respective departments for monitoring, control, and maintenance.

1.4. All Betterments, excluding those related to computer software, are capitalized if the improvement cost is equal to or greater than the Capitalization Threshold. Major enhancements, including Upgrades to computer software, are capitalized only when the total cost of enhancement is equal to or greater than the Internally Developed Software Threshold Amount.

1.5. Cost of a Capital or Purchased Intangible Asset may include:
   a) Purchase price net of rebates
   b) Taxes, including GST (subject to allocation rules)
   c) Customs and freight
   d) Shipping and handling costs
   e) Installation, retrofit or fit-up costs
   f) Cost of major additions or improvements to the asset ('Betterments')
   g) Asset retirement obligations (if material)

1.6. Trade-in allowances are added to the net cost of new Capital Assets to determine their value at the time of purchase. This allowance will be recorded as capital disposal revenue, known as "Proceeds on Disposal of Assets."

1.7. Significant disposal costs associated with end-of-life assets shall be accrued and treated as part of the asset's cost.

1.8. When costs are less than the threshold for the Capital Asset class, but form part of an integral component of the Capital Asset, and the total of these costs equal or exceed the Capitalization Threshold, then these costs may be capitalized.

1.9. Capital and Purchased Intangible Assets shall be grouped into the following categories with the following estimated Useful Life:

Capital and Purchased Intangible Asset Category	Estimated Useful Life
Building improvements	15 years
Furniture and equipment	5 – 10 years
Computer hardware and software	3 – 5 years
Licenses and course content	Lesser of expected Useful Life or license expiry

1.10. Estimating the useful lives of Capital and Purchased Intangible Assets is a matter of professional judgment and should be applied on a consistent basis. Factors to be considered in estimating the Useful Life of a Capital Asset, new or used, include:
   a) Expected future usage
   b) Technical obsolescence
   c) Expected wear and tear over time
   d) Studies of similar items retired
   e) The maintenance program
   f) The condition of existing comparable items

1.11. Departments acquiring a Capital Asset may adjust the estimated Useful Life either based on the factors identified above or, in the case of a used Capital Asset, based on the age and condition of the asset at the time of acquisition. Factors to be considered in estimating the Useful Life of a Purchased Intangible Asset include:

a) Expected future usage

b) Technical obsolescence

c) The terms of the contract or agreement that resulted in the acquisition of the asset

1.12. When assets are donated, if they meet the definition of a Capital Asset, they are capitalized based on their appraised value. An independent third party must appraise this value.

1.13. Works of art or other intangible assets that may be donated are not capitalized or recorded to revenues.

1.14. The Amortization method shall allocate the cost, less Residual Value (if material), of the Capital or Purchased Intangible Asset reasonably over its estimated Useful Life.

1.15. The University uses the straight-line Amortization method for Capital and Purchased Intangible Assets.

1.16. The Finance Department will annually assess the reasonability of Useful Life assumptions assigned to each Capital and Purchased Intangible Asset category and the remaining Useful Life of these assets. The rationale supporting the decision to revise Useful Life estimates should be documented. Significant events which may indicate a need to revise the estimated Useful Life of a Capital or Purchased Intangible Asset include:

a) Completion of a Betterment

b) Change in the extent to which the asset is used

c) Change in the manner in which the asset is used

d) Removal of the Capital Asset from service for an extended period of time

e) Physical damage or destruction

f) Change in the demand for the services provided through the use of the Capital or Purchased Intangible Asset,

g) Significant technological developments, and

h) Change in the law, environment or public preferences, which affects the usage and time periods over which the Capital or Purchased Intangible Asset is used

i) When conditions indicate that a Capital or Purchased Intangible Asset no longer contributes to AUArts' ability to provide goods and services, or the value of future benefits associated with the asset is less than its net book value, the cost of the Capital or Purchased Intangible Asset will be reduced to reflect the decline in value

j) Under Public Sector Accounting Standards, works of art and historical treasures cannot be recorded as Capital Assets in the financial statements. Acquisition costs and donations will be directly expensed

k) Guidelines for the accounting of Computer Software and Cloud Computing Arrangements are provided in Appendix A and Appendix B

l) Courses and course content acquired externally, whether licensed through a third party or purchased outright, will be considered a Purchased Intangible Asset. Any costs, including acquisition, initial updates, or modifications, are deemed the cost to acquire and bring the asset into service. Any subsequent updates and modifications must meet the criteria for Betterments to be capitalized

2. ACQUISITION

2.1. As per the Signing Authority Matrix, an authorized Expenditure Officer must approve all Capital and Purchased Intangible Asset purchases.

2.2. Capital and Purchased Intangible Asset purchases not included in the Capital Budget require approval by the Vice President, Finance and Operations before purchase.

2.3. All Capital and Purchased Intangible Asset purchases are subject to the Purchasing Procedure.

2.4. Capital Assets purchased but not ready for use will be recorded as Work-in-Progress (WIP). Department Directors are responsible for notifying Finance when Capital Asset purchases have been put into use and can be amortized.

3. IDENTIFICATION AND PHYSICAL SAFEGUARDING

3.1. Employees must take all reasonable actions to safeguard University assets and shall immediately report missing Capital Assets to their immediate supervisor.

3.2. No asset shall be removed from the University premises without the express permission of the responsible department manager.

3.3. Where practicable, the Manager, Procurement & Retail Operations will ensure that furniture and equipment Capital Assets are affixed with a unique inventory tag.

3.4. Computing and Technical Services will ensure computer hardware is physically identified with a unique inventory tag.

3.5. Capital Assets will be inventoried and reconciled to records with a physical count no less than once every three years.
   a) The Finance Department, in cooperation with department directors, will coordinate physical counts of Capital Assets and will reconcile the counts to the Capital Asset records.
   b) Each Department is responsible for counting its Capital Assets and reconciling the count to Capital Asset records.
   c) Discrepancies will be investigated and followed up on by the Finance Department. The respective department directors and Capital Asset records will be updated based on the physical count results.
   d) Disposals will be accounted for by the removal of inventory tags and submission of the Capital Asset Disposal Form to the Finance Department.

3.6. The University maintains a Permanent Art Collection. The Estimated value as of the date of acquisition will be established by independent appraisal for insurance purposes.

4. MAINTENANCE

4.1. Repairs and maintenance are expensed in the period they are incurred unless the repair and maintenance improves the performance or extends the life of the Capital Asset, in which case, it is considered a Betterment, and the cost is added to the value of the Capital Asset.

5.   DISPOSALS

5.1. The disposal of University Capital Assets must be managed fairly and equitably. The interests of the University take precedence when the method of disposal is chosen.

5.2. The Vice-president, Finance and Operations will approve all Capital Asset disposals.

6.   BUILDING IMPROVEMENTS

6.1. Disposal of internally funded building improvements must be reported and signed off by the Director, Campus Operations to the Finance Department for write-off.

6.2. Disposal of externally funded building improvements must be confirmed with the Advancement and Finance Department prior to the disposal.

7.   FURNITURE, EQUIPMENT AND COMPUTER HARDWARE AND SOFTWARE

7.1. Department directors are responsible for identifying and signing off on the assets for disposal within their units.

7.2. Internally funded furniture and equipment and computer hardware and software may be disposed of in the following manner, subject to the authorization required as noted above:

Disposal Type and Restrictions	Approval	Consideration*
Surplus To dispose of assets no longer needed or in use by the University Department is responsible for removal costs	Vice-President, Finance and Operations	Not applicable
Trade-In To trade-in a Capital Asset for another newer, similar Capital Asset	Vice-President, Finance and Operations	Fair Value consideration
Direct Sale to Staff, Related Party or non-Related Party Capital Assets may not be gifted to employees per the Code of Conduct	Vice-President, Finance and Operations	Fair Value consideration
Stolen or Lost Capital Assets that have been lost or stolen must be immediately reported to the Vice-President, Finance and Operations	Vice-President, Finance and Operations	Not applicable
Dismantled Parts Applies to furniture and equipment only Parts are retained by the unit	Vice-President, Finance and Operations	Not applicable

Consideration
   Department directors, in consultation with the Finance Department, shall establish an

Disposal Type and Restrictions	Approval	Consideration*

estimated Fair Value price for the Capital Asset(s).

Capital Assets with a sale value of less than $5,000 may be sold based on a written offer, contingent on final approval from the Vice President, Finance and Operations or their delegate.

Capital Assets with a sale value of $5,000 or more shall be open to public bids as coordinated by the Manager, Procurement & Retail Operations.

Depending upon the nature of items offered for sale, a reserve bid and/or a bid deposit may be required.

All sales must be completed through the Bookstore and will be sold at a mark-up to reflect the Bookstore's services. Employees may not collect cash or cheque from purchasers.

7.3. Any disposal method other than those outlined above must be approved by the Vice President, Finance and Operations.

7.4. Externally funded Capital Assets may only be disposed of once approval is granted from the Advancementthe relevant Dean, and the Vice President, Finance and Operations, to ensure adherence to the funding's terms of reference.

7.5. The Department in possession of the Capital Asset identified for disposal continues to be responsible for the asset until the disposal is completed.

8. CAPITAL ASSET DISPOSAL FORM

8.1. All disposals of furniture, equipment, computer hardware, and software must be communicated to the Finance Department using the Capital Asset Disposal Form.

8.2. Disposal of computer hardware and software must be decommissioned pursuant to the IT Backup, Retention and Disposal Procedure.

8.3. All costs of disposal are the responsibility of the Department that benefited from the Capital Asset while it was in use.

8.4. All environmental, health and safety disposal rules must be adhered to. The Director, Campus Operations must be notified before a disposal is undertaken.

E. DEFINITIONS

Amortization: A method to systematically allocate and expense the benefit received by the University over the course of an asset's Useful Life.

Asset Retirement Obligations: A legal obligation associated with a Capital Asset that will be settled at a future date. The legal obligation may arise from contract, legislation, etc.

Betterment: Cost of major additions or improvements to the existing asset that enhances its service potential or extends its Useful Life.

Bulk Purchase: The acquisition of similar Capital Assets that have a unit value below the Capitalization threshold for each individual unit but have a minimum value of $5,000 as a group.

Capital Asset:	An investment in or purchase of tangible Capital Assets including furniture, equipment, building, etc. whose value will benefit the University over more than one fiscal period. Capital Assets must be owned by the University, used on a continuing basis and are not held for sale.

Capitalized Costs:	Capitalized costs include the purchase price of the asset and other expenses directly related to bringing the asset to its intended use, such as installation, transportation, and testing costs.

Capital Lease:	A lease arrangement that transfers the effective risk of ownership to the University as though the Capital Asset had been purchased and financed.
Generally, a Capital Lease has been entered into when the following conditions are met:

1) the term of the lease equals 75% or more of the expected life of the asset, or

2) the present value of the lease payments equals 90% or more of the Fair Value of the asset, or

3) there is an option to acquire the asset at the end of the lease for a price that makes it highly probable that the option will be exercised

Capitalization:	The process of recording a cost as a capital or purchased intangible asset and subsequently amortizing it over several accounting periods instead of recording it as an operating expense and recognizing it in one accounting period.

Cloud Computing:	Arrangements where software, platform or infrastructure is hosted by the vendor and is not stored on hardware owned or physically located on the University's premises.

Collections:	Canadian Public Sector Accounting Standards (PSAS), defines "Collections" as a specific type of asset that generally consists of works of art, historical treasures, and similar items. These assets have cultural, aesthetic, or historical significance and are typically preserved and protected rather than used for operational purposes.

Fair Value:	Value of a capital or purchased intangible asset that would reasonably be agreed upon by an arm's length transaction between willing, knowledgeable parties under no compulsion.

Internally Developed Software:	Software that is developed in-house by University staff or by a third party on behalf of the University or acquired from a third party and subsequently modified to meet the University's business needs.
Intangible Capital Assets	Canadian Public Sector Accounting Standards (PSAS), define Intangible Capital Assets as identifiable non-monetary assets without physical substance that provide economic benefits or service potential to the entity. These assets are controlled by the public sector entity as a result of past transactions or events, and they are expected to generate future economic benefits or provide a future service potential.
Internal Staff Time	Costs related to the development/construction stage and capitalized. Payroll and payroll-related costs of employees who are directly associated with and who devote time to computer software projects.
Purchased Computer Software	Off-the-shelf software acquired by the University from a third party, that is ready for use with little or no change.
Purchased Intangible Asset	An identifiable non-monetary economic resource without physical substance, acquired through an arm's length exchange transaction between knowledgeable, willing parties who are under no compulsion to act. Intangible assets acquired through a transfer, contribution, or inter-entity transaction, are not Purchased Intangible Assets. Software is not included as it is accounted for as a Capital Asset in accordance with Public Sector Accounting Standards.
Related Party	Two parties who are known to each other and who are not operating at arm's length.
Residual Value	The proceeds expected to be recouped on the capital or purchased intangible asset when it is disposed of.
Threshold Amount	The minimum total cost that an individual Capital Asset, Purchased Intangible Asset, Bulk Purchase, or capital project must have before it is recorded as a capital or purchased intangible asset in the financial records.
Upgrade	The enhancement of the existing service potential and functionality of computer software and hardware.
Useful Life	The period during which a capital or purchased intangible asset may be put towards operational use in the University. Useful Life may be shorter than physical life because the Capital Asset may become obsolete before it is worn out. Capital or Purchased Intangible Assets will be at the end of their Useful Life when they are of no further use or potential use to the University and need to be replaced.

Work in Progress   Capital or Purchased Intangible Assets under development or construction that have not yet been put into use. Capitalized Costs will not be amortized until such asset is put into use.

F. RELATED POLICIES

- Code of Conduct Policy
- Delegation of Signing Authority Policy

G. RELATED LEGISLATION / STANDARDS

- Public Sector Accounting Standards

H. RELATED DOCUMENTS

- Capital Asset Disposal Form
- IT Backup, Retention and Disposal Procedure
- Purchasing Procedure
- Signing Authority Matrix

I. REVISION HISTORY

Date (mm/dd/yyyy)	Description of Change	Sections	Person who Entered Revision (Position Title)	Person who Authorized Revision (Position Title)
11/16/2021	Prior fixed asset procedure 200.13.01 overhaul	All	Manager, Finance and Accounting	Chief Financial Officer
11/23/2021	Name changed from 'Fixed Assets Procedure'	Name	Manager, Finance and Accounting	Chief Financial Officer
04/17/2023	Clarify requirements related to the revision of Useful Life Allow for Capitalization of Bulk Purchases	All	Manager, Finance and Accounting	Vice President, Finance and Operations
01/25/2025	Guidance on the Capitalization of Purchased Intangible Assets, computer software, Cloud Computing arrangements and Internal Staff Time	All	Director, Finance	Vice President, Finance and Operations

APPENDIX A: GUIDELINES ON CAPITALIZATION OF COMPUTER SOFTWARE

1. **Purpose**

    1.1 For the purpose of these guidelines, the following items are considered computer software subject to consideration for Capitalization:
      a) Externally Purchased Computer Software which is then installed on AUArts computer hardware; hereinafter referred to as "Purchased Computer Software".
      b) Internally developed computer software installed on AUArts computer hardware; hereinafter referred to as "internally developed computer software".

2. **Purchased Computer Software**

    2.1 Purchased software is off-the-shelf software acquired by the University from a third-party and is ready for use with little or no changes.
    2.2 Purchased software must meet the following requirements to become eligible for Capitalization:
      a) Purchased software must meet the definition of a Capital Asset in accordance with this procedure; and
      b) The purchase price of software must exceed $5,000.
    2.3 Where software is included in the purchase price of hardware (e.g. operating system software) and the cost of the software cannot be reliably calculated, the software should be capitalized as part of hardware and amortized over the estimated Useful Life of the hardware.
    2.4 Warranty costs and service/maintenance agreement costs are not capitalized if they are listed as separate line items on the purchase orders or invoices or can be reasonably estimated. Otherwise, warranty, service, and maintenance costs are capitalized with the value of the asset they belong to.

3. **Internally Developed Software**

    3.1 Internally Developed Software is software that is:
      a) Developed in-house by University staff or by a third party on behalf of the University or
      b) Acquired from a third party and subsequently modified to meet University business needs.
    3.2 Internally Developed Software must meet the following requirements to become eligible for Capitalization:
      a) Internally Developed Software must meet the definition of a Capital Asset in accordance with this procedure
      b) The costs incurred during the development/construction stage must exceed $25,000
      c) Internally Developed Software projects must be approved by management
      d) The Finance team must receive an approved Authorization for Expenditure Form

3.3 There are three main phases generally associated with software development projects: the preliminary/planning phase, the development/construction phase, and the post-implementation/operation phase. Capitalization begins and ends with the development/construction phase, which is the phase that brings the software to a functional level for deployment to production.

4. Preliminary/planning phase

4.1 Activities in the preliminary/planning phase include establishing high-level functional and non-functional requirements, determining sourcing options (internal resources, evaluation and selection of external resources) and evaluating alternatives to assess the viability of the investment.

5. Development/construction phase

5.1 Activities in the construction phase involve software development (coding), configuration, interfacing, testing, deployment, and warranty work or the acquisition and implementation of hardware or infrastructure.

5.2 Capitalization of costs should begin when both of the following conditions are met:
    a) The preliminary or research project phase is completed
    b) Management authorizes and commits to fund the project, and it is highly probable that the project will proceed

5.3 For purchased software modified to the extent that it is considered internally developed, these events are deemed to have occurred when the University commits to purchasing the software.

5.4 To be considered for Capitalization, the project must demonstrate the following criteria:
    a) Technical feasibility of the project
    b) An intention on the part of the University to complete the project
    c) An ability to use the asset to generate future economic benefit
    d) Available resources to complete the project
    e) Reliably measurable cost of the project

5.5 This should be evidenced by appropriate documentation demonstrating management's approval and intent to pursue the project. Based on the preliminary project plan, the project can be budgeted as capital or operating.

5.6 Costs for an information technology project may be incurred over a significant period of time. Capital costs should be accumulated during this period, with Amortization commencing in the year the system in question is substantially complete and ready for use after all necessary testing has finished.

5.7 Some Internally Developed Software projects are large and complex and may be implemented in phases or modules. If a module, once completed, can operate on its own (i.e., it is not dependent on another module), then it may be considered a Capital Asset and amortized independently. If multiple modules need to work together to operate the end solution, the entire solution is considered one Capital Asset, and the modules should be grouped and amortized collectively.

5.8 CTS must have a suitably rigorous process for identifying costs to be capitalized that can withstand audit (i.e. time records, review and approval of costs charged, etc.).

6. Post-implementation (operation) phase

6.1 The post-implementation phase involves end-user training, maintenance, and ongoing support.

6.2 Depending on their nature, Internally Developed Software project activities may not follow these three noted phases in a specific sequence; therefore, the decision to expense or capitalize should be based on the nature of the costs incurred and not necessarily the timing of their occurrence.

6.3 The table below displays the breakdown of expensed and Capitalized Costs by project phases and steps:

Activity	Capitalize	Expense
Preliminary Project Phase		
The strategic decision to undertake a project		X
Feasibility study (including, but not limited to): • Current state assessment • Formalized terms of reference • High-level requirements analysis • Conceptual formulation of alternatives • Evaluation of alternatives • Determination of the existence of needed technology • Establishment of feasibility		X
Business case (including, but not limited to): • Recommendation of and justification of selected alternative • Cash flow projections • Impacts on programs and other relevant decision criteria		X
Request for proposal (including, but not limited to): • Preparation • Inviting vendors to demonstrate or bid on the project • Selecting a successful proposal		X
Restructuring of the workforce (selecting personnel or consultants to head the development process)		X
Final selection of alternatives • Evaluating technology		X
Application Development Phase		
Design of chosen path, including software configuration, software interface and detailed technical specifications	X	
Coding	X	
Hardware installation	X	
Installation of software applications on a server or in the cloud	X	
Testing, including the parallel processing phase, to ensure the software is working as intended before implementation	X	
External contractor costs directly related to the development of the software	X	
Salary and benefit costs of employees assigned to the project	X	
Cost of software needed for data conversion between the old and new system	X	
One-off licensing fee to use the software	X	

Activity	Capitalize	Expense
Software maintenance licensing fee		X
Business process re-engineering		X
Data conversion processes including purging or cleansing of existing data reconciliations, creation of new data, etc.		X
Other administrative activities • Admin support that is NOT directly attributed to preparing the software for use • Hospitality, travel, and promotional costs • Expenditures on training staff to operate the computer software, except where the training is considered necessary for the implementation of computer software solution		X
Post-implementation/Operation Stage		
User training • End-user training for software after it goes live and once it is in use includes staff time, materials, and travel costs.		X
Maintenance and annual licenses • Upkeep, maintenance, repairs, or minor upgrades are used to maintain functionality for the remaining life (includes annual system patches, incremental reporting functions, additional access licenses, etc.)		X
Ongoing vendor support		X
Upgrade costs that improve functionality of existing software, including major revisions and are reasonably separable from maintenance costs (exceeding $25,000)	X	
Upgrade costs that improve the functionality of existing software, including major revisions, but NOT reasonably separable from maintenance costs		X
Extended warranty		X
Post-implementation review		X

7. Business process re-engineering

7.1 The University may undertake a project to re-engineer its business processes. The project often includes developing a new computer software system or enhancing the existing software system that will form part of the re-engineered business processes.

7.2 Business process re-engineering costs are not capitalized, including those incurred in conjunction with the acquisition, development, or implementation of internally developed computer software.

7.3 The cost of acquisition or construction of Capital Assets (for example, purchasing hardware) as part of this activity would be subject to the Capitalization threshold outlined in this procedure.

7.4 The following internally generated or third-party costs typically associated with business process re-engineering activities are examples of costs that should be expensed as incurred:

   a) Current state assessment: the process of documenting the University's current business process

   b) Process re-engineering: the effort to re-engineer the University's business processes to increase efficiency and effectiveness

c) Restructuring the workforce: determining the employee makeup necessary to operate the re-engineered business processes

8. Enhancements and Upgrades

8.1 Costs incurred on modifying existing computer software will only be capitalized if they result in additional functionality, i.e. enabling the software to perform tasks it was previously incapable of performing. If the total cost exceeds $25,000, follow the Capitalization guidelines described in Section 3. Internally Developed Software.

8.2 Costs incurred to maintain the existing service potential and functionality of computer software will be expensed.

APPENDIX B: GUIDELINES ON CLOUD COMPUTING ARRANGEMENTS

1. Purpose

1.1   These guidelines provide guidance on the accounting of Cloud Computing arrangements. It does not intend to override the procedure and is subject to the same Capitalization threshold criteria as prescribed in the procedure.

1.2   Cloud Computing refers to arrangements where software, platform or infrastructure are hosted by the vendors and are not stored on hardware owned or physically located on the University's premises. Cloud-computing arrangements do not result in the acquisition or ownership of the software, but they do provide access to the benefits that result from that asset in the form of a service. As a result, the Capitalization of such costs depends on the University's ability to control the future economic benefits arising from a cloud-computing arrangement and is dependent on the specific circumstances of each arrangement.

1.3   There are typically three service models under a Cloud Computing arrangement: Software as a Service (SaaS), Platform as a Service (PaaS) and Infrastructure as a Service (IaaS).

   a) Software as a service (SaaS)—This arrangement is a software distribution model in which applications are hosted by the service provider, and the customer pays for access but does not manage or control the underlying infrastructure or software itself.

   b) Platform as a service (PaaS)—This arrangement is a model where the cloud provider delivers both hardware and software tools needed for application development. The provider hosts the hardware and software so that the customer does not need to perform installation or purchase in-house hardware and software. The customer normally controls the deployed applications. This model does not replace the full infrastructure of the customer's needs.

   c) Infrastructure as a service (IaaS)—This arrangement is a model where virtualized computing resources are provided over the Internet. The third-party provider hosts the hardware, software, servers, storage, and other components on behalf of its customer. The customer has control over deployed applications but does not have control of the infrastructure supporting it.

1.4   All three types of arrangement identified involve the purchase of access to software applications and their related support systems. The extent of the required infrastructure hosted by the service provider to support the implementation of the service determines the type.

2. Accounting for Cloud Computing arrangements

2.1   Multiple-element contracts

   a) Multiple-element contracts are Cloud Computing arrangements that include both a software asset component and a service component related to implementation, setup, and other support services received as part of the contract.

   b) To account for such arrangements, the different elements should be considered individually in the context of the larger agreement, with control being the main driver of whether a Cloud Computing arrangement qualifies for Capitalization or should be expensed.

c) The software component of a Cloud Computing arrangement should be accounted for in accordance with Section 2 of the Guidelines on Capitalization of Computer Software.

d) Costs associated with the service component of Cloud Computing arrangements can be capitalized if::
   i. The implementation service is distinct from the service of receiving access to the software.
   ii. The implementation service cost gives rise to a separate asset based on the recognition criteria outlined in Sections C.4 and C.5 of this procedure.

e) The implementation service is distinct from the service of receiving access to the software when:
   i. It is performed internally or by a third party other than the cloud vendor;
   ii. It is performed by the cloud vendor, but another company would be capable of performing the service without also providing access to the software.

f) Implementation costs that give rise to a separate intangible asset will be accounted for in accordance with Section 3 of the Guidelines on Capitalization of Computer Software.

g) In cases where the implementation service is distinct from the service of receiving access to the software but does not give rise to a separate intangible asset, the associated costs are going to be recognized as an expense when the service is received.

h) Subscription-based services and pay-as-you-go services are typically challenged to meet the definition of Capital Assets outlined in Section C.4 of the procedure, as payments are made as services are received. Subscription fees would be recognized as prepaid and expensed over the subscription period.

i) AUArts Cloud Computing arrangements should be reviewed to determine whether and to what extent AUArts can exert control over the future economic benefits of the arrangement. In the context of cloud-computing arrangement, the control is present based on several different factors:
   i. The software is highly customized for AUArts' purposes:
      o entity specific and not easily transferable to another entity or for use for another purpose;
      o custom design and/or configurations, such as custom user interfaces and configurations for AUArts-specific systems and infrastructure, ensure the software can only provide future economic benefits to AUArts uniquely;
      o the customization required to enable AUArts to generate future economic benefits from the asset;
      o a significant portion of costs and effort in implementation associated with the modifications and customization rather than the standard or base version of the product;
      o a reliably measurable future economic benefit to the entity as a result of the customization in the form of cost savings, improved service quality, or enhanced student experience.
   ii. Significant upfront costs that disincentivize abandoning the project
   iii. Termination penalties that trigger on termination of the agreement
   iv. Risks from use of the service rests with the AUArts

j) As contract terms become more restrictive to limit access and outright block AUARTs' access to the service and related infrastructure developed in the implementation, the less AUARTs can exercise control. Meanwhile, termination penalties, a guarantee of service by the vendor over the term of the contract, and a high degree of specialized customization that is not easily transferable or outright banned by the agreement increase AUArts influence and control over the arrangement.

k) All cloud-computing contracts should be forwarded to Finance in advance to review and determine the accounting treatment of the proposed cloud-computing arrangement.

l) Finance will review the contract terms for the following:

   i. Are there any distinct services, elements, and associated costs that should be considered individually? If yes, determine if any of these components meet both the Capital Assets definition and recognition criteria outlined in Sections C.4 and C.5

   ii. Does the arrangement provide control of the software/ intellectual property, or does the third party retain control:

     o In the context of licenses and subscriptions, to what degree is access limited to a specific time period

     o Are there restrictions placed on the entity's ability to use the asset

   iii. Does the arrangement provide access to the software code or rights to copy or otherwise modify the source code?

     o The right to take possession of a copy of the software and run it on the company's own or a third party's computer infrastructure can indicate control

     o Software access that provides an opportunity for modification and customization at the entity's discretion can also indicate control

   iv. Is the arrangement indefinite or for a limited period?

     o An indefinite license would give indefinite access to future economic benefits from the license, while one covering a limited period can be terminated.

   v. Is the license transferable, or is its use restricted to the entity?

     o If the entity owns the license, it can transfer and operate as desired, whereas rules restricting an entity's ability to use the license would indicate the third party retains control

2.2 Cloud Computing service contracts

a) Cloud Computing service contract is an agreement whereby a contractor supplies time, effort, and/or expertise instead of a tangible product. Arrangements that do not meet the definition of multiple element contracts in Section 2.1 of this Guideline are considered service contracts, and the related cost should be expensed.

b) In Cloud Computing service contracts (i.e., an arrangement without a software asset component), AUArts may incur implementation and other up-front costs that directly or indirectly relate to the software service received over time. In Cloud Computing service contracts, the implementation services are generally not distinct from the service of receiving access to the software.

c) AUArts will need to carefully review the terms of their software service contracts and consider the nature of both the service they will receive and the implementation costs they will incur.

d) Capitalize or Expense

    i. The following table summarizes the recommended treatment of various implementation and upfront costs that AUArts may incur in a Cloud Computing service contract. This table may not address all situations. Therefore, exercise of judgment is required.

Accounting treatment of implementation and upfront costs related to service contracts

Activity	Defer	Capital	Expense
Upfront payments relating to enhancing the functionality of the software service.(Note1)	X	X	
Evaluation of the entity's existing hardware and software for compatibility with the software service			X
Enhancement or modification to the entity's existing software that will continue to be used under the Cloud Computing arrangement		X	
Testing for proper functionality of the software service			X
Business process re-engineering			X
Employee Training on the use of software service			X
Data conversion costs, including: • Reconciling new data with the date extracted from the old system • Purging existing data • Creating or inputting new data			X X X
Maintenance work to be performed by a third party			X
Rights to future service Upgrades and enhancements	X		
Overhead costs, including general and administrative costs			X

Note 1

i. Costs incurred for enhancements to the Cloud Computing arrangement will be deferred and expensed over the software's access period. These costs may be related to:
    o   Upfront costs incurred on the following activities required to enhance the functionality of Cloud Computing software: architect, design, configuration, prototype and report development of the new cloud software system.
    o   Upfront costs incurred on the enhancement of future functionality of Cloud Computing software.

ii. Costs incurred for enhancements or modifications to the software already recorded on the AUArts books as a Capital Asset will be capitalized.

e) AUArts has to carefully analyze the services provided under a service contract to determine the appropriate accounting for the related costs. This includes gaining an understanding of the nature of services and their timing so that the costs are recognized in the appropriate period.

f) A critical factor in assessing whether to expense or capitalize an item of expenditure is determining whether the resulting economic resource meets the recognition criteria outlined in Sections C.4 and C.5 this Procedure. Otherwise, the related expenditure should be expensed.

2.3 Amortization of Cloud Computing arrangements

a) The Amortization of the resulting Capital Assets should be based on the lower of:
   i. Expected Useful Life, and
   ii. Duration of the Cloud Computing contract

b) The same criteria apply to the deferral of prepaid upfront costs.

Appendix C: Guidelines on Capitalization of Internal Staff Time

1. Purpose

1.1   These guidelines direct the Capitalization of internal staff time engaged in the delivery of computer software projects.

1.2   This guideline is not all-inclusive, and professional judgment must be exercised in applying it to each circumstance.

2. Internal Staff Time Measurement and Reporting

2.1   The University will capitalize internal resources when 50 % or more of their time is assigned and directly attributable to the delivery of computer software projects quarterly. The corresponding credit will be recorded directly to the department code where the salary and benefit expense occurred.

2.2   Internal staff effort directly attributable to the capital projects will be allocated to the project based on the actual hours/time spent on it. The dollar value of hours/time spent on the project will be calculated using the hourly loaded salary rates.

2.3   Adequate supporting documentation for the internal staff effort spent on the project will be maintained by and provided to Finance every quarter.

3. Internal Staff Time Directly Attributable to the Project – TO BE CAPITALIZED

3.1   The costs of internal staff effort incurred during the construction or development period and directly attributable to the project will be capitalized to the related asset.

4. Internal Staff Time, Ancillary in Nature – TO BE EXPENSED AS INCURRED

4.1   The cost of effort spent by staff whose contribution to a project is considered ancillary in nature will be excluded from Capitalization. The following are examples of project roles and activities which are considered ancillary in nature:
a) Pre-project planning and scoping activities (e.g. studies and assessments including feasibility studies; strategic planning)
b) Support services (e.g. administrative support, financial services, human resources)
c) Management support of the project (e.g. Steering Committee)
d) Quality assurance (e.g. project audits)
e) An advisory capacity to the project (e.g. attending workshops)
f) End-user training
g) Organizational change management (e.g. business process re-engineering activities)
h) Ongoing support and maintenance