Capital Expenditure

Policy

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Policy Owner: Deputy Director of Finance, Financial Control on behalf of Director of Finance
Approved by:

- **QMSE on: 17 May 2016**
- **Audit and Risk Committee on 2 June 2016**
- **Finance and Investment Committee on: 7 June 2016**

Contents

1 Introduction

1.1 Accounting for capital is governed by the requirements contained in financial reporting standards under FRS102 and the associated accounting guidance for the Higher Education sector as set out in the Higher Education Statement of Recommended Practice 2015 (HESORP 2015) (or its successors):

Queen Mary University of London (QMUL) must adhere to these standards in preparing its financial statements and this policy is therefore consistent with FRS102. They require that capital expenditure is recorded separately from revenue expenditure and to this end QMUL requires that they are budgeted for and approved separately in order that the implications for the Statement of Comprehensive Income, Balance Sheet and Cash flow can be identified.

1.2 The overall purpose of this policy is to:

- Confirm and clarify the current policies in place, which should be followed on behalf of QMUL
- ensure that capital expenditure across QMUL is clearly identified, planned, authorised and accounted for accurately in a timely manner.

1.3 This document describes the Capital Expenditure Policy that must be adhered to on behalf of QMUL and includes details of what is classed as capital expenditure and the process to be followed.

1.4 This policy supports Queen Mary, University of London Financial Regulations, section 14 – Financial Planning; the Scheme of Delegation of Financial Authority and the accounting policies referred to in the Financial Statements, as defined in section 4 below.

http://www.arcs.qmul.ac.uk/policy_zone/index.html

1.5 Capital expenditure and associated costs on land, buildings, equipment and any other capital spend (e.g. software), can only be approved as part of QMUL's Capital Programme agreed by Council, as outlined in the Financial Regulations.

1.6 The Scheme of Delegation of Financial Authority outlines the areas of responsibility and approval limits related to capital expenditure.

http://www.arcs.qmul.ac.uk/policy_zone/index.html

1.7 This policy also provides examples of what should not be capitalised, that is expenditure that is classed as revenue and should be charged to the Statement of Comprehensive Income.

1.8 This policy is owned by the Deputy Director Financial Control on behalf of the Director of Finance.

1.9 This policy is supplemented by user guidance and training, as described in section 19.

2 Governance and funding

2.1 Queen Mary Senior Executive determines the overall capital budget for QMUL and retains overall responsibility for capital expenditure.

2.2 The capital budget is allocated between:

- IT expenditure which is managed by the IT Strategy Board;
- Estates and Facilities expenditure which is managed by the Estates Strategy Board;
- Faculty capital spend which is managed at Faculty and School/Institute/PS Department level;
- Other specific sums, for example research equipment renewal fund and specific funding for large capital research projects, for which ownership is agreed as required; and

A summary report on overall capital expenditure is included in the monthly management accounts reviewed by QMSE and a comprehensive and more detailed report is also reviewed at Estates Strategy Board.

2.3 For grant funded equipment – where full grant funding is provided, the responsibility for approval lies within the relevant School. However, the capital must be accounted for in the same way, as per the guidance in this policy.

2.4 Capital funding for all capital spend, including grant funded equipment, is approved through completion and sign off of the Gateway Approval form, through the relevant governance process. This includes review and sign off by Finance.

3 Capital budgeting process

3.1 All anticipated capital expenditure, with the exception of fully grant funded, should be budgeted for during the budgeting process, covering e.g. major estates and IT projects and equipment. Budget guidance is distributed by the Financial Management team.

3.2 The budgeting process is not authorisation to initiate spend. QMUL's capital authorisation process must be followed, in accordance with the governance described in section 2 of this policy.

4 Accounting policies

4.1 The following accounting policies are extracted from the Queen Mary University of London Financial Statements.

Intangible assets

Intangible assets are stated at cost or at impaired value. Where it is considered that there has been any impairment in the value of an asset, the difference between the carrying value and the higher of its net realisable value or value in use is expensed in the consolidated statement of comprehensive income and expenditure.

Third party software and the costs associated with its implementation costing less than £10,000 per individual item or group of related items is written off in the year of acquisition. All other costs are amortised over 5 years, the period of its estimated useful life.

Fixed assets

Fixed assets are stated at cost or deemed cost less accumulated depreciation. Cost includes the original purchase price of the asset and the costs attributable to bringing the asset to its working condition for intended use. Where parts of a fixed asset have different useful lives, they are accounted for as separate items of fixed assets.

i. Buildings are depreciated over 50 years. Depreciation on leased buildings is calculated over the life of the lease if the lease is less than 50 years. No provision for depreciation is made against the value of land.
ii. Assets in the course of construction are stated at cost and are not depreciated until they are transferred to the completed asset class when ready for use.
iii. Major refurbishment works are depreciated over 20 years
iv. Plant & Machinery is depreciated over 15 years.
v. Fixtures & Fittings are depreciated over 10 years
vi. Equipment is depreciated over 5 years
vii. Plant & Machinery, Equipment and Fixtures & Fittings costing less than £10,000 per individual item or group of related items is written off in the year of acquisition. All other items are capitalised.
viii. Where assets are acquired with the aid of specific grants they are capitalised and depreciated over the shorter of the term of the grant or the depreciation terms as set out above.
ix. Assets held under finance leases are depreciated over the period of the finance lease or the depreciation terms as set out above whichever is shorter.
x. Improvements to properties held under short leases are depreciated over the life of the lease.
xi. Expenditure on an asset after it is purchased is capitalised when the expected future benefits from that asset as a result of the expenditure are greater than those previously assessed.

xii. Where it is considered that there has been any impairment in the value of an asset, the difference between the carrying value and the higher of its net realisable value or value in use is expensed in the income and expenditure account. Circumstances which could give rise to an impairment are reviewed annually.

xiii. QMUL owns heritage assets, none of which either individually or collectively are material to these Financial Statements, which have not been capitalised.

xiv. Expenditure to ensure that a tangible fixed asset maintains its previously recognised standard of performance is recognised in the income and expenditure account in the year it is incurred. QMUL has a planned maintenance programme which is reviewed annually.

Finance Leases

Leases in which QMUL assumes substantially all the risks and rewards of ownership of the leased asset are classified as finance leases. Leased assets acquired by way of finance lease and the corresponding lease liabilities are initially recognised at an amount equal to the lower of their fair value and the present value of the minimum lease payments at inception of the lease. Minimum lease payments are apportioned between the finance charge and the reduction of the outstanding liability. The finance charge is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Operating leases

Costs in respect of operating leases are charged on a straight-line basis over the lease term. Any lease premiums or incentives are spread over the minimum lease term.

Income Recognition

Capital grants are recognised in income when QMUL is entitled to the funds subject to any performance related conditions being met. Where grant funded assets are in the course of construction, we consider on a case by case basis whether their construction constitutes a performance related condition. In the event that it does, income will be recognised as the expenditure to complete the asset is incurred.

5 Capital vs revenue

What is capital?

5.1 Capital expenditure is money spent on acquiring, upgrading and building assets. It is generally used to purchase or develop property, furniture or fixtures, computer hardware and software, laboratory and other equipment.

5.2 QMUL defines capital expenditure (as per the Scheme of Delegation of Financial Authority) as:

- any expenditure over £10,000 on an item or group of related items which has a life of more than 1 year and
- has a use in the teaching of students, research, the care of patients or for administrative purposes.

  This covers all construction and improvements which increase the value and useful economic life of a building, major equipment purchases, software, and expenditure related to research, consultancy and other areas of knowledge transfer.

5.3 Capitalised items are written off to the Statement of Comprehensive Income via a depreciation charge (definition – see section 20 – Appendix 1 Glossary) which is set in accordance with the asset life attributed to the items asset class as defined in the fixed asset accounting policy.

5.4 Costs should be considered as gross costs including VAT and finance will review the VAT treatment on a project by project basis. Due to the mix of activities undertaken QMUL is not able to recover all VAT and consequently budget holders should consider it to be a cost.

5.5 Examples of expenditure (> £10k per item) that would be included as capital:

- New construction (new buildings or major additions)
- Building renovations or upgrades (capital improvements)
- Freehold property acquisitions
- New or replacement equipment or furniture (replacement only where any existing asset has been fully depreciated or disposed of)
- Telecommunication and information technology hardware
- Heating, ventilation and air-conditioning (new or replacement where any existing assets have been substantially depreciated), subject to 5.7 below

5.6 The cost of a fixed asset is its purchase price and any costs directly attributable to bring it into working condition for its intended use. These costs include:

- Acquisition costs
- Site preparation and clearance
- Delivery and installation costs
- Professional fees i.e. architect fees, quantity surveyor (but not Procurement)
- Internally generated costs where these re directly attributable to the asset eg project management

5.7 For a repair or replacement to be capitalised, it must increase the value and useful economic life of the asset (see 5.9 below).

5.8 A replacement may also be capitalised if the new item/part is of significantly improved quality and higher value compared to the old item.

5.9 The following examples would be capitalised:

- Replacing a lift by enlarging the shaft and increasing the carrying capacity from 5 to 20 people
- Building an extension to a lecture theatre
- Replacing a flat roof with a pitched roof if it increases the useful life of the building
- Extending a nursery to increase capacity

For more specific guidance refer to the relevant sections 6 - 8 covering – Estates and Building Projects, IT Projects, Institute and Research Equipment.

Note: Please also refer to section 9 – Feasibility Studies and section 10 – Strategic Studies.

What is revenue?

5.10 Replacement or restoration of the original functionality even if over £10,000 would not qualify as capital expenditure, where it is bringing the asset back to its original state (no enhancement).

5.11 The following maintenance examples would not be capitalised, as they only bring the asset back to the original state (no enhancement):

- General repairs and maintenance (e.g. repair of potholes)
- Repainting office / nursery
- Plumbing or electrical repairs (e.g. burst pipe, replacing lights, heating and ventilation system repairs)

5.12 Costs not directly related to the construction of the project such as administration and general overhead costs would be classed as revenue.

Note: Some projects may be a combination of revenue and capital items.

Note: Please also refer to section 9 – Feasibility Studies and section 10 – Strategic Studies.

6 Estates and buildings projects

6.1 If the asset is constructed by QMUL, the capital costs will include:

- Labour costs of own employees or building contractor, arising directly from the construction of the tangible fixed asset
- Professional fees directly related to the construction of the asset (e.g. architect, employer's agent, project manager, quantity surveyor)

- Delivery and installation of heating, lighting, lifts and air conditioning

6.2 The following costs will not be included as capital costs:

- Costs not directly related to the construction of the project such as administration and general overhead costs including unspecified and percentage based project office costs
- Costs incurred by, or on behalf of those staff, who are directly working on the project but are not directly related to the construction or acquisition of the asset e.g. training, general advice (finance, procurement) and consumables.
- Costs of moving into a new building.

6.3 Relevant capital plant and machinery or furniture installed in a new or refurbished building should be distinguished from the construction or refurbishment and depreciated in accordance with the depreciation policy for the asset class.

6.4 Maintenance costs which include elements of tangible improvements/“betterment” to the asset can be capitalised. For example – repainting a lecture theatre would be classed as revenue (and not capitalised). However, refurbishment of the lecture theatre which included an extension to increase capacity would be classed as capital.

7 IT projects

7.1 For IT related projects, the following can be capitalised (if over £10,000):

- Purchased software
- Hardware
- Training for implementation
- Direct consultancy costs and internal staff costs (up to the point of implementation)

7.2 The following should not be included:

- Any margins
- Staff training, software and hardware maintenance costs and software licences once the project has been completed
- Costs related to Finance or Procurement staff
- Annual software licences

8 College wide capital equipment including Institute and Research equipment

8.1 Equipment costing £10,000 or more per individual item or group of related items, and where the economic benefit of the asset has a useful life of more than one year, should be capitalised.

Example 1 - microscopes, slide scanners, centrifuges where individually they cost > £10,000

Example 2 - a computer lab where all computers are replaced may cost £50,000, but the individual computers cost less than £10,000 each – would not be capitalised.

Example 3 – where purchasing a number of component parts to build a piece of equipment (an asset) which overall costs more than £10,000 would be capitalised.

Note: It is important to be aware that it is not always what is invoiced. It is necessary to take into account all the part payments for the related items e.g. 3 x payments of £8,000 = £24,000. The £24,000 would be capitalised. In such cases, Finance will rely on Faculties to provide information, to help determine and ensure these assets are identified and capitalised.

For further advice and guidance, please contact Finance (see section 19).

9 Feasibility studies

9.1 Feasibility studies for potential capital projects are capitalised by default. Where a project does not receive approval from the appropriate QMUL Committee, the feasibility study costs (initially charged to capital), cannot be capitalised and must be charged back to the revenue budget of the department initiating the study.

9.2 All projects in progress, will be reviewed in November and May, to ensure they are likely to provide value by the year end and will be continuing. Otherwise, costs cannot be capitalised.

If the project has not been started in order for the costs to be treated as capital, a commitment will need to be provided from QMSE/ Finance and Investment Committee that a project will proceed.

10 Strategic studies

10.1 Strategic studies may not be capitalised e.g. costs incurred to produce an IT Strategy, as these do not directly relate to a specific asset.

11 Grants

11.1 Where assets are acquired with the aid of a specific grant, the grant is attributed to the relevant asset and recognised in income when QMUL is entitled to the funds subject to any performance related conditions being met.

11.2 Where assets are acquired with the aid of specific grants the assets are capitalised in accordance with the fixed asset policy and depreciated over the shorter of the term of the grant or the depreciation term in accordance with the relevant asset.

12 Operating leases

12.1 An operating lease is a contract agreement for the use of an asset and tends to be short term (but not always), compared to the useful life of the asset or piece of equipment. For example, a piece of equipment may have an economic useful life of 25 years, but may be leased under an operating lease to an organisation (lessee) for 5 years.

12.2 Costs incurred as part of an operating lease are classed as revenue and not capital.

12.3 With an operating lease, the title of the asset does not generally pass to the lessee (organisation using the asset), but remains with the lessor (organisation providing the asset).

12.4 When considering purchasing vs operating vs finance leases, a business case should be put forward to consider the benefits of both options for QMUL e.g. becomes a financing decision.

12.5 The accounting for operating leases is overseen by Financial Accounting and the Finance Faculty Business Partnering Team.

13 Finance leases

13.1 A finance lease is a contract agreement for the use of an asset and tends to be more longer term (but not always).

13.2 Leased assets acquired by way of finance lease and the corresponding lease liabilities are initially recognised at an amount equal to the lower of their fair value and the present value of the minimum lease payments at inception of the lease. Minimum lease payments are apportioned between the finance charge and the reduction of the outstanding liability. The finance charge is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability. Financial Accounting will provide a schedule of interest charges over the life of the lease.

13.3 For assets held under finance leases, QMUL has a policy to depreciate the assets over the period of the finance lease or the asset life attributed to their specific asset class as defined in the accounting policy.

13.4 The lessor (providing the asset) is usually the legal owner of the asset during the course of the lease. However, the lessee (using the asset) has control over the asset, incurring both the benefits and risks of economic ownership.

13.5 With a finance lease, the lessee may have the option to acquire ownership of the asset (e.g. paying the last rental amount, bargain option purchase price).

13.6 When considering operating vs finance leases, a business case should be put forward to consider the benefits of both options for QMUL e.g. becomes a financing decision.

13.7 The accounting for finance leases is overseen by the Financial Accounting team.

14 Accounting for capital expenditure

14.1 Capital expenditure must be allocated to the relevant capital account codes at the time of commitment e.g. when a Purchase order is raised. Relevant account codes will be advised by the Financial Management team.

14.2 Finance will have overall responsibility for determining the distinction between capital and revenue and treatment of leases, in line with the UK accounting rules, based on information provided by faculties and departments. Finance should be consulted to discuss proposed items of spend, to ensure decisions are made about the correct treatment.

14.3 Purchase requisitions should be raised on Agresso for planned capital expenditure, after the governance process has been followed, to correctly approve the spend.

14.4 Committed capital expenditure - purchase requisitions should be raised, coded to the relevant capital account codes as advised by Finance and approved, for the full value of any contracted sums. This ensures QMUL has visibility of its commitments throughout the financial year.

14.5 Accruals for equipment – should be included in the monthly management accounts. Receipting of goods/services against purchase orders related to capital spend should be actioned on a timely basis once the goods/services have been received as per requirements in the original order, to ensure accruals can be included in the monthly management accounts.

14.6 Accruals for projects - Project Managers should inform the Business Partner – Estates and Facilities or Business Partner - IT about work executed to date, so that the value of this can be taken into account, where the invoice has not yet been received and/or paid.

14.7 Assets under construction – will remain under "work in progress" until completed. Projects Managers and the Relevant Finance Business Partner who will liaise with the Fixed Assets and Cashflow Accountant will regularly review projects and anticipated completion dates. Completed assets must be advised to finance by the project manager and included on the Fixed Asset Register.

14.8 Depreciation - should be charged from the time an asset comes in to use, at the start of its useful life (e.g. building comes in to use). The Fixed Assets and Cashflow Accountant must be notified when an asset comes in to use, so that it can be included on the Fixed Asset Register and depreciation charged according to QMUL's policy.

14.9 Depreciation will be charged monthly in the management accounts in line with the depreciation polices outlined in section 4.

14.10 Retentions – a Register of Retentions is maintained and information is included in the notes to the accounts. Retentions are accrued monthly by the Finance Partner – Estates and Facilities, through the construction phase of the project. These will be reviewed periodically and released in the event that they are not due to be paid.

15 Monitoring and reporting

15.1 Capital expenditure will be monitored and reported on monthly, co-ordinated by the Financial Management Team and will cover spend overseen by:

- Estates Strategy Board (ESB)
- IT Strategy Board (ITSB)
- Faculties/Professional Services

15.2 The Financial Management Team will be responsible for providing Financial Reports to ESB and ITSB

16 Disposal/sale of assets

16.1 If an asset, that has previously been designated as a capital item (e.g. piece of equipment, building), comes to the end of its useful life or is disposed of (e.g. given away, scrapped or sold), Finance must be notified via an Assets Disposal Form submitted to the Fixed Assets and Cashflow Accountant, so that the Fixed Asset Register can be updated and the relevant accounting entries actioned.

17 Impairment of assets

17.1 In the event of any impairment (loss) in the value of an asset over and above normal wear and tear (e.g. change in use of the asset or economic life is shortened), Finance must be notified via the Fixed Assets and Cashflow Accountant, so that the Fixed Asset Register can be updated and the relevant accounting entries actioned.

17.2 Circumstances which could give rise to an impairment are also reviewed annually by the Fixed Assets and Cashflow Accountant.

18 Further guidance, queries and training

18.1 This policy is supported by user guidance and training arranged and provided by Finance.

18.2 If you require any further guidance or have any queries related to this policy or about capital expenditure, please contact:

- your Finance Partner or the Fixed Assets and Cashflow Accountant.

Contact details can be found on the Finance intranet page

http://qm-web.finance.qmul.ac.uk/people/index.html

18.3 If you have any queries about raising purchase requisitions/orders or goods receipting, please contact:

- Procurement Team

Contact details can be found on the Procurement intranet page

http://qm-web.finance.qmul.ac.uk/purchasing/team/index.html

19 Appendix 1 - Glossary of accounting and QMUL terms

Term	Definition
Accruals concept	The principle that revenue and costs are recognised as they are earned or incurred, are matched with one another, and are dealt with in the Statement of Comprehensive Income in the period to which they relate, irrespective of the period of receipt or payment.
Accruals at QMUL	QMUL follows accruals accounting. This is when income and expenses are recorded as they occur, regardless of when cash is exchanged. This means that assets are recorded in the accounts when they are acquired or costs incurred. A Purchase Order example for the purchase of equipment: • the school raised a purchase order for a microscope costing £15,000 and placed the order with the supplier in September • the supplier delivered the microscope in December as per the order but the organisation has not yet received and paid the invoice. • the school has “goods receipted” the Purchase Order for the microscope, as the microscope has been delivered as per the specification requested. • Finance can “accrue” (record in the accounts) the £15,000 amount owed (the liability) to the supplier for the microscope delivered, which will be paid at a later date once the invoice has been received. This means

Term	Definition
	the accounts reflect the amount owed to the supplier, which provides a more accurate forecast. For projects – we take into account the value of work executed to date but where the invoice has not been received and/or paid.
Capital expenditure	The cost of acquiring, producing or enhancing fixed assets.
Capital commitments	The estimated amount of capital expenditure: • purchase order raised against a capital account code and order placed with supplier • contracted for but not yet provided for • authorised but not yet contracted for Purchase order example for purchase of equipment • a school decides to purchase a new microscope and raises a purchase requisition in September for £15,000, which is approved and a purchase order created. • the purchase order is sent to the supplier to place the order, with the delivery date being in December. The school is now committed to spending the money, from its allocated budget. • the funds remain committed until the goods or services are received and paid for, when it becomes actual expenditure. Major projects example – • a contract has been signed for a new building project but it has not been completed yet. • the funds for the new building have been agreed from the budget and set aside to spend on the new building, but no actual expenditure has been incurred.
Depreciation	The measure of wearing out, consumption or other loss of value of a fixed asset whether arising from use, the passing of time, or it becomes obsolete through technology or market changes. It is an accounting entry (non-cash), and indicates how much of an asset’s value has been used up. Finance are responsible for the accounting entries, which writes down the asset cost in the balance sheet and are charged to the Statement of Comprehensive Income.
International Financial	Is a single set of accounting standards, developed and

Term	Definition
Reporting Standard (FRS)	maintained by the International Accounting Standards Board with the intention of those standards being capable of being applied on a globally consistent basis.
Fixed asset	An asset that is not consumed or sold during the normal course of business, such as land, buildings, equipment, machinery, vehicles. Any asset expected to last, or be in use for, more than one year is considered a fixed asset and has a cost over £10,000.
Impairment of an asset	The value of an asset is less than the amount recognised in QMUL books. For example – loss in the value of the asset or when the purpose of that asset no longer exists.
SORP	Statement of Recommended Practice; a set of clarifications of how accounting standards apply to a specific sector e.g. Higher Education.