Capital or Expense?
A guide for asset and maintenance managers

The purpose of this policy advice note is to provide asset and maintenance managers with general guidance on how to account for major maintenance expenditure on their building assets.

Maintenance expenditure can range from a few dollars to fix a broken fitting, to many thousands of dollars to replace a roof or a large air conditioning plant. In most cases, work undertaken is readily identified as maintenance and treated as an expense. However, at times the nature or intent of the work (or parts of the work) extends beyond restoring the asset to its original condition, capacity or function. In these cases, managers must decide whether the expenditure is most appropriately classified as “maintenance”, or as a “capital outlay” that increases the value of the asset on which the expenditure is incurred.

Treating an expenditure as maintenance (i.e. as an expense) affects the cost of a department’s outputs. Capital expenditure, on the other hand, has an impact on the value of the department’s assets and, subsequently, depreciation and equity return. Accounting for expenditure on assets in an appropriate and consistent manner will provide a more accurate indication of a department’s output costs and of the value of its assets.

When is maintenance-type work classified as an expense?

The Maintenance Management Framework (MMF) defines “maintenance” as “work on existing buildings undertaken with the intention of:

- re-instating physical condition to a specified standard
- preventing further deterioration or failure
- restoring correct operation within specified parameters
replacing components at the end of their useful/economic life with modern engineering equivalents

making temporary repairs for immediate health, safety and security reasons (e.g. after a major building failure)

assessing buildings for maintenance requirements (e.g. to obtain accurate and objective knowledge of physical and operating condition, including risk and financial impact, for the purpose of maintenance).

The Australian Accounting Standards Board's *Framework for the Preparation and Presentation of Financial Statements* defines "expenses" as "decreases in economic benefits during the accounting period in the form of outflows or depletion of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants". It is the first part of this definition (i.e. "decreases in economic benefits... in the form of outflows or depletion of assets") that is relevant to this policy advice note.

In the context of these two definitions, maintenance is a reflection of the consumption (through usage) of the building asset. As this consumption results in a reduction in the value of the asset, it meets the definition of an expense. However, works undertaken in the course of maintenance may include activities that result in the expenditure being classified as capital.

### When is maintenance work classified as a capital expenditure?

"Expenditure on assets must be capitalised (i.e. added to the carrying amount of the asset) when it improves the condition of the asset beyond its originally assessed standard of performance or capacity.", in accordance with Queensland Treasury’s *Non-Current Asset Policies for the Queensland Public Sector – NCAP 1 Recognition of Assets*.

In general, work that includes upgrades, enhancements and additions to a building asset would fall into the category of capital expenditure when it results in any of the following:

- an increase in the asset's useful function or service capacity
- an extension of its useful life
- an improvement to the quality of the service(s) delivered through utilisation of the asset
- a reduction in future operating costs
- the upgrade or enhancement becoming an integral part of the asset.

Conversely, work falls into the category of maintenance expenditure when it does not result in an improvement to the building asset (i.e. it simply preserves the asset’s original serviceability).
An example of work that is initiated under maintenance but falls into the category of capital expenditure is the replacement of a deteriorated roof over an open patio, undertaken in conjunction with work to convert the patio into an enclosed space. While the requirement for maintenance of the patio roof is the catalyst for the work, the building owner may see advantages (e.g. cost savings, time savings, minimisation of impact upon building users) in enclosing the patio at the same time. This work to enclose the patio results in an enhancement to the building asset (i.e. the useful function of the asset has increased as the patio can now be used during poor weather conditions). Consequently, expenditure on this work (i.e. the roof replacement and the patio enclosure) would be capitalised on the basis that enclosure of the patio has increased the useful function of the asset.

Extension of useful life

Significant components\(^1\) within buildings (e.g. major electronic security systems) are identified, recognised and depreciated separately. The useful life of each of these components is generally different to that of the building asset and to each other.

*Accounting Standard AASB 116: Property, Plant and Equipment* defines "useful life" as:

- "the period over which an asset is expected to be available for use by an entity; or"
- "the number of production or similar units expected to be obtained from the asset by an entity".

An example of the two ways in which useful life can be considered is an air conditioning chiller, which has a useful life estimated on the basis of its expected running hours but also its expected workload.

The *Non-Current Asset Policies for the Queensland Public Sector – NCAP 5 Depreciation and Amortisation* add that the useful life of an asset to one department may well differ from its useful life to another entity, or even differ between business units within the same entity.

Factors that influence the useful life of building assets and their components include:

- physical wear and tear as a result of usage
- environmental conditions
- technical obsolescence
- commercial obsolescence
- legal compliance issues
- other limitations on the continued safe and legal use of the asset.

In the context of these factors, an extension of the useful life of a building asset may result from work incorporating:

- a more robust material than that used in the original structure

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\(^1\) Criteria to satisfy the definition of a significant component of a complex asset is in the Queensland Treasury’s *Non-Current Asset Policies for the Queensland Public Sector (NCAP) guideline – NCAP 2 Complex Assets*. 

• a component that benefits from an improved design (e.g. a new, more efficient compressor of the same capacity as the original).

As such, expenditure in these instances should be carefully reviewed with respect to its categorisation as either capital expenditure or expense (or a combination of both).

### Reduction in future operating costs

Reductions in the future operating costs of building assets may occur as a result of repairs that incorporate new materials, more efficient components, or new technology. For example, the integration of more durable or weather-resistant materials may serve to reduce maintenance costs, while the installation of a more modern air conditioning plant may lead to a decrease in energy costs.

Even if these types of replacements are precipitated by maintenance requirements and fail to result in an increased output capacity or improvement in service quality, the expenditure should still be reviewed in terms of its capital content. In such cases, the intent of the work may be a relevant issue. If the primary intent is to reduce future operating costs, the expenditure should be classified as capital. However, replacement of an asset component purely for maintenance reasons – even if the replacement is made with a modern engineering equivalent that has the potential to reduce future operating costs – should be categorised accordingly unless there is a material change or enhancement in the physical characteristics of the building asset.

### Conclusion

Asset and maintenance managers need to consider issues of capital versus expense when assessing both the short and long term maintenance requirements of their building assets. The intent of this policy advice note is to identify and provide guidance on addressing these issues.

In conclusion, key considerations for asset and maintenance managers making decisions regarding maintenance works include:

• financial management and accounting policies and guidelines
• value-for-money principles (when ascertaining whether it is more economical to upgrade, replace or refurbish buildings rather than continuing to make ongoing repairs)
• the value of the asset
• the intent of the work
• the scope of the work
• the outcome of the work
• the impact of the work upon asset value, depreciation and equity return
• consistency in decision making.
References

Accounting Standard AASB 116: Property Plant and Equipment (Australian Accounting Standards Board)

Framework for the Preparation and Presentation of Financial Statements (Australian Accounting Standards Board)

Maintenance Management Framework (Department of Housing and Public Works)

Non-Current Asset Policies for the Queensland Public Sector (Queensland Treasury)
- NCAP 1 - Recognition of Assets
- NCAP 2 - Complex Assets
- NCAP 5 - Depreciation and Amortisation

For further information

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