Fiscal Policies Capital Assets

Preface

Capital assets represent one of the largest asset classifications of the State. The State utilizes FAS (Fixed Asset System) to provide inventory control of and accountability for capital assets, to monitor the physical condition of capital assets, and to gather information for the preparation of a Comprehensive Annual Financial Report (CAFR).

This policy discusses certain accounting standards that may allow for more than one accounting treatment under Generally Accepted Accounting Principles (GAAP) or additional information helpful to agencies. Actual FAS procedures and basic accounting are not discussed in this policy, but are addressed in the FAS user manual.

Definitions

Ancillary Costs: Costs in addition to purchase or construction costs, related to placing a capital asset into its intended location and condition for use. Ancillary costs are included in the cost of the capital asset; however, minor ancillary costs may be expensed. Ancillary costs include the following:

1. For Buildings and Improvements Other Than Buildings - Professional fees of architects, attorneys, appraisers, financial advisors, and similar fees; damage claims; costs of fixtures permanently attached to a building; insurance premiums, interest expense (for enterprise fund assets), and related costs incurred during construction; and other expenditures/ expenses.
2. For Land - Legal and title fees, surveying fees, appraisal and negotiation fees, damage payments, site preparation costs, costs related to demolition of unwanted structures, and other expenditures/expenses.
3. For Machinery, Equipment, & Other - Transportation charges, installation costs, and any other normal and necessary expenditures/expenses.
4. For Infrastructure - Landscaping, curbs, gutters, sidewalks, noise abatement walls, and any other necessary expenditures/expenses. (Note: For CAFR purposes, only the Idaho Transportation Department uses the Infrastructure class. All other agencies report infrastructure-like assets under the Improvements Other Than Buildings class).

Approved Internal System: An agency can use its own system instead of FAS, but the system needs to be approved by the Deputy Controller of the Division of Statewide Accounting of the State Controller's Office. An approved system must:

1. Provide for control of and accountability for the agency's inventoriable capital assets.
2. Ensure that all recorded capital assets are classified properly, accurately, and systematically.
3. Enable the agency to monitor the physical condition of those capital assets.
4. Provide information necessary for the State's CAFR.
5. Provide a written audit trail of transactions meeting Legislative auditor requirements.
6. Record current year and accumulated depreciation or amortization expense.
7. Meet Department of Administration's Risk Management insurance requirements.

Book Value: The cost of any asset less its related accumulated depreciation or amortization.

Building: Walled and roofed structure plus improvements that are permanently attached. This capital asset is recorded at cost including ancillary costs. Land costs are excluded. A mobile home on a permanent foundation is a building. Building improvements include items such as loading docks, heating and air-conditioning equipment, refrigeration equipment, and all other property permanently attached to the structure. Items not included are furniture, carpeting, fixtures, or other equipment that are not an integral part of the structure.

Capital Asset: Land, inventoriable personal property (valued at $2,000 or more), State-owned buildings, virtually owned assets by the State (as in the case of a capital lease), and assets for which the State is responsible (although ownership/title may not have passed). Responsibility may include managing, maintaining, or having possession of the asset the majority of the asset's remaining useful life. For land to be a capital asset, title must pass to the State or entity responsible for the asset.

Capital assets include buildings, improvements other than buildings, construction in progress, land, infrastructure, machinery and equipment, capital leases, collections, and intangible assets such as easements, water rights, timber rights, patents, trademarks, and computer software. Capital assets that have a value equal to or greater than $5,000 and a useful life greater than one year are included in the financial statements. The capitalization threshold for intangible assets is $200,000.

Capital Lease: Lease with contractual terms transferring to the State substantially all benefits and risks inherent in ownership of the property. Capital leases are capital assets meeting one or more of the four following criteria:

1. Ownership of the leased property is transferred to the State by the end of the lease.
2. The lease contains a bargain purchase option.
3. The lease term is equal to 75 percent or more of the estimated useful life of the leased property.
4. The present value of the minimum lease payments (at inception of the lease), excluding executory costs (e.g., insurance, maintenance, and taxes, including any profit thereon), is 90 percent or more of the fair value of the leased property. (See FASB 13)

Capital Outlay: A budgetary term. While capital assets may be purchased from the capital outlay budget, not all purchases from the capital outlay budget are capitalized.

Capitalized Asset: All capital assets, excluding non-capitalized art, library, and historical treasure collections, with a cost of at least $5,000 per asset and a life expectancy of greater than one year. The capitalization threshold for intangible assets, such as software, water rights, and easements that will be reported on closing packages for CAFR reporting, is $200,000.

Collections: An accumulation of one or more items that represent works of art, historical treasures, library or museum items, or similar assets. Collections may be capitalized or non-capitalized. Capitalize collections if the collection as a whole has a value of $5,000 or greater.
Exception: The agency can elect to waive capitalization, and expense collections that meet all of the following criteria:

1. The collection is held for public exhibition, education, or research to further public service rather than for financial gain.
2. The collection is protected, kept unencumbered, cared for, and preserved.
3. The collection is subject to an organizational policy requiring that the proceeds from the sales of collection items be used to acquire other items for collection.

NOTE: Collections already capitalized at June 30, 1999, should remain capitalized even if they meet conditions for exemption from capitalization.

Construction in Progress: Capital asset reflecting the cost of construction work undertaken, but not yet completed, that will result in a capitalized asset when finished. Enterprise funds include interest expense in construction in progress; governmental activities, including internal service funds, do not include interest in the cost of capital assets.

Depletable Resources: Natural resources that are characterized by two main features: 1) the complete removal (consumption) of the asset, and 2) replacement of the asset only by an act of nature (petroleum, minerals, and timber).

Depreciation: Systematic allocation of the cost of a depreciable capitalized asset (less salvage value) over its estimated useful life.
Depreciable Capitalized Asset: Capitalized asset that is gradually used up and loses function over time due to normal and ordinary wear and tear, obsolescence, and other factors. These assets are exhaustible by their very nature. Most capitalized assets are depreciable. Land, easements, infrastructure reported under the modified approach, and non-capitalized art, library, and historical treasure collections are considered inexhaustible and are not depreciated. Construction in progress is not depreciated.

Donation: An asset received from an individual or a non-State entity, recorded at estimated fair market value at the date of acquisition.
Easement: An intangible capital asset that reflects the purchased right to use land without ownership. This right is considered permanent and inexhaustible. Easements are perpetual in nature and transfer with the land if the land is sold. Permanent easements are recorded as land. Temporary easements purchased as ancillary to placing a capitalized asset into its intended state of operation are capitalized.

Impairment: A significant, unexpected decline in the service utility of a capital asset. Generally, an impairment is permanent. (See GASB 42)

Improvements Other Than Buildings: Costs associated with permanent improvements such as roads, bridges, curbs and gutters, tunnels, parking lots, sidewalks, drainage and lighting systems. The costs are not specifically identifiable to a particular State-owned building. This asset class includes leasehold improvements and infrastructure-like assets.

Infrastructure: Capital assets that are roads, bridges, tunnels, drainage systems, water and sewer systems, lighting systems, weigh stations, rest areas, or ports of entry owned or managed by the Idaho Transportation Department.

Infrastructure-like Asset: Capital assets that are stationary in nature and can be preserved for a greater number of years than most capital assets. Examples of infrastructure-like assets include roads and bridges other than those owned or managed by the Idaho Transportation Department, tunnels, drainage systems, water and sewer systems, dams, parking lots, lighting systems, and similar assets. For tracking and CAFR reporting purposes, infrastructure-like assets are included with Improvements Other Than Buildings.

Intangible Asset: An asset that possesses all of the following characteristics:

- Lack of physical substance, i.e., intangible assets cannot be touched.

- Nonfinancial nature. Intangible assets have value but are not in a monetary form like cash or investments.
- Initial useful life extending beyond a single reporting period. The asset can be used for multiple years.

Examples include rights to natural resources, patents, trademarks, copyrights, software, and similar assets. (See GASB 51) The capitalization threshold for intangible assets is $200,000.

<u>Inventoriable Capital Asset:</u> Capital assets of the State with a unit cost of at least $2, 000, any item below $2,000 that is considered to be vulnerable to loss, and <u>all</u> land regardless of cost.

<u>Land:</u> Capital assets that are real property, excluding buildings and depletable resources, with the title owned by the State. Land costs include ancillary costs.

<u>Leasehold Improvement:</u> Capital assets that represent major expenditures required to prepare leased premises for initial or continued use. Expenditures may include construction of walls, installation of heating/electrical systems, floors, plumbing, etc. Repairs and renovations such as painting a wall, installing carpet, or general carpentry work, are considered normal operating expenditures. For tracking and CAFR reporting purposes, Leasehold Improvements are included with Improvements Other Than Buildings.

<u>Machinery, Equipment, & Other:</u> Durable capital assets that are complete in and of themselves and are not permanently attached to a building or land. This asset category includes such items as lawnmowers, tractors, graders, vehicles, computers, copy machines, office furniture, and similar assets. Mobile homes not on a permanent foundation should be included in this category. Other assets included in this category include capitalized collections.
<u>Transferred Capital Asset:</u> An asset transferred from one fund or State agency to another fund or State agency.

Policy

Asset Identification

Immediately upon receipt and acceptance, all inventoriable capital assets of the State will be tagged, when practical, with a numbered State of Idaho Property Tag affixed in a readily identifiable location. Land and other assets that cannot be reasonably tagged are excluded from the tagging requirement; however, they are assigned a property number for tracking in the fixed asset system.

Capital Assets

Managers of each State agency has the responsibility to record at a minimum all inventoriable capital assets. These assets should be systematically and accurately recorded and properly classified in FAS or in an agency's approved internal system, except for the following situations:

1. Primary control of items in <u>major</u> art, library, and museum collections may be through the agency's cataloging system.
2. Non-capitalized art and historical treasure collections, intangibles, and construction in progress may be tracked outside of FAS provided an agency's auditor has approved of the system being used to track these assets.

Per *Idaho Code, 67-5746*, each agency director is responsible for conducting an annual inventory of all personal property. Personal property includes furniture, equipment, etc., that cost $2,000 or more per item, high pilferage items, and other sensitive items. At the option of each agency's management, inventoriable capital assets may be defined and recorded at values less than $2,000.

Capitalized Assets

Only capitalized assets are reported in the financial statements. Non-capitalized art and historical treasure collections are disclosed in the notes to the financial statements.

Assets below the $5,000 capitalization threshold are expensed. Assets $5,000 and above are generally capitalized by the agency with the following exceptions:

1. Construction in Progress (CIP) through the Department of Administration, Division of Public Works: Agencies should not record a CIP project as their own capital asset until the agency has received a Project Completion Statement from the Department of Administration. Even though an agency may already be occupying the constructed building, the CIP project is carried as an asset of the Department of Administration until the Project Completion Statement is sent to the agency. (Note: Not all Project Completion Statements are for capital assets.) An exception to this policy is made for joint Division of Public Works and the colleges and universities CIP projects. For these types of joint construction projects, the colleges and universities will report the amount that they are reporting for CIP in their financials to the SCO through annual closing packages to ensure proper reporting in the CAFR.
2. Capital Leases: If the lease involves acquisition of more than one asset, each asset is to be capitalized if the present value of minimum lease payments, or fair market value, whichever is less, is $5,000 or more. Leases not meeting these criteria are treated as operating leases.
3. Collections previously capitalized must continue to be capitalized.
4. Additions to non-capitalized art and historical treasure collections are not capitalized regardless of dollar value. Newly acquired collections that qualify as a non-capitalized art and historical treasures collection do not have to be capitalized if it is not cost beneficial to determine the value. (However, the preferred accounting treatment is to capitalize the collection if the value can be determined and it is $5,000 or more.)
5. Repairs and improvements (including remodels) to an existing capital asset that extend the useful life of the asset, improve its capacity or efficiency, or significantly reduce operating costs should be capitalized if the costs are $5,000 or more. Costs under $5,000 are expensed and not tracked in the capital asset system. *Routine* repairs and maintenance that help an asset maintain the original useful life are expensed regardless of cost. Asbestos removal and underground storage tank removal should be expensed.
6. Library Collections: Agencies are advised to apply the capitalization threshold ($5,000) to individual items rather than to whole library collections for most in-house agency library resource materials. To avoid depreciating a work of art or historical treasure that is appreciating, set the salvage value equal to the historical cost. If the situation changes and the work of art or historical treasure loses value, change the salvage amount accordingly.

Exceptions to this policy would be for major library collections such as the State Library Collection, State Law Library, and library collections at the colleges and universities that do not meet the art and historical treasure exemption. These major library collections will assume a 10-year useful life for all acquisitions within a given year. The library resources acquired in a given year are capitalized as a single unit and depreciated over ten years using the straight-line method. The library records system should maintain detailed records.

Intangible Assets

Intangible assets acquired through non-exchange transactions, purchased or licensed computer software (which includes acquisition through an installment contract), or internal development costs are capitalized as intangible assets. The capitalization threshold for intangible assets is $200,000.

Internally developed software includes software developed in-house by the agency's personnel, developed by a third-party contractor on behalf of the agency, or commercially available software that is modified using more than minimal incremental effort before being put into operation. Outlays related to internally developed software should be capitalized only when all of the following occurs:

A. An objective exists to create a specific internally generated intangible asset.

B. The service capacity to be provided by the asset upon its completion can be determined.

C. The technical or technological feasibility for completing the project is evident.

D. The current intention, ability, and presence of effort to complete or, in the case of a multiyear project, continue development of the intangible asset can be demonstrated.

Outlays relating to internally developed software that are incurred before these criteria are met should be expensed. Once these criteria are met, outlays incurred should be classified in accordance with the following various project stages:

I. Preliminary Project Stage - Activities in this stage include outlining and planning for the desired model and evaluation of alternatives, the determination of needed technology, and the final selection of alternatives for the development of software. Outlays associated with activities in this stage should be expensed as incurred.
II. Application Development Stage - Activities in this stage include the design of the chosen path, including software configuration and software interfaces, coding, installation to hardware, and testing. Once the agency has met the four criteria (A, B, C and D) as previously outlined, then outlays incurred in the Application Development Stage should be capitalized. Once the computer software is substantially complete and ready for its intended use, capitalization should cease.
III. Post-Implementation/Operation Stage - Activities in this stage include training and software maintenance. Outlays associated with activities in this stage should be expensed as incurred.

The cost of acquiring mineral, water, and timber rights should be capitalized as intangible capital assets. Significant costs to allow for resource extraction establish a depletion base. This base should be capitalized.

A depletion base consists of the following:

A. Acquisition Costs – price paid for the right to search and find an undiscovered resource or the price paid for an already discovered resource.

B. Exploring Costs – In most cases these costs are expensed as incurred. If these costs are substantial and the risks of finding the resource are uncertain capitalization may occur.

C. Development Costs – The two types of development costs are:

- Tangible – Those that can be moved to other sites should not be part of the depletion base. Those that cannot be moved should be depreciated over the shorter of their useful life or the life of the resource
- Intangible – These are considered part of the depletion base. Costs include drilling costs, tunnels, shafts, and wells.

D. Restoration Costs – Substantial costs to restore property to its natural state after extraction should be added to the depletion base.

Once a depletion base is established, the allocation of cost to accounting periods (depletion expense) can be determined. Should an agency have depletion expense, the computation is complex and agencies are encouraged to contact the SCO for assistance with the multiple-step calculation.

Intangible assets with an indefinite useful life, such as permanent right-of-way easements, should not be amortized. However, intangible assets should be amortized when the useful life is limited. For example, intangible assets such as patents and certain land use rights, whose useful life is often limited by contract, law, or regulation, are amortized over the expected useful life of the asset using the straight-line method. (See GASB 51)

Depreciation and Amortization

For depreciable capital assets, depreciation or amortization expense is recorded as a direct expense of the fund and function (budget unit). Except for collections, depreciation for all depreciable capitalized assets is calculated and recorded using the straight-line method:

$$\text{Depreciation} = \frac{\text{Cost - Salvage Value}}{\text{Useful Life}}$$

The following ranges are available for asset useful life:

Buildings and Improvements to Buildings: 3 - 50 years
Improvements Other Than Buildings: 5 - 50 years
Machinery, Equipment, & Other: 3 - 40 years
Infrastructure (ITD Bridges): 75 years
Intangibles: 3 - 40 years

As part of the annual agency inventory physical count, it is recommended to review the useful life of assets and make appropriate changes.

Setting Useful Life for an Improvement

When recording useful life for an improvement, the useful life of the original asset needs to be considered. The general rule is that the improvement is depreciated over the improvement's useful life or the original asset's remaining useful life, whichever is shorter. It may be necessary to increase the original asset's useful life if it is anticipated that the improvement will extend the useful life of the original asset. If the original asset is at the maximum of its range and cannot be changed, record the improvement at its anticipated useful life.

Dispositions

The procedures and guidelines set forth by the State Board of Examiners are to be followed when an inventoriable capital asset is sold, scrapped, or disposed from inventory. (See SBEX Policy No. 442-40)

When a capital asset is replaced or disposed of, the original cost and accumulated depreciation are to be removed from the books. Any associated gain or loss upon disposal must be recorded through FAS or through the agency's fixed asset system.

For example:
A heating, venting, and air conditioning (HVAC) system was included in the building cost when originally built. The original HVAC system is removed and a new one added that improves efficiency.

Methods to use:

- Do Not Record – Use this method only if the asset has been fully or close-to-fully depreciated so that the remaining amount is immaterial. The record of the old asset is kept and the disposition is not recorded.
- Record an Estimated Amount – The cost of the new HVAC system is deflated to the year of acquisition of the original HVAC system through the use of the Consumer Price Index (CPI). Then that estimated amount and the related accumulated depreciation are removed from the books. Contact the DSA Help Line (332-8827) for assistance.

Sale of Portions of Non-capitalized Art and Historical Treasure Collections: It is the State's policy that proceeds from the sale of items in a non-capitalized art and historical treasure collection shall be used to purchase other items for the collection or for conservation of the collection.

Impairments

Asset impairment is a significant, unexpected decline in the service utility of a capital asset. The events or changes in circumstances that lead to impairments are not considered normal and ordinary. With the occurrence of a prominent event or changes in circumstances agencies should evaluate whether an impairment of a capital asset has taken place. Possible asset impairments should be evaluated and reported in accordance with Statement 42 as set by the Governmental Accounting Standards Board. It is recommended to the agency to contact the SCO upon the occurrence of such an event.

Administrative Procedures

1. Agency capital asset record systems shall contain at least the following data elements:
2. Agency Name and Code Number - The agency name and three-digit agency code number.
3. In-Service Date - The date the agency takes title to or places the capital asset in service.
4. Asset Class - General category that specific class codes will roll up to, such as Land, Buildings, Improvements Other Than Buildings, etc.
5. Class Code - A code used to categorize the type of capital asset.
6. Cost - The total cost (value) assigned to the capital asset.
7. Accumulated Depreciation or Amortization - The total depreciation expense incurred to date for the capital asset.
8. Depreciation or Amortization Expense - The total depreciation expense incurred fiscal-year-to-date for the capital asset.
9. Budget Unit - The funding source or sources associated with the acquisition of the asset.

10. Disposal Date - The date the agency officially relinquishes the capital asset.
11. Fund Number - Record the number of the fund utilizing/purchasing the capital asset.
12. Inventory Property Tag Number - The serial number on the State of Idaho property tag (or other unique identifier) affixed to the capital asset. This is not required for land, buildings, or other capital assets that cannot reasonably be tagged. However, an identifying number is needed.
13. Location - An identification code to indicate where the capital asset is located (physical address for real property).
14. Acquisition Method - Describes how the property was obtained.
15. Insurance Indicator **-** Describes the type of insurance coverage the agency has on the asset.
16. Ownership Status - to differentiate legal ownership as follows:
    - State agency owned
    - Combined ownership by the State and another entity
    - Endowment land
    - Federally owned (responsibility for asset stays with the federal government)
    - State-owned possible federal claim
    - Non-State entity owned but the State uses and has responsibility for the asset. For example, assets purchased with grant funds.
    - Leased
    - Non-State entity owned (responsibility rests with the entity)
    - Other State-agency owned
17. Replacement Value **-** The cost to replace the asset in today's market.
18. Quantity - The physical count of inventoriable items, as follows:
    - Equipment: whole units
    - Buildings: square feet
    - Land: rounded to the nearest whole acre or square foot (except shoreland)
    - Shoreland: waterfront footage - rounded to the nearest whole foot
    - Construction in Progress: number of capital projects under construction
19. Useful Life - The estimated number of years of use to be received from the *capital asset*. Not required for non-depreciable capital assets.
20. Condition Code - Describes the condition of the property.
21. County Code - The county where the land or building is located.
22. Depreciation or Amortization Date - Date the depreciation or amortization was last calculated and processed.

We recommend that an agency capital asset record system include the following data elements for personal property:

- Serial Number - The sequential identification number assigned by the manufacturer (not the model number).
- Description - An explanation of what the capital asset is.
- Manufacturer - Either the name of the manufacturer or the commonly accepted trade name.
- Model year - For automobiles.
- Order Number - The purchase order number used for acquisition of the capital asset.

We recommend that an agency capital asset record system include the following data elements for real property:

- Block Number - A legal description of a specific real property.
- Parcel - A legal description of a specific real property.
- Tract - A legal description of a specific real property.

- Easement - Defines the type of easements attached to a real property.
- Lot Number - A legal description of specific real property.
- Construction Code - Defines the building construction type based on information from Risk Management.
- Zip Code - The zip code associated with the building address.